MONEY TALKS: HOW ESG CAME TO DOMINATE INVESTMENT

AFRICAN CONCERN: FINANCE PUNISHES CLIMATE VICTIMS

EASTERN PROMISE: CHINA GREENS ITS ECONOMY

ESG AND INVESTMENT

IMPACT 2021

AN FII INSTITUTE PUBLICATION

FAIR SHARES
GREEN FINANCE FOR A JUST TRANSITION

FII INSTITUTE
Future Investment Initiative Institute
Impact on Humanity

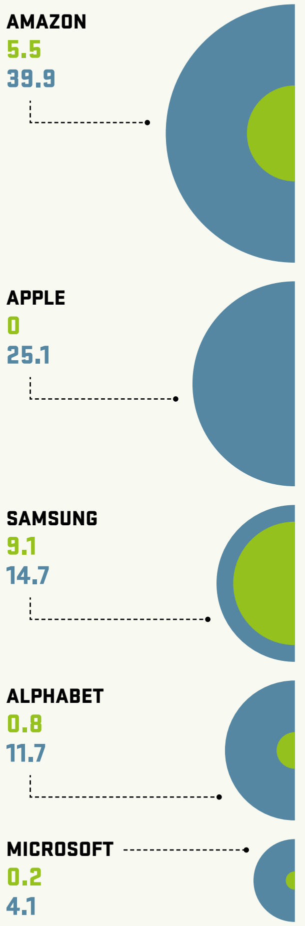
ESG FACTS

IMBALANCE INVESTMENT IS WEIGHTED TOWARDS DEVELOPED MARKETS

ESG-backed investment is soaring and is an indicator of good financial performance, but research from Attali & Associates (see page 12)shows that it is restricted primarily to developed markets, not emerging ones, apart from China, India and Southeast Asia. Official definitions of carbon emissions mean that the heavy scope 3 emissions of supply chain companies in emerging markets are given poor ESG scores

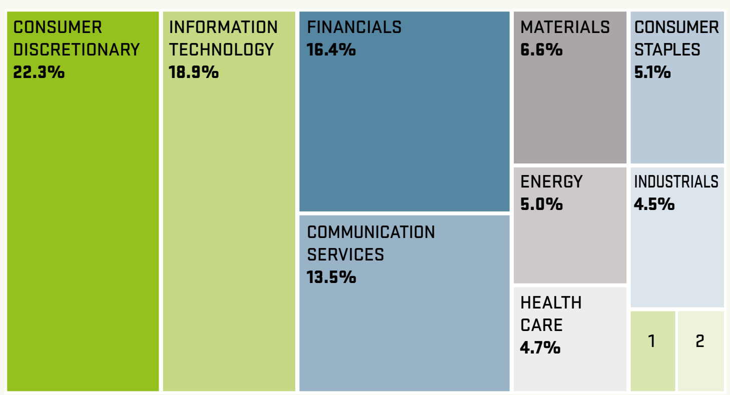
SCOPE 2 & 3

Greenhouse gas emissions from leading tech companies 2020, million metric tons of CO_2 equivalent



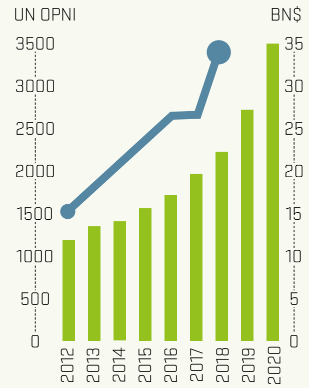
SECTORS

composing the MSCI EMs ESG Leader Index



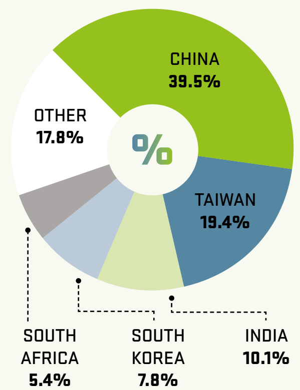
1. REAL ESTATE 1,8% 2. UTILITIES 1.3%

ESG INVESTING BECOMES MAINSTREAM



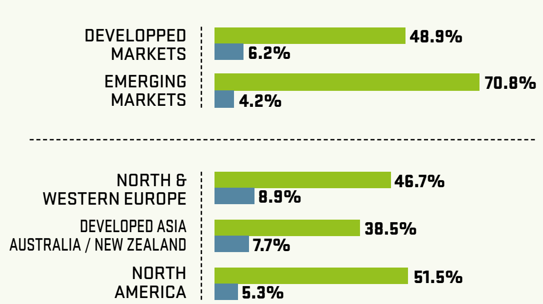
COUNTRIES' WEIGHT

in the MSCI EMs ESG Leader Index



CORPORATE FINANCIAL PERFORMANCE (CFP) RELATION

Combined results from more than 2,200 unique primary studies released since the 1970s of CO_2 equivalent



COMPANIES' CARBON FOOTPRINT

Elements of scopes 1, 2, 3 in the calculation of a company's carbon footprint

SCOPE 1 DIRECT EMISSIONS	SCOPE2 INDIRECT EMISSIONS	SCOPE 3 INDIRECT EMISSIONS
DIRECT EMISSIONS FROM OWNED OR CONTROLLED SOURCES	INDIRECT EMISSIONS FROM THE GENERATION OF ENERGY CONSUMED BY THE REPORTING COMPANY	ALL OTHER INDIRECT EMISSIONS OCCURRING IN A COMPANY'S VALUE CHAIN
FUEL COMBUSTION • COMPANY VEHICLES • FUGITIVE EMISSIONS	PURCHASED ELECTRICITY, HEAT, AND STEAM FOR OWN USE	PURCHASED GOODS AND SERVICES • CAPITAL GOODS • BUSINESS TRAVEL • EMPLOYEE COMMUTING • WASTE GENERATED IN OPERATIONS • USE OF SOLD PRODUCTS • TRANSPORTATION AND DISTRIBUTION (UP-AND DOWNSTREAM) • INVESTMENTS • LEASED ASSETS AND FRANCHISES

INFOGRAPHIC: MATTEO RIVA • SOURCES: FITCH RATINGS, ATTALI & ASSOCIATES, AUGUST 2021

EDITORIAL

WE ALL NEED TO MAKE ESG WORK FOR THE PLANET

FII INSTITUTE publishes its fourth impact report as the world slowly begins to settle on its "new normal," the boundaries of which are still being defined. The pandemic has caused tremendous loss and suffering but has also focused attention on the need for concerted action to prevent and respond to future health and environmental crises.

In the past, FII Institute has highlighted biodiversity loss as an existential threat and both a cause and effect of climate change, as well as the crisis of deforestation and the ever-increasing threat of novel viruses. In this edition of our Impact Series, we highlight the need to improve Environmental, Social and Governance (ESG) frameworks to bridge the gap between developed and emerging markets.

Here, we feature voices of investment practitioners from Africa, India and China, whose views concerning the gaps and biases in ESG reporting and standards are paramount but are seldom truly heard. One area of consensus that emerges regards the need for better data, as a key input into scoring. Realizing that goal is tied to factors such as legislative reform, standardization and technology.

With this Impact Report and our 5th anniversary of FII platform, held on the eve of the COP 26 and G20 summits, FII Institute's goal is to stimulate broad discussion and action while underscoring the irrefutable fact that all of us are stakeholders in the ESG discussion.

Richard Attias

Richard Attias
CEO, FII Institute

CONTACT US:
info@fii-institute.org
@fiiksa
FII Institute
Future Investment Initiative

COVER ILLUSTRATION: ANDRIY ONUFRIYENKO VIA GETTY IMAGES • PORTRAIT ILLUSTRATION: ANJA JAGER / SOOTHING SHADE

FII INSTITUTE Future Investment Initiative Institute Impact on Humanity

TABLE OF CONTENTS

PROSPECTUS FOR A NEW PLANET: HOW TO MAKE ESG MORE FAIR

The development of ESG-backed investment is positive.
It makes money do good things. But the system is not perfect.
The FII Institute presents three problems and three solutions

POOR DATA

Unreliable and inconsistent ESG data is problematic. "Greenwashing" is inevitable in such a market. Investors may not achieve the ends they seek. Investment in emerging economies loses out. Populations in these places feel that they are being punished unfairly, since they are the victims of global warming caused by richer countries' carbon emissions.

"We cannot deny that there is danger of companies using ESG for greenwashing. It's a global issue concerning ESG ratings as a whole. The question is, how can we make sure that data, assessments and ratings represent the true picture of a company's performance?"

TRACY CAI
CEO Corporate Social Responsibility Consultancy SynTao

→ PAGE 38

RATING BIAS

Misunderstanding of cultural and social practices and often unconscious bias are distorting the system. Many ESG evaluations do not factor in societal norms and business cultures. Also, they are not weighed to take into account the wealth-generation profiles and energy needs of less developed regions. The fact is, not every country is beginning its transition journey at the same place.

"Though everyone uses the acronym ESG, individual elements have different emphasis. In the US, you see a focus on the Social. In Europe, most important is the E pillar. In emerging markets, the starting-point is more Governance."

RISHI KAPOOR
CEO, Investcorp

→ PAGE 32

UNFAIRNESS

Social unfairness already results from unbalanced global investment patterns, as well as biodiversity damage, in parts of the planet already lacking in infrastructure and social and economic development. If is not corrected, bias in the application of ESG will mean that migrants will continue to leave less developed markets to seek work in wealthier countries.

"Seventy percent of the population of the Middle East and Africa is young. These people are leaving the continent to look for jobs, but the jobs have to be in Africa. I think we need to think about this capital migration and make sure that Africa continues to grow, to employ and to prosper."

AYAAN ADAM
Senior Director, AFC

→ PAGE 26

ILLUSTRATIONS: ULI KNORZER

"So much of global growth is going to come from emerging markets. We need the investment community to reach out to them. It's absolutely critical that we join up and that the developed, emerging and frontier markets to work together."

DAVID HARRIS,
Head of Sustainable Business, London Stock Exchange Group

→ PAGE 16

NEW SYSTEM

Reform of ESG rating is essential. Better and more nuanced reporting will help. Current systems assigning a single number or letter to a perceived level of risk, do not take into account different cultural practices, the relative reliance of emerging economies on carbon-producing industries, or the invisible effects of weighting for geographical location or across the three ESG pillars.

"The elimination of cultural bias must not be confused with tolerance of practices on which we must remain strictly intransigent. What we are trying to highlight is the bias of ESG analytical grids, to adjust them to frameworks that do not fit the traditional standards of the western corporate world."

JACQUES ATTALI
Founder and Chairman, Jacques Attali & Associates

→ PAGE 12

REBALANCING

Rebalancing of global investment flows is urgently needed. Current systems punish the countries that are suffering most from the effects of climate change and deprive them of capital resources they need to invest in cleaner technology and generate wealth. They punish perceived failure rather than rewarding ambition on the journey to transition.

"When you look at the amount of investment that is missing, the vast majority is in emerging markets. If institutional investors and the financial system don't deliver a solution, we simply won't meet the UN Sustainable Development Goals. Rather than a funding gap, we are actually facing an investment gap."

ISABELLE MILLAT
Head of Sustainable Investment Solutions, Societe Generale

→ PAGE 20

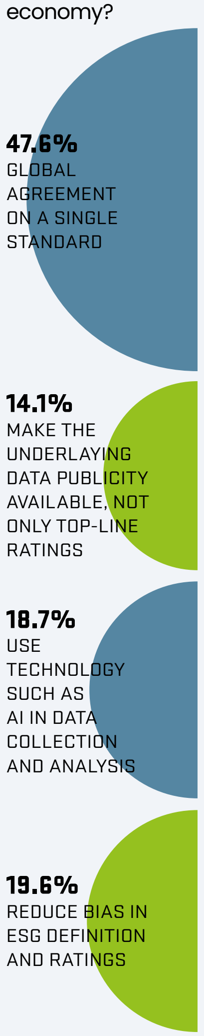
COMMUNICATION

Many investment stakeholders across the world are pointing out the current bias of ESG and attempting to address it. There are many examples of intelligent and well-delivered investment. It is time to start a global conversation about how the global ESG system needs to evolve in order to enhance inclusion and equitable participation by all emerging economies.

AN UNFINISHED JOURNEY
NOW IS THE TIME FOR MORE UNIFORM ESG STANDARDS

HOW ESG STANDARDS BECOME (EVEN) MORE EFFECTIVE

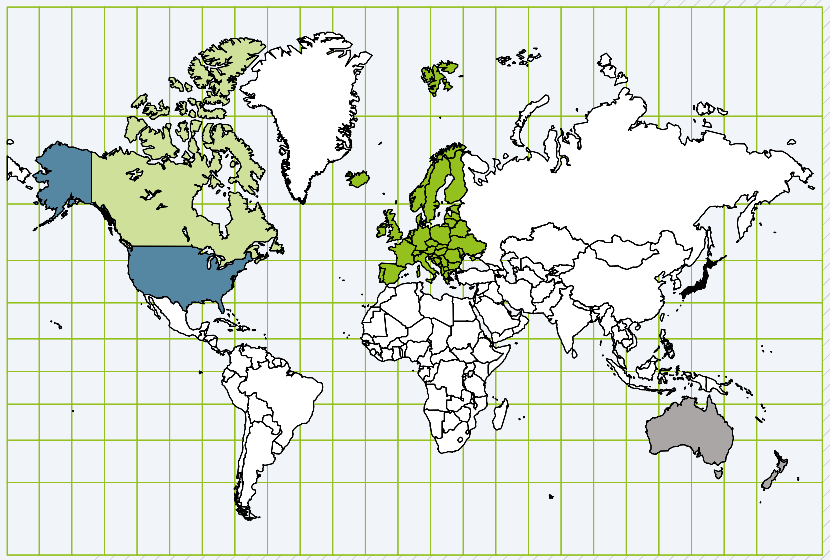
at driving the transition towards sustainable economy?

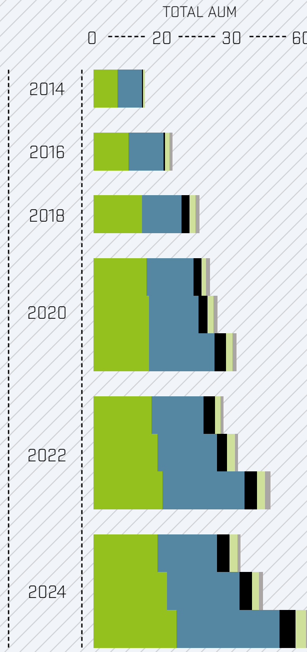


RESULTS FROM SURVEY OF ATTENDEES AT FII INSTITUTE CONFERENCE THE NEO-RENAISSANCE, MOBILISING ESG FOR A SUSTAINABLE FUTURE, 15 APRIL, 2021

ESG GLOBAL PROJECTED ASSETS UNDER MANAGEMENT

By country





ESG REPORTING FRAMEWORKS

GLOBAL REPORTING INITIATIVE (GRI)
Launched in 1997 as the first global framework for sustainability reporting. with the support of the UN Environment Programme (UNEP). This Amsterdam-based non-profit began using the term ESG in 2009. Has 10,000 reporters in more than 100 countries

CDP (ORIGINALLY CARBON DISCLOSURE PROJECT)
UK-registered, began in 2002. Works with more than 6,000 companies, 550 cities and 100 states and regions. Acts as a secretariat to Climate Disclosure Standards Board (CDSB), set up at the 2007 World Economic Forum in Davos.

CAPITALS COALITION
Began in 2012, also in response to Natural Capital Declaration. Regards natural, social, human and produced capital as the "foundation of well-being and economic success." In 2016, released the Natural Capital Protocol.

SUSTAINABILITY ACCOUNTING STANDARDS BOARD (SASB)
US-based. Began in 2011. Intended to complement GRI, CDP, the International Integrated Reporting Council (IIRC) and the Task Force for Climate-related Financial Disclosures (TCFD). Has established a new Value Reporting Foundation with IIRC.

TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES
Began in 2015. Was set up by the G20's Financial Stability Board to factor climate risk into accounting. Supporters have a collective market capitalization of nearly $12 trillion and are responsible for assets of $138.8 trillion.

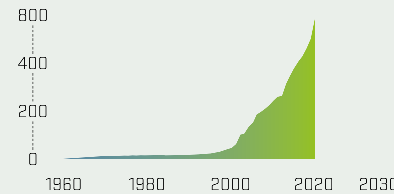
NATURAL CAPITAL FINANCE ALLIANCE
Formed in 2012 to support the Natural Capital Declaration at the Rio+20 conference by financial institutions committed to integrating natural capital into reporting. Run by UEP. Produces evaluation system ENCORE.

INTERNATIONAL INTEGRATED REPORTING COUNCIL (IIRC)
Launched in 2010 in the UK by companies, accounting bodies, the UN and GRI as a "global coalition of regulators, investors, companies and standards-setters. Mission is a globally accepted integrated reporting framework.

INFOGRAPHIC: MATTEO RIVA • SOURCES: BLACKROCK INVESTMENT INSTITUTE, BLOOMBERG, FII INSTITUTE, GSIA, PRI RESPONSIBLE INVESTMENT REGULATION DATABASE, UNPRI.ORG

CUMULATIVE NUMBER OF POLICY INTERVENTIONS

By year

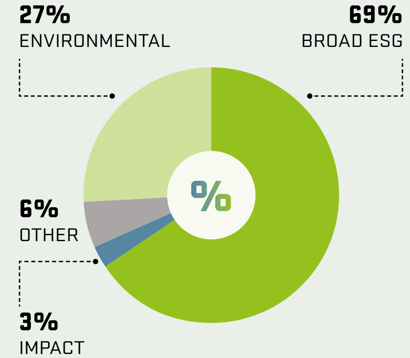


UN PRINCIPLES FOR RESPONSIBLE INVESTMENT

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 each report on our activities and progress towards implementing the Principles.

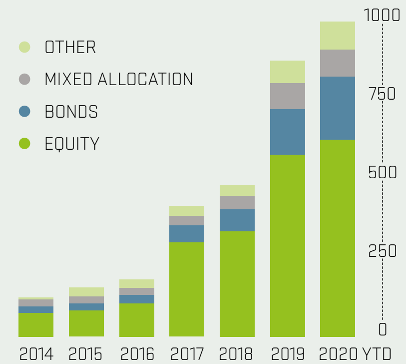
FUNDS LAUNCH PER THEME

European 3Q funds



ASSETS UNDER MANAGEMENT

at ESG-mandated funds



A BRIEF HISTORY OF ESG

2004 UN Principles for Responsible Investment. UN Global Compact report

2009 UN's Sustainable Stock Exchanges (SSE) initiative launched

2014 EU Non-Financial Reporting Directive (NFRD)

2015 Paris Climate agreement. Sustainable Development Goals are adopted by UN member states

2016 Hong Kong Stock Exchange requires listed companies to issue ESG reports

G20's Financial Stability Board task force on climate-related financial disclosure (TFCD)

2019 EU Green Deal

2020 Covid-19 pandemic.

World Economic Forum reports on Sustainable Value Creation. The SASB, IIRC, GRI and CDP publish shared vision of financial accounting.

Global green bonds market reaches $1 trillion in cumulative issuance since 2007

EU, China, Japan, and South Korea affirm commit to net zero emissions. Number of ESG indices in China doubles. Japan releases non-mandatory ESG handbook

Mexico is the first country to issue a Sovereign Sustainable Development Goals (SDGs) Bond

EU Taxonomy Regulation. TCFD-aligned disclosures mandatory for listed UK companies.

2021 Fires, droughts, flooding and hurricanes. US re-enters the Paris Agreement. Securities and Exchange Commission launches consultation on regulation of climate change disclosure

South Africa-owned Rand Water issues green bonds worth R1.2 billion linked to the UN Sustainable Development Goals

FII Institute signs MoU with European asset manager Amundi to cooperate on ESG. Commissions Attali & Associates to research new ESG metrics

G20 summit in Rome. COP 26 climate conference in Glasgow. FII Institute fifth edition in Riyadh

ESG RATING AGENCIES THAT REPORT ON EMERGING MARKETS

NAME	SCOPE	EVALUATION
MSCI ESG RATINGS	RATINGS ON 14,000+ ISSUERS	AAA TO CCC
S&P GLOBAL	1,000+ DATA POINTS ACROSS RELEVANT TOPICS	0 TO 1000
FTSE RUSSELL'S ESG RATINGS	7,200 SECURITIES IN 47 MARKETS INCLUDING THE FTSE ALL-WORLD INDEX	OVERALL RATING PLUS PILLAR AND THEME SCORES
FITCH	140,000 SCORES ACROSS 10,000 ENTITIES AND TRANSACTIONS	1 TO 5
SUSTAINALYTICS (OWNED BY MORNINGSTAR)	RATINGS ON 20,000 COMPANIES IN 172 COUNTRIES	0 (NEGLIGIBLE RISK) TO 40+ (SEVERE RISK)
BLOOMBERG	11,800+ COMPANIES IN 80+ COUNTRIES	0 TO 10
MOODY'S	5,000 ESG ASSESSMENTS OF LARGE COMPANIES COVERING 273 ESG DATA POINTS	AAA TO CCC

BATTLE TO SAVE THE PLANET

AS THE EFFECTS OF GLOBAL WARMING INTENSIFY, ESG IS BECOMING DOMINANT AS A WORLDWIDE INVESTMENT TOOL

Firefighters try to put out a wildfire over a highway on 5 August 2021 in northern Athens, Greece.

PHOTO: MILOS BICANSKI VIA GETTY IMAGES

THE TERM ESG was launched at the first global summit held by the newly formed United Nations Global Compact in 2004. In the same year, a report from the International Finance Corporation, *Who Cares Wins*, also used the still unfamiliar acronym. The power of three letters to change the world has been astonishing. In less than two decades, ESG-backed investment, rating and reporting has crossed the world like wildfire.

According to a trusted source, Bloomberg Intelligence, global ESG assets under management are expected to reach $53 trillion by 2025, which would amount to more than one-third of the $141 trillion in projected total assets under management. Bloomberg's report adds: "A perfect storm created by the pandemic and the green recovery in the US, EU and China will likely reveal how ESG can help assess a new set of financial risks and harness capital markets."

Japan (see page 42) has become the largest center for sustainable investment after Europe and the United States. Its sustainable assets under management quadrupled from 2016 to 2018. China (see page 36) has only begun to adopt ESG in the past five years, but it is fast catching up.

So what is ESG? The three letters stand for Environmental, Social and Governance. They provide a way of calibrating what was previously called Corporate Social Responsibility (CSR) and Socially Responsible Investment (SRI) under three pillars. E can include sub-factors including energy and resource use, waste and pollution, including carbon emission and the responsible handling of adverse environmental effects; S can equate to employee health, safety and diversity and engagement with and providing support to local communities; and G the structure and remuneration of the company's boards. The ESG pillars can be sub-divided into anything from 14 to 120 further categories.

An ESG score is derived from assigning a value to elements from the three pillars and adding them together. Companies compile their own scores to demonstrate their commitment to sustainability. They are also assessed externally for ESG by firms called ratings agencies using both company-reported and public data, although no common methodology is used and their output can be in the form of a number or one or more letters (see page 6). Reference to ESG is becoming an investment norm, as David Harris, head of sustainable business at the London Stock Exchange Group points out (see page 16), particularly for fixed income investments by both individuals and asset managers, including extremely large pension funds.

Analysis from Attali & Associates, Bloomberg, FTSE Russell, MSCI ESG Ratings and other authoritative sources indicates that companies that rate highly for ESG outperform their peers in terms of financial returns, both for developed and emerging markets (see page 2). ESG-backed investment is therefore a 'win-win', allowing investors to help the planet and achieve good returns.

The green, social and sustainability bonds market is also booming. Moody's forecasts a records issuance of $375 billion of green bonds in 2021.

EFFECTS OF CLIMATE CHANGE

The devastating effects of Covid-19 have led to a quickening of ESG's adoption in the last two years and the effects of climate change have escalated in devastating weather events, including storms, flooding and savage fires. Global warming and the pandemic have underlined the need for fewer carbon emissions and less damage to the environment in human activity (the E pillar in ESG), economic rebalancing between individuals and countries (S) and more transparent governance and decision-making (G).

The need for home and socially distanced working has also accelerated digital technologies. Real-time reporting, facilitated by fintech companies and AI, means that investors now have unprecedented access to real-time financial data. This has driven the adoption of exchange traded and index-linked funds. Developments in technology have made it far easier for brokers and small investors to construct portfolios of sustainable investments, and the demand for them ↘

is growing at a pace that investment markets can barely keep up with.

The results look permanent. With bellwether firms like BlackRock, Axa, Fidelity International, and the big four professional services firms Deloitte, PricewaterhouseCoopers (PwC), Ernst & Young (EY) and KPMG now all advocating ESG, many people believe that a tipping-point has been reached.

ESG appears to be the right concept at the right time, hence its growing popularity. Its supporters believe that its use could help to reduce the use of hydrocarbons and exploitation as the world goes through its energy transition. In the corporate world, they include Larry Fink, chairman and CEO of the world's largest money-management firm, BlackRock, whose annual letter to CEOs is regarded as a weather vane for investment. BlackRock was the first asset manager to publish ESG ratings of the companies held in its exchange-traded fund business, iShares.

Critics argue that some of the world's largest funds, including BlackRock, still contain significant investments in the oil and gas sector. According to Morning Star, the three largest, with combined assets under management of $85 billion, contain investments in ExxonMobil, Chevon, and ConocoPhillips. The Northern Trust World Custom ESG Equity index fund has investments totalling $213 million in more than 50 oil and gas groups. However, the oil and gas companies themselves point out that they need investment to transition to renewable energy and decarbonize.

Other financial commentators, including Jacques Attali, CEO of Attali & Associates, fear that the prioritizing of ESG, if carried out to favor the interests of companies and investors insensitive to the needs of emerging markets, could actually widen the divisions between the richest and poorest countries. Attali & Associates' research has shown (see page 14), that biases are written into ESG and how it is applied, meaning that companies in emerging markets are deprived of investment.

TOO MANY SYSTEMS

It is an extremely common criticism among finance experts, including Isabelle Millat, head of sustainable investment solutions for Societe Generale (see page 20) that, in the absence of an accepted reporting convention for ESG, there are currently too many competing and rival systems. There are four main global reporting frameworks and scores of commercial rating agencies, each with its own methodology (see page 8). Each of the ratings agencies that record ESG data for emerging markets has its own way of calculating. It is therefore impossible to correlate or compare the scores made by different agencies.

There are no equivalents to International Financial Reporting Standards for disclosing non-financial information. Consequently, data mostly comes from sometimes unreliable sources. It is hard to challenge, and can be of poor quality, especially in countries in which extra-financial data reporting is not yet the norm. Increasing volumes of global trade point to the need for a global level playing field for sustainability performance. Consequently, strong momentum is building up for the rationalizaton of the current 'alphabet soup' of ESG.

History will come to show that, while the world was engulfed in wars and a global pandemic, two years – 2020 and 2021 – changed global investment patterns and norms dramatically and perhaps permanently.

In September 2020, The World Economic Forum published a white paper *Assuring Stakeholder Capitalism Towards Common Metrics and Consistent Reporting of Sustainable Value Creation*. Timed to make an impact at the UN's COP26 climate summit this November, the white paper promotes the concept of stakeholder capitalism. It adds a third pillar to the three pillars of ESG – Prosperity.

In the same month, the world's leading sustainability benchmarkers, the SASB, the IIRC, the GRI and the CDP (see page 7) published a shared vision of financial accounting and sustainability disclosure achieved by integrated reporting. And last year, the G20, whose Financial Stability Board offshoot was established in 2009, endorsed the TFCD's recommendations.

HIGH-PROFILE CONFERENCES

In the last two years, the FII Institute has become an active and important participant in this space through a series of high-profile conferences and publications prioritizing the seldom-heard views and interest of emerging economies in the ESG debate.

The election of US president Joe Biden brought the prospect of closer alignment, rather than divergence, of US and EU sustainability policies. The US has laid down significant markers on climate change. It has re-signed the Paris climate agreement, and the Securities Exchange Commission has launched a public consultation on climate change disclosure in company reporting (see page 7).

In June 2021, the SASB and the IIRC merged and announced the creation of a new body, the Value Reporting Foundation (VRF). The VRF is working closely with the global standards-setter for financial reporting, the IFRS Foundation. Later this year, in time for the global climate change summit COP26 in the UK in November, it plans to announce an International Sustainability Standards Board (ISSB).

So are we closer to the goal of a unified, global, mandatory sustainability disclosure? Historically, mandatory carbon reporting has predated sustainability reporting in the world's financial markets. ESG reporting is more complicated and will take longer to bring about.

The logic of investment markets means that changes to regulation and reporting are inevitable to meet the needs of the growing imperative of sustainable investment. Only global cooperation and dialogue among stakeholders will bring about an equitable solution that is fair for the entire planet. ■

BlackRock was the first asset manager to publish ESG ratings of the companies held in its exchange-traded fund business, iShares.

Volunteers and residents start the clean-up process at their shops and restaurants following severe flash flooding on 18 July, 2021 in Bad Neuenahr-Ahrweiler, Germany.

PHOTO: THOMAS LOHNES VIA GETTY IMAGES

CALL TO IMPACT

1 The concept of ESG began in 2004. It had underwritten almost half of the world's public and private investment by 2020. The EU is ahead of the US on sustainable investment. China is beginning the journey.

2 It is widely believed that something equivalent to IFRS for financial reporting, which was adopted across the world in the 2000s, will be needed for sustainability to facilitate a global transition.

3 The SASB, the IIRC, the GRI and the CDP have published a "shared vision" of accounting and sustainability. WEF has published a white paper on the subject.

4 COP 26, to be held in the UK this November, is likely to see the launch of a new International Sustainability Standards Board (ISSB), tasked to harmonize sustainability reporting.

5 The FII Institute is emerging as a thought leader on the issue of increasing fairness and equity in global capital flows.

TACKLING INVESTMENT BIAS

The FII Institute has commissioned Attali & Associates to devise a new methodology for ESG rating that won't discriminate against emerging economies. Impact talked to its founder and chairman, Jacques Attali.

PARIS-BASED consultancy Attali & Associates (A&A) is a good choice to solve a international problem that has many complex elements. The company is an adviser to governments, business and investment funds on long-term strategies and decision-making. Dr. Attali has extensive knowledge of investment, from micro to macro. The concept of the "Economy of Life" is a thread that runs through his professional and personal philosophy.

He explains that A&A's ESG project for the FII Institute began in June. It will deliver its final findings and recommendations in October, in time for the FII Institute's fifth edition. A preliminary report, the first of its kind, analyses ESG practices for countries in emerging markets. It includes data from 40 listed companies in emerging markets and an extensive literature search of more than 2,000 studies. Its findings are alarming: ESG criteria are designed around the needs of the world's most technologically and socially advanced companies, while those of the developing world are sidelined. The Attali & Associates' report reveals that 90 percent of the global corporate ESG market remains concentrated in the world's advanced economies.

The few emerging market companies that are part of the global ESG ecosystem, that are officially rated by ESG professionals, belong to a small group located in Asia, notably in China, Taiwan, India and South Korea (although considering Taiwan and South Korea as emerging countries is questionable).

Those in Africa and Latin America are generally out of reach of the financial windfall of sustainable and responsible investment that has become available from the financing sources in the world. They are also stigmatized. The report notes: "Companies in emerging markets often bear the costs of Western funds' ambiguous portfolio cleaning – be it financial, reputational, social, or ecological."

Low ratings under ESG, the report finds, may not reflect a company's actual profile, because of at least four kinds of bias – carbon, governance, geographical and the weighting of criteria. Dr. Attali sees this market distortion as unjust. He notes: "it is important to give the companies of the Global South the funds they need to improve and not to systematically target them as 'bad guys'." There is a vicious circle: Under the existing methodology, the worse your rating is, the worse is your access to the financial markets. The companies that need to improve their practices the most do not receive the funds they need. And it should be the contrary." ↘

PHOTO: JULIEN LIENARD / CONTOUR VIA GETTY IMAGES

Jacques Attali photographed in Cannes, France. He is a musician and author, as was well as an economist.

"Climate change does not respect national boundaries. It's a global and a local issue."

JACQUES ATTALI

Founder & Chairman
Attali & Associates

Jacques Attali was born in Algeria in 1943. After an academic career, he served as a special adviser to French president Francois Mittterand from 1981 to 1991. In this role, he served as the president's personal representative at EU and G7 summits and attended bilateral meetings between the president and foreign heads of state. He was the founder and first president of the European Bank for Reconstruction and Development, which uses international investment as a tool for economic and social advancement.

In the NGO field, Dr. Attali co-founded Action against Hunger in 1979 and a decade later Positive Planet. A leader in micro-finance, the non-profit was active in more than 80 countries. It employed 500 staff, and provided funding and advice to 10,000 micro-finance players in 50 countries. It is now focusing on action in France and the US. The consultancy Atttali & Associates was set up in 1994.

ESG as formulated only recognizes, and often penalizes, a company's current position. It does not factor in its capacity or determination to change, on a continuum of improvement.

CARBON EMISSIONS

There is another injustice. Companies in emerging countries, the report notes, suffer disproportionately from the effects of climate change, yet their access to funding to reduce its industries' carbon emissions is being restricted. Dr. Attali says: "Climate change does not respect national boundaries. It's simultaneously a global and a local issue. Consumers in Europe and the US have an interest to ensure that that the rest of the world also has its chance to improve and that investment does not only go to US and European companies that will not make the largest contribution to the problem in the future through their emissions."

In fact, investing in a company that is improving sustainability performance in a bull market can be financially beneficial. He explains: "When you invest in a company that has a bad rating as it is calculated today, that does not equate to bad returns; on the contrary, the fact that there is a large margin for improvement could create a lot of profit if the company intends to go in that direction. A good rating methodology will help investors to understand that it is in their own interest to invest in a company that still has a long way to go but that is progressing."

For Dr. Attali the basic need is clear – for a specific ESG methodology for emerging markets which would allow them to reach the level of developed ones when deserved. He does not think that such a rating would consist of one number or letter. Such an approach is too simplistic. There would be at least three aspects to an ESG investment rating – will it make money? Will it improve ESG globally? And will it contribute to the development of the Economy of Life?

A parallel ESG investment market would be attractive to investors wanting their money to work harder and to achieve greater benefits for the planet and for people. But he emphasises that this would not be a "soft market." He explains: "The elimination of cultural bias must not be confused with tolerance of practices on which we must remain strictly intransigent – child labor or modern forms of slavery. These cannot benefit from any form of complacency. What we are trying to highlight is the bias of ESG analytical grids, to adjust them to frameworks that do not fit the traditional standards of the western corporate world."

Such a market, he explains, would only be transitional. Eventually, the ESG investment markets of the developed world and Global South would converge. But ESG rating in developed markets would need to be reformed too, he says: "The methodology for both markets should be modified but this not what we are working on at the moment."

NATURE OF PRODUCTS

Another long-term aim would be for ESG investment to embrace Economy of Life principles because, by definition, activity or industry that poisons life should suffer from disadvantages in attracting investment. Today this is not the case, as ESG criteria do not focus on the nature of products.

Dr. Attali's vision may seem idealistic, but a 30-minute video call with this prolific and energetic man can easily convince you otherwise. It is now accepted, he notes, that profit is not the only dimension of a company's success. It also includes the interests of employees,

THE ECONOMY OF LIFE

A society that takes care of the next generations by prioritizing and investing in sectors that are fundamental to their well-being and by excluding those which directly or indirectly kill people. Sectors whose essence is to protect life have proved to be essential during the Covid-19 pandemic. They constitute the true wealth of nations and will be the economic backbone of the coming decades. Among them are health, the environment, clean energies, agriculture, healthy food, education, and sustainable finance and security.

> **"The elimination of cultural bias must not be confused with tolerance of practices on which we must remain strictly intransigent."**

consumers, and the environment. Ten years ago, he observes, the idea of a sustainability methodology for rating investment funds would have seemed utopian. Now it is accepted.

He sees a danger in the current ESG system, in that it allows companies to use the lax and poorly defined terminology of sustainability for the purpose of "greenwashing." And he warns that the move to ESG unification currently being pursued by verification bodies such as the SASB, the IIRC, the GRI and the CDP (see page 10) may not improve the situation, or could even make it worse.

He says: "There is a risk that the most powerful companies will impose an ESG methodology that is designed to disadvantage their competitors. That's why it is important to have an agreed system for emerging markets for climate change and ESG impact more generally. The time for convergence will come later."

With its new ESG proposals, The FII Institute hopes to begin a process of dialogue and persuasion, reaching out to money markets, governments, investors and consumers. Its messages should be compelling to those who want to slow down climate change, re-energize biodiversity and even out the glaring and life-damaging equalities between the western world and the Global South. ■

PHOTO: ERIC FEFERBERG VIA GETTY IMAGES

Jacques Attali in Paris, before appearing on a TV programme called France 2022 to talk about the next French president.

FORMS OF ESG BIAS

→ **Carbon.** The greenhouse gas attracts negative scores, so low-carbon sectors such as consumer, IT, financial and communication services are favored. These sectors are the largest in Western countries and less prevalent in emerging ones, much of whose wealth derives from manufacturing and extractive industries. Many ESG ratings only consider, under the E pillar, direct, or scope 1, carbon emissions, not the indirect scope 2 and 3 emissions caused by the value chains of outsourced manufacturers.

→ **Cultural.** The report notes: "Governance scores in emerging markets are lowered because of the prevalence of majority shareholders [such as] State-Owned Enterprise (SOEs), especially in China. Traditional ESG-developed market ratings would consider such corporate structures a threat to competitiveness and independence, perceiving SOEs' interests as closely aligned with those of the state, rather than of other shareholders. Family-owned enterprises, prevalent in India, suffer from the same criticism."

→ **Geographical.** The Sustainalytics ESG system assigns a risk rating to floods and earthquakes. The report notes: "Emerging market companies are disadvantaged by their geographical location and higher vulnerability to natural disasters." Generic factors about countries and regions are common in calculations used to create ESG ratings. The report notes: "In a study by FTSE Russell, around 50 percent of an ESG score is explained by the country, size, and activity".

→ **Weighting.** Choosing which pillar is given the most prominence – E, S or G – is obviously a material factor in determining a company's final score. Here, the Attali report finds no consistency or transparency. And ratings agencies are not required to explain their rationale for the relative value they have assigned to the pillars.

NEW FRONTIERS FOR SUSTAINABLE INVESTMENT

Enlightened money markets, like the London Stock Exchange Group, do not fear ESG assessment that would take into account differential rates of progress in emerging economies towards the global transition.

DAVID HARRIS, LSEG's group head of sustainable business, believes that while ESG themes need be harmonized, a process which is happening, more important than a single rating methodology is the need for more consistent, reliable and transparent data. Without that, he says, we have nothing. He argues that the need to channel sustainable investment into emerging economies is leading to unprecedented communication between asset holders and managers and the world's financial regulators.

How did you become involved in sustainable investment?

David Harris: I first worked for Arthur D. Little and PwC as a sustainability and climate consultant working with companies. Then I joined FTSE in 2002 shortly after it launched the FTSE4Good index family in 2001, helping pioneer the concept of ESG investing. That was a few years before the term ESG existed. Later, we worked with others in the industry to help form the Principles for Responsible Investment (see page 8), to which FTSE became a founding signatory when they were launched in 2006. The London Stock Exchange Group has three divisions – Capital Markets, covering listings and trading; Data & Analytics, incorporating Refinitiv and FTSE Russell; and Post Trade incorporating LCH. My job is working within Data & Analytics to make sure that LSEG is joined up across the piece, in terms of supporting investors and helping companies understand sustainable investment. As a listed company, we also have to make sure we are meeting high sustainability standards ourselves. Since LSEG acquired data and infrastructure provider Refinitiv in 2021, there's been a focus on integrating the two businesses, particularly in data and analytics. Refinitiv has a very wide coverage of 10,000 companies with history that for some companies goes back 20 years. This is complementary to FTSE Russell's sustainable investment indexes and benchmarks, which are the basis of passive and exchange traded funds and are also used to measure and benchmark the performance of active funds.

> **"My job is to make sure that LSEG is joined up in terms of supporting investors and helping companies understand sustainable investment."**

How important is ESG?

It is moving from forming part of investment to being an element of normal investment. Investors aren't asking "why?'" any more but "why not?" Based on the analysis by the Global Sustainable Investment Association, ESG is incorporated into more than a third of professionally managed assets. However, there are a variety of different levels of sophistication. Some investors take a relatively simplistic approach, others a more comprehensive one.

Why has this happened?

This has primarily been driven by institutional investors such as large pension funds waking up to the fact that sustainability analysis is synonymous with long-term returns. Some are "universal investors" who, through diverse investments, own a stake in the global economy. They believe that high sustainability standards will lead to more stable global economic growth and want to influence that. Climate change is driving real change and disruption across many industries, and this has led to a growing focus by the investment and finance communities, as well as regulators.

In which regions is ESG most evolved?

The EU has been a leader. Its direction has been good but some regulation has been designed very quickly and needs to be ironed out to ensure that it is pragmatic, joined up and usable by markets. The US has very little ESG regulation relative to the EU, but under the current administration that may start to shift. What you do see among US-listed companies is that those that operate internationally tend to match their peers in other markets and have high international standards of sustainability reporting, but those that operate mainly domestically don't. Typically, in those markets that have the largest and most sophisticated asset owners, you have the highest levels of high-quality ESG reporting. In "frontier markets," like Africa, (see page 24) there are few large companies and relatively smaller institutional investment, outside South Africa, so the need for ESG reporting has been lower. Some emerging markets have very good sustainability reporting. For example, the Johannesburg Stock Exchange (JSE) has promoted high-quality reporting and guidance for issuers for over a decade. Brazil, Malaysia and Thailand are also examples of emerging markets that have encouraged disclosure from an early stage. Asia Pacific is rapidly catching up. The market that is most challenged is China, where little ESG information is reported. As Chinese companies open up for international investment, that's going to be a major challenge. But it looks as though environmental reporting will start soon.

PHOTO: LSEG

DAVID HARRIS
Head of Sustainable Business
London Stock Exchange Group

> **"Many companies don't provide the underlying information that you need to make assessments."**

What are the biggest problems with ESG?

Many companies don't provide the underlying information that you need to make assessments. So we have to estimate or gap fill, or score a company down for poor disclosure. Essentially, what we are trying to do is to bring together all the different themes that underlie sustainability – from anti-corruption to human rights, to climate change to biodiversity to corporate governance. When you look across markets you see that some have far better reporting standards than others. Investors and stock exchanges have a role in requiring high-quality disclosure. What we don't want to see is different countries going off in different directions because, typically, investors invest globally and companies operate across multiple jurisdictions. We need things to be joined up.

Do we need more uniformity in the use of indicators?

Yes, and it's starting to happen. Many of us, including FTSE Russell, have been asking ↘

global regulators to adopt a more uniform approach. The International Organization of Securities Commissions (IOSCO), which regulates global investment, and the International Financial Reporting Standards (IFRS) Foundation, are the two most important players in this field. They are looking to announce a Sustainability Standards Board (SSB), in time for COP26 in Glasgow in November (see page 11). The IFRS and the SSB will take the existing frameworks and try and bring them together in a single set of standards, initially for climate but then widening out to other ESG themes. They are also coming up with a governance structure which, hopefully, will be announced at COP. IOSCO will then try to ensure that the regulators are joined up around the new standards.

How long will it take?
Everyone is asking how quickly this can be done, so I think they will try and accelerate progress as much as possible. A lot of the work has been done already. There has to be a realization that the sustainability agenda is not static. It will continue to evolve. Some ESG themes are more established than others on what good reporting should look like. What you need to remember is that only a few years ago, most regulators were nowhere on this agenda, but now they are engaged. Change is happening at pace at the moment and collaboration through forums such as GFANZ (Glasgow Financial Alliance for Net Zero) is helping it to go in the right direction.

Has the pandemic been a factor in the rate of change?
I think that widespread ESG adoption was happening already across markets and investment classes, but that Covid has possibly acted as an accelerator. Much of it has been driven by asset owners and managers waking up and realizing that this is relevant to them, taking a long-term view.

Should there be one methodology for ESG rating?
For me, what's most important is the reliability and transparency of data. I don't think it matters if you have different scores from different providers because it gives the investor interesting insights and a lot of information that they can work through. Different assessments are helpful, as long as the methodologies are transparent, provide differing perspective and angles on sustainability performance. The most important priority is how to make the underlying raw materials more consistent. If we don't have that we don't we have anything. Also, we need to move away from using the information simplistically and start being able to interrogate and understand data in a more sophisticated way. That is actually common in investment.

> "Only a few years ago, most regulators were nowhere on this agenda, but now they are engaged. Change is happening at pace."

PHOTO: COLIN FISHER VIA ALAMY

The Scottish Exhibition and Conference Center in Glasgow is to host the COP 26 climate change conference in November.

Are the UN' SDGs important?
Yes, because they were agreed by 193 governments. They provide a strong international basis for consensus around the actions required to improve equality and lessen environmental damage. They were designed with governments in mind but you can use them as a lens to categorize other criteria. We have used the SDGs to group ESG indicators into themes that can be used to create SDG-based indexes for investors.

How important is financial cooperation to increasing investment in emerging markets?
It's crucial. So much of global growth is going to come from emerging markets. We need the investment community to reach out to them. It is absolutely critical that we join up, and that developed, emerging and frontier markets all work together. I think that uniting around this issue is causing asset owners and managers to talk to each other more than ever before, which is a good thing. Global forums that are pushing for taxonomies for sustainable finance are important. For example, the International Platform on Sustainable Finance (IPSF) was launched by the EU and China in 2019. Now it has more than twenty members, which are located in both developed and emerging markets.

What do you think about the idea of a separate ESG rating system, weighted toward the needs of emerging markets?
I think that making different calibrations for different markets is sensible and is already happening. Climate models should allow for differing decarbonization trajectories for different countries. Developed markets' emission curbs do need to be much steeper. Many investors are already acessing companies on a relative basis by sector and country, so this is normal. The main challenge from a number of emerging markets is simply a lack of relevant disclosure from individual companies.

How big a factor will green bonds be in stimulating sustainable investment in emerging markets?
The biggest focus has been on equities to date, but most large investors are committed to applying sustainable investment across all asset classes and portfolios. All are equally important for emerging markets. The IFRS's SSB work will likely be focused on corporate reporting for listed or private companies at an organizational level, rather than for specific bond ratings, but could have some cross-application. There needs to be a focus on sustainability-related data applying to the issuer, as much as on the bonds themselves. ■

CALL TO IMPACT

1. Pension fund investment has been the largest single driver of ESG because of their long-term investment horizon and due to the stewardship linked to being a "universal investor."
2. Development toward harmonization of standards has evolved rapidly in recent years with growing collaboration between regulators.
3. American companies, particularly domestically focused ones, have been behind most developed markets on sustainability reporting. The EU is ahead but not all EU regulation has yet been tested in practice.
4. Some countries in emerging markets have high reporting standards, such as South Africa, Brazil, Malaysia and Thailand.
5. The desire to facilitate sustainable investment in emerging economies is causing fund owners and managers, ratings agencies, reporting frameworks and regulators to cooperate in an unprecedented and encouraging manner.

HOW 'DATA GAP' HOLDS BACK POOR COUNTRIES

Ethical investment is booming. But the market is undeveloped. Much progress will be needed in capital protection and liquidity before it is on a scale to address the needs of the Social Development Goals.

ISABELLE MILLAT, head of sustainable investment solutions at the Global Markets division of investment bank Societe Generale, says that a lack of reported data is the biggest barrier to investment reaching developing markets. She discusses the challenges and opportunities of selling ESG investment products to individual, or retail, investors, and how better standards and frameworks could help.

How is the market for ESG investment developing?
Isabelle Millat: It's growing a lot. For us, ESG activity in France is doubling year on year. Having better ESG frameworks plays an important role in all this. On the one hand, we want to customize our investment products for different markets. Investors have different financial and ESG needs. For example, retail customers need capital protection. On the other hand, this exponential growth in the market for ESG investments will not be able to continue if there is not enough transparency and a certain level of standardization that makes investors comfortable. So it is now necessary to strike a balance.

What does this growth say about where retail investors and the wider public stand on issues such as climate change and biodiversity loss?
People have a genuine interest in ESG products, but of paramount importance is that we are now able to deliver the same level of capital protection and liquidity as with other solutions, and the same price competitiveness. A small portion of investors would probably accept, if not a lower return, then at least a longer time horizon. But above all, we as financial professionals have to make sure we not only do good but also do it well.

How do you select securities that qualify for an ESG portfolio or an ESG fund or other product that you provide, and how complex is that process?
Firstly, we have set certain standards and thresholds. These are the result of internal discussions with experts, as well as market and regulation observation, and meetings with investors to understand their expectations. So we have a policy as to what we want to market as ESG, and we update it as relevant if market and regulatory expectations evolve. Secondly, you need data, which is a challenge. Even if you want to invest in, say, circular economy stocks, you still need to find a reputable external supplier with access to good data. Of course, if companies don't report the right data, even the best supplier can't give it to you. And the more you dig into precise sustainability topics, the tougher it gets to find enough quality data and investable stocks that meet your criteria. You can spend months working with ratings agencies and financial engineers on this. It gets very complex.

Rather than each financial service provider applying its own ESG methodology, would it be helpful to have standardized data disclosure and standardized criteria against which companies seeking ESG finance could be measured?
It would be helpful, especially for retail. Institutional investors have their own requirements and have the capacity to consider large amounts of information when they are deciding whether to buy or not. For retail investors, right now it is a priority for us to engage with distributors and explain solutions in order to inform investment decisions. But a level of standardization will make it easier for retail investors to select from available solutions. Further up the ESG chain, a form of standardized reporting from companies will be helpful. The sustainable investing value chain starts with companies. Good data is necessary to create good solutions.

> "We have a policy as to what we want to market as ESG, and we update it as relevant if market and regulatory expectations evolve."

PHOTO: PHILIPPE COUETTE

ISABELLE MILLAT
Head of Sustainable Investment Solutions
Societe Generale

Will the new regulatory frameworks emerging in the EU and US help in this regard or are we just creating an even more complex patchwork of standards and regulations?
I think it will help. The EU regulation has ten streams. If we focus on corporate reporting, the EU is working on a corporate reporting directive and the US is moving in that direction too, with a focus on climate data reporting for instance. That is a must. But it should build on the reporting initiatives that have been launched already, such as those of the GRI, SASB and TCFD. They must also take a global approach. The EU reporting directive should account for the indicators required in other EU rules, such as those in the Sustainable Finance Disclosure Regulation (SFDR). Regarding what has been done on the other EU regulation streams, like the low carbon benchmarks, the jury is still out. We do need standards but we see in real life how hard it is to meet various investors' needs without customized solutions.

> "A level of standardization will make it easier for retail investors to select from available solutions. Further up the ESG chain, standardized reporting for companies will be helpful."

To achieve sustainable development on a global scale, huge amounts of private capital need to flow into emerging economies and developing countries. But few companies from those regions are included in

ESG investment products or indices. What are the main obstacles?
First, emerging market companies are still not reporting a lot of ESG data. They started later than companies in developed countries. They need to put together the resources to do that. Second, for retail investors, we are juggling with liquidity obligations and downside risk protection, and it can be harder to deliver those in emerging markets. It's a catch-22 and we need to start somewhere. The more money flows into these stocks, the more liquid they will get. I think institutional investors can pave the way here. We need to break that frontier with institutional investors first. On the positive side, a few ESG Emerging Market benchmarks are already liquid enough to accommodate certain retail products.

If that breakthrough doesn't happen, what are the likely consequences? What will be the consequences of excluding emerging market companies from sustainable development?
When you look at the amount of investment that is missing to finance the UN's Sustainable Development Goals, the vast majority is in emerging markets and developing countries. If institutional investors and the financial system as a whole don't deliver a solution to connect the money that is there with bankable projects, we just won't meet the UN Sustainable Development Goals. Analysis carried out by the UNEP Finance Initiative has shown that, rather than a funding gap, we are facing an investing gap.

How do we close the gap? Is the solution impact investment, or blended finance where development banks and governments shoulder the risk in order to attract more institutional investors and shift the momentum?
Blended finance and leveraging public money is absolutely one aspect of it. But we also need to work upstream to make more projects bankable. That means looking at all revenue flows that can be generated, potentially pooling smaller projects and developing standardized contracts. A lot of it is in terms of the size of the projects. Colleagues working in this area have highlighted the example of a city in North Africa wanting to install street lighting. Such a project involves significant investment costs. But by rethinking its design and objectives to capture more potential revenue streams – mounting security cameras, putting wi-fi transmitters on lampposts, etc. – it became more bankable.

A solar-powered streetlight illuminates people selling food from roadside stalls in Porto-Novo Benin, West Africa

PHOTO: PASCAL MAITRE VIA PANOS PICTURES

> "Even in developed markets, some investors are convinced that just exiting a given sector does not necessarily advance sustainable development. They prefer to invest in the best in the sector."
>
> **ISABELLE MILLAT**
> Head of Sustainable Investment Solutions
> Societe Generale

> "If institutional investors and the financial system as a whole don't deliver a solution to connect the money that is there with bankable projects, we just won't meet the UN Sustainable Development Goals."

Some companies in emerging markets can be the best in their field in a particular country, but cannot reach the sustainability scores of peers in developed markets. They may face challenges beyond their control, such as infrastructure problems or the unavailability of clean energy. Should ESG criteria be made more sensitive to the context in which companies operate?
We are already working on promoting the concept of transition to our clients. Even in developed markets, some investors are convinced that just exiting a given sector does not necessarily advance sustainable development. They prefer to invest in the best in the sector or in those who are not the best today but who display the best progress. At the end of the day, clients decide how they want to allocate their money. But more and more are receptive to the transition argument. In emerging markets, where investment in transition is most needed, we still face the same limitations we discussed earlier: to promote transition you need companies to report on it; and there is still the liquidity challenge. We cannot magic these issues away, but we do need to keep working to improve the situation. ■

CALL TO IMPACT

1. Lack of capital protection and liquidity in emerging markets are barriers to ESG investment.
2. Another issue inhibiting ESG rating in emerging markets is a huge reporting gap.
3. Failing to connect investors with opportunities in emerging markets risks putting the UN SDGs out of reach.
4. We need to break the barrier with institutional investors first. More investment will create greater liquidity.
5. Retail investors would be comforted by a certain level of standardization in company disclosure and global regulation.

LAND OF PROMISE
AFRICA IS RICH IN MINERALS AND NATURAL RESOURCES BUT IS DEPENDENT ON HYDROCARBONS

TOP FACTS

Youngest

Africa is the world's second-largest and second-most populated continent, after Asia. Africa's population is the **youngest** amongst all the continents.

1.1 billion

It's home to **1.1 billion** citizens, more than **50 nations** and around **2,000 languages**. Sub-Saharan Africa has six of the world's 10 fastest-growing economies.

By 2025

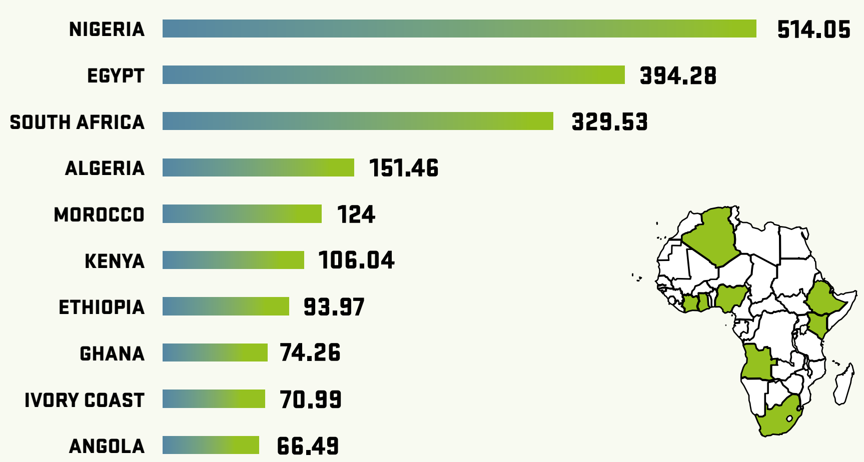
It is the least wealthy continent per capita. But the World Bank expects that most African countries will reach **middle-income** status (defined as at least $1,000 per person per year) by 2025 if current growth rates contine.

LARGEST CITIES

In 1,000s, year 2021

HIGHEST GROSS DOMESTIC PRODUCT (GDP)

Year 2021 (in billion $)

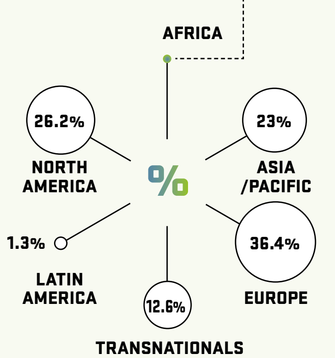


GREEN BONDS

73.8%

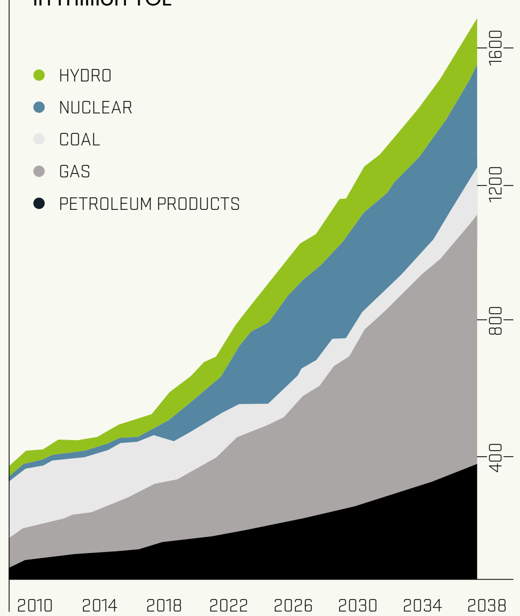
of African Green Bonds are coming from South Africa (2020)

but Africa has only **0.4%** of issuance in 2020



AFRICA ENERGY CONSUMPTION

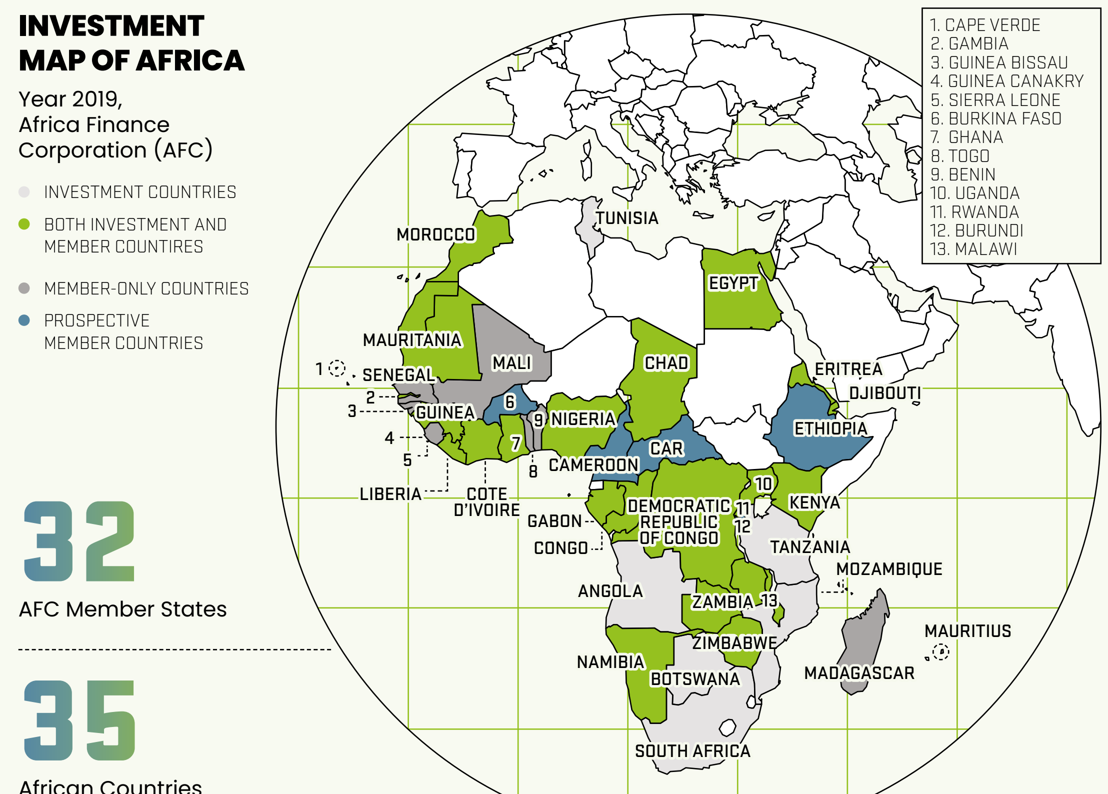
in million TOE



INFOGRAPHIC: MATTEO RIVA • SOURCES: AFRICAFC.ORG, AL JAZEERA, AFRICA ENERGY OUTLOOK 2040, STOCKHOLM FINANCIAL SUSTAINABLE CENTRE

INVESTMENT MAP OF AFRICA

Year 2019, Africa Finance Corporation (AFC)



32

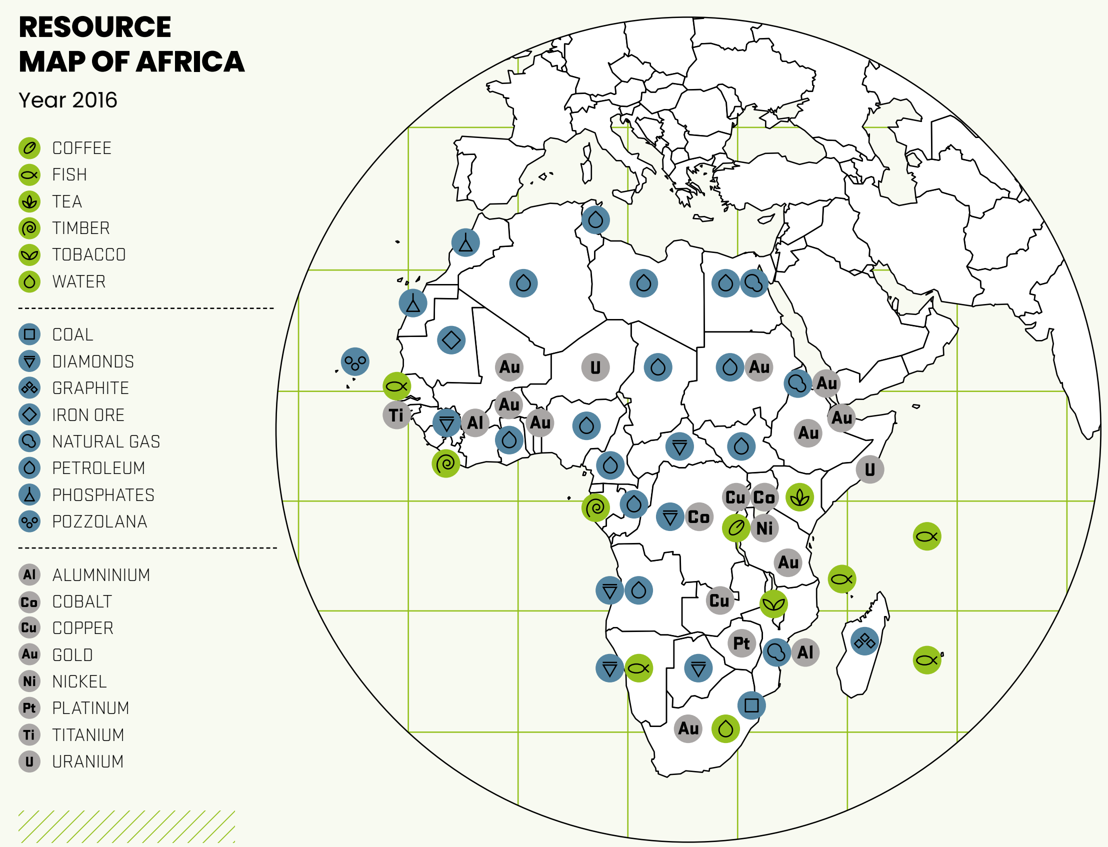
AFC Member States

35

African Countries invested in AFC

RESOURCE MAP OF AFRICA

Year 2016



TOP FACTS

Slums

No part of the planet is **urbanizing faster** than sub-Saharan Africa. Its population will likely double in number by 2050, and more than 80% of that increase will occur in cities, especially in slums.

Resources

Rich in **oil and natural resources**, Africa is the world's fastest-growing region for foreign direct investment.

30%

The approximate share Africa posseses of the earth's **remaining mineral resources.** More than half of Africa's export earnings come from hydrocarbons.

Top 30

The region is home to five of **the top 30 oil-producing countries** in the world. Algeria, Angola, Cameroon, Chad, Republic of Congo, Egypt, Eritrea, Gabon, Ghana, Kenya, Libya, Nigeria, South Sudan, Sudan, Tunisia, and Mozambique are all rich in oil and gas.

HOW VICTIM BLAMING HARMS AFRICA

At the heart of debates on ESG investing in Africa lies an injustice. Africa is the continent most economically vulnerable to global warming, while having contributed least to rising temperatures. Meanwhile, the continent is being shut out from the sort of investment flows it desperately needs to help it mitigate and adapt to the economic and social ravages of climate change.

NEW FII INSTITUTE RESEARCH has revealed that 90 percent of the global corporate ESG market is invested in advanced economies. Even the relatively small volumes that are being directed toward ESG in emerging markets are skewed towards China, Taiwan, India and South Korea. Global ESG investments reached $1.3 trillion last year. This is anticipated to rise to $53 trillion by 2025, accounting for some 38 percent of assets under management. The fear is that as ESG funds grow, Africa will continue to be cut out of this critical investment source.

The injustice is particularly acute as Africa is home to 15 percent of the global population but only responsible for 4 percent of global emissions. African economies are already suffering some of the worst impacts of global warming. In March 2019 a storm tore into southern Africa that the United Nations described as "one of the worst weather-related disasters ever to hit the southern hemisphere".

Cyclone Idai made landfall in Beira, Mozambique on 14 March. It resulted in the over a thousand deaths across Mozambique, Malawi and Zimbabwe and left over 2.6 million people in desperate need of humanitarian assistance. Beira is Mozambique's fourth-largest city with key energy infrastructure investments and natural gas deposits off its coastline. Some 95 percent of the city's infrastructure was wiped out, prompting the UN to declare it a level 3 emergency on a par with Syria or Yemen.

The threat to Africa's economy goes beyond extreme weather events. The State of Climate in Africa report 2019 warns of threats from above-average rising sea levels, changing precipitation patterns and coastal erosion, all threatening human health and safety, food and water security and socio-economic development.

AGRICULTURAL YIELDS

According to UNEP a warming of 2 degrees Celsius would reduce agricultural yields across Sub-Saharan Africa by 10 percent and cause significant damage to ecosystems on land and in oceans. It estimates that the cost of adapting to climate change across Africa could reach $50 billion a year by 2050. The bottom line is that Africa needs money, both to build resilient infrastructure and a cleaner, more prosperous future, and to avoid the ravages of global warming created by others. The question is, where will that money come from?

According to Ayaan Adam, Senior Director Africa Finance Corporation and Chief Executive AFC Capital Nigeria, the way ESG investing is constituted is acting as a blockage to the sort of investments required to build much-needed infrastructure in Africa that is resilient to climate change.

"We didn't cause the sea to rise, we didn't cause the globe to heat up and yet we are being punished," points out Adam. "A significant part of the transition to sustainable economies requires our resources. Africa is a home to gold, platinum, diamonds, lithium and manganese, copper and other minerals that are going to be used for electrical mobility. But if we are not able to mine them because these are not investments that are attracting the right capital flows, it is doubly unfair for Africa."

She adds: "Seventy percent of the population of the Middle East and Africa is young. These people are leaving the continent to look for jobs but the jobs have to be in Africa. Despite being the richest continent in terms of mineral resources, we only get a small fraction of their value. I think we need to think about this capital migration and make sure that Africa continues to grow, to employ and to prosper. I also don't think Africa can afford to sell its resources for them to come back at 15 times the price. This is one of the things that has continued to under-develop the African continent. We must benefit from our resources by capturing more from the value chain."

Almost one-third of the world's mineral reserves, many of which are used in lithium-ion batteries for products such as electric vehicles, smartphones and off-grid energy storage are found in Africa. In addition, according to UNEP, 40 percent of the world's gold, 90 percent of its chromium and platinum, and the planet's largest reserves of cobalt, diamonds and uranium are found on the continent. Africa is central to human survival with 65 percent of the world's arable land and 10 percent of the planet's fresh water sources. The Congo Basin is the planet's second lung after the Amazon, acting as a critical carbon sink for climate regulation.

Africa is also home to 8 percent of the word's natural gas and 12 percent of its oil, which has led to frustration with ESG targets around Africa's energy resources. Only 43 percent of sub-Saharan Africans can access electricity supplies, compared to a global access rate of 87 percent. The number of people in Africa without electricity has actually been rising in recent decades as population growth outstrips the electrification rates.

The idea that this scale of energy deficit can be bridged by renewables without first transitioning through oil, natural gas and liquefied petroleum gas is fanciful. One solution is to build small-scale gas networks that could be converted to hydrogen when it is available. The problem is that the natural gas industry, once seen as a carbon-friendly substitute for more carbon-intensive fuels such as coal, is today facing increasing pressure from investors for failing to meet ESG targets. Critics of ESG point out that these targets fail to recognize the urgency of transitioning away from polluting and health-threatening energy sources such as charcoal burning before being able to adopt carbon-free alternatives.

"Again, we are not the big emitter, but we are being penalized by the new capital reallocation at a time when we need a lot of money to power Africa and to build our infrastructure in a climate-resilient fashion, to connect Africa to itself and to connect Africa to the rest of the world," points out Adam.

BATTERY PRODUCTION

Given its richness in minerals used for battery production, investment in supply chain infrastructure has the potential to transform Africa into a global battery hub. A potential regional supply chain could exist where the Democratic Republic of Congo and Zimbabwe provide the minerals and South Africa creates the manufacturing capacity. And yet, despite a global race to set up battery factories in China, Europe, Asia and America, the opportunities for investment in Africa are still not forthcoming. China dominates this market, producing 74 percent of the world's lithium-ion batteries. This dominance leaves battery supplies vulnerable to trade disputes or shifts in government policy, which in ↘

PHOTO: XAVIER GLOBAL CONCEPT

> "The number of people in Africa without electricity has actually been rising in recent decades."
>
> **AYAAN ADAM**
> Senior Director
> Africa Finance Corporation

turn could leave Africa exposed to volatile commodity pricing.

Another area in which Africa is failing to benefit from investment flows concerns green bonds. A relatively new investment tool, green bonds were first issued by the European Investment Bank in 2007. They are designed to raise funds for environmentally aligned sustainable development projects. Recent research by the Stockholm School of Economics Sustainable Finance Center shows that African private and public sectors are lagging behind in their use of these innovative financial tools.

The report shows that between 2007 and 2019 there has been a 300-fold increase in bond issues. Over this period, Europe issued 36 per cent of the bonds, with America issuing 26 percent and Asia Pacific 23 percent. Only 11 bonds or 0.4 percent of the total issuance has been generated in Africa, raising $2 billion compared to the $120 billion raised in Asia Pacific over the same period. One of the green bonds issued in 2015 was in Morocco, where funding was used to build one of the largest concentrations of solar panels in the world. The size of 3,500 football fields, the Noor-Quarzazate complex is located at the gateway of the Sahara Desert. The complex provides 580 megawatts of electricity, enough to power a city twice the size of Marrakesh.

Morocco's NOOR III in Ouarzazate, Morocco, is the world's largest concentrated solar power project

PHOTO: FRANCESCO ZIZOLA / NOOR / LAIF

CALL TO IMPACT

1 Investment initiatives targeted at Africa must focus on the need for infrastructure projects that build resilience to climate change.

2 Investment cash flows must build Africa's manufacturing base to stem a historical tide of resource extraction, where Africa fails to benefit from the more lucrative value chain.

3 Fund allocation targeted at Impact investing must switch to higher value climate-resilient infrastructure projects to redress an imbalance in ESG investing that disadvantages the smaller value projects typically available in Africa.

4 Hybrid investment tools that mitigate risk or the disincentive of long-term returns should be structured by combining state-funded cash flows such as Development Financial Institutions with more traditional commercial investment streams.

5 ESG goals must no longer prejudice carbon investments which alleviate health, education and economic well-being, while ultimately helping to transition to more sustainable energy sources.

UTILITY COMPANY

In July this year, the South African state-owned utility company Rand Water became the first in Africa to issue green bonds worth R1.2 billion linked to the UN Sustainable Development Goals. The bond is linked to ESG targets including increasing solar energy capacity, greater access to safe clean water and higher female representation at senior management level.

Moves are afoot to improve opportunities for ESG investing in Africa, points out Geoffrey Odundo, Chief Executive of the Nairobi Securities Exchange. "In Kenya we have set up something we called the ESG framework with national issuance aligned to green bonds and sovereign green bonds. All the assets to be raised are aligned and build up to our companies embracing integrated reporting and sustainability reporting, providing the building blocks to make them ESG compliant," says Odundo. "However, there is still a need for more rigor around regulation, so that sustainable assets are well regulated and in clear alignment with global reporting standards. We also see the need for more Impact investing."

> "There is clearly a need for more investment opportunities in Sub-Saharan Africa."

GEOFFREY ODUNDO
Chief Executive
Nairobi Securities Exchange

Impact investing is designed to address social and environmental challenges, while generating balanced financial returns. This growing market provides capital in areas such as sustainable agriculture, renewable energy, conservation, micro-finance and affordable and accessible services including housing, healthcare and education. According to the 2020 Annual Impact Investor Survey there is currently US $715 billion invested in Impact investing managed by 1,720 organizations globally. Between 2016 and 2019 assets have grown by 17 percent globally. However, there is clearly a need for more investment opportunities in Sub Saharan Africa, which grew by 7 percent over the period, the lowest regional growth compared to Western Northern and Southern Europe, the fastest growing region of investment attracting a 25 percent growth in investment flows.

Africa provides a mass of opportunities for Impact investing, ranging from housing, education, climate capacity and agribusiness. One problem inhibiting investment in these fields is that large-scale investment opportunities are in short supply. A potential solution could be to widen Impact investing opportunities for infrastructure projects. The sort of project that could attract Impact Investing is the Kigali Bulk Water Supply Project in Rwanda, one of the first public-private partnerships in water supply and treatment in Sub Saharan Africa.

Another group of institutions that is set to play a key role in future ESG investing are Development Financial Institutions (DFIs), which provide loan guarantees and technical assistance for development projects and policy reforms. They have already been providing funds for Covid responses and helping to mitigate the impact of trade disruption that has been caused by the pandemic.

DFIs have traditionally invested in projects that banks have deemed too risky or too long-term. The current hope is that new co-funding models between banks and DFIs are emerging that will be able to drive Africa's recovery forward in the post-pandemic world.

According to the World Bank, economic growth in Sub-Saharan Africa is estimated to have contracted by 2 percent in 2020. However, a number of investment trends are set to emerge after the pandemic. New demand generated by the Africa Continental Free Trade Area, along with a groundswell of innovation from a population of which over 60 percent is under the age of 25. There are other opportunities related to increasing urbanization, infrastructure development and industrialization.

"Covid has demonstrated many things, including how disruption to supply chains has affected Africa," points out Adam. "There is now a significant move for Africa to really industrialize, and it is possible do that in a carbon-neutral fashion. We also need to begin connecting Africa within itself because we now have a population of more than 1.2 billion going on 1.5 billion people." ■

ESG DISCLOSURE HAS A LONG WAY TO GO

Voluntary guidance on sustainability reporting first appeared in Singapore, Thailand, India and Hong Kong from the mid-2010s. Now the ESG concept is making rapid inroads. But levels of reporting show a wide level of variance and even Australia, which has the most developed ESG observance, has problems to resolve.

ESG-BASED INVESTMENT in the Asia Pacific region is lagging far behind that in Europe or North America. According to the Principles for Responsible Investment (PRI), Asia Pacific markets made up less than 10 percent of the $90 trillion assets under management incorporating sustainability experienced in 2018.

Progress has been made and regulators, led by stock exchanges, are showing an increased interest in mandating or recommending ESG disclosure in most Asian markets. In 2019, the Philippines issued mandatory sustainability reporting guidelines for listed companies on the "economic, environmental and social" aspects of their organisations, Hong Kong upgraded its 2015 guidelines and added a new environmental KPI on climate change and a requirement to report according to a set of social KPIs.

In 2020, Japan released a non-mandatory but detailed handbook on ESG disclosure for listed companies. China and Korea are expected to release their own guidelines in the near future. In the same year, the Financial Supervisory Commission (FSC), which is Taiwan's peak financial regulator, announced a new plan for corporate governance.

Although it has been knocked back by civil unrest in recent years, Thailand has been emerging as a regional leader in ESG reporting.

While Australia ranks first in the region for ESG reporting in the Asian Corporate Governance Association's 2021 survey, ahead of Hong Kong and Singapore, compared to the best performers globally, it has shortcomings. A PWC ESG analysis in 2020 concluded that "ESG reporting falls short of the standard for financial reporting, and therefore below stakeholder expectations". The report found that while 80 percent of the 115 ASX 200 listed companies reviewed disclosed their ESG strategy to stakeholders, evidence that strategies were integrated with core corporate strategies and targets was limited. It concluded: "Without this integration, companies risk ESG being viewed as optional, undermining confidence in the veracity of ESG goals, targets and reporting."

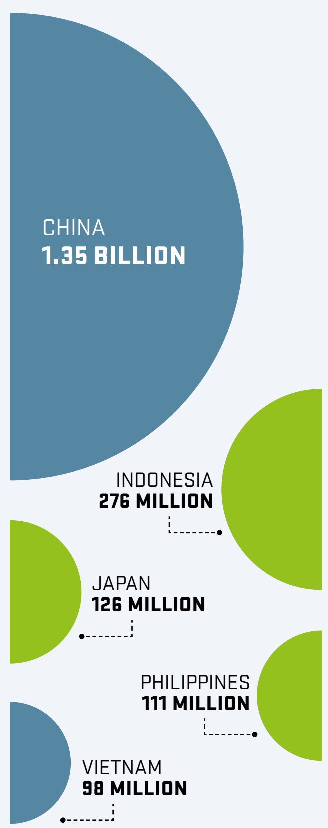
Its analysis of 115 companies showed that ESG KPI identification was not widespread. The most prevalent area for targets was climate change and greenhouse gas emission, but target-setting across other ESG KPIs was inconsistent, especially for those concerning social and governance factors.

It found that investors were increasingly vocal in their support for ESG to be linked to remuneration, suggesting this low rate of adoption may need to change.

The Asia Corporate Governance Association concludes that Australia's corporate governance ecosystem suffers from "systemic weaknesses", especially "the lack of a lead national anti-corruption agency, as well as mechanisms for bank regulatory risk management." ■

2.24 billion
31% of the world

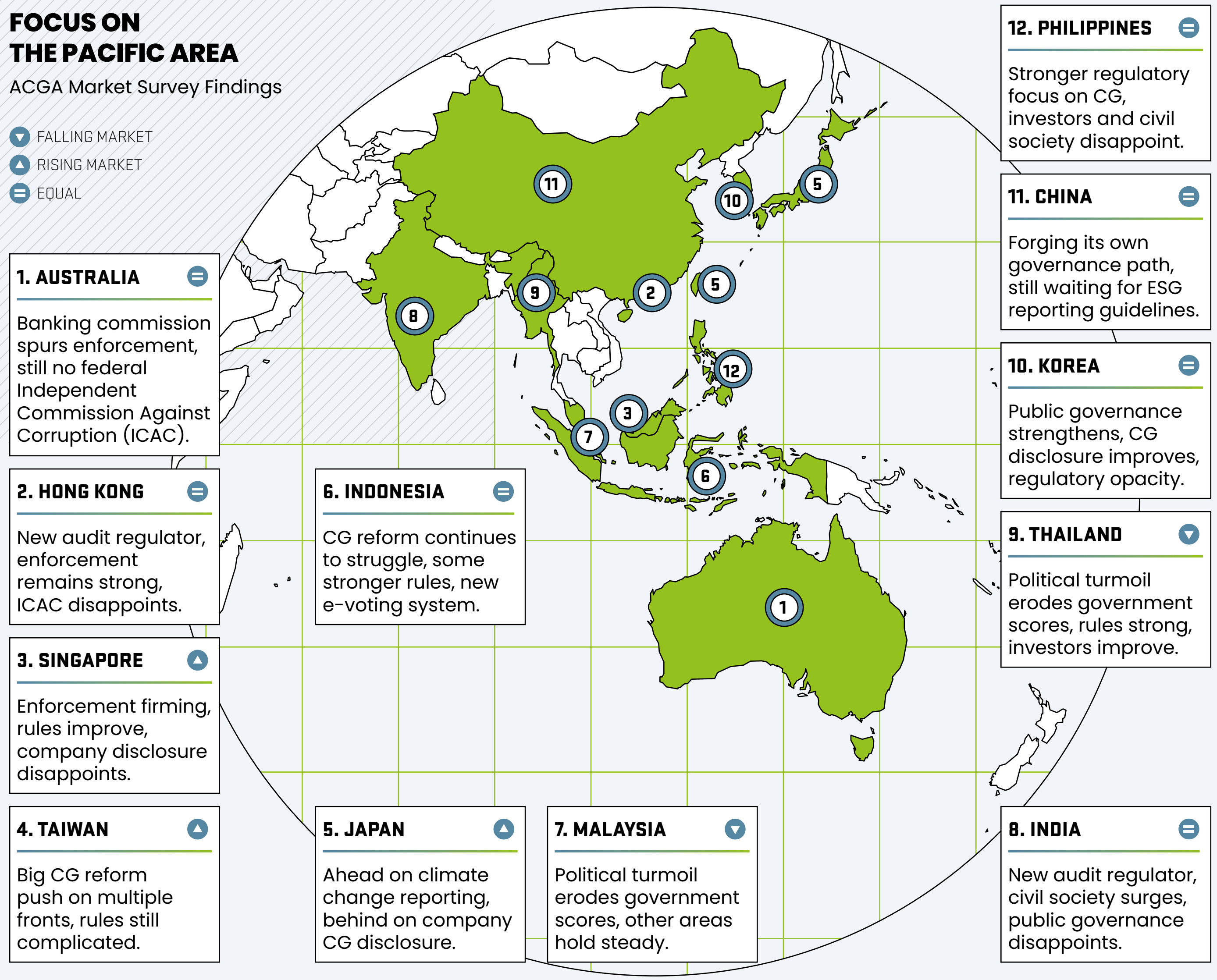
MOST POPULATED COUNTRIES



INFOGRAPHIC: MATTEO RIVA • SOURCES: ACGA-ASIA.ORG, NATIONMASTER.COM, PWC.COM.AU

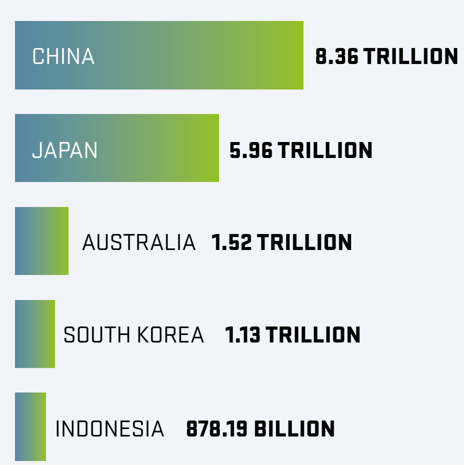
FOCUS ON THE PACIFIC AREA

ACGA Market Survey Findings

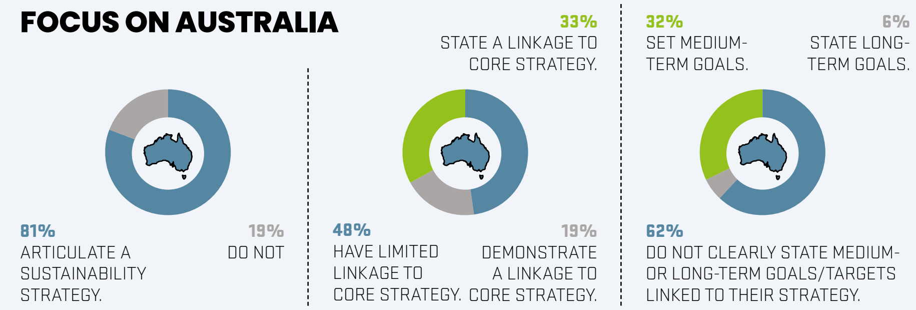


TOP GDP

in US $



FOCUS ON AUSTRALIA



98% of companies identified at least 5 material ESG issues.

85% translated ESG issues into well-articulated risks with at least basic commentary on mitigation strategies.

54% discussed opportunities arising from their ESG strategies, areas of focus or risks.

HOW TO LET YOUR CAPITAL TALK

For Bahrain-based investment corporation Investcorp, ESG has become a strategic pillar of its business activities in India. Impact talked to Co-CEO Rishi Kapoor about Investcorp's ESG approach for India, the chances of its rollout to other emerging markets and the lessons it can offer for developed markets

How important is India for Investcorp's business activities?
Rishi Kapoor: We entered India recently, early in 2019 – our first foray into a true emerging market. It dawned on us quickly that the investor universe has a much higher sensitivity about how an investment manager like Investcorp acts in emerging markets than in developed markets. So we used India as a pilot for qualification and validation of our responsible business framework in emerging markets. It also gave us an opportunity to find answers that are not a one-size-fits-all approach to ESG.

You could not just use ESG approaches you had already worked with in other markets such as North America or Europe?
Though everyone uses the same acronym, ESG, the individual elements have different relevance and emphasis for different people and regions. In the US, you see a focus on the Social, especially on social equity and diversity. In Europe, most important is the E pillar, especially climate change. And in emerging markets where we are becoming quite active of late, like in Middle East and India, the starting point is more Governance, that is, good business practices.

There are no social issues in India?
Of course there are, and highly important ones. But they are different than in the US. They are certainly driven by considerations about equity, inclusion, access – but less about diversity. In our US investments, the ESG focus is on diversity, inclusion, and management of emissions and greenhouse gases. In our Indian investments, we focus on waste management, energy management, efficient use of resources and ethical procurement. Of course we would also love to increase our share of non-fossil energy consumption in India, but it's not practical for us to expect that we can change the power grid in India to renewables. What we can do is work to optimize the energy utilization of our companies.

So efficient utilization of energy ranks high on your ESG scorecard for India. What else?
There are two more core issues: ethical business practices and responsible employment. Through our focus on these three fields, we want to ensure the adoption and ongoing monitoring of sound labor practices, occupational health and safety standards, diversity and equal opportunity employment, best-in-class governance, transparency and tax and regulatory compliance across all our investments in India.

If you measure the ESG position of your Indian companies, they will definitely rank much lower than your portfolio in developed markets.
Measurement is a very bland instrument. It would be a shame to stop there. Making an impact via a measurable improvement in outcomes is what counts. We don't try to find the best pupils in the ESG class, we focus more of our energy on improving the end state of the company we invest in relative to the starting point.

Let's assume your "outcome improvement" approach to ESG became mainstream. For the next decades about 90% of all ESG investment would have to go to India, China, Africa. The "best-pupil approach," on the other hand, would imply investing all the ESG money in Norway...
Neither of those ends is the right outcome – and both of them are part of the whole story. It's always on us to make our capital talk. And that's what our investment decisions do. Each tries to answer the question of how we can deploy the capital of our investors to improve and enrich the life of future generations.

Was this new approach a kind of cultural change for Investcorp?
The principle of responsibility has always been there. I have worked for Investcorp for 30 of its 40 years, and the mindset hasn't changed. What has evolved is how we have formalized these values in our practices, so that responsibility is not some kind of nebulous concept – but part and parcel of our business as an investment firm.

INVESTCORP

Founded in 1982 by Nemir A. Kirdar, Investcorp is a global manager of alternative investment products. The company's main activities involve corporate investment, real estate and credit management, with 37.6 billion US$ worth of assets under management, as of June 2021. Investcorp's headquarter is located in Manama, Bahrain, with further offices in New York, London, Abu Dhabi, Riyadh, Doha, Mumbai and Singapore. During its four decades of private equity investment, Investcorp bought (and later sold) almost 200 companies, including iconic names like Tiffany's (1984), Breguet (1987), Gucci (1989) or Corneliani (2016). The company employs more than 430 people coming from 43 countries. With the opening of its Mumbai office in 2019, Investcorp has accelerated its adoption of a common ESG framework, with an initial aim of becoming fully aligned with this framework for all its investment activities in India as a pilot, and then propagating these across the rest of the firm worldwide.

PHOTO: PR

RISHI KAPOOR
Co-CEO Investcorp

> "Measurement is a bland instrument. Making an impact via an improvement is what counts."

You often use the term 'responsibility' ...
Because that's the way we let our capital talk. Our work at Investcorp is based on three pillars of responsibility: being a responsible operator by being a responsible investor; being a responsible employer; and, equally important, being a responsible citizen. For each of these pillars we have highlighted five areas that are really material for us, such as product quality, transparency or data privacy in the operations pillar, or wellness, inclusion and labor practices in the employer pillar.

That's not exactly the shareholder value maximization approach for which investment firms are notorious.
To us, shareholder value creation means sustainable value creation. Without sustainability, there is a risk of these values getting eroded. Our mission is to enrich the lives of future generations. Without sustainability, that mission would be at risk.

This responsibility means you really want to change something in the companies you invest in.
When we invest in a company we establish a baseline for ESG issues: Where are you right now on these points? Then ↘

“All of us would like to have better data available to a broader community.”

we agree on the company’s objectives – and then we embark on the journey together.

One advantage you have is access to real company data. Could those better data be used for getting more realistic ESG data for the public sphere, too? If you can make your capital talk – can it talk to me as well?

All of us would like to have better data available to a broader community. But on the other hand, these data are a property of the company – and data privacy is one of our values as a responsible investor. This question of confidentiality has not yet been answered.

So some technology that could help to keep data private but still make use of it would be fine?

By the end of 2022 we will see the emergence of platforms for the exchange of ESG data, where the platform providers can guarantee data privacy and also make it accessible. There is no need for 20 of those marketplaces, but my guess is that we’ll see more than one and less than five marketplaces for broadly accessible and standardized data.

The Indian pilot you started in 2019 has already landed?

Yes. The applicability of our pilot is relatively broad and we are already in the process of rolling it out. It could open up other emerging markets for us.

You’re on the way to transferring your Indian experience to other markets in Asia Pacific?

Big parts of Asia Pacific are not really emerging markets any more. Our second preference besides India in the region is the Middle East – and there, too, you have a wide range of more developed and more emerging markets. But at some point in time we will also begin to operate in Africa and Latin America. And then we can benefit from what we have learned in India. ▪

Protesters participate in a protest march during a global climate strike, part of the ‚Fridays for Future’ movement in New Delhi

PHOTO: MANISH RAJPUT / SOPA IMAGES / LIGHTROCKET VIA GETTY IMAGES

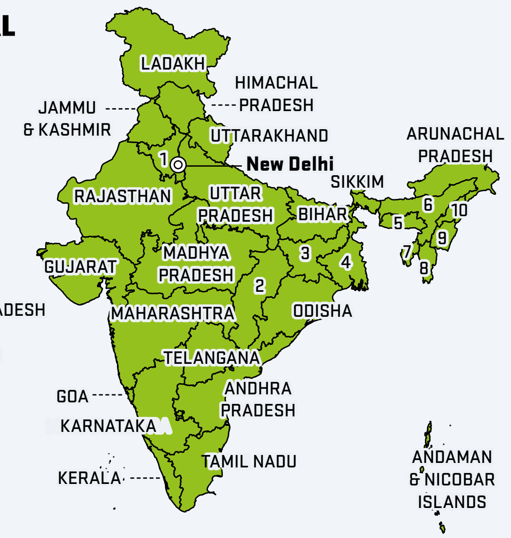
CALL TO IMPACT

1. ESG is not one-size-fits-all, but means different things for different people in different regions.
2. ESG investing needn't mean honoring the best pupil in class – it can also mean investing where the highest impact can be expected.
3. Forcing all ESG investments to follow one approach yields suboptimal returns. For each investment, context matters.
4. When investing in emerging market companies, the main focus should be on the G part of ESG: governance, transparency and business ethics.
5. ESG data at company level still have accessibility and standardization issues. ESG data-exchange platforms of trusted providers could solve them.

INFOGRAPHIC: MATTEO RIVA • SOURCES: WIKIPEDIA

REGIONAL DIVISION

Year 2021

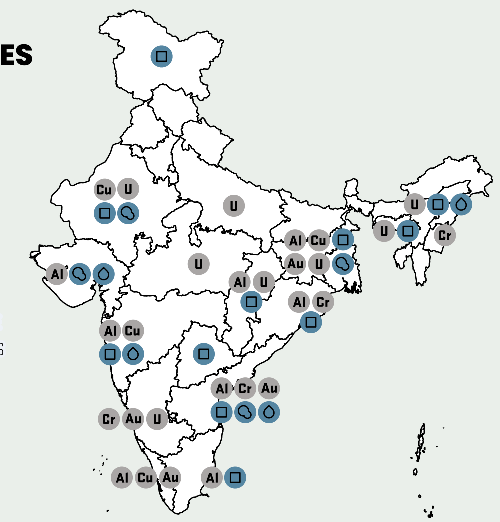


1. HIMACHAL PRADESH
2. CHATTISGARH
3. JHARINKHAND
4. WES BENGAL
5. MAGHALAYA
6. ASSAM
7. TRIPURA
8. MIZORAM
9. MANIPUR
10. NAGAAND

NATURAL RESOURCES

Year 2021

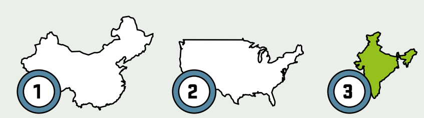
88 Minerals produced



COAL LIGNITE
NATURAL GAS
PETROLEUM

Al BAUXITE
Cr CHROMITE
Cu COPPER
Au GOLD
U URANIUM

ENERGY NEEDS MET BY COAL, OIL AND SOLID BIOMASS >80%



India is the world’s **third-largest energy consumer** after China and the United States, and its third-biggest oil importer.

$3 trillion GDP

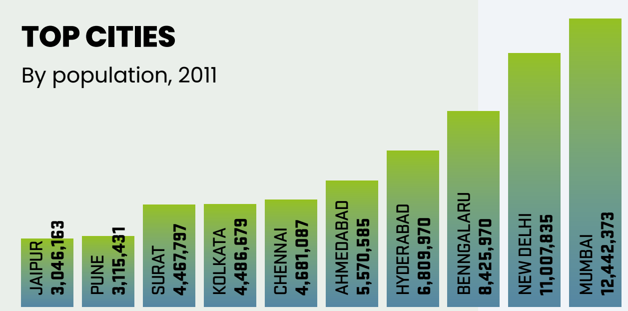
1.2 billion people

28 States

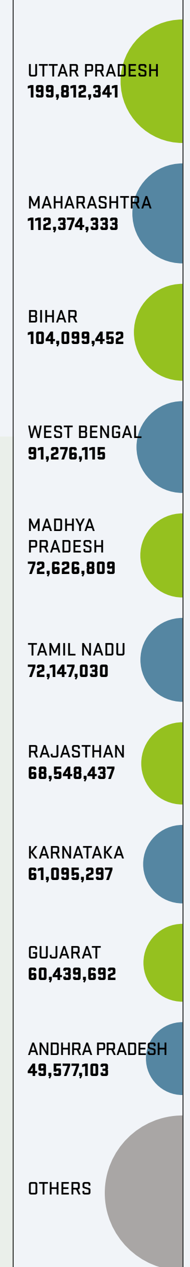
22 Languages

TOP CITIES

By population, 2011



By population (2011)



TOP FACTS

ESG focus

India has the world’s sixth-largest economy. But it has **fewer funds focused on ESG issues** than other top 10 economies, with 23 ESG funds, Refinitiv data shows. This is compared to more than 500 funds each in the US and UK, while Japan has 182 funds and China 119. Other economies in the top 10 also have more ESG funds.

63 million

According to Oxfam, **63 million Indians are pushed into extreme poverty** every year because of healthcare costs. It would take **941 years** for a minimum-wage worker in rural India to earn what the top paid executive at a leading Indian garment company earns in one year.

Inequality

While India has one of the **fastest-growing economies** in the world, it is also one of the most unequal countries. **Inequality** has been rising sharply for the last three decades. The richest have cornered a huge portion of the wealth. The top 10% of the Indian population holds 77% of the total national wealth. There are **119 billionaires**.

Coal

More than 80%of India’s energy needs are met by coal, oil and solid biomass. Coal has underpinned the expansion of electricity generation and industry, and is the largest single fuel in the energy mix. Oil consumption and imports have grown rapidly because of **rising vehicle ownership**.

FII: ESG IMPACT REPORT 2021

FIRST STEPS IN SUSTAINABLE INVESTMENT

ESG concepts and responsible investment are becoming mainstream in most parts of the world. In China, too, although ESG is relatively new, the market has grown quickly and promises to continue to do so. But some challenges need to be addressed.

IN CHINA, which has the world's second-largest economy, ESG and responsible investment are relatively new concepts. The Asian powerhouse has been knocked back by Covid-19, the Evergrande debt crisis and increasing authoritarianism, but ESG is likely to continue its development, which has been rapid.

Today, there are 19 ESG-devoted indices in the Chinese market. Only four of these were released before 2019.The Chinese-owned companies are predominantly listed in Hong Kong, Shanghai and Shenzhen or, in some cases, the United States. Their ESG reporting is influenced by the regulatory requirements in each location where they are listed. Hong Kong's stock exchange (HKEX) has required listed companies to issue ESG reports since 2016.

The disclosure requirements were upgraded in July 2020 to provide visibility of investment-relevant information on climate-related risk management, environmental target setting and supply chain management. HKEX recently launched on online platform, the Sustainable and Green Exchange (STAGE) to stimulate green finance across Asia.

ESG investment in China has gathered pace over a relatively short period of time. In 2020, the number of ESG indices in China doubled. ESG fund products that focus on ESG in its entirety experienced significant growth. The trend has been strengthened by the fact that ESG fund products have delivered above-average returns for investors.

ESG investment will also benefit from the further opening of China's capital markets to foreign investors, as announced by the country's securities regulator in September this year. It is expected that the move will further stimulate markets and encourage even greater recognition of ESG and responsible investment trends in China.

The development of ESG investment in China is strongly driven by governmental policies issuing strict regulatory requirements for ESG disclosures and guidance in order to build a green financial system. The notable increase in the quantity of quality disclosures is a positive sign.

The substantial governmental influence on ESG development is mirrored by the composition of shareholders: public investors lead the score with 1,200 state-owned enterprises listed in Shanghai and Shenzhen alone, ahead of private corporations, individual, institutional and retail investors.

Another major driver is China's aim to peak carbon emissions by 2030 and to ultimately reach carbon neutrality by 2060. This will trigger green investment in renewable energy technology and across other sectors on a large scale. According to Tsinghua University's Institute of Climate Change and Sustainable Development (ICCSD), the switch would require the deployment of more than RMB170 trillion ($26 trillion) across the energy, industrial, transport and building sectors.

How can China further advance and reach its full ESG potential? Market players and observers highlight various issues that still need to be addressed. Areas of concern range from policy, corporate governance, reporting and transparency along supply chains, the adoption of modern technology and the design of financial products. ■

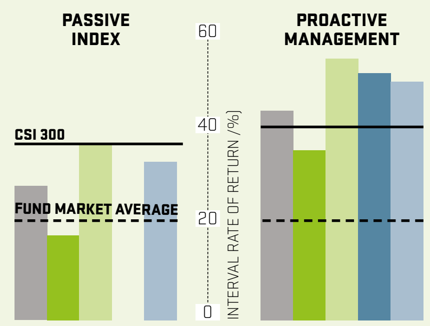
REGIONAL DIVISION

Year 2021

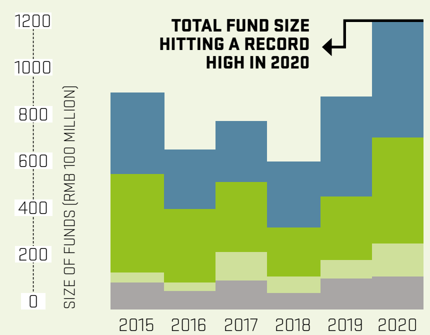
1.35 billion
inhabitants

ESG INVESTMENT

Return of active VS passive ESG Funds in 2020 (Annualized)



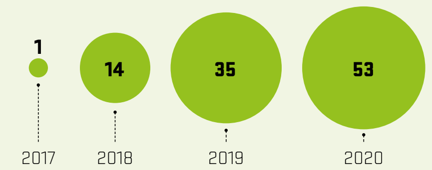
Distribution of ESG by year



INFOGRAPHIC MATTEO RIVA • SOURCES: PINGAN INVESTMENT IN CHINA 2020

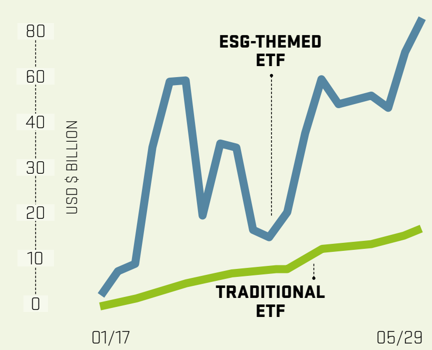
ESG THEMATIC REPORTS

By year



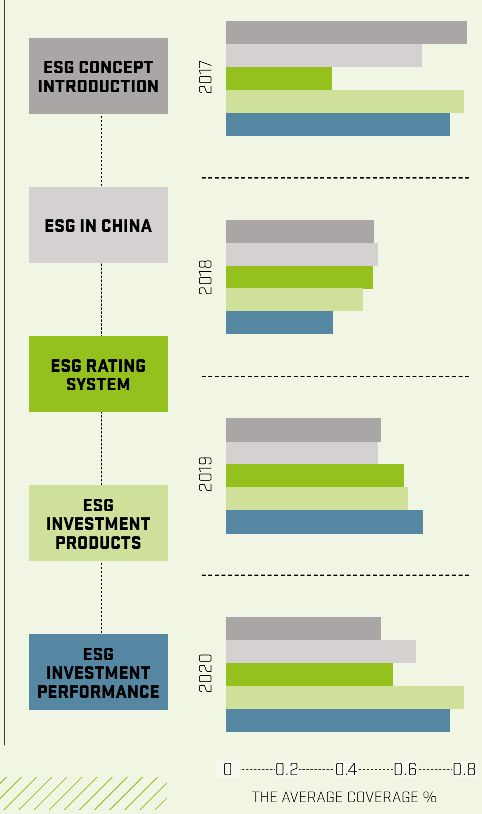
ESG VS TRADITIONAL

Traditional vs. ESG-themed ETFs



ESG MAJOR THEMES

Five major themes identified in ESG reports



CALL TO IMPACT

1 Experience. Corporations should integrate ESG principles in their corporate strategy and make a decisive transition from short-term to long-term thinking. Many businesses have already established ESG teams but the lack of ESG experience and expertise still prevalent in many businesses needs to be overcome.'

2 New products. There is a potential for index providers and fund managers to develop specific and diversified ESG products that provide a wider range of options for investors. The unfolding development into a low-carbon and, ultimately, carbon-neutral economy opens the door to new innovative products.

3 Technology. Worldwide, retail financial services group Ping An shows the potential. It was the first Chinese company to sign up to the UN Principles for Sustainable Insurance. Its CN-ESG database can verify ESG data using web crawlers, data mining, machine learning, knowledge graphs, natural language processing and satellite sensing.

GREEN REVOLUTION IN CHINA

China initially adopted a top-down rather than bottom-up approach to ESG – driven by government, rather than investors.

AS THE COUNTRY'S ECONOMIC MODEL has shifted in the last five years from rapid growth to a more holistic approach, ESG provides an excellent paradigm for high-quality, sustainable development and good financial returns. Tracy Cai, co-founder and CEO of the leading ESG and Green Finance consultancy SynTao, explains that ESG investment is gaining strength and attracting both domestic and foreign investors.

How did ESG get started in China?
Tracy Cai: It all started with information disclosure requirements issued by stock exchanges for listed companies. The Shanghai Stock Exchange released guidelines for corporate social responsibility reports in 2008. In 2011, the Hong Kong Stock Exchange began to investigate information disclosure standards. In 2015, it published detailed guidelines for ESG reporting and implemented a "comply or explain rule." The Chinese government has continuously encouraged the green finance market through a top-down approach with public policies such as the Open Government Information Regulations. In 2012, the CBRC (the China Banking Regulatory Commission) issued guidance for green credit loans and later for green bonds and green investment. In 2015, the government emphasized its commitment to developing green financing in a public statement. Earlier this year it released green finance assessment rules for the banking industry.

What is the status of ESG investing in China today?
Today the ESG market is worth approximately 120 billion Yuan. This still represents only a small proportion of the overall market. However, ESG investment has grown significantly over the past few years and has delivered above average returns.

> "The Chinese government has encouraged the green finance market with public policies such as the Open Government Information Regulations."

How is ESG driven and supported?
We used to rely heavily on natural resources such as coal and that put a burden on the environment. Now we are moving towards a high-quality economy and environmental protection has a greater importance. The Chinese government realized early on in the process that it needed a development model for the transition of the economy. As early as 2017, China's economic development switched from a stage of rapid growth to a stage of high-quality development. Parallel with the economic transition, we have realized that a more sustainable development model is needed. This includes the support of sustainable development with the ultimate goal of ESG integration.

How does this differ from other countries?
The approach in developed countries is quite different. There, it's the investors, such as pension funds and responsible finance companies, and also the green movements which drive the development of ESG. In comparison to China, it's a bottom-up approach. There are also different strategies at play. In countries like the United States, ESG integration and impact investing are the predominant strategies, whereas in China it all kicked off with positive and thematic screening. The approach is directly linked to the government's initiative.

What impact have the Chinese government's policies had?
There are already signs that the strategy is paying off. This year's UN ESG report states that China has made significant progress in terms of eliminating poverty, promoting clean water, and sanitation. China is also advancing in areas such as gender equality, infrastructure and sustainable cities. We have the lowest levels of unconditional fossil fuel subsidies among all G20 countries. This underlines that there is a clear commitment to overcome challenges, rather than lowering ESG standards.

What role do international standards play?
As policymakers were making this progress, market players such as financial institutions and corporate companies also want to attract foreign investment. Once they realized the importance of ESG investment and the commercial benefits it could bring, they adopted international standards. Companies in China that meet ESG requirements successfully attract investment and deliver higher returns. The notion that emerging economies sacrifice economic growth by supporting green policies is a myth. However, there are still challenges to overcome. In terms of efficient infrastructure, experience and expertise, sufficient data supply and the overall ecosystem, the ESG market in China is still lagging behind developed countries. But the opportunities for emerging markets including China are clear.

PHOTO: PR

TRACY CAI
Founder & CEO
SynTao

Tracy Cai is founder and CEO at SynTao, a leading agency that promotes ESG and responsible investment in China. She is also a founding board member of the China Social Investment Forum. Ms. Cai has extensive experience and expertise in Green Finance, Environmental, Social and Governance and responsible investment. Prior to founding SynTao, she worked for Morgan Stanley and GE Capital before moving into the non-profit sector, working for the World Wide Fund for Nature (WWF). Tracy holds a Master of Public Administration (MPA) from Harvard University and a master's degree in finance from Peking University.

> "Companies in China that meet ESG requirements attract investment and deliver higher returns."

How much foreign investment and domestic investment does the Chinese ESG market attract today?
When we first started SynTao in 2012, our client base consisted almost entirely of European companies, mainly institutional investors such as pension funds that required data on the Asian and, particularly, Chinese markets. Since then, we've experienced a huge surge in demand from domestic clients. This was triggered by the governmental policies I mentioned. Today, 80 to 90 percent of the business we conduct is from China including Hong Kong.

How has SynTao kept up with these changes?
We've evolved with our clients. We started off exclusively as a consultancy before we widened our service offering to data provision. We're now the only Chinese data provider on the Bloomberg system. We put in a lot of effort to promote responsible governance and investment. For example, we're a founding member of the China Social Investment Forum, a non-profit organization and platform where we engage with national and international players and promote responsible investment. At our 8th annual meeting in 2020, we had around 400 participants. We're seeing more and more investors from financial institutions who want to talk to us and find out more about these topics. We also see more competitors – a sure sign that the market is developing.

Are there regional differences?
There are indeed some differences within China. Unsurprisingly, eastern regions along the coast are more sensitive toward the dangers of climate change. People are more aware of the threat of flooding, for example, as it is a reflection of global warming and happens more frequently in Eastern China. And of course, the eastern and southern regions are more economically advanced than central and western regions. So, they tend to be more active on environmental and climate-change issues.

Is there a danger of greenwashing and, if so, how can it be avoided?
We cannot deny that there is danger of companies using ESG for greenwashing. But this is not limited to China – it's a global issue concerning ESG ratings as a whole. The question is, how can we make sure that data, assessments and ratings represent the true picture of a company's performance? It requires mutual efforts by all parties involved, from governments, data providers and all the different stakeholders along the supply chains.

What do you see as the role that each of these stakeholders can play?
Firstly, governments need to establish strict rules and guidelines in cooperation with third-party experts like us. Secondly, from a data point of view, we need to develop our databases to efficiently compare and cross-check corporate statements with historical and industry peer performance to ascertain if their statements align with reality. Technology plays an important role in this. We utilize artificial intelligence to do the groundwork so experts can validate the data. It still takes experts to do that, and we must be very cautious to be confident about our assessments. Lastly, the public, acting as stakeholders, can engage in the process by practicing responsible consumption. This is already happening. On Weibo, which is like a Chinese Twitter, for example, many users are sharing this experience of leading a low-carbon lifestyle. ESG is already a hot topic, proving that interest among the wider public is strong.

> "We need an even deeper understanding of the markets, where ESG ratings are prepared. Better dialogue would improve the whole system."

Is it desirable to create an international standard of ESG guidelines and, if so, is it feasible to do so?
It's definitely desirable and also feasible but will undoubtably take considerable effort throughout the entire financial ecosystem, from mandatory disclosure of information and infrastructure development to database typology and analysis. We need an even deeper understanding of the markets, especially where ESG ratings are prepared. A better dialogue between investors and service providers, for example, would improve the whole system.

What do you believe needs to happen next?
According to our data, more than a thousand A Share-listed Chinese companies released ESG reports this year. That's a 16 percent increase compared to last year. However, that only accounts for about one-quarter of all the A Share-listed firms. So, I think the government needs to set stronger requirements for information disclosure. That's the basic thing – without the data it's hard to know the performance of the firm. Also, the quality of the data needs to be improved – we need more resources and better sourcing. Furthermore, data providers and rating agencies should integrate more holistic life cycle thinking in their ratings. It is essential for understanding and evaluating the full picture. In terms of technology, we need to advance big data capability and natural language processing. Interestingly, there is recent research that suggests that AI-driven data provided by some technology services favor ESG data from developed countries over sources from emerging markets. Latin American companies, for example, receive lower ratings. In my opinion, it just highlights that there seem to be differences in how technology is utilized. We require better interpretation of data and more open dialogue between all the different stakeholders to harmonize procedures and standards.

Looking to the future, where do you see ESG going?
ESG investment in China undoubtedly has great potential. Naturally, this is linked to carbon neutrality. Investments of 2,000 billion Yuan will be needed between now and 2060, the target year for carbon neutrality announced by president Xi in 2020. We will also see a big boom in related service markets. According to our estimates, we will generate a market worth 2–5 billion Yuan per year. Awareness among companies is getting stronger as well. They are setting up ESG teams to make informed responsible investment decisions. Previously, companies would merely comply with guidelines, whereas now they realize the benefits and proactively engage in ESG. ■

Morning sun and fog on Shanghai's Lujiazui financial district and the Huangpu river

PHOTO: DANNY HU VIA GETTY IMAGES

CALL TO IMPACT

1 The development of ESG in China was kickstarted by the government through a top-down approach. While government support still plays a role, the market has matured. ESG is mainstreaming.

2 Since the emergence of ESG investment in China, the market has grown significantly. Future development will be driven by government policies, a higher-quality economy and carbon cutting.

3 ESG represents a great opportunity for developing countries. Rather than being a hindrance, it can lever in both foreign and domestic investors.

4 Green investors in China believe that standardized international ESG guidelines, including mandatory disclosure and infrastructure development, are desirable and feasible. However, they will take considerable effort to achieve. Better dialogue between investors and service providers will improve the whole system.

CLOSING THE GAP

JAPAN IS SEEN BY SOME AS LAGGING BEHIND EUROPE AND THE US WHEN IT COMES TO ESG. BUT HOW MUCH OF THIS IS SIMPLY THE RESULT OF CULTURAL DIFFERENCES AND POOR COMMUNICATION?

The Shibuya Crossing in Tokyo's financial center is one of the most crowded and busy crossings in the world

PHOTO: YUGA KURITA VIA GETTY IMAGES

"I WILL ENSURE that Japan keeps getting better," said Shinzo Abe, the country's former prime minister. "Better this year than last year, and better next year than this year." Central to achieving his ambition were the 'Abenomics' policies, launched after his re-election in 2012 and designed to lift Japan from its economic slump, with improvements in corporate governance standards playing a key role.

But although ESG investment has continued to increase in Japan, dig deeper, and "a more complex picture emerges," says a 2021 report from McKinsey Sustainability. While performing well on sustainability – the country has already made significant progress towards decarbonization – it was still lagging behind Europe when it came to social performance and behind both Europe and North America in terms of governance, the document states.

In terms of overall awareness of ESG issues, however, Japan is behind Europe but ahead of the US, believes Archibald Ciganer, portfolio manager of the Japan Equity Strategy at investment firm T. Rowe Price. What's more, the government's pledge to achieve net zero has raised awareness to another level.

Unsurprisingly for a country long associated with technological advances, Japan was one of the first places to start producing electric cars, and the government's October 2020 target to achieve carbon neutrality by 2050 has in turn put pressure on companies to prioritize sustainability. Japanese companies also score highly on employee health and safety, the McKinsey report states, although the country's famous long-hours working culture has meant it perhaps has a long way to go in terms of employee well-being. The country even has a name for death from overwork – "karoshi" – although Abe's 2018 Workstyle Reform Act introduced some caps on excessive working hours and improved arrangements for time off.

As far as ESG practices by Japanese corporates go, "each pillar is at a different stage", says Ciganer. "Corporate Japan is about 'best in class' in term of environment – manufacturers in particular have been extremely efficient at reducing emissions, managing waste and recycling compared to those of other advanced countries. However, disclosure is still occasionally insufficient.

While Japan has remained slightly behind Europe in terms of the social pillar, again much of this gap is also "due to poor disclosure," he adds. "The gap can be closed fairly quickly, although corporate Japan does need to treat its employees better in general." But it was governance where Japan was "still significantly behind." Pressure from both the government and shareholders mean that corporate governance is improving fast, and Japan's Stewardship Code and Corporate Governance Code have both been reviewed – in 2020 and 2021 respectively – to increase external director representation on boards, improve diversity, and more. However, fully closing the gap with Europe "could be a 20-year process", he says.

The government's ambitious net zero target has undoubtedly raised awareness of ESG issues in Japan, but it is also viewed as overly ambitious by many. "Especially given the fact that Japanese manufacturers are already extremely efficient when it comes to emissions," Ciganer states. Large Japanese corporates are nonetheless eager to try to find solutions to meet the objective – "motivation is high and the expectation is that this could lead to valuable technological innovation, on top of the environmental benefits," he says.

PENSION INVESTMENT FUND

One key driver for ESG in Japan has been the vast Government Pension Investment Fund (GPIF), estimated to be the largest pension fund in the world. Founded in 2006, one of its five key investment principles is that in order to "enhance long-term investment returns and fulfill our stewardship responsibilities, we shall advance various initiatives (including the consideration of ESG factors) that promote long-termism and the sustainable growth of investee companies and the capital market as a whole".

FII: ESG IMPACT REPORT 2021

Established with the aim of supplementing the nation's pension payments, the fund now holds at least $1.5 trillion in assets, and in 2017 shifted its emphasis further towards ESG-related activities by moving almost $27 billion into strongly ESG-focused shares such as the FTSE Blossom Japan Index – which is specifically designed to measure the performance of companies that "demonstrate strong ESG practices" – and the MSCI Japan Empowering Women Index. A further $10 billion was allocated to low-carbon indices the following year, and the sheer size of the fund gives it immense power to drive standards. A 2018 GPIF survey found that "more than 60 per cent of companies considered the selection of ESG indices positively".

"The ESG movement in Japan did not start with the GPIF but with foreign asset managers and asset owners – but it was significantly amplified by the GPIF," Ciganer states. This is because many smaller pension funds in Japan now "mimic GPIF's practices and asset allocation when running their own portfolios. You could say that GPIF was the bridge that allowed ESG to come from overseas into Japan."

> "It is completely true that Japanese companies are better at carrying out ESG activities than reporting them"

ARCHIBALD CIGANER
Portfolio Manager
T. Rowe Price

RESPONSIBLE INVESTMENT

According to the Responsible Investor newswire service, Japan is now "one of the fastest-growing markets for responsible investment". More and more Japanese companies are keen to display their credentials to investors via their ESG scores, and many of the country's larger firms are also using ESG ratings to measure the performance of their immense supply chains. Hitachi appointed its first chief environment officer in April 2021, and has also withdrawn from its thermal power business, while Honda has set a target of ending the sale of petrol and diesel cars by 2040. However, some commentators have said that detailed plans of how other companies intend to achieve their environmental ambitions and meet the government's net zero target remain thin on the ground.

"That's a fair observation," says Ciganer. "Japanese firms are eager to meet this new challenge but they're still formulating plans – I believe that is a natural process. One positive is that Japanese firms have a head start because they are, on average, ahead of their western counterparts in terms of lowering emissions, recycling and the like."

According to the AIG (Alternative Investment Guide) news platform, it could even be argued that Japan suffers from "greenwashing in reverse", with many companies having ESG ratings that are "significantly worse than they deserve". One reason for this is a comparative lack of stock analysts, it says, coupled with cultural differences. "In our view, Japanese companies are far better at actually carrying out ESG activities than reporting them," it says, with the language barrier in particular being underestimated – it can take Japanese companies much longer to carry out reporting in English than Western counterparts, and many will only have ESG reports in Japanese. The significance of cultural differences also continues to be underappreciated, it adds, with Japanese executives perhaps inclined to underplay their success due to the country's culture of humility – known as "kenkyo".

"It is completely true that Japanese companies are better at carrying out ESG activities than reporting them," agrees Ciganer, with the reason simply being "poor communication. For a long time, Japanese company management has felt that focusing on "doing good" was sufficient while "explaining that you are doing good" was just a waste of money. More broadly, I believe there is a communication deficit between Japanese companies and their stakeholders. Things are only starting to change now."

EXECUTIVE PAY

The CEO to worker pay ratio is far less stark in Japan than elsewhere – at around 50 times, while in Switzerland and Germany it's closer to 150 times and in the US it's more than 350 times. Despite this, using ESG considerations to help determine executive pay remains rare in Japan, unlike in Europe and the US.

Japan does have "its share of ESG failings," the AIG document states, adding both independence and low levels of gender diversity to the lack of English-language investor materials. "But Japan overall has in our view a rougher deal in conventional indices, metrics and the media than it deserves."

When it comes to gender diversity, Ciganer's firm has had since 2020 a global policy to vote against the CEO when there is no female representation on the board of directors, and while Japanese companies were at first hesitant to comply, they have since "made progress very quickly," he says.

He comments: "For instance, in the 60-odd stock portfolio I manage, about 16 companies had no female representation a year ago but that number has now fallen to six and we think it might drop to three by the next AGM season. It's still early days of course, but this is a similar process to what Japan experienced with non-executive directors before so we think progress will be extremely fast."

At senior management level, however, diversity in Japanese companies is still very limited at "maybe 3 per cent for gender diversity", and only slow progress is being made. Ciganer says, "Senior managers at Japanese companies today are people who were hired out of college 30 years ago. So if a Japanese company changes their hiring practices today to bring in more women, the impact on senior management composition will only be visible around 2050. We need to be patient and realistic."

Ciganer doesn't think that cultural bias in ESG interpretation will significantly impede foreign investment in Japan. He points out that Japan presented an Expanded Sustainable Development Goals Action Plan in 2019 as part of its G20 presidency. And he argues, "They're remarkably universal, and asking all companies to strive to contribute to these goals is entirely reasonable." ■

Automated body welding workshop at Toyota Motor's Tsutsumi plant on Honshu Island

PHOTO: KAZUHIRO NOGI / AFP VIA GETTY IMAGES

CALL TO IMPACT

1. Japan is now seen as one of the fastest-growing markets for responsible investment.
2. In October 2020, prime minister Yoshihide Suga pledged that Japan would become carbon-neutral by 2050.
3. Japan's huge Government Pension Investment Fund moved almost $27 billion into strongly ESG-focused shares in 2017 alone.
4. Some commentators believe Japan suffers from "greenwashing in reverse," with companies better at carrying out ESG activities than reporting them.
5. Communication remains a problem, with many firms only producing ESG reports in English.

ESG IS A LAYOVER NOT A DESTINATION

FII-I has three pillars to deliver its mission: THINK, ACT and XCHANGE

1 FII-I THINK
Identify societal challenges and current inhibitors. Curate the brightest ideas to address societal issues

2 FII-I ACT
Catalyze innovation and initiatives by mobilizing partners and resources

3 FII-I X CHANGE
Create platforms for live discussions on the future of humanity. Share knowledge, stories and publications with different stakeholders

AS A FRAMEWORK for enforcing and encouraging responsible corporate behavior, ESG is flawed. This is because it offers no clear way to reconcile the needs and perspectives of firms and organizations that face very different constraints, opportunities and resources. This explains, in part, why there are so many different methodologies for measuring ESG performance: everyone has a reason for wanting a different way to count what they have, what they don't have, and what they can do to advance the cause of sustainability. This opens up the very real possibility that there is no one 'consensual metric'. And instead of looking for one, a better near-term approach may be to look for ways to build awareness around (and address) gaps, biases and errors in existing ESG metrics, even as we work towards a sustainability framework that doesn't end at organizational boundaries. This is the gist of emerging terms like 'global solidarity', and the 'great transition.' The idea is the same: to challenge people and companies to think beyond the status quo and more in terms of radical transformation. The debate over ESG is a microcosm of a larger problem: can humanity release itself from addictive behaviors that are literally killing our planet before it is too late?

In line with its mission to seek out and enable new ideas with the potential to positively impact humanity, FII Institute has begun to investigate the broader philosophical and technical problems implied by ESG, while catalyzing tools to make the system fairer to those who are adversely or unequally impacted by its requirements. This might include deploying artificial intelligence (AI) to address the 'data gap'; designing more dynamic measures of firms' transitions to sustainable business models; creating new algorithms and user interfaces (UIs) that allow firms and consumers to visualize how different operating environments and relationships affect ESG scores, and where the marginal impact per dollar spent is biggest; or creating ways to incentive firms' collaboration across geographies and industries. As we move forward, we should keep in mind that the idea that companies could, or should, care about anything other than the bottom line struck many as absurd just 20 years ago. ESG is another starting point toward a future that we will have to imagine together. Look out for more on these topics from FII in the coming months and years. ■

PHOTO: ADOBE STOCK, FII INSTITUTE

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is guided in all it does by a strong purpose, vision and mission.

PURPOSE
"Enabling a brighter future for humanity"

VISION
"Empowering the world's brightest minds to shape a brighter future for ALL, and with ALL"

MISSION
"Curating and enabling ideas to impact humanity sustainably"

SOURCES

Overview of key sources used for this report

INTERNATIONAL

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www.unpri.org

United Nations Environment Program (UNEP)
www.unep.org

UN Sustainable Development Goals
sdgs.un.org/goals

ACCOUNTING BODIES AND ESG REPORTING FRAMEWORKS

Global Reporting Initiative
globalreporting.org

IFRS Foundation
ifrs.org

International Organization of Securities Commissions (IOSCO)
iosco.org

Natural Capital Finance Alliance
naturalcapital.finance

Sustainable Accounting Standards Board/Value Reporting Foundation
sasb.org

Task Force on Climate Related Financial Disclosure TFCD
fsb-tcfd.org

Capitals Coalition
capitalscoalition.org

Task Force on Nature Related Financial Disclosure TFCD
tnfd.global

CDP
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Nairobi Securities Exchange
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JAPAN

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PUBLISHER
Future Investment Initiative Institute
3884 Alakheel
District Unit 9
Riyadh 12382 - 6613
Kingdom of Saudi Arabia

CONTACT
For clarifications and inquiries, kindly email:
info@fii-institute.org

EDITOR
William Hatchett

> “WE DIDN’T CAUSE THE SEA TO RISE, WE DIDN’T CAUSE THE GLOBE TO HEAT UP AND YET WE ARE BEING PUNISHED.”

AYAAN ADAM,
SENIOR DIRECTOR
AFRICA FINANCE CORPORATION