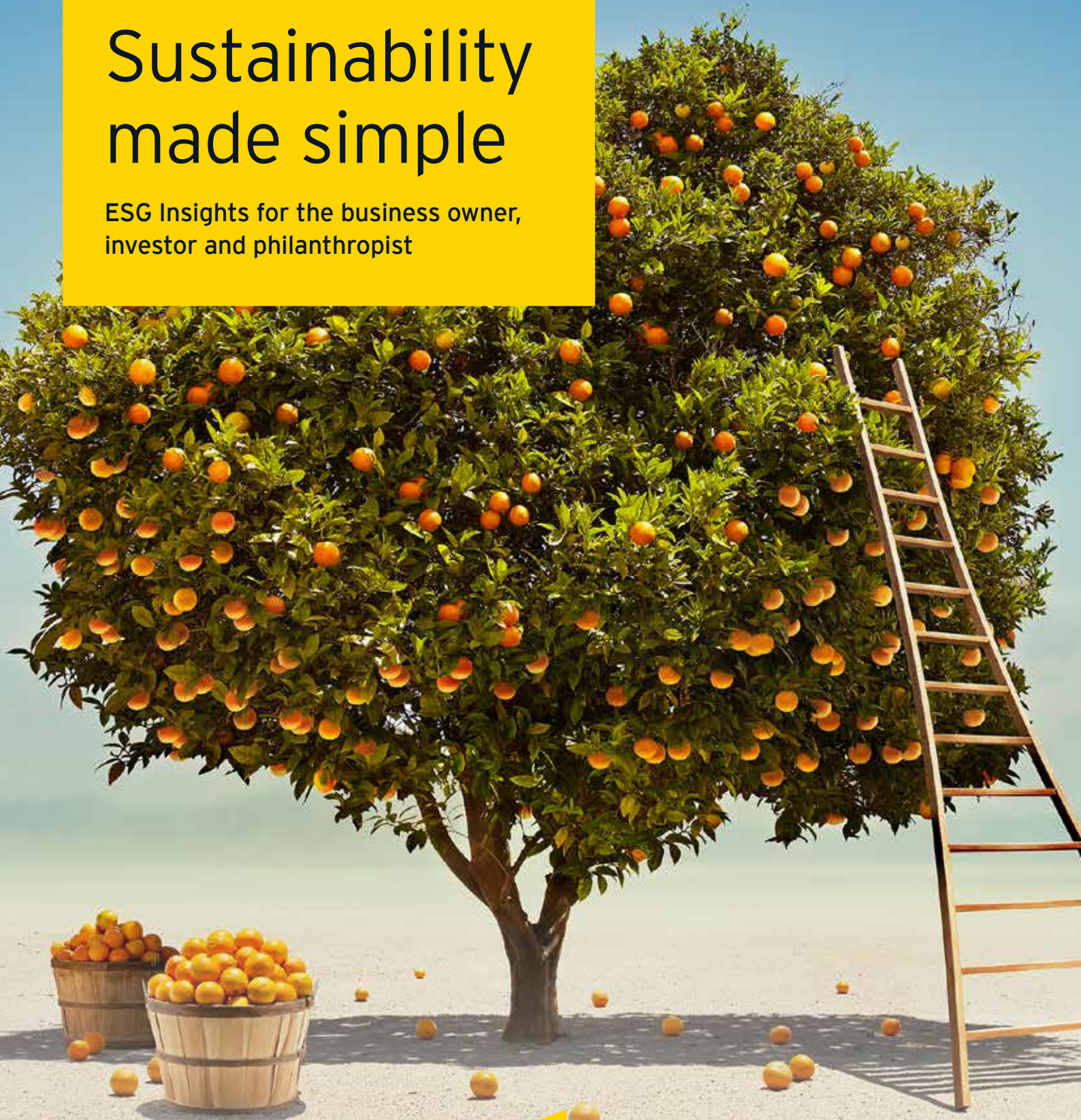


Sustainability made simple

ESG Insights for the business owner,
investor and philanthropist



Foreword by Bank of Singapore

The environmental challenges we face today are vast, complex and urgent, and taking meaningful action to chart a sustainable path for the benefit of future generations must be the way forward.

Sustainability at Bank of Singapore is grounded in our fiduciary commitment and social responsibility to create a positive and lasting value for our stakeholders. These values have guided the way we do business, helped us live up to our wider societal obligations and enabled us to adapt to an ever-changing operating environment.

The scale and speed of wealth accumulation today present a significant opportunity as individuals and institutions have increasingly applied an ESG (Environmental, Social, and Governance) lens to investing and realized the risks of separating such issues from business fundamentals.

The global COVID-19 pandemic further underscores the critical role that ESG considerations play in the way they choose to allocate their significant resources. These include the companies' ability to safeguard human health and safety, capacity to effectively manage supply chains as well as preparedness to deal with disruptions and to operate successfully in the future.

As custodians of wealth, private bankers are in a unique position to start the conversation on sustainable investing, to help steer capital into productive, sustainable and profitable areas that cumulatively drive growth in the right direction.

Engaging our clients in this conversation today is an important step that will inform not only the way we do business, but the way we live for decades to come. We are proud to collaborate with EY on this report to make sustainability accessible to business owners, investors, and philanthropists.

Bahren Shaari
Chief Executive Officer
Bank of Singapore

Foreword by the EY organization

In January 2020, it was announced that global investing heavyweight BlackRock, Inc. had joined Climate Action 100+, and would be exiting investments in thermal coal production amid other actions they were taking to set sustainability at the center of their investment approach. As Larry Fink, Chairman of BlackRock, explained, "Climate risk is investment risk." We can no longer ignore that climate change is real.

Investors, businesses and philanthropists play a key role in this global movement. They can help by channeling funds to advance sustainable innovation and practices, by recognizing and responding to risks associated with climate change and sustainability, and by focusing on action that delivers long-term value.

With this, EY teams are pleased to collaborate with Bank of Singapore on a series of environmental, social and governance (ESG) initiatives, including putting together this publication to make sustainability simple for our readers. The intention is to provide a guide that would cut through the overwhelming clutter of daily developments in this field, and to outline key frameworks and resources to equip business owners looking to start on this journey with the basics that they need.

We have a once-in-a-lifetime opportunity, post-COVID-19 pandemic, to take action now to create sustainable, inclusive growth for future generations, but we must do it together. We hope that this publication will be a starting point for this important conversation.

Nam Soon Liew

EY Asean Regional Managing Partner



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Philanthropy



State of play

How do you thrive in a changing world?

As climate change continues to impact the physical landscape – for instance, through floods, droughts, and fires that destroy man-made and natural assets and infrastructure, and diminish quality of life – the risks (and opportunities) to businesses and investors will be manifold. For one, governments and regulators are setting policies – such as mandatory disclosures and carbon emission taxes – to guide private sector action toward the achievement of their targets under global sustainability movements such as the United Nations Sustainable Development Goals and Paris Agreement. For another, expectations are changing, and the general public is increasingly advocating for sustainability in companies and their products, and this is clearly evidenced in shifting consumer and employee demands. Clearly, business owners and investors need to act.

To this end, business owners should first identify what matters. This could be achieved by regularly engaging with their stakeholders, conducting a full scan of the value chain, shortlisting the issues identified in consideration of industry and standards requirements, and prioritizing the issues in terms of probability of occurrence and magnitude of impact.

For investors, they could apply pressure on businesses to be more sustainable by incorporating investee performance on ESG factors into their investment decisions, and by actively

engaging with their investees on material ESG issues. Pre-investment ESG due diligence helps to mitigate risks. Empirically, studies also show that better performance on material ESG topics leads to higher shareholder value.

Philanthropists should be aware of the tax reliefs and compliance implications of their philanthropic efforts, and understand that careful evaluation of their progress contributes to the effectiveness of their giving. In this regard, professional mechanisms such as family offices could provide welcome support.

May this be the decade of action.



Simon Yeo

EY Singapore Climate Change and Sustainability Services Leader, Ernst & Young LLP



Zubin Dabu

Market Head/
Chairman of Bank of Singapore's
ESG Forum
Bank of Singapore

How is Bank of Singapore prioritizing sustainability within our organization?

At no time in history has mankind so quickly and collectively adapted to balance economic prosperity alongside a safe and sustainable living environment. Bank of Singapore is reinforcing its commitment to a sustainable future through our 5 pillar framework, comprising 12 material ESG factors which support delivery of interrelated United Nations Sustainable Development Goals (SDGs). This approach has helped us define our priorities and integrate ESG principles into our business strategies - from raising awareness of climate change issues, promoting diversity and inclusion in the workplace, to adopting the highest standards of integrity with our clients, staff and communities.



Key terms

Sustainability: In the context of business, and drawing from the Brundtland Commission's definition of sustainable development, it broadly refers to businesses operating in a way that meets the needs of the present without compromising the ability of future generations to meet their own needs.

ESG: Stands for "Environmental, Social, Governance" – three pillars that are typically used (especially by investors) to evaluate the sustainability performance of a business.

Climate change: A key sustainability and ESG issue that poses both business risks and opportunities.



Brian Thung

EY Asean
Financial Services
Leader

How is the EY organization prioritizing sustainability within our organization?

In 2020, the EY organization is going carbon neutral. Globally, we will be decreasing business travel by increasing the use of technology to connect with our clients, purchasing renewable energy to power our offices, and committing to sustainable procurement practices, amidst other exciting projects and initiatives. We believe that this is not just the right thing to do, but the essential thing to do for business.

Overview

A scenic view of a lighthouse on a rocky cliffside. A winding road leads up to the lighthouse, which is perched on a peak. The sky is a deep blue, and the sea is visible in the background. The lighthouse is white with a dark top section. The cliffside is rocky and has some sparse vegetation. The road is paved and has a white line on the edge. A small car is visible on the road. The overall scene is dramatic and beautiful.

How is (un)sustainability impacting our future landscape?

- ▶ Extreme weather events are destroying our physical landscape and forcing mass inward migrations. These have long-lasting consequences on our economy, food supply, and quality of life.
- ▶ Correspondingly, there has been a tilt in the preferences and expectations of consumers, investors and employees towards ESG.
- ▶ Governments and other stakeholder groups are also banding together to take globally coordinated actions. The United Nations (UN) Sustainable Development Goals and Paris Agreement targets are the main frameworks guiding global action on the policy, investor and business levels.

Changing World

In a world that is heating up, the realities of climate change are hard to ignore. Extreme weather events and natural disasters – which topped the World Economic Forum's Global Risk Report 2020 in terms of likelihood and impact¹ – are dominating media headlines for the destruction caused and the further consequences that are to come.

Already, the world is witnessing mass migrations due to flooding caused by sea-level rise. Villages along the northern coast of Java have been destroyed, and thousands from Bangladesh, India, Vietnam and parts of Myanmar have been displaced as rising sea levels and cyclones have destroyed their homes and livelihoods. The UN's International Organization for Migration estimates that by 2050 there would be 25 million to 1 billion environmental migrants.²

USD 7.9 trillion

Cost to global GDP by 2050 due to climate change

Such events, besides causing risks to businesses and investments as coastal megacities are destroyed, often affect quality of life. For instance, overpopulation due to mass migration from the outskirts to cities inward might put a strain on resources and infrastructure. Higher population densities are more conducive to the spreading of viruses which may lead to disease outbreaks becoming harder to contain (as witnessed of the outbreak of COVID-19). Agricultural degradation might cause food prices to increase. Extreme heat waves, which are expected to hit India, Pakistan, Bangladesh and China the hardest, will further impact food supply, employee productivity, and heat-induced death tolls.³

A study by the Economist Intelligence Unit found that when these effects of heat, drought, flood, and freeze were scaled up, global gross domestic product (GDP) could be USD 7.9 trillion lower than it would be without climate change.⁴

These are just some trends that are placing ESG issues on the minds of governments, business owners, investors and the wider community today.

Changing Expectations

Correspondingly, there has been a tilt in the preferences and expectations of consumers, investors and employees towards ESG.

USD 18 trillion

Global aggregate income of millennials by 2030 – a group of inclined toward environmentally-friendly purchases

Consumers across the world – notably in India, Colombia, Mexico, Indonesia, and the Philippines – are starting to demand that companies implement programmes to improve the environment.⁵ Findings from a 2019 survey of 1,000 US consumers corroborate this trend, and further report that approximately 1 in 3 consumers were willing to pay up to 5% more for environmentally-friendly products. Consumers also indicated a preference for environmentally-friendly brands in product categories ranging from cleaning products, to drinks, pre-packaged food, cosmetics and toiletries, clothing, and cars.⁶ To cater to this, there has been a rise in labels certifying that a product is ethical or sustainable, such as the B Corp label, the FAIRTRADE mark, and the Roundtable on Sustainable Palm Oil (RSPO) Certification.⁷ These consumers are typically of the millennial generation (born between 1980 and 2000), whose global annual aggregate income is expected to exceed USD 18 trillion by 2030 and continue to surpass the spending power of every other generation for at least the next 5 years thereafter.⁸

An increase in awareness also impacts the workplace. Six in 10 millennials were willing to take a pay cut to work for a socially responsible company.⁹ Unsurprisingly, research has also shown that positive social impact correlates with higher job satisfaction, and employee satisfaction is strongly and positively correlated to shareholder returns.¹⁰

95%

Millennial investors interested in responsible portfolios

Likewise, investor interest for responsible portfolios is rising. In the EY 2018 Global Climate Change and Sustainability Services survey, it was reported that:

- ▶ 97% of investors conducted either an informal evaluation (65%) or a structured, methodical evaluation (32%) of a target company's nonfinancial disclosures, up from 78% in 2017.
- ▶ ESG information was most commonly referred to when investors were adjusting valuation for risk (70%), examining industry dynamics and regulations (63%), and reviewing investment results (61%). In essence, investors wanted to understand which ESG factors companies had identified as being important to their long-term objectives, and how they had been incorporated into the company's strategic decisions.

- ▶ 79% of investors surveyed believed that using ESG factors as positive screens for potential investments lowered risk, and 85% believed that using ESG factors as negative screens yielded excess returns.¹¹

Sustainable investment is expected to be a new norm; especially with millennial investors. A 2019 survey revealed that millennial investors' interest in social impact investing had risen to 95% (a 9% increase from 2017). Plastic reduction, climate change and community development were some of the most popular sustainable investing themes.¹²

60%

Millennial employees willing to take a pay cut to work for a socially responsible company



“
Even if existing climate pledges – countries' Nationally Determined Contributions, or NDCs – are met, emissions in 2030 will be 38% higher than required to meet that target.

UNEP 2019 Emissions Gap Report

Changing Actions

Governments and various stakeholder groups are also banding together to agree on globally coordinated action.

2015 marked an important year for progress on ESG and climate-change initiatives. There are presently two main frameworks that guide ESG actions:

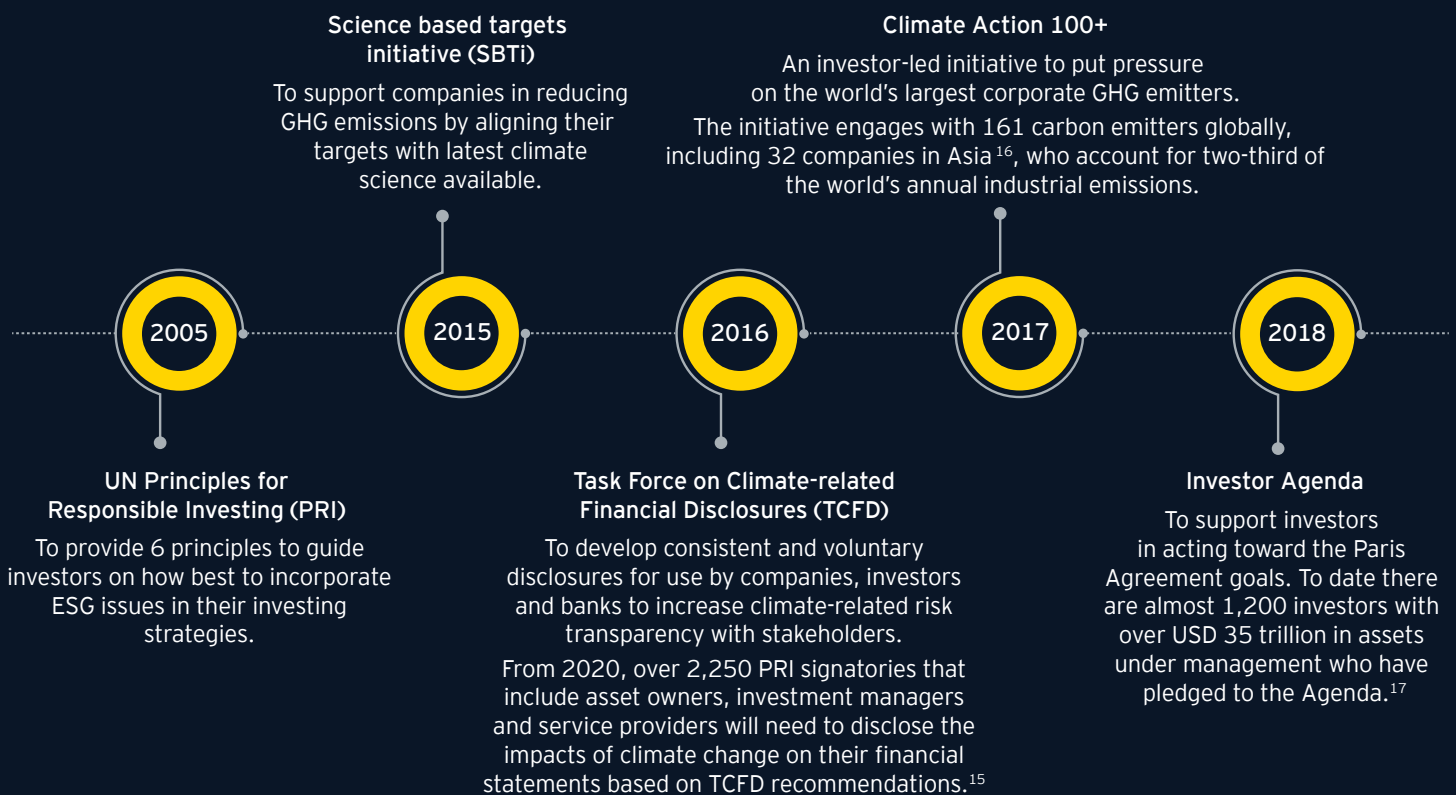
- ▶ the **UN Sustainable Development Goals (SDG)**, which were adopted in September 2015, and consists of 17 goals aimed at ending poverty, protecting the planet, and ensuring that all people enjoy peace and prosperity by 2030; and
- ▶ the **Paris Agreement**, which officially came into force in November 2016, and aims to limit global warming to 1.5 to 2 degrees Celsius above pre-industrial levels. The Paris Agreement was born out of the 21st Conference

of the Parties (COP21) in Paris, France in December 2015. 196 country representatives agreed to submit country-specific action plans to reduce their greenhouse gas (GHG) emissions, and submitted voluntary commitments known as Nationally Determined Contributions (NDCs).

However, progress to date has been limited. To deliver on the necessary emissions cuts, NDCs must increase in ambition by at least 5 times to meet a 1.5 degree target and 3 times for a 2-degree world.¹³ The UN Environment Program (UNEP) released an Emissions Gap Report warning that unless global emissions were to fall by 7.6% each year from 2020-2030, the world would not be able to meet the Paris Agreement target.¹⁴

Actions by businesses and investors

In view of this, several global initiatives have sprung up to mobilize action towards Paris Agreement's climate goals. They include:

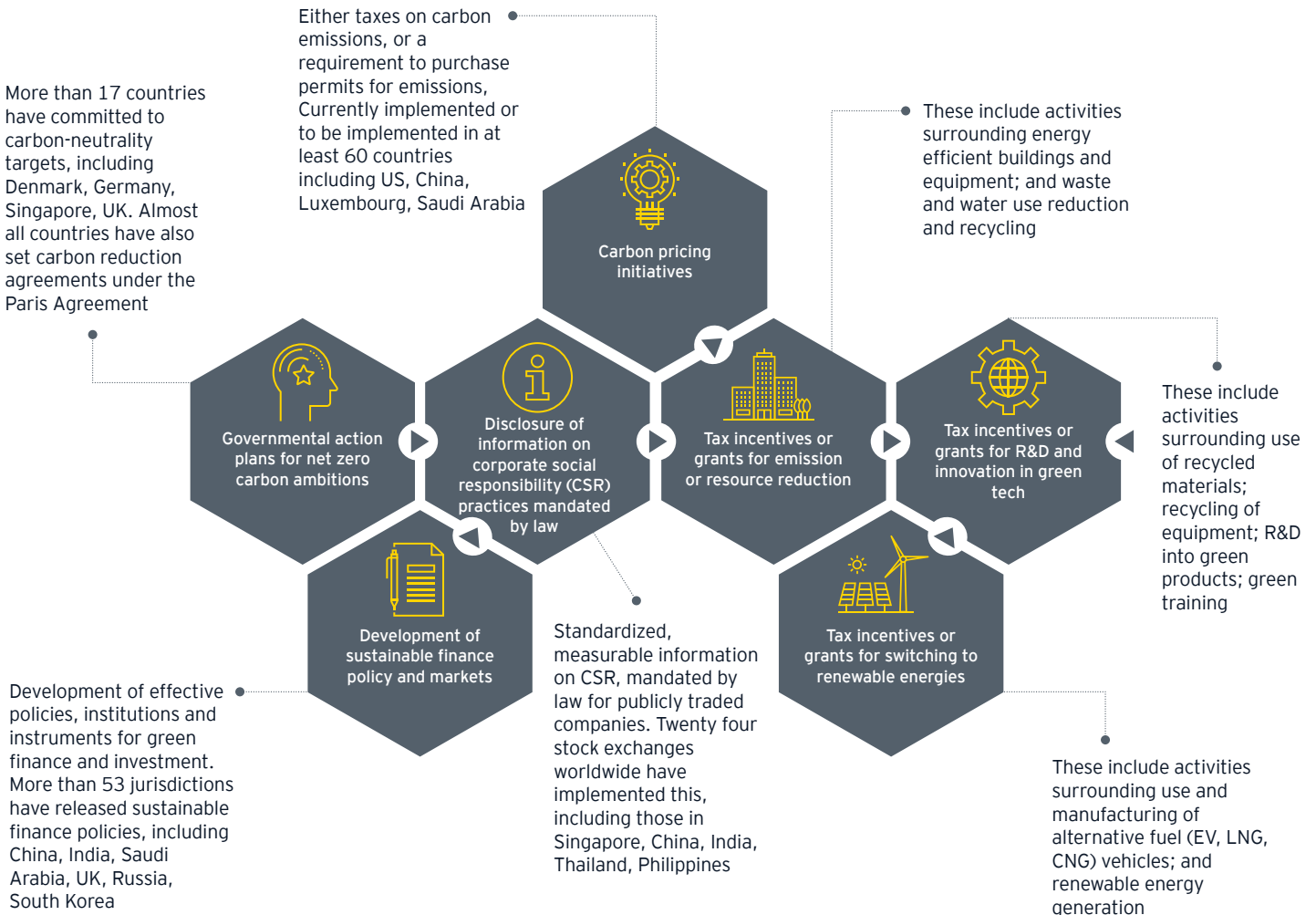


Actions by governments

Alongside these global initiatives, the regulatory landscape has also rapidly evolved to incentivize ESG action and penalize non-compliance. These trends are likely to accelerate with increasing pressures for public policy announcements to tackle climate change – for example, to move toward renewable energy channel funds into green finance, and decarbonize industries – between 2023 to 2025 in line with the Paris

Agreement milestones.¹⁸ At least 17 countries have already pledged net zero carbon emission targets.¹⁹

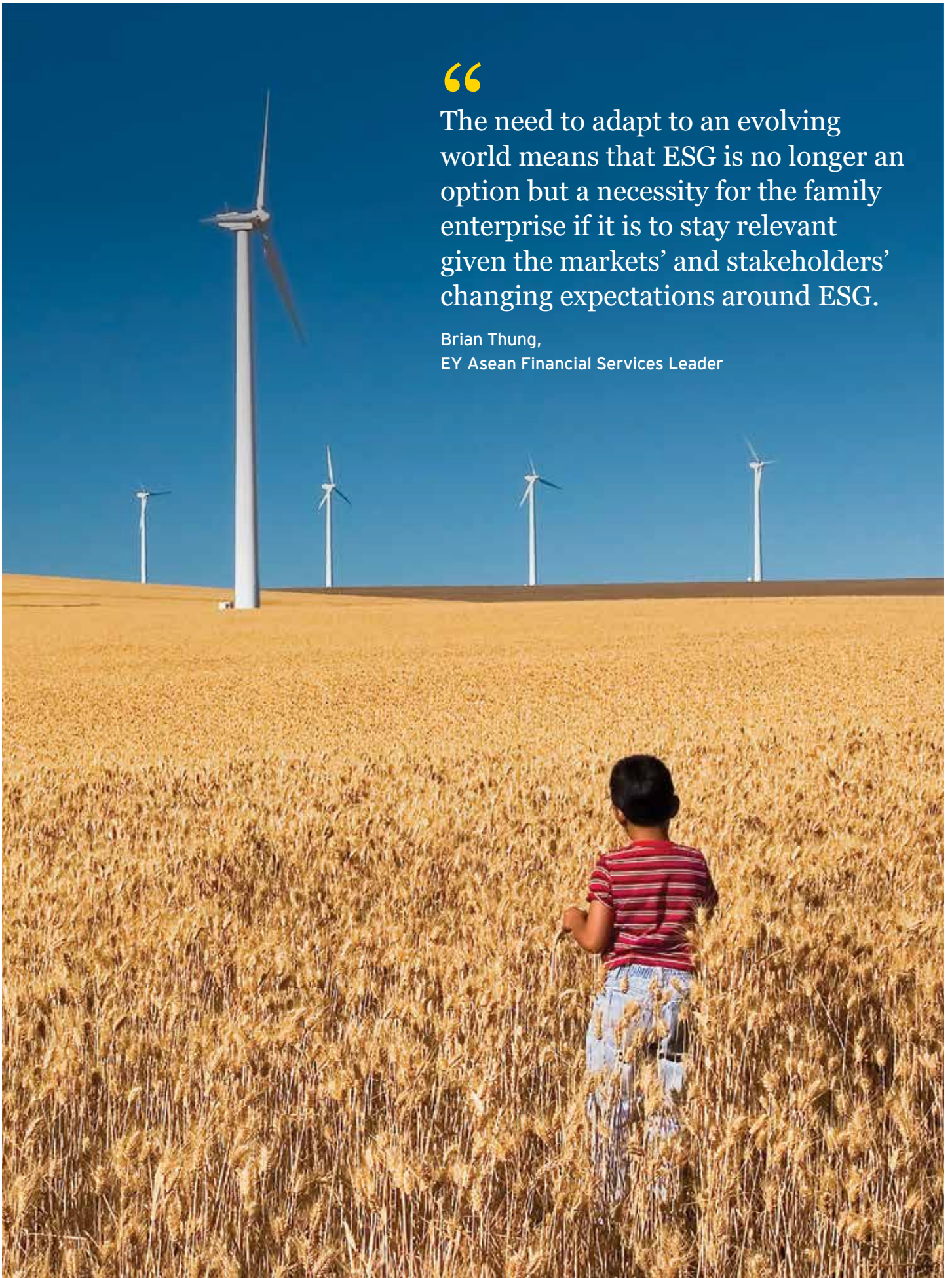
As governments, investors, consumers and the wider community are taking action to create a more sustainable future, inaction will mean being left behind. Business owners need to adapt and ask themselves, what's next?



“

The need to adapt to an evolving world means that ESG is no longer an option but a necessity for the family enterprise if it is to stay relevant given the markets' and stakeholders' changing expectations around ESG.

Brian Thung,
EY Asean Financial Services Leader



Business owner

A photograph of a stone archway spanning a river in a lush green forest. The arch is made of dark, stacked stones. The river is calm, reflecting the surrounding trees and the arch. The sky is overcast.

How can your business create long-term value that lasts?

- ▶ Long-term value is created when companies align their goals with society's goals. This means creating value not just for shareholders, but also for employees, communities, and the planet.
- ▶ Often, ESG issues arise when companies neglect their impact on these other stakeholders. This leads to myriad business risks that ultimately affect the top and bottom line.
- ▶ To mitigate these risks, companies should first identify their material ESG risks and opportunities, in order to integrate ESG into their operations and business strategy.
- ▶ To further distinguish themselves, they can also benchmark their practices against industry ESG leaders, and explore sustainable financing options.

One of the key themes at the 2020 World Economic Forum Annual meeting in Davos was “stakeholder capitalism”, a system where “private corporations are trustees of society and work for the benefit of everyone”. Stakeholder capitalism demands that businesses create value not just for shareholders, but also for employees, communities, and the planet.²⁰ This is built on the understanding that long-term value is created when companies align their goals with society’s goals. As society is increasingly demanding greater responsibility from businesses they work for, buy from, and invest in, ignoring ESG issues would mean exposure to significant risks.

If managed well, however, potential ESG risks to businesses could instead be turned into opportunities to get ahead of competition.

Focus on what matters: identify material ESG risks and opportunities

The first step is to identify what is material to the company.²¹

1. Regularly engage [internal and external] stakeholders to identify key issues of concern.

Key stakeholders such as suppliers, customers, shareholders are increasingly demanding ambitious and management-endorsed sustainability strategies. Priority stakeholders are:

- ▶ Those that **can** strongly influence the company’s performance and operations
- ▶ Those that **are** strongly influenced by the company’s performance operations

2. Assess the ESG risks along the value chain

Participants along chain include:



Manufacturers and suppliers Distributors Company Customers

- ▶ Manufacturers and suppliers: How do suppliers manage their ESG risks? How is factory waste managed? Do they have fair labor practices? Are they compliant to the relevant laws and regulations? How susceptible are their operations to disruptions due to climate change?

Resources

GRI Standards: Global Reporting Initiative is a multi-stakeholder organization that developed a globally applicable framework for sustainability reporting. In addition to its standard framework it has published sector-specific disclosure requirements.

Sustainability Accounting Standards Board (SASB): The Sustainability Accounting Standards Board is a US non-profit organization incorporated in 2011 to develop and disseminate sustainability accounting standards. SASB publishes a materiality map, which identifies the sustainability issues that are likely to affect the financial condition or operating performance of companies within an industry which may be useful (<https://materiality.sasb.org>)

- ▶ Distributors: What is the carbon footprint incurred in the transportation of goods from the supplier to the company? How are these goods packaged?
 - ▶ Company: Does the company regularly engage with internal and external stakeholders to identify its ESG risks? Does the company have a process in place to address these risks? How does the company safeguard its data?
 - ▶ Customers: What are customers’ expectations of the company’s products and how much are they willing to pay? What do customers do with the product at the end of its life? What do customers do with the packaging that comes with the product?
3. Map out a universe of issues that are most pertinent to the company, based on what was identified through the stakeholder engagement, value chain assessment and industry and standards requirements
 4. Prioritize ESG risks and opportunities by considering
 - ▶ Probability of occurrence over the short, medium and long term
 - ▶ Magnitude of financial, operational and reputational impacts

Industry spotlight: palm oil

Key stakeholders	Key risks and impacts
<ul style="list-style-type: none"> ▶ Non-governmental organizations (NGO) or media ▶ Regulators in European Union (EU), Malaysia and Indonesia ▶ Direct customers ▶ End consumers ▶ Public 	<p>Strategic New policy developments may restrict market access and dampen demand include international trends to move away from palm oil-based food and biofuel. Most recently, EU's new biofuel regulation (RED II, 2021-2030) to place stricter caps on crop-based biofuels could cause future consumption of EU palm oil to fall and may lead other countries to do the same in the medium-term.³¹ Downstream players who value Roundtable on Sustainable Palm Oil (RSPO) membership such as Nestle and Unilever may also reduce buying palm oil that has not been certified as sustainable, due to campaigns by activists and rules imposed by RSPO.³²</p> <p>Financial In Indonesia, concession holders are held liable for all fires on their land, irrespective of whether they had started the fires, and with technology, companies can still be prosecuted for fires from years ago. In 2019, companies were fined as the Indonesian government tightened action on its zero-tolerance stance toward companies with fires on their concessions.³³</p> <p>Operational Presently Indonesia and Malaysia – who collectively account for 85% of global palm oil supply³⁴ – have announced government regulations to curb plantation expansions. As such, margins are anticipated to decrease alongside lower output unless companies are able to improve yields via efficiency gains – for example, through automation, improvements in irrigation systems and agronomy practices, and technology.³⁵ This is exacerbated by physical risks faced by the industry, such as the threat of an extended dry season in 2019/2020 which may affect output.³⁶</p>

Positive corporate responses to ESG

Company	Initiative
Wilmar, L'Oreal, Clariant, Global Amine Company	Sustainable Palm Oil and Traceability with Sabah Small Producers (SPOTS) scheme: Supports 500 independent smallholders to achieve RSPO certification and 20% improvement in productivity by providing agronomic guidance, fertilizer (from waste products such as decanter cake and empty fruit bunches), privileges at the mill, and a guaranteed market for their fruit. ²⁴
Wilmar, GeoTraceability, Wild Asia, Sustainable Trade Initiative (IDH)	Smallholder Fresh Fruit Bunch (FFB) Traceability System: Improves palm oil supply chain transparency by enabling mills to map their smallholder supply base and trace smallholder FFB deliveries from the mills back to their farms. In return, smallholders receive agronomic guidance to increase productivity. ²⁵
Carbon Conservation	Smart Contract for Good program: Distributes funding to villages in Aceh when they reduce occurrences of peatland haze fires, using blockchain technology to circumvent issues of red tape and corruption in distributing funds, and satellite imaging technology to monitor the fires and inspect ground sites. ²⁶
Golden-Agri Resources	Oil Palm Genome Project: Maps out the entire genome spectrum of oil palm varieties (identifying traits for disease resistance, drought tolerance, superior quality oil and high yield) through international collaboration Developed high-yield proprietary seeds ²⁷
Sime Darby Plantation	Developed a new oil palm breed which delivers oil yield improvements equivalent to 50,000ha of new land, without increasing planted hectareage ²⁸ Launched 'Crosscheck', an open source online traceability tool that provides transparency by tracking supply back to its source, identifying where problems exist and taking action ²⁹ Uses drone monitoring for timely intervention and digitized supervision of fields; mechanical harvesters for labor cost savings and improved productivity; advanced mill and extraction technologies for minimum GHG emissions and zero discharge ³⁰

(Palm Oil Player Initiatives. Source: Modified from WWF and CSLA, 2018²²)

Per BMI Research's 2020 industry outlook report, "Respecting sustainability standards in palm oil production is shifting from being a niche strategy to a mainstream one, and players along the palm oil supply chain – from palm producers to food manufacturers and retailers – are increasingly using it as a competitive tool."²³

Industry spotlight: mining and metals

<p>Key stakeholders</p> <ul style="list-style-type: none"> ▶ Regulators in countries where mines operate ▶ Local communities ▶ Employees 	<p>Key risks and impacts</p> <p>Strategic</p> <p>The mining and metals industry is fundamentally dependent on natural resource supply, and faces a significant threat from the over-exploitation of resources and climate change. While demand is still rising with population growth and increasing affluence, ore grades have been in decline for most elements. For instance, copper ore grade has decreased to under 1% today, from 4% one century ago. This means that more earth has to be dug up to obtain the same amount of an element, leading to greater energy use, carbon emissions, and environmental impact.³⁷ This exposes the industry to greater policy risks, particularly as government regulation in many countries is set to cap emissions and decarbonize. In Europe, for example, the CO2 quotas imposed on companies will require capital expenditure in improving energy efficiency and gas emissions.³⁸</p> <p>Additionally, consumers increasingly demand transparent ethical supply chains and lower carbon footprints, and shareholder activists drive miners to reconfigure existing operations or divest.³⁹ In China, for example, the government decision to reduce air pollution has caused investors to re-assess credit risk for Chinese coal miners and steel makers, and led to the closure of more than 150 million tons of steel capacity there.⁴⁰</p> <p>Financial</p> <p>With local communities, social tensions typically arise from fears of pollution, water usage conflicts and economic landscape impacts.⁴¹ There may also be repercussions on its credit ratings.⁴²</p> <p>Operational</p> <p>Ultimately, these risks threaten a company's license to operate (LTO), which is, for the second consecutive year, the top business risk faced by the mining and metals industry, according to EY study, Top 10 business risks and opportunities - 2020, survey of more than 150 global mining executives.⁴³</p>
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Positive corporate responses to ESG

Company	Initiative
<p>Teck Resources</p>	<p>Has committed to reducing fresh water use, and for its Quebrada Blanca 2 project has entirely replaced fresh water with desalinated seawater.</p> <p>Saturated rock fill (SRF): Developed a new method to remove selenium and nitrate from mine-impacted water.</p> <p>Recycles and re-uses water in its operations an average of 3 times.</p> <p>Established independent railings review boards for all of their major tailings facilities, alongside the deployment of monitoring technology, regular inspections, and reviews by independent experts, to ensure the safety of people, communities and the environment.</p>

Further steps companies can take to distinguish themselves using ESG

To further distinguish themselves, companies could then move beyond an inward focus, to initiatives that interact more with and create value for the ecosystem. For instance, companies could benchmark their practices against industry ESG leaders and learn from them. Companies could also explore sustainable sources of finance.

Benchmark practices

Metric systems such as MSCI ESG and DJSI (the Dow Jones Sustainability Index) offer a composite environmental, social and governance perspective, enabling investors to compare and rank companies relative to their industry peers. The table below summarizes key ESG rating systems commonly used. A study done by Harvard Business School using data from MSCI ESG Ratings from 2012 to 2017⁴⁴ found that there is a

difference in advantages depending on whether the company has adopted common or strategic sustainability practices. In the study, the adoption of strategic sustainable practices was found to have a positive effect on both return on capital and market valuation. In contrast, the adoption of common sustainability practices only positively affected market valuation multiples. As more companies incorporate ESG into their operations, basic sustainability practices have become a necessity for survival, and real strategic advantage is only created through the adoption of sustainability measures that competitors can't easily match.

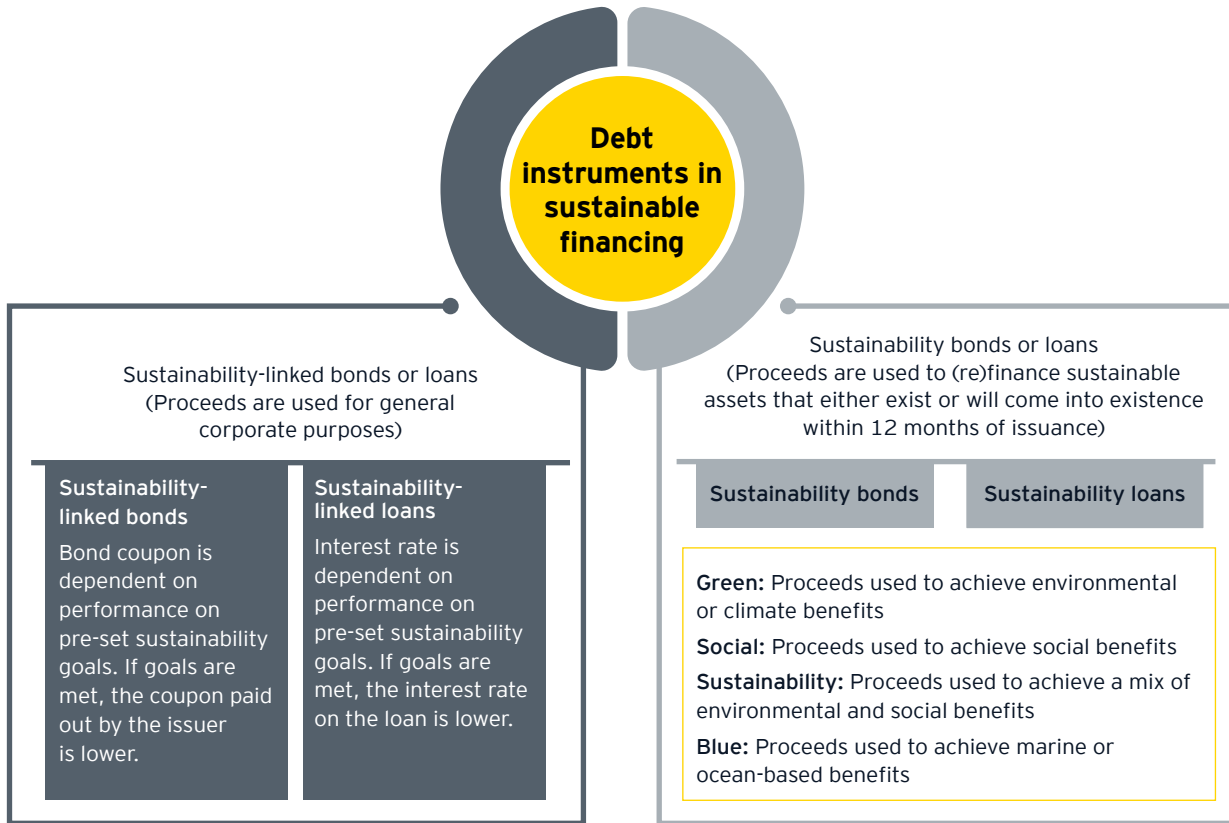
A company may start by learning from industry leaders that it is benchmarking itself against, and may ultimately outdo them to become leaders that others learn from. Oftentimes, it is also useful to have a first-mover advantage.

Rating index	Overview
Bloomberg ESG Data Service	Provides insight on ESG metrics for over 9,000 companies across over 70 countries. Also provides scores from third-party rating agencies (RobecoSAM, ISS Quality Score, and CDP Climate Disclosure Score) and an overview of a company from an ESG perspective both historically and relative to peers.
MSCI ESG Research	Aims to measure a company's resilience to long-term, financially relevant ESG risks. Rates 7,500 companies and more than 650,000 equity and fixed income securities globally as at October 2019, using a rules-based methodology to identify industry leaders and laggards.
DJSI World	S&P Dow Jones Indices has partnered with RobecoSAM for publication and calculation of ESG indices. DJSI is broken down into: DJSI World, DJSI Regions and DJSI Country. DJSI World: Represents the top 10% of the largest 2,500 companies across 60 industries in the S&P Global BMI (Broad Market Index). Scores are derived from RobecoSAM's annual Corporate Sustainability Assessment (CSA) whereby 2,500 publicly traded companies are invited to participate in the CSA for possible inclusion in the DJSI World.
FTSE4Good Index	Consists of 6 benchmark indexes covering major developed markets including the US, Japan, UK, Australia and the EU. Also includes five tradable indexes for investors who want instant and cost-effective exposure to ESG companies. Companies in developed markets require an ESG rating of 3.3 or above to be added to the FTSE4Good Index Series.

Common debt instruments in sustainable financing

The range of debt instruments is quickly expanding in response to increasing investor demand and sustainable

financing needs. Here is a quick guide on the types of products out there.



Leading by example: Frasers Property Group and Oversea-Chinese Banking Corporation, Limited (OCBC)

Green infrastructure: Frasers Property Group is a multi-national real estate and property management company. Since its green financing journey in 2018, OCBC, a Singapore bank with an Aa1 rating from Moody’s, has been supporting the Group in four out of five of its 2018/2019 loans, including an AUD 170 million green loan to Frasers Logistics and Industrial Trust* in June 2019, to finance greener and more resilient infrastructure.



Phoenix Transport and Survitec, one of the state-of-the-art facilities owned by Frasers Logistics & Industrial Trust, has received 6 star Green Star As-Built ratings from the Green Building Council of Australia (GBCA) since June 2018.

Leading by example: wpd AG and Oversea-Chinese Banking Corporation, Limited (OCBC)

Offshore wind power: wpd AG is a German developer and operator of onshore and offshore wind farms. In 2019, OCBC was the Mandated Lead Arranger for the financing of a 640 MW, 80-turbine offshore wind power facility in Taiwan, a project that is majority-owned by wpd AG. This project supports the Taiwan government’s plan to install 5.5GW of offshore wind generation capacity under the “Thousand Wind Turbines Project”, and aligns with one of OCBC’s core SDGs – SDG 7 Enabling access to clean and affordable energy. It is scheduled for completion in December 2021.



*Frasers Logistics & Industrial Trust has since been rebranded “Frasers Logistics & Commercial Trust” following a merger between Frasers Logistics & Industrial Trust and Frasers Commercial Trust. Please refer to <https://www.businesstimes.com.sg/companies-markets/flit-renamed-frasers-logistics-commercial-trust-after-merger>

Investor



Can investors do good and still do well?

- ▶ Research shows that the increasing investor demand for sustainable investments is not unwarranted. For investors who are seeking strong financial returns while wanting to do good at the same time, sustainable investing and considering firm performance on material ESG issues are key.
- ▶ Sustainable investing typically takes a few forms – ESG incorporation, sustainability-themed investing, and active ownership. After an investment has been made, **active monitoring** – particularly on material ESG topics – will help companies to continue mitigating risks and identify opportunities.

Recent media coverage on the consequences of climate change (manifested in prolonged bushfires, unexpected weather patterns, frequent droughts and floods), and regulatory changes (which include mandatory sustainability disclosures and the imposition of carbon taxes) are among the developments that have been foregrounding the ESG risks that businesses face, that investors are beginning to price into their investments today.

According to the Global Sustainable Investment Alliance, global sustainable investment has passed USD 31 trillion since 2018. The increase corresponds to a rising proportion of sustainable investments relative to total managed assets in all regions except Europe, where the decrease stems in part from stricter standards and definitions of sustainable investing.⁴⁵

Better returns on sustainable investments

The growing demand is not unwarranted. An analysis of nearly 11,000 ESG-focused funds over a 14-year period from 2004 to 2018 revealed that returns on sustainable funds did not differ materially from the performance of traditional funds. Furthermore, sustainable funds potentially offered lower market risk, which could appeal to investors seeking less volatility.⁴⁶

- ▶ A comparison of the market performance of S&P500 companies with high ESG scores with that of S&P500 companies with low ESG scores (as per the Refinitiv ESG database) over a 10-year period from 2008 to 2018 came to the same conclusion: A high-performing ESG portfolio gave less volatile returns and had a geometric mean return of 7.34%, while a low-performing ESG portfolio gave more volatile returns and had a geometric mean return of 7.18%.⁴⁷
- ▶ Other evidence shows a positive correlation between ESG and long-term value.
 - ▶ In 2015, Busch, Friede, and Bassen concluded from over 2000 empirical studies that a “large majority of studies reports positive findings” of ESG impact on financial performance, and that this positive impact appeared stable over time.⁴⁸
 - ▶ A follow-up study in 2018 confirms the same results and further traces the stronger financial performance to higher operational efficiency brought about by strong performance on ESG matters.⁴⁹ Khan, Serafeim, and Yoon of Harvard Business School make the crucial distinction that only firms with strong performance in material ESG topics exhibit outperformance in sales growth, profitability, return on equity, and return on assets. Performance on immaterial sustainability topics have little, if any, value implications.⁵⁰

For investors who are seeking strong financial returns while wanting to do good at the same time, sustainable investing and considering firm performance on material ESG issues are key.

Managing ESG risks in investment decision

ESG due diligence

The ESG due diligence process identifies material ESG related risks and opportunities, and assesses the maturity of target investee companies in managing them. Value is added by providing insight into business-critical ESG risks and opportunities in the short- and long-term, that can be leveraged upon in deal evaluation, pricing and negotiation.

“

The onset of COVID-19 pandemic, along with the recent climate changes, has brought to the forefront the importance of sustainability in our world and the businesses that it hosts.

Loletta Chow,
EY Global China Overseas Investment Network
Leader, EY Belt & Road Task Force Leader and
EY Asia-Pacific Growth Markets Leader



EY due diligence framework comprises four main stages

1. Value chain impact assessment

Identification of significant ESG impacts from raw materials and inputs through to product use and disposal

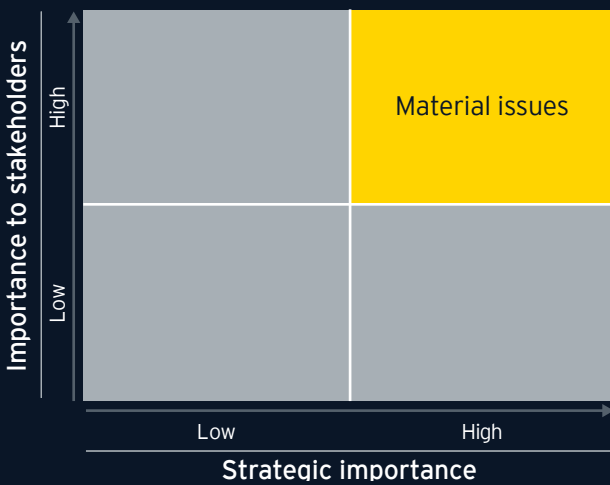
- ▶ After conducting a scan of the target investee and business value chain, it would be useful to benchmark the data using tools such as Company InfoGator and Factiva



2. Materiality assessment

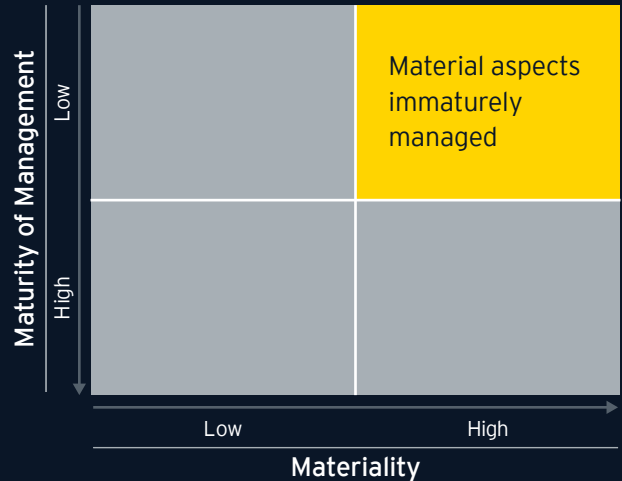
Assessment of stakeholder expectations (future buyers, customers, regulators), in the short term and long term

- ▶ In rating strategic importance, it would be useful to refer to SASB's materiality map as covered in the next section



3. Maturity assessment

Assessment of the maturity of management of material issues including commitment, strategy, efforts and result



4. Analysis of key findings

Interpretation of key findings with a focus on relevance to the investment decision

- ▶ In coming up with an action plan, it would be useful to consider the level of priority and ease of implementation

Material ESG topics by sector

Material topics vary by industry. The Sustainability Accounting Standards Board (SASB) identifies them through a rigorous methodology which considers the financial, policy, liability and reputational risks of 26 sustainability-related business issues to various industries. Industry norms and opportunities for innovation and growth are also considered (<https://materiality.sasb.org/>).

Using SASB's 2018 data, we have summarized the ESG topics that affect more than 50% of the industries in each sector.

Some of the recurring material issues across the sectors are: GHG emissions, energy management, and product design and life cycle management. Unsurprisingly, these issues correspond with the rising call for countries to transition to a low-carbon and circular economy.



Health care

- Data security
- Access and affordability
- Product quality and safety
- Customer welfare
- Selling practices and product labeling
- Business ethics



Consumer goods

- Product quality and safety
- Product design and life cycle Management
- Supply chain management



Infrastructure

- Employee health and safety
- Product design and lifecycle Management
- Business model resilience



Extractives and minerals processing

- GHG emissions
- Air quality
- Water and wastewater management
- Ecological impacts
- Employee health and safety
- Critical incident risk management



Renewable resources and alternative energy

- Energy management
- Water and wastewater management
- Product design and lifecycle management
- Materials sourcing and efficiency



Financials

- Selling practices and product labeling
- Product design and lifecycle management
- Business ethics
- Systemic risk management



Resource transformation

- Energy management
- Waste and hazardous materials management
- Product quality and safety
- Product design and lifecycle management
- Materials sourcing and efficiency



Food and beverage

- GHG emissions
- Energy management
- Water and wastewater management
- Product quality and safety
- Customer welfare
- Selling practices and product labeling
- Product design and lifecycle management
- Supply chain management
- Business ethics
- Systemic risk management



Technology and communications

- Energy management
- Customer privacy
- Data security
- Employee engagement, diversity and inclusion
- Materials sourcing and efficiency



Transportation

- GHG emissions
- Air quality
- Employee health and safety
- Critical incident risk management

(Material issues by sector. Data source: SASB, 2018⁵¹)

For the investors, this materiality map is a useful resource both in the initial selection, and continuous monitoring of investments.

Forms of Sustainable Investing

Sustainable investing typically takes the following forms⁵²:

- ▶ **ESG incorporation**, where investors consider a firm's performance on ESG issues when incorporating investments into their portfolio;
- ▶ **Sustainability-themed investing**, where investors choose investments that target specific sustainability themes;
- ▶ **Active ownership or stewardship**, where investors use their influence to push companies they hold investments in to improve their ESG risk management or develop more sustainable business practices.

ESG incorporation



Sustainability-themed investing



Active ownership

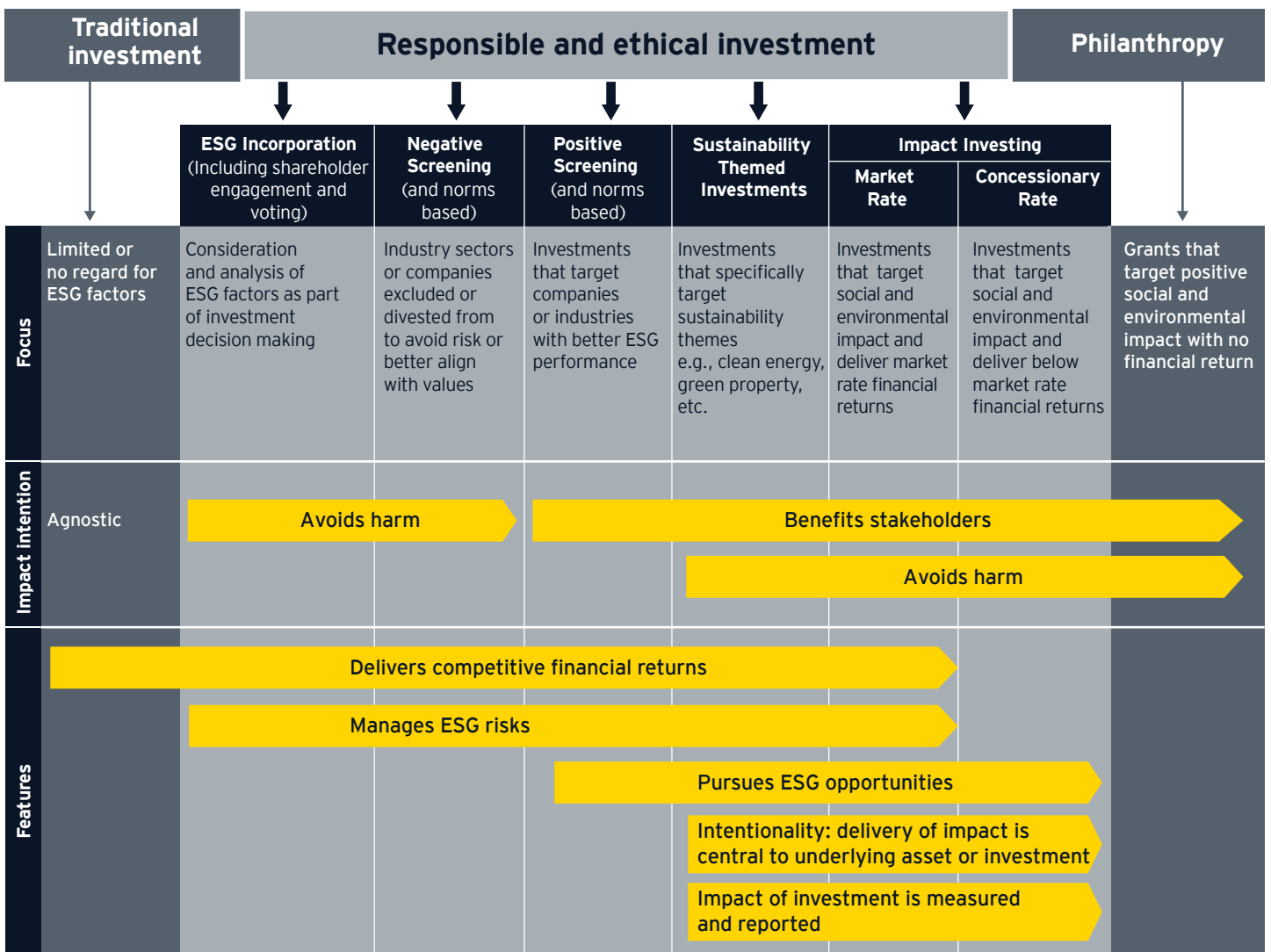


ESG incorporation

When incorporating ESG factors in the construction of one's investment portfolio, as an investor, you have a number of strategies to choose from. These strategies are not mutually exclusive and are typically used in combination with each other. For instance, the MSCI KLD 400 Social Index is a market-cap-weighted stock index that uses both Positive and Negative screening to arrive at 400 publicly-traded companies with high ESG ratings, and that do not engage in the business of alcohol, tobacco, firearms, gambling, nuclear power and military weapons.^{53 54} Other popular portfolio exclusions are fossil fuel companies and commodities companies with questionable human rights records. Also, popularly used with Positive and Negative screens is Norms-based screening, where investors check for compliance to international and industry standards and norms, often by examining the company's policies.

The choice of strategy is often dependent on the investor's impact intentions and financial and non-financial objectives. These are detailed in the diagram next page.

In particular, sustainability themed investing and impact investing at a market rate stand out for being able to simultaneously pursue good and avoid harm, and deliver measurable impact and competitive financial returns. Both strategies are similar, but impact investing sets impact or social return targets upfront, and monitors and also reports performance on these targets. Many impact investors take a thematic approach.



Sustainability themed investing

The UN estimates that USD 3 to 5 trillion of financing will be needed annually to meet the United Nations Sustainable Development Goals (SDGs) in developing countries.⁵⁵ There are several reasons why investors might want to contribute to the SDGs:

First, the SDGs comprise the most urgent environmental, social and economic issues that have been agreed on globally, and thus are material ESG factors.

Furthermore, achieving the SDGs will drive economic growth which, in the long run, will increase revenues and earnings, and correspondingly, equities and other assets.⁵⁶ Current estimates highlight that achieving the SDGs could lead to USD 12 trillion of market opportunities and create 380 million new jobs, and action on climate change could result in savings of USD 26 trillion by 2030.⁵⁷

Finally, for the uninitiated investor venturing into sustainability-themed investments for the first time, the SDGs can serve as a convenient framework to think about and pursue impact.⁵⁸

To this end, the UN PRI's Impact Investing Market Map focuses on 10 top thematic areas that are linked to SDG targets and indicators. For each area, the Market Map provides guidance on how to select potential companies to invest in, and gives common indicators for monitoring performance⁵⁹.

In the 2018 report the 10 themes identified as being of particular importance are: green buildings, energy efficiency, renewable energy, affordable housing, inclusive finance, education, health, sustainable forestry, sustainable agriculture, and water.

Case study: Renewable energy

Threats

In 2019, the Institute for Energy Economics and Financial Analysis (IEEFA) reported that over 100 globally significant financial institutions had exited their investments in coal, and the number was still set to rise. With a high probability of continued regulation surrounding carbon pricing and air pollution, coal was at high risk of becoming a stranded asset.⁶⁰ Already in 2018, 42% of the world's coal-fired power stations were running at a loss, and by 2030, it would be cheaper to make new investments in renewable energy capacity than to continue running coal plants. According to research group Carbon Tracker, shutting down its coal plants could save China USD 389 billion; the EU, USD 89 billion; the US, USD 78 billion; and Russia, USD 20 billion.⁶¹

Opportunities

The rapid rise of clean renewables in place of coal is led by

- ▶ China, who has committed more than USD 758 billion in renewable energy investments in the last decade
- ▶ US (USD 356 billion)
- ▶ Japan (USD 202 billion).

Most of these investments have gone into building solar and wind renewable capacity, which today account for about one-fifth of global generating capacity.⁶²

Per a report commissioned by the UNEP, developments in the past decade that make renewable energy a particularly attractive investment opportunity include:⁶³

- ▶ Declining costs in renewable energy production, due to manufacturing economies of scale, intense competition, record-low borrowing rates, and technological improvements improving generation efficiency. As such, generation costs have fallen by approximately 81% for solar energy, 46% for onshore wind energy, and 44% for offshore wind energy.
- ▶ Lower operational costs of renewable energy plants after the heavy upfront capital expenditure. In contrast, raw material and operational costs for coal, gas, nuclear and biomass plants remain high.
- ▶ There is an increasing trend of Power Purchase Agreements (PPAs) being signed with large private-sector companies, as many have joined the RE100 initiative and committed to becoming 100% powered by renewables. Additionally, PPAs allow companies to lock in a low electricity price for their operations in the long term. In 2018,
 - ▶ AT&T signed 820MW of wind deals
 - ▶ Norsk Hydro signed 667MW of wind deals
 - ▶ ExxonMobil signed 325MW of wind and 250MW of solar deals



Active ownership or stewardship

For existing investments in companies with questionable ESG practices or in undesirable ESG industries, rather than dropping them altogether, you could push for improvements on ESG issues to be made by **voting** on resolutions, or by **engaging** in discussions with companies (which is particularly relevant for investors such as bondholders who do not have voting rights).⁶⁴



As institutional investors and consistent with our fiduciary duty to our beneficiaries, we will work with the companies in which we invest to ensure that they are minimizing and disclosing the risks and maximizing the opportunities presented by climate change and climate policy.

Global Investor Statement on Climate Change, signed by more than 370 investors with more than USD 35 trillion in assets under management, who have committed to the Climate Action 100+ initiative⁶⁵

Leading by example: BlackRock Inc.

BlackRock is one of the world's largest asset managers with assets under management amounting to more than USD 6 trillion. One way that it has been pushing for change through active ownership is by engaging with their portfolio companies – not just with management and the board, but also with the companies' advisors (e.g., investor relations and legal teams) and even other shareholders when appropriate.⁶⁶

In areas where BlackRock is concerned that a company's governance or business practices may fall short of operational excellence, they ask questions, explain their concerns and expectations, and give the company time to respond, taking care not to micromanage.

BlackRock also advocates for greater consistency and transparency in ESG disclosures to respond to investors' informational needs, and has asked CEOs of carbon-intensive companies to consider adopting the Task Force on Climate-related Financial Disclosures framework in their disclosures.⁶⁷

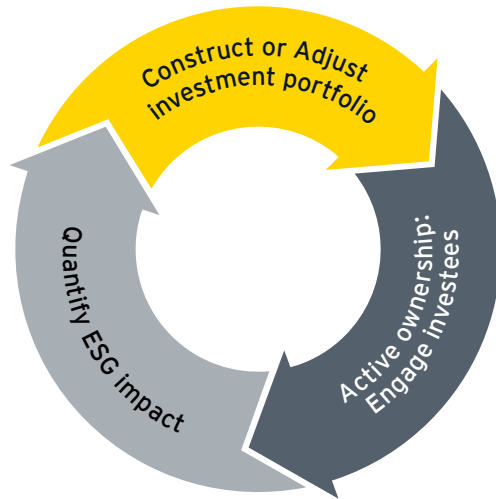
How BlackRock defines companies for engagement

	Example
Proactive approach	Engaging companies when the team identifies concerns with their performance and governance
	Engaging companies in sectors that have thematic governance issues with a material impact on shareholder value
Reactive approach	Engaging companies after an event that affects long-term company value has occurred
	Engaging companies after they request for a meeting and provide the agenda

(How BlackRock defines companies for engagement. BlackRock, 2020⁶⁸)

Monitoring ESG performance

After an investment has been made, active monitoring – particularly on material ESG topics – will help to mitigate risks and identify opportunities. This is essential in active ownership, where investors engage with investee companies on their management of ESG issues.



Active ownership: engage investees

Post-investment, investors should continue to monitor ESG performance of investees and the investees' competitors, so as to be able to constructively engage with them. This can be done by⁶⁹:

- ▶ Reviewing the investee's strategy in response to changes in regulation, markets, and technology
- ▶ Ensuring the investee's timely implementation of action plans to improve ESG practices, address new risks, or capitalize on new practices
- ▶ Checking for the investee's compliance with external legislation and internal policies
- ▶ Staying updated on the investee's changes in corporate governance practices or ESG management systems
- ▶ Pushing for better non-financial disclosures – for instance, those aligned with the GRI standards, IRIS metrics, and/ or Task Force on Climate Disclosures.

Quantify ESG impact

Besides monitoring the ESG performance and practices of investees, it is helpful that investors monitor the quantifiable risk impact to their investment portfolio. This can be done by⁷⁰:

- ▶ Adjusting variables used in valuation models for the expected impact of ESG factors

- ▶ Running different ESG scenarios to assess the impact of ESG factors on portfolio risk and return

Adjust investment portfolio

- ▶ Thereafter, investors might consider adjusting the weighting composition of companies, sectors, countries and currency in their portfolio.⁷¹

Leading by example: Hermes Investment Management⁷²

Hermes Investment Management is a socially-conscious investment firm⁷³. Some of their best monitoring practices are as follows:

The team actively analyzes ESG risks within their portfolio and ranks high-risk companies based on how effectively they manage material ESG issues. Their portfolio is also monitored for carbon level and intensity, and the highest emitters are identified.

Every two months, formal meetings are held internally to discuss these high-risk companies and agree on investee engagement objectives.

Thereafter, the team regularly engages with the company, and measures and monitors progress on investee engagement against 4 milestones:

- ▶ Raising the issue with the company
- ▶ The company recognizing that the concern is valid
- ▶ The company concretising a plan to address the issue
- ▶ The company successfully delivering on the objectives

This active ownership engagement with investees helps to inform their assessment of risk, and if successful, can also help to mitigate risk.

Philanthropy



Getting there, asking better questions

1. Do we know the tax laws in our country with regard to philanthropy? Have we optimized tax relief relative to our giving?
2. Do international tax differences affect our giving and, if so, how?
3. Do we make use of the tax relief related to social impact investing? Have we considered whether the tax laws for social impact investing differ from those for traditional philanthropy?



	Charity	Institution of Public Character (IPC)	Grantmaker	Foreign Charitable Purpose Trust (FCPT)
Description	Any organization or trust or foundation that operates on a not-for-profit basis, sets up exclusively for charitable purposes; and carries out activities to achieve these purposes which benefit the public.	Any registered charity that meets additional requirements for becoming an IPC, e.g., the activities of an IPC must be beneficial to the community in Singapore as a whole, and not confined to sectional interests or group of persons based on race, creed, belief or religion, unless otherwise approved by the Minister.	Typically non-profit entities such as private foundations that give out grants to specific charitable causes: <ul style="list-style-type: none"> a. Be a Non-Profit Organization (NPO) or Non-Governmental Organization (NGO); b. Have only private fund sources, from an individual, family or company, without need to solicit monies; c. Be established to aid exclusively charitable purposes through the provision of grants; and d. Not be an IPC. 	Charitable trusts where the settlors are NOT Singapore residents or citizens in Singapore nor constituted or registered under Singapore laws
Regulatory status	Registration as a charity required for income or property tax benefits	Registration as a charity required for income or property tax benefits Approval (as IPC) required for donation tax benefits	Registration as a charity required for income or property tax benefits Grantmakers are regulated under a lighter-touch regime.	Registration as charity is permitted, but is not required to donate to beneficiaries in Singapore so long as source of funds is foreign or to receive tax exemptions.
Singapore status	<p>Income tax – Exempt¹</p> <p>Property tax – Could be exempt²</p> <p>Donations – Not deductible, unless also qualified as IPC</p>	<p>Income tax – exempt¹</p> <p>Property tax – Could be exempt²</p> <p>Donations – Deductible, deductible for the donor at 2.5 times of qualifying donation</p>	<p>Income tax – Exempt¹</p> <p>Property tax – Could be exempt²</p> <p>Donations – provided the grantmaker registers with the IRAS as a qualifying grantmaker, deductible at 2.5 times of qualifying donation if all donations are used for grants made to IPCs and conditions are met</p>	<p>Income tax – Exempt, regardless of whether registered as a charity</p> <p>Property tax – Could be exempt²</p> <p>Donations – Not deductible</p>

¹ except for the income of “business subsidiaries”

² If approved and property is used for charitable purposes conducive to social development in Singapore

Care about the effectiveness of your philanthropy

There is a direct correlation between families' personal involvement in evaluating philanthropic progress and their overall interest in effective giving, and owners of smaller and larger family enterprises generally believe that personal oversight contributes to effectiveness. Where there is a desire

to either institutionalize the philanthropic efforts of a family, or to reduce personal involvement for individual members of a family, professional mechanisms such as family offices may be a means to help or provide support.

Some facets of family offices

Preserving legacy	Succession planning	Investments	Support
<ul style="list-style-type: none">▶ Preserving the family legacy▶ Keeping the family and wealth together▶ Reinforcing family values and goals▶ Philanthropy	<ul style="list-style-type: none">▶ Transgenerational governance▶ Clear succession that is efficient▶ Insurance▶ Preparing future generations	<ul style="list-style-type: none">▶ Clear investment goals and mandate▶ Balance between capital preservation vs growth▶ Robustness and tax efficiency of structures▶ Flexibility and ease of liquidity	<ul style="list-style-type: none">▶ Travel and administrative support for the family, real estate and its vehicles▶ Bookkeeping▶ Tax and other compliance filing

Lastly, philanthropy makes a beneficial social or environmental impact if it is effective and if that effectiveness is carefully measured and evaluated.



Getting there, asking better questions

1. Who from our family is best placed to personally oversee the effectiveness of our philanthropy?
2. Is it more effective for us to increase the family's personal evaluation of philanthropic projects or to we delegate this responsibility to external advisors and experts?
3. How do we measure the effectiveness of our giving? Do we demand qualitative or quantitative evidence from our beneficiaries? Who evaluates this evidence and what are the consequences that such an evaluation brings about.
4. Are we satisfied with our ability to enhance the effectiveness of our giving? If not, where are we lacking in expertise? Could external advisors enhance our ability to evaluate the social, environmental and economic dimensions of philanthropic projects.

A group of people are gathered around a long wooden table outdoors at night, enjoying a meal. The scene is illuminated by warm string lights hanging above the table. The background is filled with lush green foliage. The overall atmosphere is intimate and social.

“

As the baton is increasingly passed on to the nextgen, ESG has been a key area that has engaged the nextgen and bind the business owners in their pursuit of family enterprise philanthropy

Desmond Teo,
EY Asia-Pacific Family Enterprise Leader

End notes

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