Kenanga Investors

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The Changing ESG landscape and our part in it

By Ismitz Matthew De Alwis, Executive Director & Chief Executive Officer

The term ESG [environmental, social and governance] is frequently mentioned these days, but what exactly does it mean? Perhaps a decade ago, it would seem almost performative to have ESG written as part of a company's corporate social responsibility statement. The fact that it is now one of the most trending topics in the industry shows that the world, at large, has truly shifted gears for the better.

Now, it is a major part of many institutions' key performance indicators, and is something that customers or investors look out for before engaging with the said institution. It represents a more stakeholder-focused approach to business.

Ismitz Matthew De Alwis, *Executive Director & Chief Executive Officer*

Shareholders have increasingly started viewing ESG-related issues as a window into the future, and a clear hierarchy has formed. As a result of this, leading corporations now view ESG issues as a business imperative. Companies that have included ESG principles/factors into their overall strategy and risk oversight discussion have presented a more positive image. The ability to detect and manage ESG-related concerns seems to have the capacity to create an engaging narrative surrounding a business and its practices.

The Rise of Islamic finance in Islam

We also believe that Islamic finance can be an enabler in achieving sustainable development. We see promising sources of growth going forward in Islamic social finance. This includes instruments like Qard Hassan, Waqf and Zakat. In particular, we see Waqf, an Islamic endowment instrument, as an attractive asset class that integrates commercial obligations with sustainability and social objectives.

ESG investing and Shariah investing are commonly seen as two separate entities, yet they are, in fact, two sides of the same coin. Both ESG and Shariah investing seek to encourage responsible conduct with Shariah investing emphasizing being good stewards of society and the environment following Islamic principles while ESG aims for sustainable outcomes.

ESG practices and advancement are only feasible through education and training. However, it is also critical to have both integration and engagement when it comes to ESG. ESG integration will improve long-term returns through managing ESG risk and opportunities. I believe that ESG is just not one particular thing but it is broad, interconnected and informs the way we approach investment ideas and solutions. A holistic ESG plan should encompass clear directions for all business units.

Malaysia has been the hub for Shariah compliant investments in the region. According to the Securities Commission Malaysia (SC), Malaysia's Islamic capital market continues to hold a sizable part of the overall capital market, accounting for 65.85%. The market size in December 2020 was RM2.26 trillion (US$540.02 billion), up from RM2.04 trillion (US$487.46 billion) at the end of 2019.

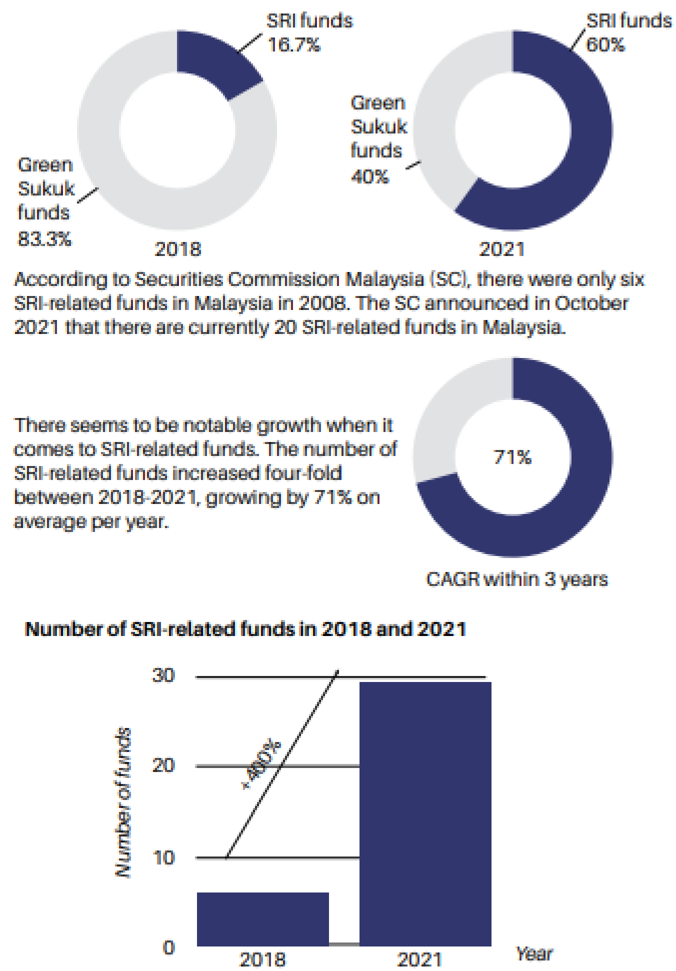
Following the COVID-19 pandemic, there has been a rise in interest in ESG, notably in Asia, where several stock exchanges have begun to introduce sustainability reporting rules. The Singaporean government's development of the Singapore Green Plan, which seeks to provide a comprehensive framework for sustainable development, green economy and net-zero emissions, prompted the Monetary Authority of Singapore (MAS) to incorporate climate change and environmental sustainability into all of its frameworks. As a central bank and financial regulator, MAS seeks to collaborate with financial institutions in Singapore to increase the financial sectors' resilience to environmental threats 2. In 2020, the Indonesia Financial Services Authority (Otoritas Jasa Keuangan) mandated ESG reporting for all listed firms in Indonesia while banks were obligated to do so beginning in 2019.

Currently, in Malaysia, the region's evolution toward sustainability has progressed at varying rates among different organizations. Bursa Malaysia has set a good precedent by providing frameworks and rules since the beginning of its ESG journey in 2010, when it founded its sustainability committee 4. The sustainability committee oversees the formulation, implementation and effective management of Bursa Malaysia's sustainability strategies. It ensures that Bursa Malaysia's strategic direction takes sustainability into account.

A recent global framework currently in the works is the joint Corporate Sustainability Practitioner (CSP) Competency Framework which was proposed this year, through the partnership of Bursa Malaysia, the UN Global Compact Network Malaysia and Brunei to support the credentialing of practitioners and professionals involved in Malaysia's corporate sustainability space 6. Additionally, the SC released the Sustainable and Responsible Investment (SRI) Roadmap for Malaysia's capital markets in 2019. This roadmap is to create an SRI ecosystem, charting the role of the capital markets in driving sustainable development. All in all, regulators are looking toward building a holistic ecosystem that takes into account the perspectives of all stakeholders, whether investors, financial institutions or society at large.

It comes as no surprise that ESG and Shariah investment are intertwined with one another.

Figure 1: Growth of SRI-related funds in Malaysia



Data sources:
1. *Responsible Investing: Looking for New Ways to Invest in Social Enterprises (8th August 2018, Bursa Sustain)*
2. *List of Sustainable and Responsible Investment ("SRI") Fund (as at 21st October 2021, Securities Commission Malaysia)*

The creation of the FTSE4Good Bursa Malaysia Shariah (F4GBMS) index demonstrates this. The F4GBMS index has been essential in identifying public listed companies that have improved their ESG policies and disclosures. It was created in Malaysia in 2014 in collaboration with FTSE Russell and represents firms that exhibit good ESG practices 8.

It is overseen by the FTSE4Good Committee, and firms are picked using FTSE's ESG approach, which is based on criteria outlined by the Global Reporting Initiative and the Carbon Disclosure Project 9. The F4GBMS serves as a basis for fund managers to develop new investment products based on a portfolio with Shariah compliant equities governed by ESG principles. As of June 2021, the index's composition consisted of 54 constituents; this index will be revised twice a year, in June and December.

In Malaysia, there appears to be a gap between social enterprises and funding. This might be due to a lack of information and financing platforms. Greater transparency and knowledge about a sector are crucial since this information will educate funders, making it easier for them to decide who they can finance and why they should invest in them. Impact investment is a growing topic of conversation in Malaysia, and it entails extending beyond funding non-profits and social enterprises. Critical to this topic is SRI. SRI funds are funds that focus on the 'social' aspect of ESG in publicly traded companies. Figure 1 shows the growth of SRI-related funds and how they have developed in Malaysia. Encouragingly, the pace of growth has not been lacking and we foresee that rising interest will stimulate more product development within the market within the next few years.

Part of the change

The challenge we all face is clearly short-term thinking. Sustainable development promises better and more resilient economies and businesses, inclusive growth and equitable societies but only in the future, after a period of adjustment and potentially some pain.

Traditional thinking on the necessity of giving up growth for ethical or responsible investing is also being reconsidered. Many studies have highlighted that the investors of tomorrow will insist on a positive impact as well as positive returns, so ESG methodology is now part of the mainstream and is here to stay.

Kenanga Investors has always recognized the importance of a company that is driven by ESG principles and goals. We are of the opinion that by managing ESG risks and opportunities, ESG integration will boost long-term results. It is our responsibility, on behalf of asset owners, generate a positive ESG impact through their investments. It is also the fiduciary duty of Kenanga Investors, as a signatory of the Malaysian Code of Institutional Investors, to engage in and promote ESG practices to all of our stakeholders. In addition to the collective benefits that we expect to derive from adopting ESG principles, it is a reality today that given the current wave ESG is riding on, we are at risk of losing competitiveness if we do not make significant strides in this direction.

As a firm, we intend to integrate ESG considerations into three major aspects; i) firm-wide, ii) product and iii) stock level. This perspective will allow us to develop overall targets and values, and focus on ESG-led portfolios and product structuring and ESG screenings throughout our investment processes, all the while maintaining an active stewardship stance through engagements with stakeholders and exacting our voting rights with investee companies.

The firm is also represented through my participation in and membership of several notable steering committees aimed at supporting Malaysia’s transition toward an inclusive and climate resilient economy such as the Sustainable Investment Platform, the FTSE Bursa Malaysia Index Advisory Committee and the Joint Committee on Climate Change (led by Bank Negara Malaysia and the SC).

As mentioned previously, Kenanga Investors is also a signatory of the Malaysian Code for Institutional Investors. As a signatory, we have developed practices to support the code and internalize the principles throughout the whole investment value chain. As investment managers, we have a say in the markets in which we invest in. We anticipate that frequent stewardship procedures within the investing community will raise awareness and, consequently, behavioural changes among community members.

Our recent appointment as the fund manager of Dana Wakaf Bencana, an emergency relief fund established for the purpose of channelling resources to those affected by climate change-related disasters as well as future pandemics, has seen us embarking on yet another milestone on the said roadmap. A collaboration between government linked agencies and the private sector, the initiative is in line with the SC's Islamic Fund and Wealth Management Blueprint released in 2017 and the Waqf Featured-Fund Framework introduced on the 12th November 2020 which aim to facilitate the growth of the Islamic social finance segment. In April 2021, we also oversaw the launch of the Kenanga Waqf Al-Ihsan Fund, where half of the derived income will be distributed to sectors such as education, healthcare, economic empowerment and environmental preservation or development. Both funds are rooted in elements of Waqf, which encourages Muslims to channel revenue and various goods and services to the groups or communities in need. This bears credence to the idea that it is possible to do well while doing good. We foresee that these initiatives will generate a considerable amount of awareness and interest due to their altruistic nature especially in today's social climate which will lead to society empowerment and poverty alleviation.

We are aware that this is a long-term effort. As such, we have set our sights clear on the endgame and are confident in making good on our commitment to this agenda. We are also intending to encourage more policy discussions to effect enhancements in ESG integration within our investment strategies, voting policies and impact reporting to our stakeholders. In Malaysia, the government and regulators are pushing this as can be seen in the many initiatives, viewing the importance of a whole nation approach in terms of developing short- to long-term key policies for sustainable development. This includes the impact of climate change on financial stability and the economy, as well as addressing social related issues like poverty. Overall, on sustainability measures, the latest Budget 2022 announced by the finance minister included a transition toward low-carbon practices; environment and diversity; and community empowerment which augurs well for Malaysia in developing the local capital market sustainable roadmap and ecosystem.

We only have one Earth, and we feel that tackling the issues that have arisen as a result of decades-long neglect toward our environment is a once-in-a-lifetime chance. We look forward to being part of the change that will solve these concerns before the harm and its consequences are permanent. We must each accept the responsibility for change. It is time to 'create the future' that we want. We owe it to ourselves, and future generations, to ensure sustainable and beneficial outcomes for all.

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Source:

[IFN Islamic Sustainable Investing Thought Leadership Report (1st December 2021)]


Thought Leadership

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This advertisement has not been reviewed by the Securities Commission.

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