A Region Under Pressure

10 ESG Themes for Asia-Pacific

Asia-Pacific provides many opportunities for the ESG investor. The region is home to half of the world's population but also generates half of global emissions. There is increasing recognition of this problem and remedial actions are quickly underway, closing gaps that may have frustrated asset managers in the past. Challenges remain, but the opportunities are myriad.

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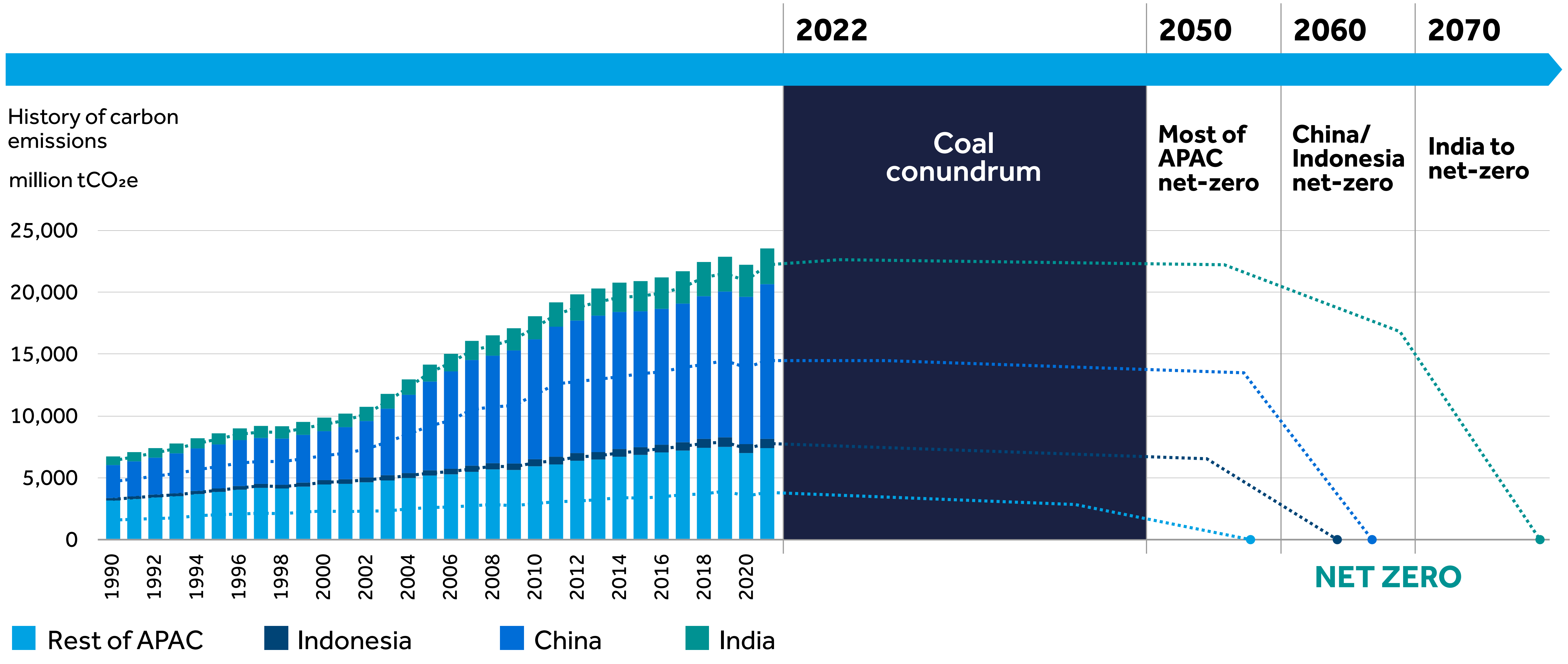
Theme # 1

The coal conundrum is on the horizon

Coal has powered Asia-Pacific's (APAC) growth. But it is also the most identifiable cause of its outsized carbon emissions.

To date, almost every major APAC economy has committed to a net-zero timetable in their Nationally Determined Contributions (NDCs). Most have set the year 2050 as their goal. But before these countries reach their net-zero future, they must deal with the coal conundrum—how do they phase out coal use in time?

APAC's pathway towards net-zero remains challenging



Source: CHRB 2020 findings

The dilemma is complicated by energy shortages which have seen coal make a comeback. This is a major issue for ESG investors.

Power shortages in China, APAC's largest emitter, have resulted in targets being relaxed or delayed.

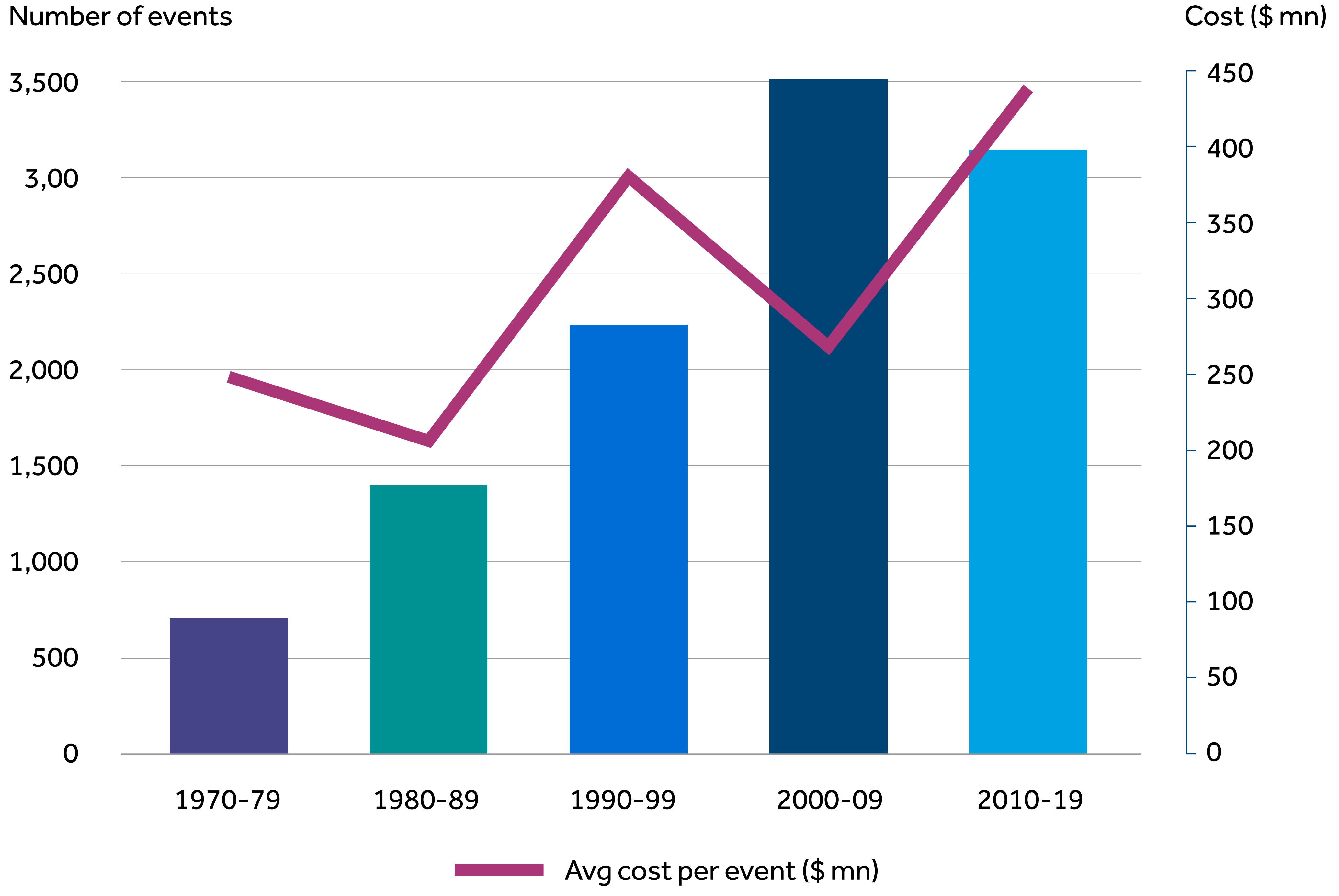
In contrast, Japan, the third largest emitter in APAC, has recorded a 1.3% CAGR decline in carbon emissions over the past decade and has pledged to achieve carbon net-zero by 2050.

Theme # 2

Extreme weather threatens economic growth

Extreme weather events are becoming more frequent and costlier, exposing investor portfolios to physical and economic risks. APAC is one of the most at-risk regions globally.

Extreme weather events becoming more frequent and costlier



Source: World Meteorological Organization

Despite this upward trend, the region is under insured. According to Munich Re, APAC had an insurance gap of 83% against the global average of 57%. In 2021, China's severe flood in Henan was only 10% insured.

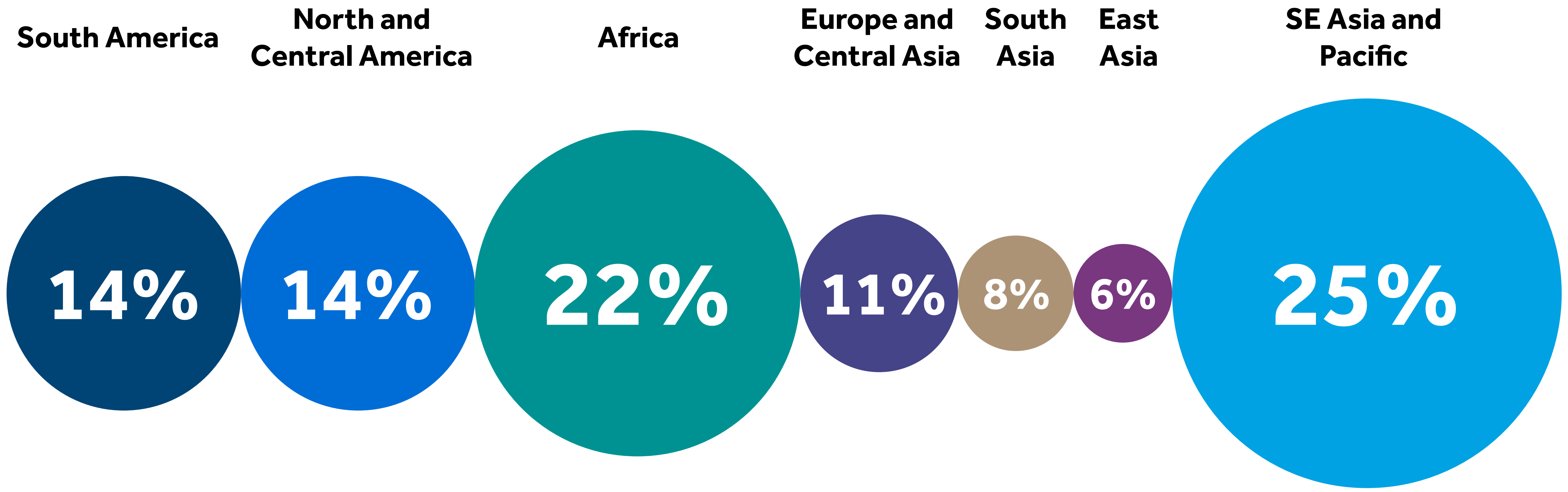
Theme # 3

Rising demand for biodiversity disclosure

Almost two-thirds of APAC GDP is reliant in some way on the region's natural habitats.

Loss of biodiversity could impact investor portfolios in key markets and sectors. APAC is highly vulnerable, particularly in the realms of agriculture, transport, and energy & utilities. The UN Biodiversity Conference (COP15) in late 2022 should confirm new, global goals for retaining biodiversity.

Biodiversity hot spots in the world



Hot spots refers to bio-geographic regions with significant levels of biodiversity threatened by human habitation.

Source: Conservation International

Businesses are beginning to take notice of the risk. Yet, there is no clear framework to convert awareness to action.

While a number of markets already require listed companies to disclose climate-related risks, there are limited international biodiversity benchmarks. This may gain further visibility in 2023, with the launch of a reporting framework from the Taskforce on Nature-related Financial Disclosures (TNFD).

Regulators and investors will likely demand disclosure and assessment of biodiversity risks from corporates.

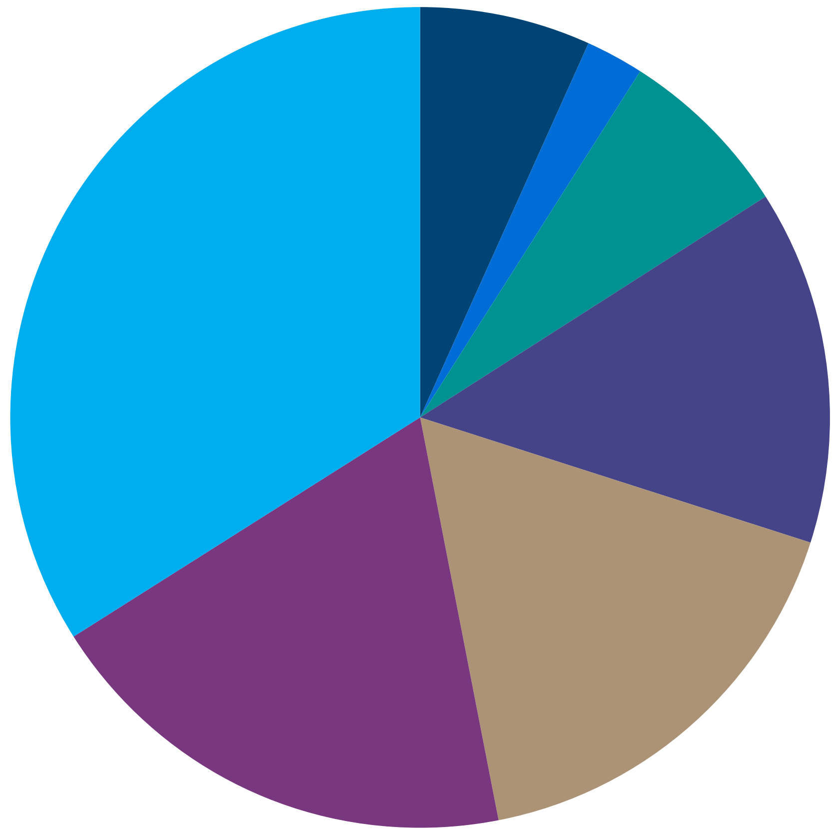
Theme # 4

Rising pressure to address social factors

Increased disclosure and reporting requirements will add to scrutiny of firms' progress on social issues such as diversity, worker rights, health & safety, and supply chain practices.

New supply chain rules could hurt laggards. Only 16% of companies in APAC have conducted supply chain due diligence.

East Asia & Pacific as the largest source of CHRB allegations findings



Source: CHRB 2020 findings

The 2020 Corporate Human Rights Benchmark (CHRB) report[1] found that the most common negative human rights impacts involved situations of forced labour, child labour, or health and safety breaches that resulted in death or injury.

[1] "Corporate Human Rights Benchmark Across sectors: Agricultural products, Apparel, Automotive manufacturing, Extractives & ICT manufacturing", CHRB, 2020 key findings

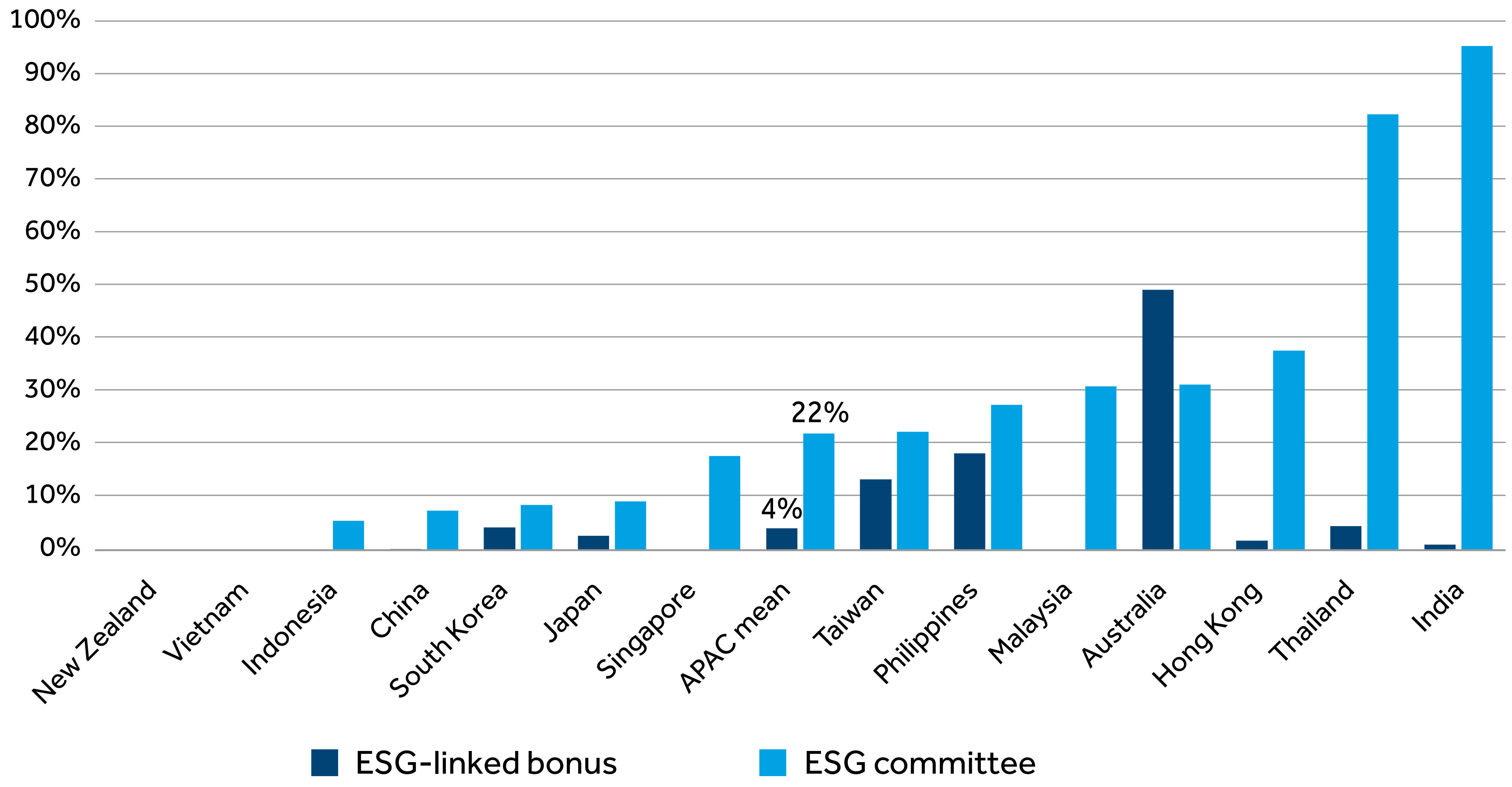
Theme # 5

Governance is improving, but still a long way to go

Strong governance ensures long-term value creation for stakeholders. Investors engage on governance topics (49% of total engagements in 2021) more than environment and social.

Despite positive trends in the regulatory environment, disclosure, and board composition, large gaps prevail on board transparency and executive compensation for APAC companies.

Limited presence of ESG committees and ESG-linked compensation are clear issues



Source: Bloomberg, Barclays Research

In our view, key developments in APAC regulation have been favourable to ESG investors.

On ESG governance structures, it remains at the firms' discretion as to how they want to demonstrate strong board oversight of ESG matters. While there is no one-size-fits-all framework, establishing an ESG committee at board or executive levels has become common practice for APAC companies.

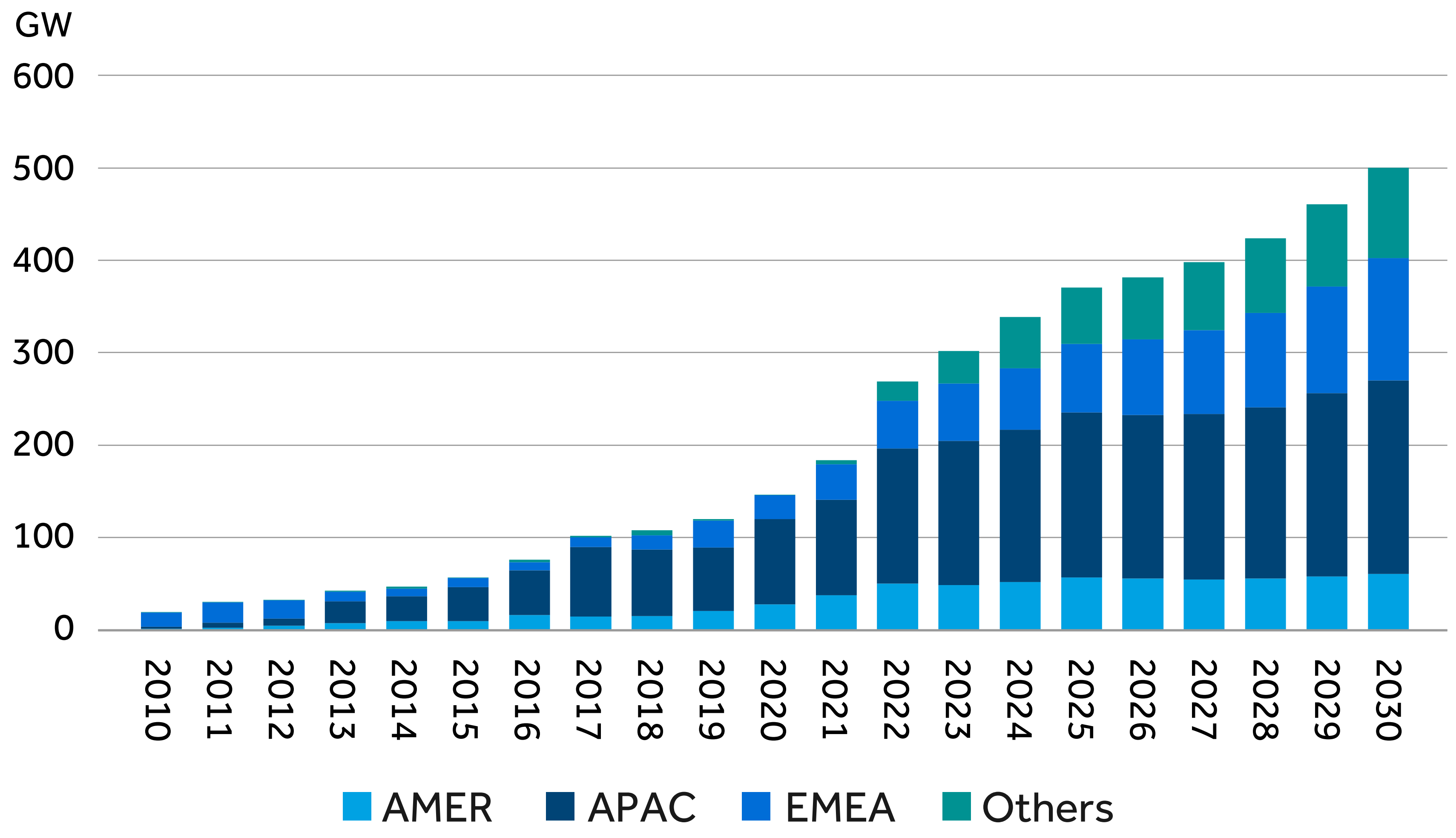
Theme # 6

Path to net-zero holds great opportunity

The road to net-zero enables unprecedented multi-sector opportunities for investors looking to boost financial returns and manage portfolio emissions.

APAC is well positioned in the energy transition as the biggest market for renewables and EVs. Earlier action taken to address building, construction, agriculture, alternative fuels etc. should pay off.

Outlook of newly installed solar capacity



Source: Bloomberg NEF

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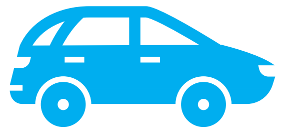
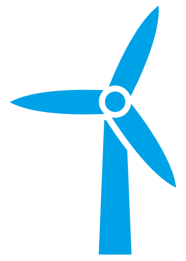
The amount of investment required in energy infrastructure alone to transform the region to net-zero.

[1] "Asia's Net Zero Energy Investment Potential", Asia Investor Group on Climate Change, March 2021

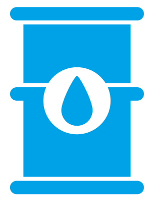
There are opportunities for APAC in many new fields, for example:



Renewables and EV



Energy storage



Alternative fuels

Green buildings

Green cements

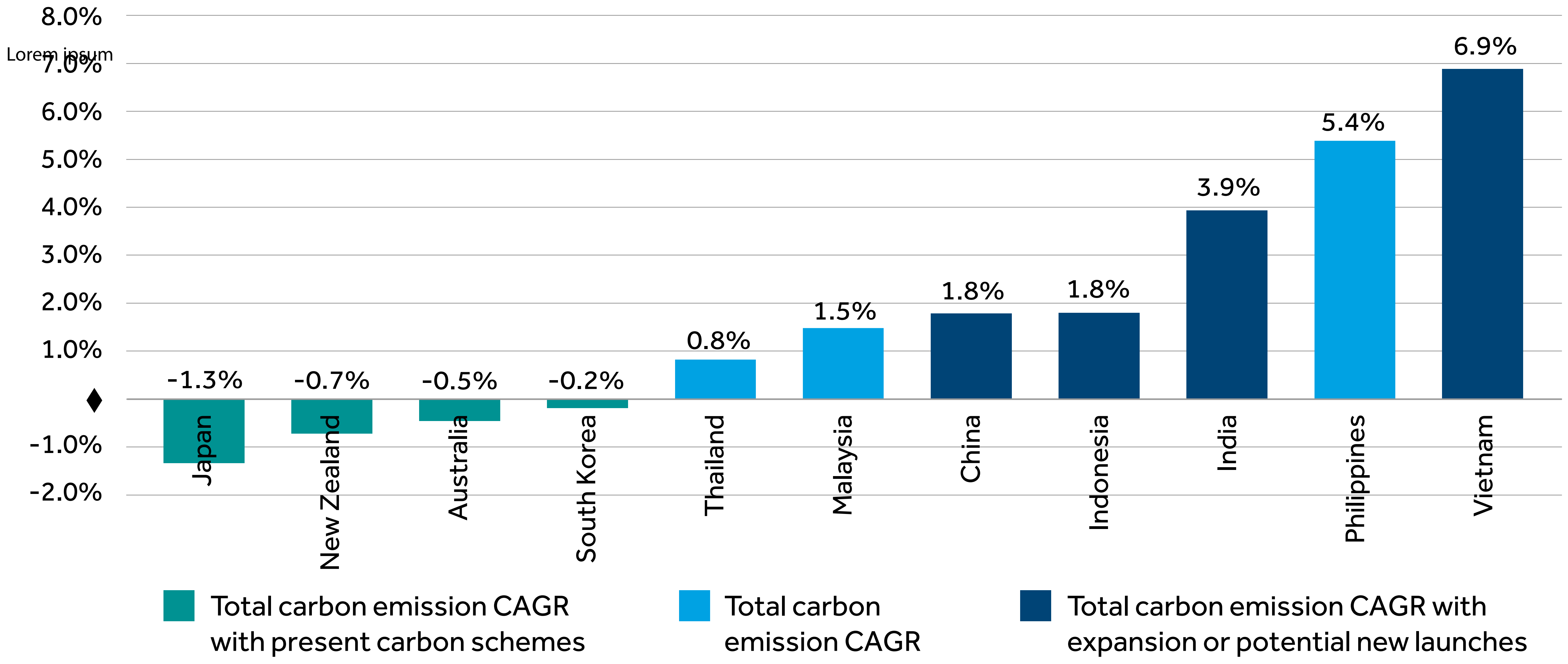
Theme # 7

Carbon markets gain traction

Carbon markets allow investors and firms to price emissions and quantify their financial impact, which helps to identify transition investments and opportunities for active carbon trading.

APAC is fast deploying carbon markets, with China expanding and seven other markets planning to launch emission trading schemes. This should strengthen net-zero commitments and actions.

Total carbon emission CAGR from 2011 to 2021



Source: BP Energy Statistics, Barclays Research

Carbon-intensive companies in APAC can adopt these methods to assess the financial impacts of their emissions:

- Internal carbon taxes: a tax applied internally and voluntarily per tonne of CO_2e emitted.
- Shadow pricing: an adopted theoretical value linked to external sources that is assigned to a targeted investment without actually changing or addressing the current emissions.
- Implicit carbon prices: used by companies to improve understanding of their carbon footprint, and evaluate the economic costs of carbon-related regulations.

Theme # 8

Improved transparency boosts ESG: funding opportunities

While APAC hosts >50% of global listed companies, lack of consistent and standardised ESG disclosure has hindered investors. Better and broader disclosure should improve funding access for the region’s firms, while widening the universe of investable ESG assets.

Upcoming ESG reporting and climate-related disclosure requirement in APAC

	2022	2023	2024	2025
Climate disclosure rules	**Japan** TSE prime market to align with TFCD starting April 2022 **Mainland China, New Zealand, Thailand, Vietnam** Climate information specific required besides ESG reporting	**New Zealand** Financials and large listed companies aligned with TFCD **Singapore** TFCD-aligned for financials, energy and agriculture in 2023	**Malaysia** Proposed climate disclosure for financials **Singapore** TFCD-aligned for building, materials and transport in 2024	**Hong Kong** TFCD aligned for financials and all listed companies by 2025
ESG reporting rules	**Hong Kong, India, Indonesia, Japan, Malaysia, Singapore, Taiwan, Vietnam** Mandatory or “comply or explain”	**India** New BRSR reporting mandatory for top 1,000 companies **Philippines** Mandatory for all listed companies **Mainland China** Central SOEs encouraged to issue ESG reports by 2023		**South Korea** Mandatory for large listed companies in 2025 and all KOSPI-listed in 2030

Source: Various regulators and exchanges

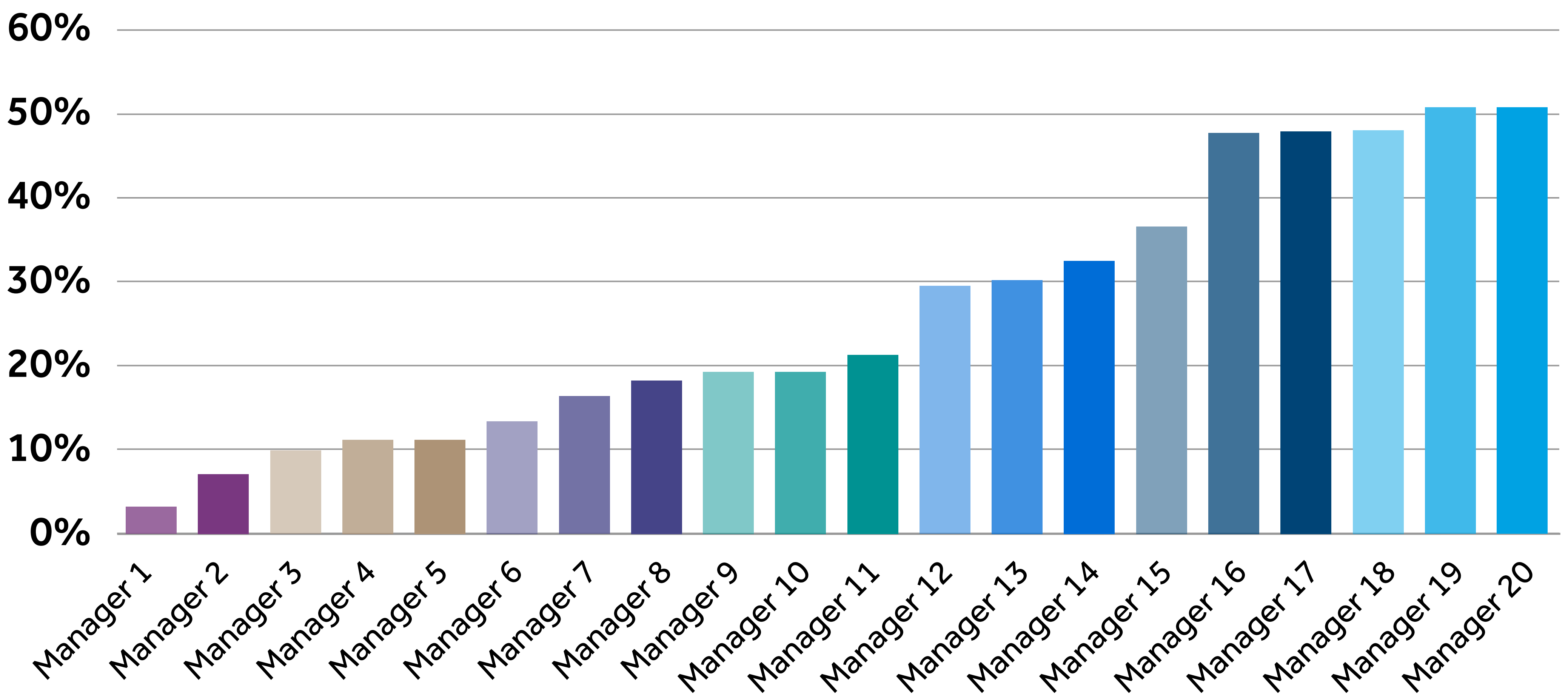
Theme # 9

Opportunities for engagement

Investors promoting active ownership are increasingly engaging with APAC companies. About 26% of 2021 engagements were within the region.

Engagement levels and approaches vary across the region. Active and engaged investors help raise standards broadly and also disincentive bad behaviour such as greenwashing.

APAC as % of 2021 engagement of 20 large global asset managers



Based on disclosed stewardship or responsible investment reports of 20 asset managers in 2021

Source: Barclays Research

49% of the disclosed topics for engagement cover governance (including disclosure and financing), followed by 28% for environmental and 23% for social issues.

Given the enhancements being made to disclosure regimes across the region, it is no surprise to find investors working with companies to initiate more proactive and detailed action plans.

Theme # 10

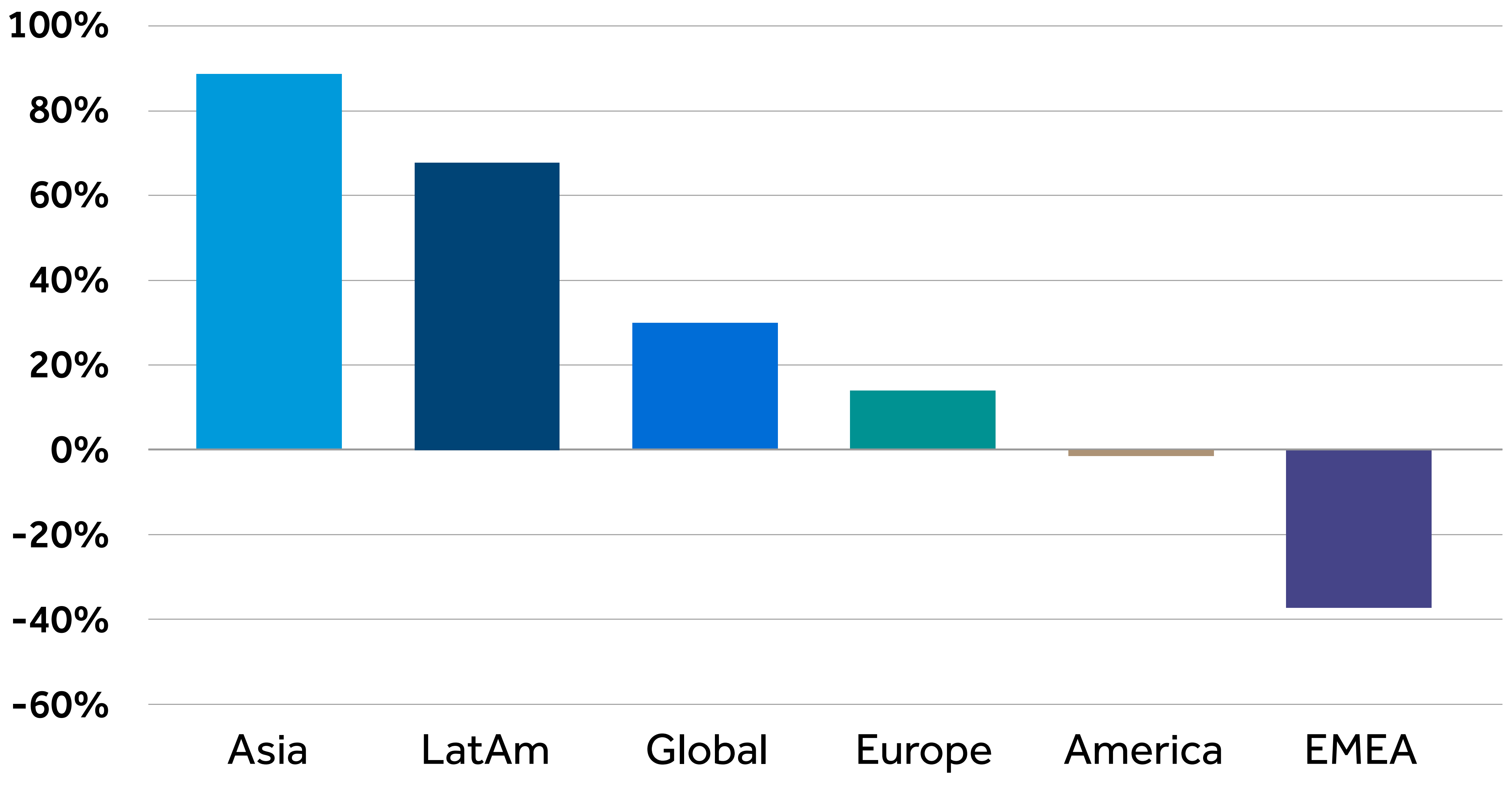
ESG capital markets: strong growth potential

Domestic capital markets are instrumental to finance APAC's net-zero journey and investors' long-term returns.

The region is well placed to take ESG market share from other countries, after APAC ESG-fund AUM growth outpaced the rest of the world since the start of 2021.

The growth of Asia ESG AUM has outpaced anywhere in the world

Change in AUM of ESG funds, 30 Jun 22 vs 31 Dec 20



Source: EPFR, Barclays Research

APAC ESG funds grew by 90% since 2021, outpacing the rest of the world.

Within Asia, China is by far the largest issuer of ESG bonds and has been the third most important for issuance, behind only the US and France.

Our Research analysts' view

Asia-Pacific holds immense potential for the development of ESG markets. The region, which accounts for ~40%[1] of global equity capitalization, more than half of EM bond issuance and around half of global greenhouse gas emissions[2], comprises just 4% of global ESG-funds AUM[3].

But that is changing fast. APAC ESG funds have outpaced every other region for AUM growth since the start of 2021. For ESG bonds, US$140 billion was raised in 2021 alone[4], with China, Japan and South Korea leading in issuance and Hong Kong and Singapore jockeying for recognition as future offshore green investment hubs.

In a promising sign that APAC's ESG star is rising, our analysis shows that 26% of ESG engagements by global asset managers were with Asia-Pacific firms. We believe that is a leading indicator for the bigger role APAC could play in growing the market for ESG-compliant assets in the years and decades to come.

[1] The World Bank (2020)
[2] The World Bank
[3] EPFR, June 2020 data
[4] Morningstart Direct

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