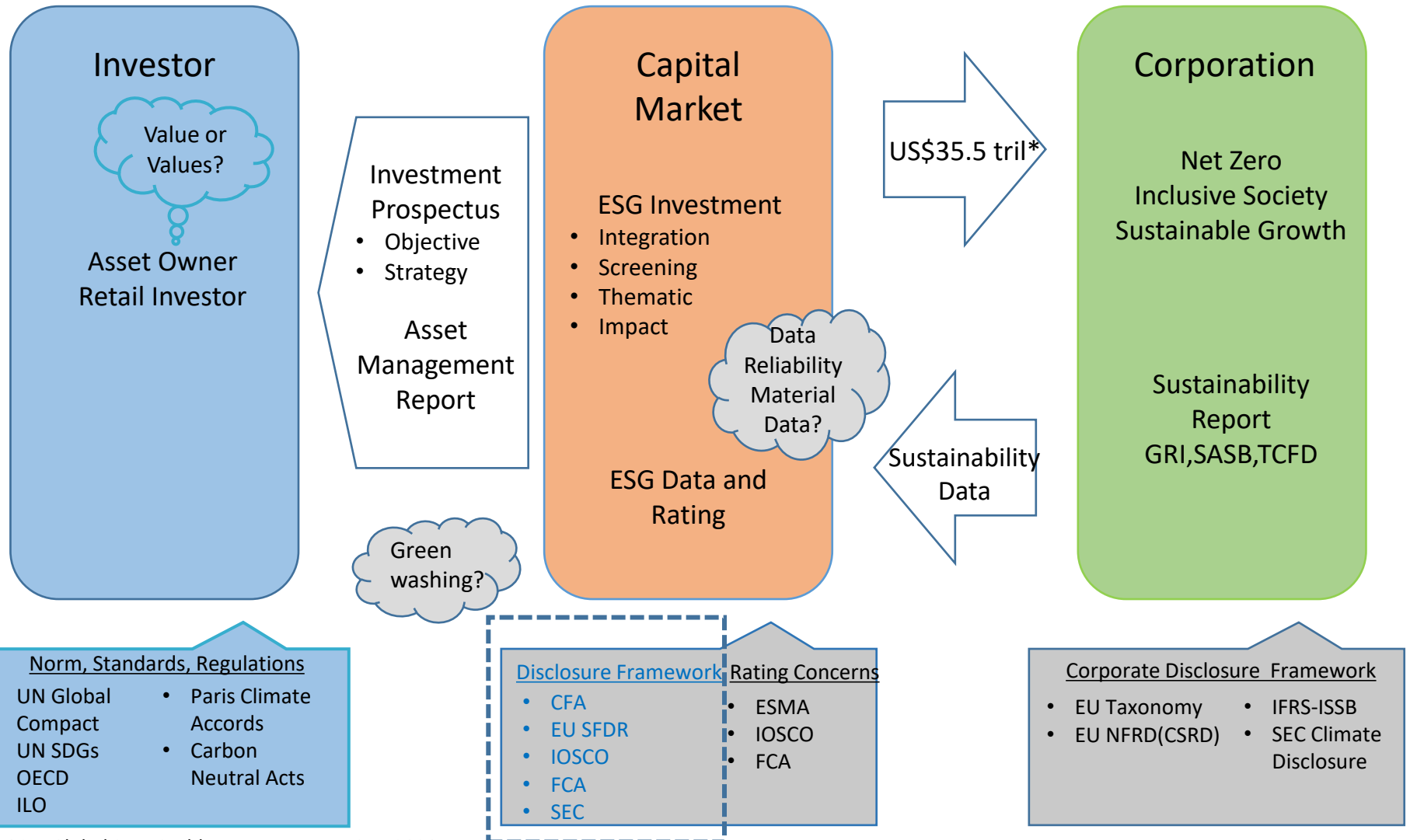




ESG Disclosure Framework for Financial Products

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Infrastructure for Fair Representation and Full Disclosure



* GSIA Global Sustainable Investment Review 2020

Global ESG Disclosure Standards for Investment Products* (1/2)

○ ESG Terminology Recommendations for Adoption

ESG Integration

- The inclusion of ESG considerations **within financial analysis** (CFA)
- The process of including ESG factors in investment analysis to better **manage risks and improve returns** (PRI)

Screening

- The application of filters to rule investments in or out based on an **investor's preferences**, such as ethics and values
- Screening of investments against minimum standards of business or issuer practice based on **international norms**
- Best-in-class investment involves selecting only the companies that overcome a defined ranking hurdle within each sector of industry (CFA)

Thematic and Sustainability Themed Investing

- Thematic investment refers to selecting companies that fall under a sustainability-related theme, such as clean-tech, climate change mitigation (CFA)
- Sustainable investment refers to the selection of assets that contribute in some way to a sustainable economy, i.e., an asset that minimizes natural and social resource depletion (CFA)

Impact Investing

- Investment made with the specific intent of generating **positive, measurable social and environmental impact** alongside a financial return (CFA)

Global ESG Disclosure Standards for Investment Products* (2/2)

- To facilitate fair representation and full disclosure of an investment product's consideration of ESG issues in its objectives, investment process, or stewardship activities
- Investment Product ESG Disclosure Requirements
 - › Sources and Types of ESG Information
 - A description of the type of ESG information used and a description of the sources from which that ESG information is obtained, and the risks and limitations of the ESG information used
 - › Systematic Consideration of Financially Material ESG Information
 - A description of how **financially material** ESG information is typically identified and incorporated into investment decisions
 - › ESG Investment Universe
 - If the ESG index is used as an investment universe(benchmark), the significant ESG characteristics of the index and construction methodology accessibility must be disclosed
 - › Screening
 - Inclusion/Exclusion threshold or condition with reference to **any law, regulation, third-party standard, guideline, or framework** used must be disclosed
 - › Stewardship Activities
 - Disclose ESG issues that are considered for Stewardship activities and explain how those stewardship activities and ESG issues are relevant to the investment product's objectives and investment process
 - › Environmental and Social Impact Objectives
 - If investments are made with the intention to generate **positive, measurable social and environmental impact** alongside a financial return, the impact objectives, stakeholders involved, time horizon, any trade-offs with other objectives, risks, progress or attainment measures, **potential negative social and environmental impacts** that may occur in the course of attaining the objective must be disclosed

EU Sustainable Finance Disclosure Regulation

- Disclosure of **sustainability risk** and **adverse Impact**
- Sustainable investment definition
 - › An investment in economic activity that contributes to an environmental objective... or an investment in an economic activity that contributes to a social objective... provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices
- (Article 6) Transparency of the integration of sustainability risks
 - › Describe how sustainability risks are integrated into their investment decisions and the results of the assessment of the likely **impacts of sustainability risks on the returns** of the financial products
 - Applies irrespective of sustainability characteristic adoption
 - Implies incorporation of sustainability risks is part of mainstream financial analysis
- (Article 8) Transparency of the promotion of environmental or social characteristic
 - › Disclose information on how those characteristics are met and if an index has been designated, information on how this index is consistent with those characteristics
- (Article 9) Transparency of sustainable investments
 - › Sustainable investment definition: an investment in economic activity that contributes to an environmental objective... or an investment in an economic activity that contributes to a social objective... provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices
- For both Articles 8 & 9
 - › If a financial product promotes environmental characteristics or contributes to environmental objectives, information on the environmental objectives set out in Article 9 of the Taxonomy Regulation to which it promotes/contributes should be disclosed
 - › A description of how and to what extent the investment underlying the financial products are in economic activities that qualify as environmentally sustainable under Article 3 of Taxonomy Regulation should be disclosed
 - Do no significant harm to other objectives
 - Comply with **minimum safeguard**; alignment with OECD, UN, and ILO norms

IOSCO Recommendations*

- Regulatory concern over how asset managers take sustainability-related risks, opportunities, and impacts into consideration
 - › To prevent greenwashing and increase comparability for consistent and efficient information flow
- (R1) Asset manager practices, policies, procedures, and disclosure
 - › Regulators should consider the development and implementation of practices, policies, and procedures relating to **material sustainability-related risks and opportunities** and related disclosure
- (R2) Product disclosure
 - › Regulators should consider clarifying and expanding on existing(or, if necessary, create new) regulatory requirements or guidance to improve product-level disclosure to help investors better understand sustainability-related products and material sustainability-related risks for all products
- (R3) Supervision and enforcement
 - › Regulators should have supervisory tools to monitor and assess whether asset managers and sustainability-related products comply with regulatory requirements and enforcement tools to address any breaches
- (R4) Terminology
 - › Encourage industry participants to develop **common sustainable finance-related terms** and definitions, including relating to ESG approaches, to ensure consistency throughout the global asset management industry
- (R5) Financial and investor education
 - › Promote financial and investor education initiatives relating to sustainability

* Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management, 2021

FCA Guiding Principles*

- Regulatory expectations to ensure that any ESG-related claims are clear and not misleading, both at the time of application and on an ongoing basis within the existing rules
- (P1) The **design** of responsible or sustainable investment funds and disclosure of key design elements in the fund documentation
 - › References to ESG (or related terms) in a fund's name, financial promotions, or fund documentation (prospectus and annual report) should fairly reflect the materiality of ESG/sustainability considerations to the objectives and investment policy and strategy of the fund
 - › Key elements of the strategy
 - The investible universe, including investment limits and thresholds
 - Any screening criteria (positive or negative)
 - Specific E, S, or G characteristics/themes or 'real world' impacts that it pursues
 - The application of benchmark/indices
 - The stewardship approach of the fund and how it contributes to meeting the fund's intended ESG characteristics, themes, or outcomes
- (P2) The **delivery** of ESG investment funds and ongoing monitoring of holdings
 - › The **resources** (including skills, experience, technology, research, data, and analytical tools) that a firm applies to pursue a fund's stated ESG objectives should be appropriate. The way that a fund's ESG investment strategy is implemented and the profile of its holdings should be consistent with its disclosed objectives on an ongoing basis
 - Should consider due diligence on any data, research, and analytical resources it relies upon
 - The fund's holdings should reflect any ESG/sustainability characteristics, themes, or outcomes that have been disclosed
- (P3) Pre-contractual and ongoing period disclosure on responsible or sustainable investment funds should be **readily available** to consumers and contain information that helps them make investment decisions

* Guiding principles on design, delivery and disclosure of ESG and sustainable investment funds, 2021

SEC Proposed Rules*

- 'ESG' related labeling can cause confusion and misrepresentation, resulting in
 - › Potentially paying higher fees for a "sustainable" strategy that may vary little from others
 - › Selecting the wrong funds due to inconsistent information disclosure
- The range of matters that different funds consider in implementing ESG strategies requires strategy-specific disclosures
 - › Integration
 - Consider one or more ESG factors alongside other non-ESG factors in investment decisions but are generally not 'dispositive' compared to other factors
 - Require a detailed narrative description of the extent to which the fund considers ESG factors as compared to other factors, especially if it considers the GHG emissions of portfolio holdings as a factor in the selection process
 - › ESG-focused
 - Consider one or more ESG factors by using them as a significant or primary consideration in selecting investments; screen for carbon emissions, board or workforce diversity, or industry-specific issues
 - Require disclosure of two greenhouse gas emissions metrics in the annual report
 - Engagement with management through proxy voting or direct engagement
 - Require how it voted on particular ESG-related matters in the annual report
 - › Impact investing
 - Have a stated goal that seeks to achieve a specific ESG impact that generates specific ESG-related benefits
 - Summarize its progress in achieving its specific impacts in the annual report
- Require all index funds to report identifying information about the index
- Require funds to submit the ESG-related disclosures in a structured data language

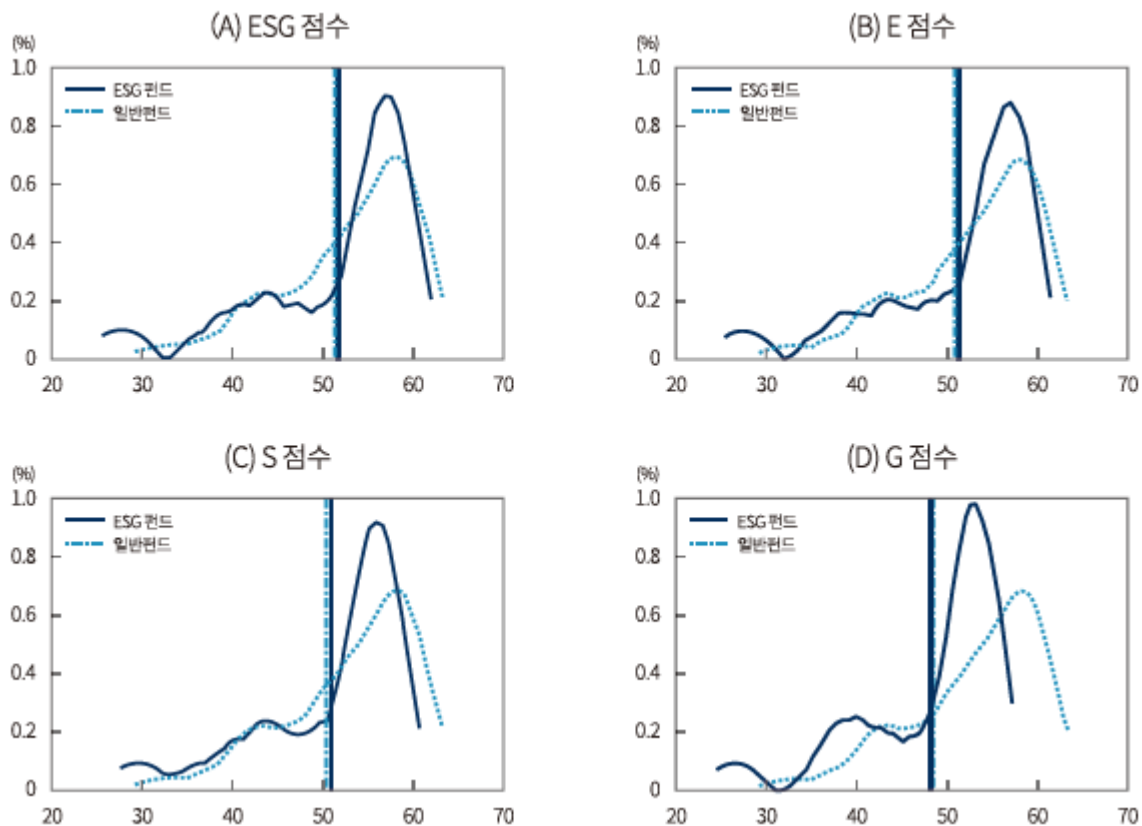
* Enhanced Disclosure by Certain Investment Adviser and Investment Companies about Environment, Social, and Governance Investment Practices, May 25, 2022

Korea's Case

- A review of investment prospectus and periodic management report of public equity funds whose name contains 'ESG' related terms reveals the following traits
 - › Terms such as 'ESG,' 'sustainable,' 'responsible investment,' and 'green' are used
 - › Investment objective is predominately excess return over a benchmark
 - › Investment strategies cover the following range and are not mutually exclusive
 - Positive/Negative Screening
 - ESG grade change momentum
 - ESG Integration
 - Engagement
 - › Almost all use 3rd party ESG ratings, although some claim to have in-house analysis capability but are not specified in the manager personnel information
 - › Many use the term 'ESG Integration' loosely, and it is expressed as an investment process where financial factors and non-financial factors are both taken into consideration, but usually along the line of screening criteria, rather than a valuation process where sustainability risk considerations are imbedded
 - › Some explicitly state that fundamental analysis takes precedence over ESG considerations
 - › Around half of the statements made around the risk profile of the fund warn investors that due to ESG screening considerations, diversification effects would be more minor and can be subject to increased volatility of the portfolio
 - › Majority of the funds use broad market indices as the benchmark, and some use ESG indices made available by the KRX, MSCI, and few tailor-made ESG theme indices by others

Concerns – Greenwashing

- 'ESG' funds and other funds have a non-significant difference in ESG scores



Note: Horizontal axis denotes aggregate ESG score of individual funds, vertical axis is the smoothed frequency, and the vertical line is the mean score of the respective score. The straight line is ESG fund and the broken line indicates other funds

Concerns – ESG Ratings and Benchmarks

- There are numerous documented cases of conflicting ESG ratings among the rating companies
 - › Christensen, D., Serafeim, G., Sikochi, A., 2019, Why is corporate virtue in the eye of the beholder? The case of ESG ratings, Harvard Business School Working Paper 20-084
 - › Dimson, E., Marsh, P., Staunton, M., 2020, Divergent ESG ratings, The Journal of Portfolio Management 47(1), 75-87
 - › Inhyung Lee, 2021, The current state of ESG rating framework and characteristic analysis, Issue Paper 21-09, 2021, KCMI
- The implication of which is
 - › “a retail investor buying EUR 10,000 worth of ESG ETF shares in March may, in theory find herself or himself better or worse off by EUR 1,000 at the end of the year, as a result of the choice of ESG rating provider made by the benchmark provider” ESMA Report on Trends, Risks, and Vulnerabilities No. 1, 2021

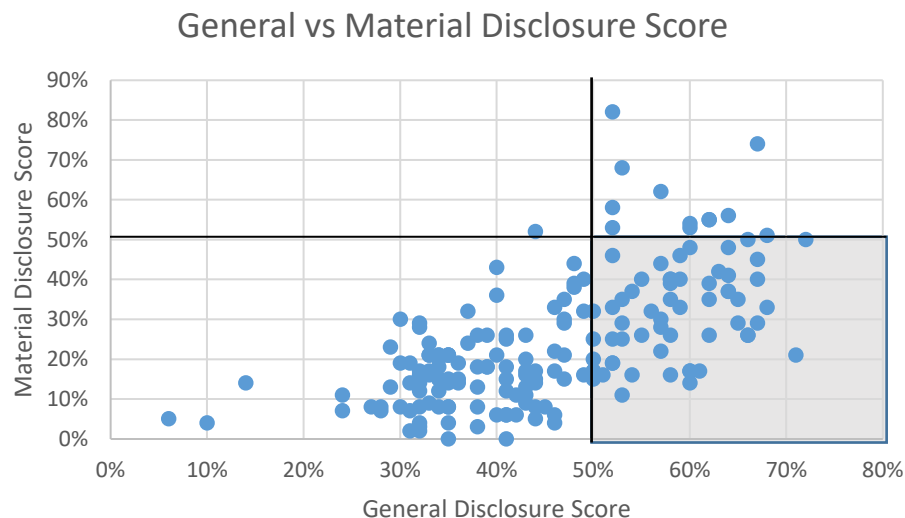
Concerns – Material Information

○ IFRS Sustainability Disclosure Standard

- › Global effort to identify and disclose sustainability information by firms that are material and related to their enterprise value
- › Largely driven by global investor demand and concerted effort by industry specialists, financial analysts, public accountants, and others to pinpoint issues, themes, and metrics for financial material sustainability information

○ Lack of material information

- › Measured against SASB Standard, large Korean firms listed in KOSPI disclose only a quarter of material sustainability information on average



Note: General Disclosure Score is the Bloomberg ESG Disclosure Score, and Material Disclosure Score is the percentage of information disclosed against SASB Standard utilizing SASB to Bloomberg Field Mapping service

Final Note

- The following questions need to be answered to promote fair representation and full disclosure
 - › Clarify the ESG investment objective and strategy
 - Is ESG the main concern or an auxiliary threshold criterion?
 - Is sustainability risk factored into valuation?
 - › Clarify how resources are deployed and utilized
 - Are there sufficient resources employed to tackle various industry-specific sustainability issues?
 - Are due diligence applied to third-party ESG data and rating services?
- There needs to be a different level of disclosure according to the extent ESG issues are dealt with
- Corporate level disclosure with an orientation towards materiality is needed



Thank You!