FREQUENTLY-ASKED QUESTIONS ON

GUIDANCE NOTE ON MANAGING ENVIRONMENTAL, SOCIAL AND GOVERNANCE RISKS FOR FUND MANAGEMENT COMPANIES

(Issued: 30 June 2022)

Governance and Strategy

1. Is it necessary for the Board of Directors (the Board) to set up a dedicated committee in overseeing the ESG risks of the Fund Management Company (FMC)?

Towards ensuring proper integration of ESG in the FMC's investment and risk management, the Board should assess and determine this by taking into consideration, amongst others, the size and complexity of the FMC's business and operations as well as its current governance structure. Subject to such assessment, determination could be made as to whether to use any of its existing committees by extending the scope of the said committee or by establishing a new and dedicated committee to oversee the management of ESG risks.

2. What are the suitable and applicable sustainability and responsible investment objectives, targets and timelines that should be adopted by the FMC?

As there is no one size fits all in respect of investment objectives of various FMCs, it is not the intention of the Guidance Note to prescribe such objectives, targets and timelines as these should be assessed, identified and decided by the FMC based on, among others, its business and operations including its specific investment objectives, clients' needs, etc.

3. What are the considerations for an ESG-linked remuneration?

An ESG-linked remuneration structure should promote and incentivize performance that is aligned with the FMC's sustainability and responsible investment objectives, targets, and performance. In developing the ESG-linked remuneration structure, FMC should ensure that the performance of its staff vis-a-vis achieving or contributing to the FMC's sustainability and responsible investment agenda and targets are measured through relevant key performance indicators.

4. What is the expectation on the scope of ESG-related training for staff?

Whilst ESG-related training and capacity building programs should be extended to all staff throughout the FMC, it should not be on a one-size-fits-all basis. The content as well as frequency of the ESG-related training and capacity building should consider the different roles and functions of the staff in respect of ESG areas as well as expectation as to the breadth and depth of the staff's understanding on the same. As an example, staff who are involved in investment analysis, portfolio management and risk management would require different ESG-related skills and knowledge compared to staff involved in sales or operational functions, and as such would require training and capacity building that is tailored to meet their respective needs.

Investment Process

5. Should ESG risks be assessed and managed on all types of assets and across all investment portfolios including non-ESG mandates?

The FMC has a fiduciary duty to properly monitor and manage all material risks affecting their investments for and on behalf of its clients including putting in place mitigation actions to address such risks. As ESG risks are increasingly recognised as sources of financial risk and could have an impact on the valuation of investments, the FMC should assess and determine the materiality of these risks and management of the same. As such, similarly, ESG risks should be assessed including their materiality for all types of assets and across all investment portfolios including non-ESG mandates. Where the FMC assesses the ESG risks as immaterial, for example, due to the type of assets or the short duration investments (e.g. same-day trading), the assessment including the justification should be documented in the investment policies. Where the ESG risks are assessed as material, they should be monitored and managed accordingly.

6. What documentary evidence should the FMC have when incorporating ESG factors in the investment process?

Documentation should be such that it could clearly demonstrate that the investment team had conducted an adequate assessment of the ESG factors. It should be clear from the documentation that research and analysis have been conducted and reasonable information has been obtained to support the ESG assessment and decision made by the FMC.

Such documentation should include, but not limited to, deliberation and determination of the approaches or methodologies adopted in incorporating ESG factors in its investment processes as well as in evaluating and rating the various types or classes of investments. The FMC should also maintain records of the ESG data points used and their sources including its assessment of adequacy and reliance of the same, be it of its own research findings including arising from any of its engagements undertaken with its investee companies or ESG data or scores of any external providers.

7. **Is having only an exclusion criteria or negative list by the FMC sufficient to demonstrate the adoption of best practices as set out in the Guidance Note?**

   No.

   Investment risk management

8. **In the absence or lack of quality data, what can the FMC consider when performing scenario analysis?**

   The SC is cognisant of the possible lack of data including quality disclosures by investee companies for the FMC to adequately assess and size the potential effects of ESG risks. For example, effects of climate change in relation to an investee company's financials or production volume such as reduced crop yield due to lower rainfall.

   To that end, the FMC is encouraged to consider open-source scenarios that are available to be used as potential proxies to size and stress test an investment portfolio's durability to withstand environmental-related shocks i.e. physical and transition risks in a disorderly scenario. Where possible, observations and findings by the FMC should be communicated to relevant stakeholders.

Stewardship

9. **Should stewardship be considered for investments in fixed income and private equities?**

   Equity shareholders may have greater power to exert influence over company management and corporates, most notably through voting at shareholders' meetings. However, stewardship in fixed income should not be overlooked given that more corporates are using the credit market as their source of funding. For large corporates, they are likely to refinance rather than repay the debt which means they will continually be launching new issues, thus stewardship in fixed income is equally important in view of its significant influence for all borrowers. As such, FMCs should consider engaging them more regularly and consider the interest of their bondholders.

   As a private equity investor, FMC can also directly influence the investee company from the pre-investment stage up to the exit-readiness stage. At the initial stage, FMC can collaborate with the management of the investee company to set ESG-related expectations and develop action plans based on the areas of improvement needed and opportunities for value creation. FMC may require the investee company to provide progress reports on those ESG action plans and ensure completion prior to exit.

10. How can FMC better influence an investee company particularly when it is a minority shareholder?

FMCs play an important role in driving ESG awareness and should work with the investee companies towards transition. However, as a minority shareholder, the FMC's ability to influence may be challenging.

Some of the approaches FMC could consider towards enhancing its ability to better influence and drive its ESG agenda are-

a) collaborative engagements with other institutional investors or stakeholders. For further guidance, FMC is encouraged to take reference from international resources, such as the United Nations Principles for Responsible Investment for guidelines on active ownership including best practices on having collaborative engagements; and
b) participate as signatories or in relevant industry platforms whereby common issues and challenges affecting institutional investors such as those pertaining to ESG can be coordinated and be better addressed.

Disclosure

11. What are the ESG metrics that should be disclosed by the FMC?

With the growing demand for sustainable and responsible investing, investors today require precise information to evaluate ESG risks and performance for a more informed decision-making. Towards meeting this need, the FMC should have clear, consistent and comparable measures which will assist the FMC in defining and achieving its ESG outcomes in a more coherent and comprehensive manner.

In formulating and defining ESG metrics, FMC must be clear as to the various metrics that are material to its business which will enable effective communication by the FMC to its stakeholders and demonstrate its commitment to fundamental principles, including assessing environmental and ethical impact. FMC can seek guidance from various ESG metrics issued or recommended by various international bodies to support the demand for standardised ESG framework by facilitating the collection of data to enable tracking of these metrics to determine progress as well as providing a common set of disclosures.

FMC should ensure that the purposes of the adopted ESG metrics are explained and substantiated by relevant and reliable data. The ESG metrics should be retained and tracked to demonstrate progress and any known limitations should also be disclosed.