ZICO | law

ESG in Action

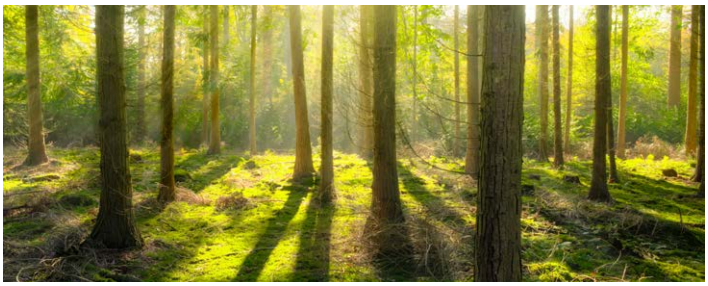
NOVEMBER 2020

Reimagining the New Corporate:

ESG INTEGRATION FOR VALUE CREATION

"Who Cares Wins", UN Global Compact's report 15 years ago, launched the Principles of Responsible Investing and set the foundation for environmental, social and governance (ESG) investing. In the wake of an ongoing global pandemic, climate change issues, data breach scandals, and modern slavery concerns, ESG issues are now in sharper focus. **Wong Kee Hooi** and **Nadarashnaraj Sargunaraj**, Partners of Zaid Ibrahim & Co. (a member of ZICO Law), examine why companies need to care about ESG, and why it is important for businesses to embed ESG considerations into their dealings and operations to ensure sustainability and value creation in the long term. They also explore how ESG measures are implemented, with emphasis on Malaysia's ESG journey.

ESG THE NEW NORM



Environmental, Social and Governance (popularly known by the acronym, **ESG**) issues have been propelled into the mainstream recently, ignited by labour issues and modern slavery concerns affecting major companies in Malaysia. The continuing global COVID-19 pandemic has also been a wake-up call for businesses to pay more attention to corporate risk governance, and has accelerated efforts to decarbonise economies.

Profits and fiscal growth are key for businesses, especially now where economies globally are being battered by the effects of the pandemic. It is however equally important for businesses to operate following basic rules of society, ethics and legal considerations. There is growing pressure for businesses to pay much more attention to ESG considerations, and to incorporate these into each and every aspect of their businesses and operations.

Companies, which previously argued that maximisation of shareholder profits was the ultimate aim, are starting to embrace ESG and integrating these into the DNA of the business.

The focus on fiscal performance and ESG policies and practices are not opposing considerations. There is growing evidence that ESG policies and practices have a positive impact on a company's fiscal performance and long-term business strategy.

WHAT IS ESG?

ESG finds its roots from the Socially Responsible Investing ("**SRI**") approach to investment,[1] which essentially means that money is not put into businesses or industries that negatively affect the environment and people.

SRI can be traced to as early as in the 1700s, where members of the Religious Society of Friends, known as Quakers, refused to take part in the slave trade or to invest in weapons of war.[2] In modern times, investors began pulling their money out of South Africa in the 1980s because of the apartheid.[3] In the US, the Domini Social Index was in launched in 1990s, where companies were selected based on a wide range of social and environmental criteria.[4]

The United Nations Principles for Responsible Investment

In early 2005, then UN Secretary General Kofi Annan called on the largest asset owners to help create a sustainable financial system known as the Principles for Responsible Investment ("**UN PRI**") that was later launched at the New York Stock Exchange under the auspices of the United Nations Environment Program ("**UNEP**").[5]

The term ESG was reportedly first coined in a 2006 report entitled "Who Cares Wins",[6] when the UN PRI was launched.[7]

The UN PRI brought some of the largest asset owners in the global markets together, around six voluntary and aspirational set of investment principles that offer possible actions for incorporating ESG issues into investment practice.[8]

The six UN PRI are set out below:

Principle 1	We will incorporate ESG issues into investment analysis and decision-making processes.
Principle 2	We will be active owners and incorporate ESG issues into our ownership policies and practices.
Principle 3	We will seek appropriate disclosure on ESG issues by the entities in which we invest.
Principle 4	We will promote acceptance and implementation of the Principles within the investment industry.
Principle 5	We will work together to enhance our effectiveness in implementing the Principles.
Principle 6	We will report on our activities and progress towards implementing the Principles.

As of November 2020, there are 3,433[9] PRI signatories ascribed to the following ethos:

"As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time)".

UN PRI SIGNATORIES IN MALAYSIA

To date, there are ten UN PRI signatories based in Malaysia:

- Khazanah Nasional Berhad
- Retirement Fund (Incorporated) *(Kumpulan Wang Persaraan (Diperbadankan))* (KWAP)
- Employees Provident Fund (EPF)
- Xeraya Capital Sdn Bhd
- Principal Asset Management Bhd
- Navis Capital Partners Ltd
- Corston-Smith Asset Management Sdn Bhd
- Singular Asset Management Sdn Bhd
- BIMB Investment Management Bhd
- Crea8 Capital

The difference between SRI and ESG is that investing based on ESG criteria is considered to make financial sense and is not solely tied to a strict moral stance against unethical businesses.

ESG factors cover a wide range of considerations, which traditionally are not part of financial analysis. However, these considerations may have financial relevance.

ESG Factors[10]

ENVIRONMENTAL

Refers to the impact of business activities on the environment and human health.

Risks are addressed by managing resources and preventing pollution, reducing emissions and climate impact, and executing environmental reporting or disclosure.

Positive outcomes include avoiding or minimising environmental liabilities, lowering costs and increasing profitability through energy and other efficiencies, and reducing regulatory, litigation and reputational risk.

Examples:
- Climate change
- Pollution
- Renewable energy
- Waste management
- Deforestation

SOCIAL

Refers to the impact that companies can have on society.

Risks are addressed by promoting health and safety, encouraging good labour-management relations, protecting human rights and focusing on product integrity.

Positive outcomes include increasing productivity and morale, reducing turnover and absenteeism, and improving brand loyalty.

Examples:
- Human rights
- Modern slavery
- Gender and racial diversity
- Health and safety

GOVERNANCE

Concerns the way companies are run.

Risks are addressed by corporate brand independence and diversity, corporate risk management, through company governance activities such as increasing diversity and accountability of the board, protecting shareholders and their rights, and reporting and disclosing information.

Positive outcomes include aligning interests of shareowners and management, and avoiding unpleasant financial surprises.

Examples:
- Corruption
- Corporate governance and fiduciary duties
- Whistleblower protection
- Privacy

HOW DID UN PRI RESPOND TO COVID-19?

The UN PRI recommended seven immediate investor actions in response to the COVID-19 outbreak, being:

1. engage companies that are failing in their crisis management;
2. engage where other harm is being hidden behind, or worsened by the crisis;
3. re-prioritise engagement on other topics;
4. publicly support an economy-wide response;
5. participate in virtual AGMs;
6. be receptive to requests for financial support; and
7. maintain a long-term focus in investment decision making.[11]

WHY SHOULD WE CARE ABOUT ESG?

The landmines - ESG related failures can be costly

According to an analysis published by the Bank of America, ESG related controversies wiped out more than USD500 billion from the value of large US companies over the last the five years.[12]

The following are some examples of financially material ESG incidents:

2002

Enron Scandal. Collapse of Enron Corporation due to deeply imbedded accounting fraud, resulted in a USD40 billion lawsuit by its shareholders after its stock price plummeted, as well as charges and prison sentences against several Enron executives. The scandal led to the effective closure of accounting giant Arthur Andersen, and the introduction of new regulations and legislation such as the Sarbanes-Oxley Act that increased accountability of auditing firms, and penalties for fraudulent conduct.

2010

The Deepwater Horizon Oil Spill. The biggest marine oil disaster in the Gulf of Mexico on the BP-operated Macondo Prospect resulted in BP recording an USD53.8 billion pre-tax charge.[13]

2015

BHP Billiton Corruption Allegations. BHP Billiton was charged for violating the US Foreign Corrupt Practices Act when it sponsored the attendance of foreign government officials at the Beijing Olympics. BHP Billiton agreed to pay a USD25 million penalty.[14]

2018

Google Sexual Harassment Scandal. More than 20,000 employees and contractors walked out of Google's offices around the world, protesting sexual harassment, misconduct, lack of transparency, and a non-inclusive workplace culture. The number makes up about 20% of Google's total employees based on Alphabet's third-quarter earnings report.[15]

2019

British Airways Data Breach. The UK's Information Commissioner Office fined British Airways GBP20 million after the airline failed to protect its customer data. The fine was related to a data breach that occurred in September 2018, exposing around 500,000 customers' personal data.[16]

According to the 2019 RBC Global Asset Management Responsible Investment Survey,[17] institutional investors considered cyber security, anti- corruption and water as the top three ESG concerns.

ESG creates value

McKinsey & Company explains in its Quarterly Report November 2019[18] on the following five ways ESG creates value:

Top-line growth
A strong ESG proposition helps companies tap new markets and expand into existing ones. When governing authorities trust corporate actors, they are more likely to grant them with approvals and licenses that afford fresh opportunities for growth. ESG can also drive consumer preference.

Cost reductions
ESG can substantially reduce costs. Executing ESG effectively can help address rising operating expenses (e.g. raw-material costs) which McKinsey has found can affect operating profits by as much as 60%.

Reduced regulatory and legal interventions
A stronger external-value proposition can enable companies to achieve greater strategic freedom, easing regulatory pressure. Strength in ESG helps reduce companies' risk of adverse government action. It can also engender government support.

Employee productivity uplift
A strong ESG proposition can help companies attract and retain quality employees, enhance employee motivation by instilling a sense of purpose, and increase productivity overall. Employee satisfaction is positively correlated with shareholder returns.

Investment and asset optimisation
A strong ESG proposition can enhance investment returns by allocating capital to more promising and more sustainable opportunities (e.g. renewables and waste reduction). It can also help companies avoid stranded investments that may not pay off because of longer-term environmental issues (such as massive write-downs in the value of oil tankers).

The need for corporate mindset change

ESG-related investments are seeing a rapid rise globally, jumping to USD30.7 trillion (+16% CAGR from 2002).[19] The main catalysts creating large investors demand for analysis on ESG issues, includes a capitulation to the thesis that poor corporate governance was harmful to the markets, and a strong intellectual and legal debate on the relationship between fiduciary duty and issues of sustainability. Thus, the demand for ESG from investors are almost always prompted by fallings of massive corporations which causes a rippling effect on the economy and industry.

The epic corporate governance and ethical failings that defined the subprime mortgage crisis in 2008-2009 and the subsequent Great Recession, along with the 1929 stock market crash which led to the Great Depression in the 1930s, ushered in standardised financial reports. These made it clear to the largest asset owners that they needed a better framework to assess risks in the market, particularly around complex derivative instruments and the shadow banking system. It became apparent that separation of board CEO and chair, board independence, oversight committees on sustainability issues, transparency, political giving, and a host of other issues are material to the long-term performance of a stock.

The rise of ESG-analysis investment approach

The ESG concept was unfamiliar among investors initially and even raised scepticism, but it is now accepted by investors as necessary to consider before making an investment.

In Malaysia, local fund managers believe companies with ESG standards are most likely to succeed in delivering sustainable returns amid the ongoing COVID-19 crisis.[20] This is consistent with the global outlook on ESG, where JPMorgan noted that the COVID-19 crisis is accelerating the trend for ESG investment.

Better resilience and risk management

As noted by the CEO of EPF, Tunku Alizakri Raja Muhammad Alias in July 2020,[21] ESG-principled sectors are favoured by investors and fund managers, and have a distinct impact on profitability. EPF's top social stocks went down less than 10% compared to the FTSE Bursa Malaysia KLCI, which declined more than 16%.

Integrating ESG and sustainable investing principles improves the ability to balance financial returns with measurable impact towards society and the environment for the benefit of future generations. Sustainability-integrated portfolios can thus provide better risk-adjusted returns to investors. It also help companies withstand market instability as businesses are increasingly rated based on ESG metrics.

The Edge Singapore reported recently that in 1Q2020 alone, about USD40.5 billion in new assets were brought in by global sustainable open-ended funds, including mutual funds and ETFs.

HOW ARE ESG FACTORS IMPLEMENTED?

The "why" of ESG adoption is clear. The real questions are "what" ESG factors to implement and "how".

ESG movement

The goal of making sustainability the new investment standard is best achieved by the implementation of policies that encourage a common framework, transparent data, and objective metrics to empower informed asset owner choice.

Globally, a range of international organisations have weighed into the debate around promoting sustainable finance.

The Financial Stability Board's Task Force on Climate Related Financial Disclosures ("**TCFD**") created in 2015[22] focusses on setting global standards for corporate disclosure.

The International Organisation of Securities Commissions' (IOSCO) Green Finance Network was set up to help public authorities around the world share best practices and identify common principles to address emerging supervisory questions related to the growth of sustainable finance.

In addition to these international initiatives, several regions and countries are looking closely at building policy frameworks around sustainable investment. Policy measures around sustainable finance should seek to attract capital into sustainable investment by underpinning a wide range of potential investment options to cater to a wide variety of different investor needs, rather than by seeking to agree on definitive standards of 'sustainability' that could restrict choice. An investor-centric framework might be the best way to mobilise capital.[23]

Greater funding required to meet SDGs

According to Malaysia's Securities Commission in its 2019 report,[24] to meet the need of the world's sustainable development goals ("**SDGs**"), the United Nations Conference on Trade and Development (UNCTAD) estimated that global funding of about USD5 trillion (RM16.1 trillion) to USD7 trillion (RM22.5 trillion) per annum from 2015 to 2030 is needed. At the same time, developing countries require SDG investment of about USD3.3 trillion (RM10.6 trillion) to USD4.5 trillion (RM14.5 trillion) annually, mainly for basic infrastructure.

To attain the goals of the Paris Agreement, USD12.1 trillion (RM38.9 trillion) is needed for investments in new renewable electric power generation over the next 25 years, and as much as USD500 billion (RM1.5 trillion) of new investments annually by 2030 to adequately limit the greenhouse gas emissions of developing countries.

Public sector financing on its own will be insufficient to provide such substantial funding, hence, the deployment of private sector investments through the capital markets will be critical in financing SDG needs.

The need for funding, coupled with greater awareness of the sustainability agenda led to the global acceleration and growth of sustainable finance, with both the public and private sectors channelling more investments towards SDGs, through the capital markets. This is evident from the increasing issuances of fixed income instruments for financing green, social and sustainable projects, and commitments for sustainable investments from responsible investors.

The green bond market has demonstrated a growth in sustainable finance where the cumulative issuances of green bonds stood at USD521 billion (RM2.1 trillion) from 2007 (when the world's first green bond was issued) to the end of 2018, with a total increase of 46% in issuances in the most recent five-year period. Other thematic bonds such as social and sustainability bonds have also been issued, with an issuance amount of USD14.2 billion (RM58.1 billion) and USD21 billion (RM85.9 billion) in 2018.

MALAYSIA'S ESG JOURNEY

The following are key challenges and issues in ESG scoring and ratings:[25]

ESG ANALYSIS ARE NOT PUBLIC

Without paid subscription to ESG analytics such as RobecoSAM, MSCI Inc, Sustainalytics or FTSE Russell, investors may find it challenging to streamline and integrate ESG data into their financial forecast or valuations.

SUBJECTIVITY IN SCORING AND APPLICATION

Investors and stakeholders have divergent views on the importance of each ESG Pillar (E/S/G) depending on their (i) specific geopolitical consideration 'G'; (ii) awareness to surrounding social issues 'S'; and (iii) concerns for the environment 'E'. As a result, different investors may be applying varied weightage of concern to the same sector based on their internal preferences and organisational values. This will also mean that scoring for each Pillar and Theme (e.g. Climate Change under 'E', Anti-corruption under 'G', or Health and Safety under 'S') could vary significantly.

NO SINGLE "ONE-SIZE-FITS-ALL" ESG FRAMEWORK

When it comes to ESG reporting standards, there are many variations globally such as the Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB), Task Force on Climate-Related Financial Disclosures (TCFD), Carbon Disclosure Project (CDP), International Integrated Reporting Council (IIRC) and many others. As PLCs have varied preferences when it comes to ESG KPIs, this means they would also prioritise different criteria when it comes to ESG disclosures, assuming they are not subjected to a fixed set of disclosure requirements. As a result, PLCs in the same sector within the same country may not be reporting on similar data points, or scoring may not be comparable even with disclosure. We believe there is a need for consistency between frameworks and mandatory data requirements if investors were to be able to act on the data meaningfully.

GAPS IN DISCLOSURE AND DATA

At current standards, corporate disclosure for Malaysia and Asia is still at its infancy. Among the three pillars of ESG, 'G' appears to have the highest amount of required disclosure and fixed set of reported information as mandated by the regulators (Bursa Malaysia and Bank Negara Malaysia) in the Corporate Governance report, while the 'E' and 'S' pillars were far more variable and lacked uniformity in disclosures across data sets. A quick comparison of disclosures by Malaysian companies extracted from The Carbon Disclosure Project ("**CDP**") website indicates that disclosure is still lacking by CDP standards, but channel checks suggest that CDP standards are stringent and are not easily attainable especially for companies that are new to this standard of reporting (refer to chart on CDP for disclosure on Environmental data). To recap, Bursa in its 2018 annual report highlighted that the quality of sustainability disclosures require considerable improvement (average score of 49%), while we observed that material information may not be widely available and consistent across the board for all companies, making comparability of the data cumbersome at this juncture. All in, we are of the view that the quality and comparability of disclosed data is still lacking.

ESG DATA ARE LAGGING INDICATORS

The data collected by most companies at this juncture are reported on a per annum basis in the annual report which is released in 1Q or 2Q the following year, implying that the latest ESG data reflects historical data points with a three-six months delay. Additionally, we acknowledge that this may be too preliminary, but the ESG space lacks forward looking data for now. We are of the view that meaningful data should capture forward looking impact to a company's earnings or valuations. An example of forward looking data would be potential green revenues from a new initiative or cost savings capabilities in energy or water usage.

PUBLIC'S LIMITED UNDERSTANDING OF ESG ISSUES

The limited understanding of particular ESG themes, the lack of cohesive guidelines and varying degrees of information received by different investors, would cause some investors to place higher importance on certain ESG Themes and Pillars, as compared to others. This will impact the subjectivity of the scoring and application.

ESG GREENWASHING

Given the absence of a single ESG reporting standard, ESG offerings in the market may be driven by companies' ability to hype up ESG initiatives through effective marketing and advertising even though it may not reflect the best ESG principles or outcomes. That is why consistent and comparable data is crucial for investors to value the true cost of a company's ESG efforts.

Thus, it was proposed that it is crucial to shift from voluntary to mandatory ESG reporting. As highlighted, data gaps as well as the standardisation of reported data by companies, and the accessibility of quick comparable data are some of the key factors limiting meaningful ESG comparisons for investors.

Currently, Bursa Malaysia has a list of disclosure considerations in the Bursa Malaysia's Sustainability Reporting Guide for Environmental & Social data indicators, but not all companies appear to disclose the same set of indicators. It is expected that reporting requirements will be more enforced and uniformed over the next few years as local public listed companies get a better grip of meaningful reporting based on material matters.

Meanwhile, organisations such as the UN PRI are already making it mandatory for its signatories to report on climate indicators by 2020, as compared to voluntary reporting in 2019.

More advanced ESG economies like the United Kingdom have made it mandatory for all listed companies to report on carbon emissions, human rights and diversity in directors reports, while the European Union makes it mandatory for all listed companies with more than 500 employees to disclose environmental, social and anti-corruption issues.

Another example would be France's Article 173 of France's Energy Transition for Green Growth Law in 2016 requiring investors to outline how they incorporate ESG criteria into investment decisions. This measure fosters engagement and integration from both sides and pushes for consistency, standardisation and recognition in reporting, making it is easier for investors in these regions to incorporate ESG factors into equities valuation and modelling.

Malaysia has to work along a similar path by making reporting requirements more stringent going forward to enable more standardised reporting.

ESG-related measures implemented in Malaysia

SECURITIES COMMISSION

SRI Roadmap for the Malaysian Capital Market

In November 2019, the Securities Commission ("**SC**") published the Sustainable and Responsible Investment Roadmap for the Malaysian Capital Market ("**SRI Roadmap**"), to chart a strategic direction to accelerate the growth of SRI and green-financing for the next five years.

This recognises that to facilitate further growth of the SRI segment, Malaysia needs to ensure its policies align with international practices and global developments. The 20 recommendations contained in the SRI Roadmap are mapped to five overarching strategies aimed at driving the development of a vibrant SRI ecosystem for Malaysia as well as the region,[26] namely:

- Widening the Range of SRI Instruments
- Increasing SRI Investor Base
- Building a Strong SRI Issuer Base
- Instilling Strong Internal Governance Culture
- Designing Information Architecture in the SRI Ecosystem

SECURITIES COMMISSION

SRI Sukuk Framework[27]

An immediate initiative rolled out under the SRI Roadmap was the revision of the SC's SRI Sukuk Framework in 2019 to expand the list of eligible SRI projects, enhance disclosure and reporting requirements, and clarify the role of external reviewer. The SRI Sukuk Framework was introduced in 2014 to facilitate the financing of projects that benefit the environment and society, by providing the framework for the issuance of green, social and sustainability sukuk.

Key components of the framework are:

(i) proceeds raised from the issuance of the SRI Sukuk are utilised only for the purpose of funding activities relating to the eligible SRI projects;

(ii) proceeds allocated for eligible SRI projects are credited into a designated account or otherwise tracked;

(iii) internal processes for evaluation and selection of the eligible SRI projects are established; and

(iv) annual reporting is made on eligible SRI projects, the amount allocated and utilised for such projects, and disclosure on where un-utilised amounts are placed or invested.

SECURITIES COMMISSION

Guidelines on Sustainable and Responsible Investment Funds[28]

The Guidelines on Sustainable and Responsible Investment Funds ("**Guidelines on SRI Funds**")[29] was issued in December 2017 to (i) facilitate and encourage greater growth of SRI funds in Malaysia, (ii) ensure greater alignment of Islamic funds with SRI, and (iii) widen the range of SRI products in the market to attract more investors to the SRI segment, which are instrumental in developing and branding Malaysia as a regional SRI centre.

The Guidelines on SRI Funds apply to fund products within SC's oversight, such as unit trust funds, real estate investment trust funds, exchange-traded funds, and venture capital and private equity funds. It introduces additional disclosure and reporting requirements that aims to encourage greater transparency in investment policies and strategies of SRI funds. Fund managers that manage qualified SRI funds under these Guidelines will be eligible for tax incentives.

SECURITIES COMMISSION

Malaysian Code on Corporate Governance

The new Malaysian Code on Corporate Governance ("**MCCG**")[30] issued in April 2017 further enhances the ecosystem for SRI in Malaysia. Greater internalisation of a corporate governance culture as envisaged under the MCCG supports the sustainability agenda through more responsible and proactive practices.

The MCCG emphasises that the board should ensure the company supports long-term value creation and includes strategies on environmental considerations underpinning sustainability. In addition, the Comprehend, Apply and Report (CARE) approach that entails a shift from 'comply or explain' to 'apply or explain an alternative' aims to encourage companies to put more thought and consideration when adopting and reporting their corporate governance practices, elevating it beyond a mere box-ticking exercise.

The three broad principles of the MCCG are as follows:

Principles	Scope
Board Leadership and Effectiveness	• Board Responsibilities • Board Composition • Remuneration
Effective Audit and Risk Management	• Audit Committee • Risk Management and Internal Control Framework
Integrity in Corporate Reporting and Meaningful Relationship with Stakeholders	• Communication with Stakeholders • Conduct of General Meetings

Under the three overriding principles, the MCCG pushes for strengthening the independence of the Chairman, Board and Audit Committee; independence of directors (serving above 12 years) to be retained vide a two-tier voting process; board diversity; transparency in directors' remuneration; implementation of a risk management committee; and improved shareholders participation in general meeting.

SECURITIES COMMISSION AND MINORITY SHAREHOLDERS WATCH GROUP

Malaysian Code for Institutional Investors

To reinforce investors' commitment in adopting ESG practices and goals for the long term within their decision-making process, the SC and the Minority Shareholder Watch Group ("**MSWG**") launched the Malaysian Code for Institutional Investors ("**MCII**")[31] in 2014, a code and set of best practices collectively developed by Malaysia's largest institutional investors, to strengthen the accountability of institutional investors to their own members and investors.
The MCII which is voluntary, sets out six broad principles of effective stewardship by institutional investors as follows:

PRINCIPLE 1 - Disclosing Policies on Their Stewardship

PRINCIPLE 2 - Monitoring Investee Companies

PRINCIPLE 3 - Engaging Investee Companies

PRINCIPLE 4 - Managing Conflicts Of Interest

PRINCIPLE 5 - Incorporating Sustainability Consideration

PRINCIPLE 6 - Publishing Voting Policy

Commencing from 2016, signatories to MCII are expected to report annually their application of MCII's principles on their websites vide compliance statements,[32] or in their annual reports and other publicly accessible documents. As at 2020, there are 28 signatories to the MCII.[33]

BURSA MALAYSIA[34]

Sustainability Framework

Bursa Malaysia, in October 2015, launched a Sustainability Framework which effectively made ESG reporting a listing requirement. It comprises amendments to the Main Market Listing Requirements and ACE Market Listing Requirements ("**Listing Requirements**") and the issuance of a Sustainability Reporting Guide and Toolkit. Pursuant to the amendment, listed issuers are required to provide a narrative statement of the management of material economic, environmental and social risks and opportunities in their annual report.

In tandem with the 2015 amendments, Bursa Malaysia also issued a Sustainability Reporting Guide ("**SR Guide**") to aid listed issuers in embedding sustainability in their organisations and reporting on it. Compliance with the SR Guide is voluntary. The SR Guide was revised in 2018, to include current case studies, reference to the SDGs and the TCFD recommendations, some guidance on integrated reporting and a new chapter on assurance to provide guidance on how it may be conducted.

The SR Guide is designed to provide listed issuers with information on, among others:

- Why sustainability is important and how it makes good business sense.
- How to embed sustainability into organisations using basic principles including: Materiality; stakeholder engagement and robust reporting of sustainability performance.
- Detailed guidance on how to report in accordance with sustainability-related Listing Requirements, including example disclosures and good practice recommendations.
- Selecting themes and indicators for disclosure, based on the listed issuer's material sustainability matters.

The SR Guide is supplemented by Six Sustainability Toolkits on Governance, Materiality Assessment, Materiality Matrix, Stakeholder Engagement, Stakeholder Prioritisation Matrix and Themes & Indicators ("**Toolkits**"),[36] which provide step-by-step guidance on how to establish governance process for sustainability, perform a materiality assessment, identify and engage with stakeholders.

Following the launch of the Sustainability Framework, Bursa Malaysia embarked on an extensive awareness building initiative amongst listed issuers and institutional investors, which includes organising a series of sustainability programmes for listed issuers.

Bursa Malaysia's Sustainability Engagement Series which has been ongoing since 2016, customises programmes for listed issuers' directors/CEOs, CFOs and Chief Sustainability Officers, company secretaries and sustainability practitioners.

BURSA MALAYSIA
FTSE4Good Bursa Malaysia Index

Bursa Malaysia Berhad in partnership with FTSE Russell, launched an ESG index for public-listed companies in December 2014, known as the FTSE4Good Bursa Malaysia Index ("**FTSE4GBM Index**"), to provide more visibility and profiling of ESG-compliant companies. FTSE4GBM indexes can be used in four main ways:[37]

(i) support investors in making ESG investments in Malaysian listed companies
(ii) increase the profile and exposure of companies with leading ESG practices
(iii) encourage best practice disclosure; and
(iv) support the transition to a lower carbon and more sustainable economy.

The FTSE4GBM Index constituents are selected from the top 200 Malaysian stocks in the FTSE Bursa Malaysia EMAS Index, screened in accordance with the transparent and defined ESG criteria, and designed to identify Malaysian companies with recognised corporate responsibility practices.

Companies that meet a variety of the ESG inclusion criteria are eligible to be included on the FTSE4GBM Index, thus enabling companies with leading ESG practices to enhance their profiling and exposure. The criteria are consistent with the global ESG model that FTSE has developed, and draw strongly from the leading global disclosure frameworks such as the Global Reporting Initiative and Carbon Disclosure Project.

Assessments are based on publicly available data sources and therefore companies are encouraged to ensure that high quality data and information are provided publicly on their ESG practices and performance. Index governance is aligned with that of the FTSE4Good and FTSE Bursa Malaysia Index Series. The FTSE Bursa Malaysia Committee defines the eligible universe through the composition of the FTSE Bursa Malaysia Index Series, and the independent FTSE4Good Committee is responsible for overseeing the ESG criteria. As at June 2020, there are 73 constituents of the FTSE4GBM Index.[38]

The FTSE4Good Index components are not publicly available.[39]

ESG Rating Measure of the overall quality of a company's management of ESG issues.	**Environmental**		**Biodiversity Climate Change Pollution and Resources Supply Chain Water Use**		**Over 300 indicators in the model with each Theme containing 10 to 35 indicators** **An average of 125 indicators are applied per company**
	Score: Measure of the quality of a company's management of Environmental issues	Exposure: Measure of the relevance of Environmental issues for a company	Score: Measure of the quality of a company's management of issues related to each Theme	Exposure: Measure of the relevance for a company of each Theme	
	Social		**Customer Responsibility Heath and Safety Human Rights and Community Labour Standards Supply Chain**		
	Score: Measure of the quality of a company's management of Social issues	Exposure: Measure of the relevance of Social issues for a company	Score: Measure of the quality of a company's management of issues related to each Theme	Exposure: Measure of the relevance for a company of each Theme	
	Governance		**Anti-corruption Corporate Governance Risk Management Tax Transparency**		
	Score: Measure of the quality of a company's management of Governance issues	Exposure: Measure of the relevance of Governance issues for a company	Score: Measure of the quality of a company's management of issues related to each Theme	Exposure: Measure of the relevance for a company of each Theme	
1 Rating	3 Pillars		14 Themes		300+ indicators

Figure 1: FTSE Russell's ESG Rating Data Structure (2016)
Source: FTSE Russel, 'ESG Ratings and data model'

The rating data structure, as illustrated in Figure 1 above, allows investors to understand the company's exposure to and management of ESG issues in multiple dimensions as the overall rating is broken down into underlying pillar, theme exposures and scores.

REIMAGINING THE NEW CORPORATE

The COVID-19 pandemic has forced us to reflect on the way we live and operate. It accelerated calls for long-term sustainability, resilience, inclusiveness, fairness, health and zero-carbon economies, with ESG factors having to take center stage in decision making.

Acknowledging the importance of building a resilient country, the Government of Malaysia recently announced that the road to recovery from the pandemic has to be on a green recovery pathway and the 2021 Budget is expected to include a special focus on the sustainability agenda.

On the corporate front, BlackRock CEO's 2020 letter to US CEOs[40] sent a strong message that there is tremendous expectation placed on companies to integrate ESG factors into its business strategy, operations and across their decision-making. Companies must be deliberate in embracing a wider, shared purpose and serving all stakeholders, including shareholders, customers, employees and communities. In this way, companies and investors will enjoy greater long-term prosperity.

With the increasingly challenging and competitive markets, it is clear and inevitable that, going forward, the New Corporate would need to reform and be committed to integrating ESG factors in its business management and dealings in order to emerge stronger, more resilient and sustainable for better value creation!

CONTACT US

If you have any questions or require any additional information, you may contact the following persons or the ZICO Law partner you usually deal with.

Wong Kee Hooi
Partner
kee.hooi.wong@zicolaw.com
t. +603 2087 9862

Kee Hooi heads the Projects, Infrastructure & Utilities practice group. She provides strategic and legal advice to sponsors, foreign investors, financiers and Government bodies on structuring the development, construction and financing of major projects across all sectors, from utilities, energy, infrastructure, construction to manufacturing. She regularly advises clients across many industry sectors who are investing in the green sector by providing insight into the drivers, challenges and financing aspects of the sector including assisting with the structuring of the clients' commercial arrangements for participation and financing of their projects and issues relating to compliance with legislative and regulatory requirements.

Nadarashnaraj Sargunaraj
Partner
nadarashnaraj@zicolaw.com
t. +603 2087 9935

Raj is a partner in the firm's corporate commercial practice and advises on a wide range of corporate and regulatory compliance matters, including on competition law, personal data protection and anti-corruption. Raj regularly assists clients to develop internal protocols on compliance, and to conduct trainings on awareness. Raj also advises clients in responding to actual investigations and raids by enforcement authorities. Raj has in-house experience where he was responsible for implementing various compliance programmes including on competition law and personal data protection

This article was edited by ZICO Knowledge Management.

This article is updated as at 6 November 2020. The information in this article is for general information only and is not a substitute for legal advice. If you require any advice or further information, please contact us.

LIST OF REFERENCES

[1] Georg Kell, 'The Remarkable Rise of ESG' (*Forbes*, 11 July 2018) <https://www.forbes.com/sites/georgkell/2018/07/11/the-remarkable-rise-of-esg/#1fab24481695>.

[2] Khairani Afifi Noordin, 'InTheKnow: Types of social investing' (*The Edge Markets*, 18 July 2017) <https://www.theedgemarkets.com/article/intheknow-types-social-investing>.

[3] Andrea Bertotti Metoyer, 'Socially responsible investing' (*Encyclopaedia Britannica*, 21 December 2015) <https://www.britannica.com/topic/socially-responsible-investing>.

[4] James Chen, 'MSCI KLD 400 Social Index' (*Investopedia*, 27 November 2019) <https://www.investopedia.com/terms/d/domini_400.asp>.

[5] 'About the PRI' (*Principles for Responsible Investment*) <https://www.unpri.org/pri>.

[6] Gillian Lofts, 'Who cares wins in the brave world of ESG' (*Financial Times*, 18 November 2018) <https://www.ft.com/content/64ce9225-0c55-3256-967c-5fae6622c637>.

[7] Principles for Responsible Investment, 'About the PRI' <https://www.unpri.org/pri#How_is_the_PRI_funded>.

[8] Principles for Responsible Investment, 'What are the Principles for Responsible Investment' <https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment>.

[9] UN PRI, 'Signatory directory' <https://www.unpri.org/signatories/signatory-resources/signatory-directory> as at 6 November 2020.

[10] 'What is ESG Investing?' (ADEC Innovations) <https://www.esg.adec-innovations.com/about-us/faqs/what-is-esg-investing/ >.

[11] 'How responsible investors should respond to the COVID-19 coronavirus crisis' (*Principles for Responsible Investment*, 27 March 2020) <https://www.unpri.org/covid-19-resources/how-responsible-investors-should-respond-to-the-covid-19-coronavirus-crisis/5627.article>.

[12] 'ESG Matters' (*Bank of America Merrill Lynch*, 23 September 2019) <https://www.bofaml.com/content/dam/boamlimages/documents/articles/ID19_1119/esg_matters.pdf>.

[13] Principle for Responsible Investment, 'Principles for Responsible Investment an Investor Initiative in Partnership with UNEP Finance Initiative and the UN Global Compact' (2020) <https://www.unpri.org/download?ac=10948>.

[14] US Securities and Exchange Commission 'SEC Charges BHP Billiton with Violating FCPA at Olympic Games' (20 May 2015) <https://www.sec.gov/news/pressrelease/2015-93.html>.

[15] Lisa Marie Segarra, 'More Than 20,000 Google Employees Participated in Walkout over Sexual Harassment Policy' *Fortune* (3 November 2018) <https://fortune.com/2018/11/03/google-employees-walkout-demands/>.

[16] 'British Airways fined £20m over data breach' (*BBC*, 16 October 2020) <https://www.bbc.com/news/technology-54568784>.

[17] '2019 Responsible Invest Summary Executive Summary, An Evolving Landscape' (*RBC Global Asset Management*, 2019) <http://go.pardot.com/l/441592/2019-10-14/qbhs24>.

[18] Witold Henisz, Tim Koller, and Robin Nuttall, 'Five ways that ESG creates value' (*Mckinsey Quarterly*, November 2019) <https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/five-ways-that-esg-creates-value>.

[19] Marie Vaz, 'ESG A Growing Tide of Responsible Investors' (*Research by Kenanga*, 24 December 2019) <https://www.bursamarketplace.com/mkt/tools/research/ch=research&pg=research&ac=900751&bb=917048>.

[20] Ayisy Yusof, 'Local fund managers believe in ESG standards for sustainable returns' (*New Straits Times*, 7 July 2020) <https://www.nst.com.my/business/2020/07/606649/local-fund-managers-believe-esg-standards-sustainable-returns >.

[21] Shaheera Aznam Shah, 'Companies with ESG mandates earn high score among investors' *The Malaysian Reserve* (8 July 2020) <https://themalaysianreserve.com/2020/07/08/companies-with-esg-mandates-earn-high-score-among-investors/>.

[22] UNEP Finance Initiative, 'TCFD – Task Force on Climate-Related Financial Risk Disclosures' <https://www.unepfi.org/climate-change/tcfd/>.

[23] Barbara Novick, Blackrock Inc, 'Towards a Common Language for Sustainable Investing' (*Harvard Law School Forum on Corporate Governance*, 22 January 2020) <https://corpgov.law.harvard.edu/2020/01/22/towards-a-common-language-for-sustainable-investing/>.

[24] Securities Commission Malaysia, 'Sustainable and Responsible Investment Roadmap for the Malaysian Capital Market' (November 2019) < https://www.sc.com.my/upload/sri-roadmap-2019/book/sri-roadmap-2019.pdfs>.

[25] Marie Vaz, 'ESG A Growing Tide of Responsible Investors' (*Research by Kenanga*, 24 December 2019) <https://www.bursamarketplace.com/mkt/tools/research/ch=research&pg=research&ac=900751&bb=917048>.

[26] *Ibid.*

[27] Securities Commission of Malaysia, 'Sustainable and Responsible Investment Sukuk Framework An Overview' (November 2019) <https://www.sc.com.my/api/documentms/download.ashx?id=84491531-2b7e-4362-bafb-83bb33b07416>.

[28] Securities Commission of Malaysia, 'The SC Continues to Drive Sustainable and Responsible Investment (SRI), Issues New Guidelines on SRI Funds' (19 December 2017) <https://www.sc.com.my/resources/media-releases-and-announcements/the-sc-continues-to-drive-sustainable-and-responsible-investment-sri-issues-new-guidelines-on-sri-funds>.

[29] Securities Commission of Malaysia, 'Guidelines on Sustainable and Responsible Investment Funds' (19 December 2017) <https://www.sc.com.my/api/documentms/download.ashx?id=9a455914-71db-4982-a34b-9a8fc7df79b5>.

[30] Securities Commission of Malaysia, 'Malaysian Code on Corporate Governance' (April 2017) <https://www.sc.com.my/api/documentms/download.ashx?id=70a5568b-1937-4d2b-8cbf-3aefed112c0a>.

[31] Minority Shareholder Watchdog Group and Securities Commission of Malaysia 'Malaysia Code for Insitutional Investors' (June 2014) < http://www.iicm.org.my/wp-content/uploads/2018/05/MALAYSIAN-CODE-FOR-INSTITUTIONAL-INVESTORS-MCII.pdf>.

[32] Institutional Investors Council Malaysia, 'Compliance Statements' <http://www.iicm.org.my/compliance-statements/>.

[33] Institutional Investors Council Malaysia, 'List of signatories' <http://www.iicm.org.my/list-of-signatories/>.

[34] Sustainable Stock Exchanges Initiative, 'Bursa Malaysia' <https://sseinitiative.org/stock-exchange/bursa-malaysia/>.

[35] Bursa Malaysia, 'Sustainability Reporting Guide' (2nd edn, 2018) <https://bursasustain.bursamalaysia.com/droplet-details/resources/sustainability-reporting-guide-2nd-edition>.

[36] Bursa Malaysia, 'Sustainability Toolkit – Governance' (2018) <https://bursasustain.bursamalaysia.com/droplet-details/resources/sustainability-toolkit-governance>.

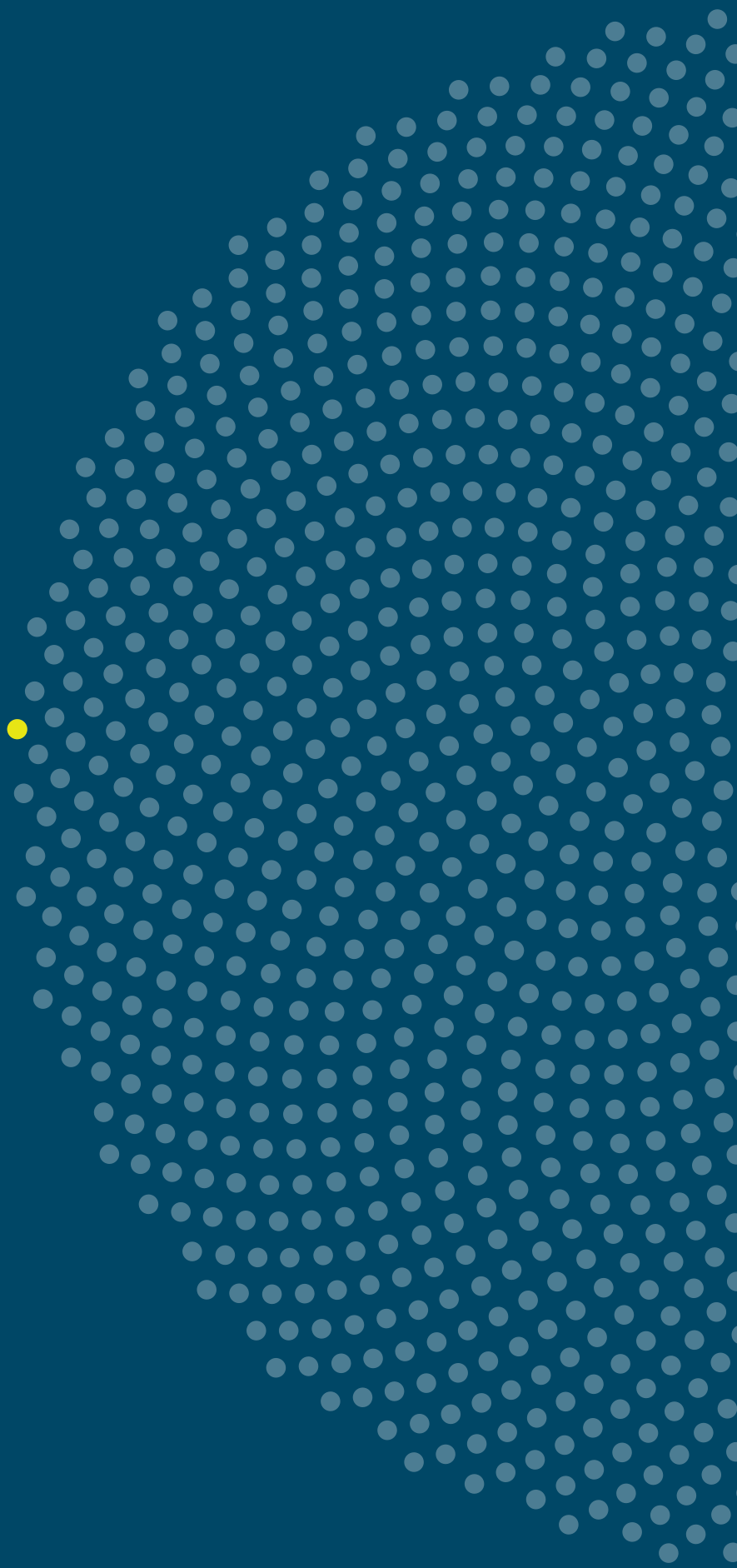
[37] Bursa Malaysia, ' FTSE4Good Bursa Malaysia Index' (16 March 2018) <https://bursasustain.bursamalaysia.com/droplet-details/resources/ftse4good-bursa-malaysia-index>.

[38] Bursa Malaysia, 'FTSE4Good ESG Scores on Malaysian Public Listed Companies now available on Bursa Malaysia website' (*Bursa Malaysia*, 14 August 2020) <https://www.bursamalaysia.com/about_bursa/media_centre/ftse4good-esg-scores-on-malaysian-public-listed-companies-now-available-on-bursa-malaysia-website#:~:text=Bursa%20Malaysia%20launched%20the%20F4GBM,practice%20disclosures%20amongst%20Malaysian%20PLCs>.

[39] Marie Vaz, 'ESG A Growing Tide of Responsible Investors' (*Research by Kenanga*, 24 December 2019) <https://www.bursamarketplace.com/mkt/tools/research/ch=research&pg=research&ac=900751&bb=917048>.

[40] BlackRock, 'Sustainability as BlackRock's New Standard for Investing' <https://www.blackrock.com/corporate/investor-relations/blackrock-client-letter>.

ASEAN INSIDERS,
by origin and passion



ASEAN 10/10

BRUNEI | CAMBODIA | INDONESIA | LAOS | MALAYSIA
MYANMAR | PHILIPPINES | SINGAPORE | THAILAND | VIETNAM