Can ESG investing in China help make better investment decisions? – it’s complicated

We get many questions about ESG investing in China.For the uninitiated, the letters stand for Environmental, Social and Governance. ESG is a set of investment criteria, based on the “Principles for Responsible Investment (PRI)”, a Geneva based organisation supported by the United Nations.PRI started as a network of investors aiming to set certain sustainability and responsibility criteria by which investments should be judged. It has caught on, and some studies suggest that responsible investment may lead to better investment returns but this is by no means universally accepted. ESG investing may also serve as a risk management tool, but many remain sceptical here as well. Despite it now being a major trend in worldwide investing, it will probably need many more years of development to fully achieve its stated aims.Given the growing importance of the Chinese asset management market, around RMB17tn (US$2.5tn) this year, we decided to take a closer look at the state of play of ESG investing in China.China is facing enormous challenges in virtually every aspect of ESG investing and disclosure. The main sources are government laws and regulations, financial supervision authorities and voluntary disclosure by listed companies. A few examples:

- The 2018 Environmental Tax Law targeting pollution.
- The Asset Management Association of China’s (AMAC) Green Investment Guidelines.
- The China Securities Regulatory Commission’s (CSRC) requirements that all listed companies and bond issuers must disclose ESG risks associated with their operations.

Drivers of ESG investing in China are somewhat different from those in more developed markets.The main attention of investors seems to be going out to corporate governance issues, which in China is seen primarily as a value creation issue. Corporate governance does not have a long history in China, and the understanding of it is still evolving, in particular among foreign investors.Another issue often mentioned by asset managers is environmental standards coupled with renewable energy, which in China is mainly driven by government policy. In particular compliance with pollution regulations plays an important role (carbon emissions less so). In China, environmental issues are usually considered from the standpoint of risk management, and therefore not directly leading to alpha. ESG investing depends heavily on disclosure and the availability of data. What is the situation in China?A number of foreign ESG data providers are now active in China, partly driven by the growing inclusion of Chinese companies in international indexes. Increasingly there are home grown providers active in the field. Some foreign providers have either invested in local companies, or cooperate with them. A few names: MSCI, Vigeo Eiris, Sustainalytics, Moody’s and SynTao Green Finance.However, most data are very recent, not standardized and often hard to access. Rating and scoring are still in their very early stages and there is very little consensus between the different rating agencies. As a consequence, asset managers have to rely to a larger extent on their own research than would be the case in more mature ESG markets.Like in the rest of the world, ESG investing is developing fast in China, no doubt punctuated by a feeling of heightened uncertainty. Even if the jury is out on the capacity of ESG to generate alpha, just from a risk management perspective we think ESG investment will have an (increasing) role to play in the investment process of asset managers, PE/VC funds and other investors in the Chinese financial markets.If you have any questions on ESG investing and compliance in China, you are welcome to contact us August 2020.