Suruhanjaya Sekuriti
Securities Commission
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World Capital Markets Symposium
Kuala Lumpur

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RENAISSANCE OF CAPITALISM:

MARKETS FOR GROWTH

6th & 7th February 2018

CONTENTS

EXECUTIVE SUMMARY

FINANCE AT A CROSSROADS

Modern day capitalism has delivered unprecedented growth in the last two centuries. After three industrial revolutions spanning the steam engine, mass production, and digital technology[1], the world is prosperous, with quantitative indicators indicating we are living in the best period of human history.

However, as we stand on the cusp of the Fourth Industrial Revolution, we face global challenges requiring bold solutions. Inequality is at its highest level since before the Great Depression, populism is on the rise, and trust in the financial system has declined. There are still 700 million people living in extreme poverty[2], while the next wave of technology stands to render millions of current jobs obsolete[3]. Addressing these challenges will require a renaissance of capitalism, in which the financial economy and the real economy work together to create a more sustainable, inclusive, and prosperous world. By making strides to address long-term social and environmental problems, markets can begin to regain public trust. This can only result from stronger efforts across all major stakeholders, including corporations, investors, intermediaries, governments, and civil society. By reconnecting consumers and end investors to the investment process, we can embark collectively towards a sustainable age.

THE RENAISSANCE OF CAPITALISM

Capital markets can be a powerful positive force in society by directing financing into the most pressing areas. To do so in a way that addresses the challenges before us, we need to shift away from the financial short-termism of markets today towards a longer term economic and social perspective. We are making progress, evident from the key themes which emerged from the WCMS 2018 discussions.

- **Enhancing global standards for sustainability:** There has been a proliferation of different terminologies and standards related to measuring and communicating sustainability in the past decade, e.g. ESG, SRI, Green, Impact Investing, Low Carbon, etc., with a vibrant parallel industry of standard-setting bodies. While each of these fill a much-needed gap or niche to help signpost the path forward, a clear direction is now needed via the harmonization of standards for both disclosure and governance, with inclusive economic growth further stimulated by a combination of incentives and minimum sustainability thresholds
- **Shifting corporate activity towards long term value creation:** We have seen three waves of development as companies go beyond a narrow focus on financial interests. The first and most common is related to Corporate Social Responsibility, which is often focused on charities and programmes peripheral to core business activities. Some companies have gone a step further to incorporate sustainability from an efficiency perspective, by adopting less resource intensive production methods.

1 1st: mechanization of production utilizing steam, 2nd: mass production facilitated with electrical power, 3rd: automation using electronics and IT. Source: *The Fourth Industrial Revolution: what it means, how to respond*, World Economic Forum report 2016

2 World Bank poverty headcount (2016) and Our World in Data

3 *Artificial Intelligence, Automation, and the Economy*, Executive Office of the President of the United States, December 2016

Yanis Varoufakis

A select few have started making more fundamental business model choices that take into account long term sustainability trends

- **Aligning investment choices to values and the greater good:** In recent years, various funds and institutional investors have moved from restriction screening (i.e. exclusion of vice such as tobacco, casinos, industries with human right violations) towards more active investing for impact. This transition has been aided by an increase in disclosure standards and accessibility to data, as well as research debunking the myth that investments into sustainable companies result in lower economic returns. However, there are still areas, especially traditionally un-bankable projects, which require public authorities to intervene further; in these cases, the public sector plays a dual role by directly contributing funds as well as facilitating the channelling of private capital and development financing to appropriate projects

- **Bridging the infrastructure gap:** One of the key challenges faced globally today, in addition to the 2 degrees climate transition, is the inertia of shifting to low carbon infrastructure–which are currently low volume and high cost. There is a need for greater involvement of public organisations to bridge the gap between short-term private costs and long term societal benefits. The government has a key role to play as both the direct contributor of funds as well as the facilitator channeling private capital and development financing to appropriate projects. Further, significant progress has resulted from collaboration between governments, project companies as well as funding institutions. For instance, we have observed a mix of better defined concessions, use of blended finance as well as a shift towards use of credit guarantees/ enhancements driven by governments and multilateral organisations. Capital market innovations have also increased the pool of funding available, thereby increasing number of projects financed and built, driving sustainable and inclusive growth

- **Broadening representation and the importance of inclusivity in decision making:** One of the most prominent opportunities to increase global prosperity is to strengthen inclusion and diversity initiatives, particularly those targeted at the participation of women and youth. There has been greater awareness and recognition of the challenges women face in the workforce and in their climb up the corporate ladder. However, there is still much to be done to enable the effective and uninhibited participation of women in the economy. Despite mounting evidence that gender diversity on boards improves the quality of decision-making and drives stronger financial outcomes, women remain underrepresented on boards. Similarly, the potential of youth and the benefits that can be derived from their participation should not be underestimated, but rather cultivated and recognised. As part of this dialogue, capital market players have been and will continue to collaborate to drive effective inclusion and diversity initiatives

- **Harnessing the power of technology and innovation:** The disruptive impact of technology has been felt across industries. Technology is enabling countless opportunities for sustainable growth, including lowering the cost to reach underserved consumers, creating more efficient markets that divert financing to the right places, and creating more useful services for end users. In particular, digital products such as mobile payments, low cost remittance programmes and digital identification systems will continue to help address global inequality and sustainability. Technological progress can dovetail with social enterprises to expand financial inclusion and advance societal good

LAYING THE ROAD AHEAD AND NEXT STEPS

Our success will depend on continuing and accelerating this progress. As we embark on a paradigm shift towards sustainable and inclusive finance, we need to understand how well-functioning capital markets can support various participants in this system to facilitate the right growth engines of the real economy.

As highlighted earlier, while some progress has been made, more can be done to spur the paradigm shift towards sustainable and inclusive growth:

National regulators, multilateral development organizations, and industry bodies can work together to develop harmonized sustainability reporting standards, define and publish long term roadmaps on sustainability initiatives as well as develop incentives such as capital and tax relief to both corporates, investors and other key capital market participants. These actions will collectively drive behaviour towards long term value creation, as well as support the pioneering of innovative financing methods for sustainable and inclusive growth.

Corporates can make a difference by taking up the governments and regulators' call in dedicating more effort towards incorporating principles of sustainability into governance and business decisions, as well as tracking, disclosing contributions and emissions footprint appropriately through the entire supply chain.

Guided by metrics and best practices, corporates will need to improve sustainability management across four key areas: governance, disclosure, stakeholder engagement, and business performance.

Investors and intermediaries should also do their part by promoting more effective investment frameworks and decision processes, incorporating sustainability disclosures and ESG metrics. Capital market players, especially stock exchanges, can also drive an improvement in standards by persuading or requiring corporates to have a minimum degree of long term economic and societal value creation. These, along with active involvement in corporates' sustainability agendas, can ensure an economy wide uptake of sustainability topics.

These actions will help establish a renaissance of capitalism, in which the current strengths of a market economy can be combined with the longer term benefits of sustainable and inclusive growth.

Fareed Zakaria

ACHIEVING SUSTAINABLE AND INCLUSIVE GROWTH

THE NEED FOR A RENAISSANCE OF CAPITALISM

Based on WCMS 2018 sessions[4]: **Special Video Message** by His Royal Highness (HRC) The Prince of Wales; **An Afternoon with** Fareed Zakaria; and **Adults in the Room** by Yanis Varoufakis

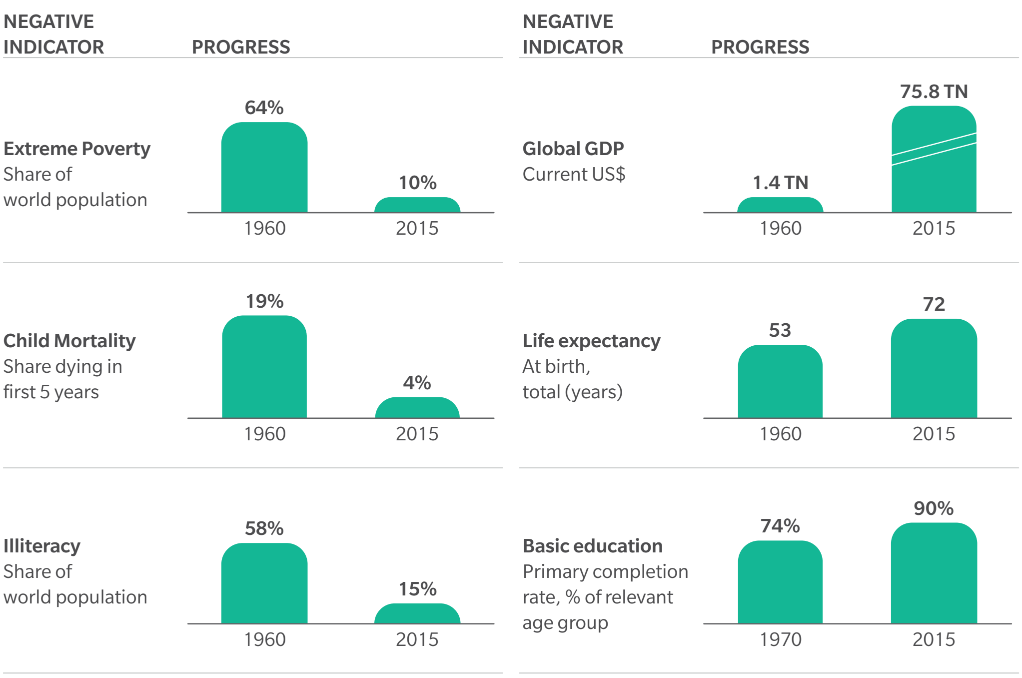
Capitalism has been instrumental in delivering unprecedented growth globally in the past century. After three industrial revolutions, the world is prosperous, with quantitative indicators indicating we are living in best period of human history (see Exhibit 1). Since the 1980s, the world has raised more people out of poverty than the preceding 100 years. However, it must be recognised that there has, in recent times, been a sense of disquiet and unease, which has become more evident in quantitative economic indicators.

Global capitalism is facing daunting new challenges. Inequality is at its highest level since the Great Depression and expected to deteriorate further. Automation and machination is contributing to widening inequality, and is breaking down the traditional linkage between GDP and employment growth. Trade growth is also stalling as we come to terms with new political regimes focused on isolationism, protectionism and populism.

A new kind of internationalism is necessary to prevent these challenges from impeding progress in the rest of the world. Global economies must collectively better manage capital and trade flows in order to support sustainable and inclusive growth. With Asian economies increasingly dominating global capital and trade, Asia must also play a pivotal role in addressing the unequal growth from globalisation.

4 Full details of attendees and speaker bios available in the Conference Programme (Appendix). Additional inspiration also drawn from the full set of WCMS 2018 sessions

EXHIBIT 1: SELECTED GLOBAL DEVELOPMENT INDICATORS



Source World Bank, GapMinder

Separately, there must also be a paradigm shift in the perception of economic value or growth, to one that incorporates the increasing importance of non-tangible contributions to society. This is especially true in an age of digital disruption, where information technology will disintermediate existing value chains while presenting significant new opportunities.

Modern day capitalism and capital markets need to be revitalised. Many of our greatest global challenges, such as climate change and wealth disparities, are not adequately addressed by old paradigms in financial services. Addressing these global challenges will require not just regulatory scrutiny and an increased focus on good conduct throughout the financial system, but also a true renaissance of capitalism that puts long-term value creation, sustainability, and inclusiveness at the centre of the markets supporting the real economy.

As we embark on a paradigm shift towards sustainable and inclusive finance, there is a need to understand how well functioning capital markets can support the real economy. The shift to sustainability is not simply a trend, but an urgent call to action. Only by closing the consumer and stakeholder value gap can we set ourselves back on the path of true sustainable growth.

CHALLENGES WE NEED TO ADDRESS TO DELIVER SUSTAINABLE OUTCOMES

Based on: **Moving the Needle** with Helen Clark; **Aligning Values with Investment** with Dr Steve Waygood, Fiona Reynolds, Georg Kell, Datuk Dr. Mohd Daud Bakar, and Sean Kidney; **All Things Being Equal** with Anna Mars, Junko Nakagawa, Sophie Guerin, Vicky Lay, and Sir David Tweedie; and a **special video message** by HRH The Prince of Wales

WCMS 2018 covered a wide range of challenges relating to the need for sustainability and the importance of inclusivity. Challenges are becoming more profound and global conditions are suggesting that now is the time for change. Some of the challenges discussed are outlined here.

PLANET

As the scale of human development puts a strain on the planet's resources and natural capital, societies are becoming more vulnerable. Challenges related to our resource consumption include water scarcity, pollution, and ecological degradation, which are becoming more severe as our global population increases to 9 billion people by 2050. Such negative environmental impact has already resulted in adverse, extreme weather conditions, as well as rising sea levels, which threaten our infrastructure as well as our food and water security. In response to the direct and indirect effects of climate change, all sectors will need to incorporate climate resilience into their planning.

The imperative for sustainable growth is global, but emerging economies will particularly be spurred to react. Asia faces a high likelihood of additional severe weather events, even as many of its economies race to build new infrastructure. Based on the WCMS 2018 discussions, this report touches on a variety of promising responses to environmental challenges, ranging corporate ESG reporting to impact investing, as well as to platforms for trading renewable energy.

PROSPERITY

Inequality of opportunity is also a challenge both within and between countries. Developing countries have faster growth rates and are thus converging on economic levels seen in developed economies, but the distribution of wealth within countries remains uneven, and risks becoming even more unequal.

Shared prosperity takes many forms, including access to sanitation, electricity, housing and resilient infrastructure, as well as gainful employment, vibrant industry and innovation resulting in reduced inequality. Overall, conditions have been improving, but progress must continue. Long-term planning is needed to build sustainable industries and cities to ensure global economic growth is shared equally.

One way to support low and middle income populations is to give them access to formal financial services, which can lower their costs for making payments, taking loans, and addressing other financial needs. Financial inclusion cuts across multiple sustainability themes, such as poverty, economic growth, gender equality, and income inequality.

"We have to lift our levels of resilience ever higher. If development isn't risk-informed, it isn't sustainable development, because you'll see it all wiped away by earthquakes and storms and droughts."

Helen Clark, former Prime Minister of New Zealand and Administrator of the UN Development Programme

Between 2011 and 2014, bank account ownership has increased from 51% to 62%[5] globally. However, there remains substantial imbalances across geographic boundaries and between genders, with prohibitive costs of financial services transactions, e.g. at 7% for remittances in certain emerging economies, resulting in less than one-fifth of adults using a bank account to receive wages and pay utility bills. More can be done to drive inclusive growth, especially via digital platforms helping countries leapfrog traditional but costly financial infrastructure requirements.

5 Accelerating Financial Inclusion in South-East Asia With Digital Finance, Oliver Wyman and Asian Development Bank, 2017

L-R: Deborah Henry, Datuk Nicol David, Heidy Quah, Edwin Macharia

PEOPLE

There are also many opportunities for empowerment and inclusion. In particular, women and youth across the world face persistent challenges. The youth population is growing quickly in regions with high poverty, compounding the difficulties they face in finding employment. Besides, this challenge is compounded by the digital revolution and rise of automation, which are reshaping the skills needed to succeed in the workforce of the future. The youth of today represent the main engines of tomorrow's economy, and the conditions they grow up in will determine their ability to contribute fully and positively to society.

There is still much progress to be made in achieving equality of opportunity for women. Many countries have laws obstructing women's abilities and on average, women spend more time on unpaid domestic and care work.

The World Economic Forums estimates it will take 217 years to close these gaps globally but encouragingly, 13 years to eliminate the education-specific gender gap[6]. In the halls of power, women representation is increasing, but far from equal with women making up only 20–25% of key decision makers[7].

6 Global Gender Gap Report, World Economic Forum, 2017

7 Women in Financial Services report, Oliver Wyman, 2016: In 2016, 23% of parliamentary seats were occupied by women. Meanwhile in the business world, female representation is growing on Boards of listed companies (20% in OECD in 2016), but progress is slow

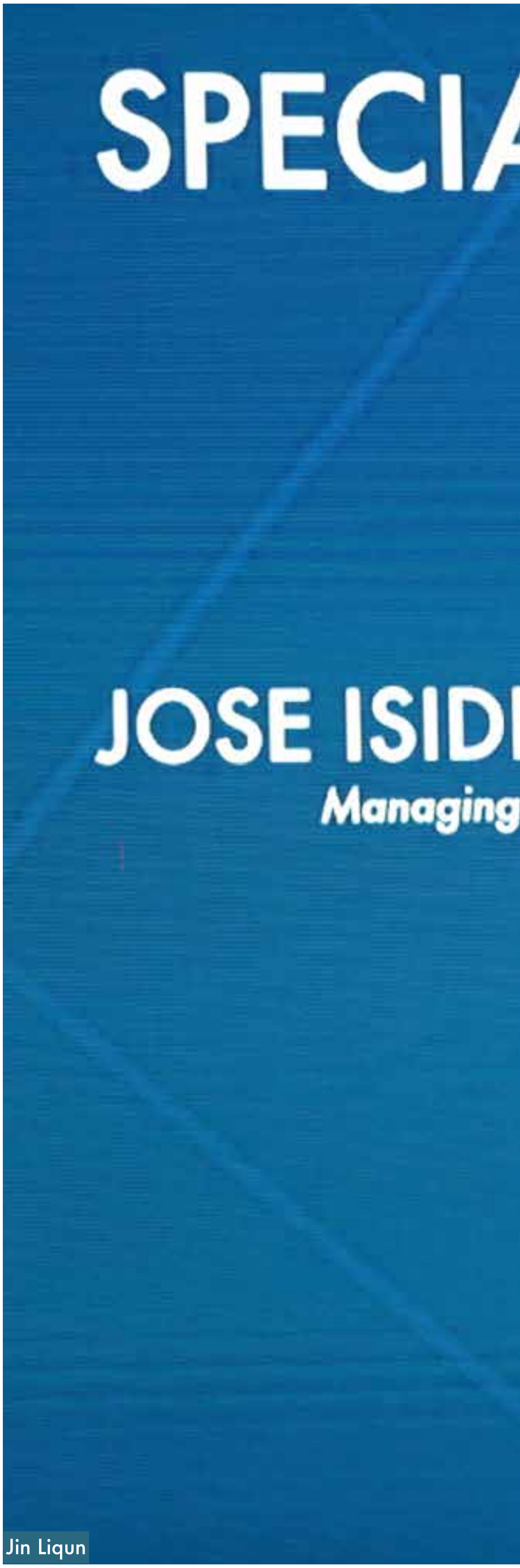
RECONNECTING FINANCE AND THE REAL ECONOMY

Having covered the challenges of the new century, including the urgency for action against climate change and various forms of inequality, in this section we focus on themes of change discussed, and how markets can further drive collective social, environmental, and economic prosperity.

At WCMS 2018, we gathered five key themes of progress, ranging from ensuring corporates and investors contribute more to good governance and long-term value creation, to enablers from regulatory bodies and national authorities to drive convergence of efforts towards a common goal of sustainable and inclusive growth.

"Rightly harnessed, markets are one of the most powerful channels for delivering long-term economic growth and generating positive externalities for society as a whole"

Tan Sri Dato' Seri Ranjit Ajit Singh,
Executive Chairman Securities Commission

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ENHANCING GLOBAL STANDARDS FOR SUSTAINABILITY

Based on: **Today's Governance for Tomorrow's Future** with Ashley Alder, Masamichi Kono, Tan Sri Datuk Wira Azman Mokhtar, Professor Didier Cossin, and David Wright; **Moving the Needle** with Helen Clark; and **Future of Finance** with Sir David Tweedie, Douglas Flint, Dato' Sri Nazir Razak, Jacob Hook, John D'Agostino, and Riz Khan

Uniting behind the global sustainability agenda, the international development community has converged on a set of large-scale and long-term sustainability goals, namely the Sustainable Development Goals (SDGs) launched by the United Nations in 2015. This is a collection of 17 goals, each tied to a list of 169 quantifiable metrics, as illustrated in Table 1.

With guidance from ESG disclosure standards, companies have started to report and track actionable and standardised sustainability metrics. These disclosures, by increasing transparency and data accessibility, lay the foundations for effective sustainability management and form part of a gradual shift in the focus of corporate governance toward sustainable outcomes, and away from short-term financial returns.

Regulation is also a key driver of this progress. For example, in 2015, Malaysia's national exchange, Bursa Malaysia, launched the Sustainability Framework which sets outs requirements for listed companies to disclose a narrative statement on their material EES risks and opportunities in their annual reports. The 2013 update to the UK Companies Act required UK-incorporated companies listed on the London Stock Exchange,

TABLE 1: UN SUSTAINABLE DEVELOPMENT GOALS: OECD CATEGORISATION OF "5 PS"

CATEGORY	SUSTAINABLE DEVELOPMENT GOALS	EXAMPLE METRICS
PEOPLE	• End poverty • End hunger • Healthy lives • Education • Gender equality and empowerment	• **Global poverty rate:** 11% in 2013 from 28% in 1999 • **Undernourishment:** 11% in 2016 from 15% in 2002 • **Maternal mortality:** declined 37% from 2000 to 2015 • Primary age children **out of school:** at 9% since 2008 • Fewer than a third of **management positions** are **held by women**
PROSPERITY	• Access to energy • Economic growth and employment • Infrastructure, industrialization, innovation • Reduce inequality • Safe sustainable cities	• Access to **electricity**: 85.3% in 2014 • Global **unemployment** rate: 5.7% in 2016 from 6.1% in 2010 • In range of at least 2G **cellular signal:** 95% in 2016 • **Cost of remittances:** 7% of amount, above 3% target • In 2014, 9 in 10 people living in urban areas breathed air that did not meet the WHO's **air quality guidelines**
PLANET	• Water and sanitation • Sustainable consumption and production • Climate change • Oceans and marine resources • Terrestrial ecosystems	• Access to **safely managed sanitation:** 39% in 2015 • Globally, our **material footprint** increased from 48.5 billion metric tons in 2000 to 69.3 billion metric tons in 2010 • **Planetary warming:** reached 1.1 °C above benchmark • **Overfishing** of marine fish stocks: 31% in 2013 • **Protected land:** 15% of all terrestrial land in 2017
PEACE	• Peaceful and inclusive societies	• Firms receiving bribery requests: 18%
PARTNERSHIP	• Global partnership	• Official development assistance: rose 8.9% in 2016

L-R: Sean Kidney, Dr. Steve Waygood, Fiona Reynolds, Georg Kell, Datuk Dr. Mohd Daud Bakar

"We need to align the real economy and sustainability issues. The issue of sustainability cannot be solved without being involved as a community. The principles of responsible investment are about how you incorporate ESG factors. We need a common language and we need frameworks."

Fiona Reynolds, Managing Director
UN Principles for Responsible Investment

Nasdaq, or NYSE to report their greenhouse gas emissions. Similarly, in South Africa, companies listed on the Johannesburg Stock Exchange must also comply with a robust set of ESG standards in line with the King Report on Corporate Governance.

To ensure more widespread sustainability reporting, there is a need to facilitate a global convergence of disclosure standards. The information released by companies should be more standardised, concise, and comprehensive to facilitate shareholders and investors making informed comparisons across companies and industries. Some of the key players in setting sustainability standards have been the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), and the Carbon Disclosure Project (CDP).

On the back of increasingly available ESG information, a number of sustainability indices have also been introduced, such as the Dow Jones Sustainability Index, the FTSE4Good Index, the MSCI Sustainable Impact Index, and the Global ESG Benchmark for Real Assets (GRESB). These providers have also played a role in setting expectations for sustainability reporting.

As discussed in the WCMS 2018 session on Aligning Values with Investment, a new wave of standards is also emerging for climate bonds, debt instruments linked to climate-change solutions. The non-profit Climate Bonds Initiative, co-founded by WCMS moderator Sean Kidney, has developed a climate bond taxonomy as well as certification scheme, helping this asset class grow rapidly to US$155 BN in 2017. This initiative has been largely successful, catalysing the first Big Tech green bond by Apple in 2016, while Poland became the first sovereign country to issue a green bond at the end of 2016. More progress is also expected in South East Asia, where the ASEAN Capital Markets Forum has taken a leadership role in identifying green finance standards for bonds, equities and funds; launching the ASEAN Green Bond Standards (AGBS) in late 2017.

There are already some differences in major standards described above, with potential for further divergence as standards deepen and evolve. The multitude of standards with partial overlaps is likely to create confusion for corporates, investors and consumers, and must be simplified and harmonized.

As such, while the creation of a strong global ecosystem of standard-setting and advisory bodies will form the cornerstone of future developments, further progress can be made on the following fronts:

1. Encourage greater adoption of **ESG reporting among companies,** which can be driven together by companies, shareholders, and regulators. Specifically, companies can continue joining industry collaborations and leading by example; shareholders can make use of proxy voting and public pressure; while regulators can strengthen both their voluntary guidelines and requirements related to ESG disclosures
2. **Harmonize regional and global standards** and definitions, thus ensuring convergence in the same direction
3. **Promote integrated reporting** where companies discuss how their positions on ESG issues shape their operations and business strategy. Today, many companies provide only a separate sustainability report, or a sandboxed sustainability section in their annual reports. Again, adoption will be driven by encouragement from companies, shareholders, and regulators. Local advocacy groups such as the Malaysian Integrated Reporting Council can play a significant role through creating awareness on the value proposition of integrated reporting and supporting companies in adopting integrated reporting
4. Beyond integrated and transparent reporting, companies can draw on their ESG data to better **engage consumers and end investors** using storytelling formats such as video and alternate reality (AR). Data about social and environmental impact lends itself to visualisation, and sharing this data in an engaging way can enrich public discussions about sustainability

SHIFTING CORPORATE ACTIVITY TOWARDS LONG TERM VALUE CREATION

Based on: **Future of Finance** with Sir David Tweedie, Douglas Flint, Dato' Sri Nazir Razak, Jacob Hook, John D'Agostino, and Riz Khan; and **Today's Governance for Tomorrow's Future** with Ashley Alder, Masamichi Kono, Tan Sri Datuk Wira Azman Mokhtar, Professor Didier Cossin, and David Wright

Over the years, there has been greater adoption of sustainable business practices among companies, which is an indicator of changing societal expectations on corporates, markets and investments. Sustainability metrics are becoming more intertwined with company strategies, where business model choices are increasingly determined with a long-term sustainability lens (Refer to Exhibit 2). Climate change has been a major catalyst for this change and the broader sustainability agenda, coupled with evolving expectations and purchasing trends from the younger generation.

Positive impact on sales from millennials opting to spend on goods and brands with a positive social outcome have formed a strong business case for sustainability initiatives, particularly relating to long term procurement and production of manufacturing goods. In combination with peer pressure from institutional investors and advocacy groups, companies are increasingly reviewing their supply chain, operations and products from a sustainability perspective.

However, there remains a need to address a broader fundamental conflict. Companies, directors, and boards are increasingly tasked with much broader responsibilities than pure financial returns, including the need to consider environmental, social and governance factors in addition to the interest of shareholders. This is contrasted with the investor landscape – the majority of investors, as agents on behalf of the ultimate beneficiaries of the funds they manage, are still tasked with the relatively narrow responsibility of delivering financial returns.

As described by Douglas Flint on the Future of Finance panel; "there is governance with a very narrow prism, matched with corporates with a broader set of responsibilities that they are charged to deal with". The gap between the accountabilities of these two agents to their ultimate beneficiaries need to be bridged to avoid conflicts and ensure that long term outcomes can be achieved in a sustainable and responsible fashion.

One key way to catalyse the shift of corporate activity towards long term value creation is to better involve large passive shareholders, as Professor Didier Cossin during the session on *Today's Governance for Tomorrow's Future* highlighted *"We need more (of a) ownership mentality. Governance is not on the board or on the executive team, but it is really key stakeholders, among them are the owners and the rest of society"*. The role of pension funds and sovereign wealth funds, as leaders of change is key, particularly given the long term nature of their investments.

To provide the support and patience required for the realization of long–term value, investors should actively influence companies to incorporate long term, sustainable outcomes into their business plans and corporate goals, while discouraging excessive focus on short term financials. This certainly requires balancing financial metrics such as total shareholder return and earning targets against a more holistic understanding of firm value, including the management of sustainability risks and issues.

Recent research[8], found that US firms with a longer term corporate planning horizon, added nearly 12,000 more jobs on average than other firms between 2001–2015. Had all US public listed firms created as many jobs, the US economy would have added 5 million additional jobs over this period, potentially unlocking more than US$1 trillion in US GDP (0.8% of GDP per year on average). Clearly, long term value creation could have a positive and profound impact on real economic growth.

Within the context of capital markets, long term value creation necessitates the adoption of a balanced regulatory posture which is conducive for the real economy, such as capital-raising and business formation, while being sufficiently robust against activities potentially undermining both the legitimate interests of market participants as well as systemic integrity of the market. Regulatory approaches and frameworks cannot be a one-size-fits-all model, but instead must consider the heterogeneity of markets with varying economic and social dimensions.

"A lot of what's driving ESG is the next generation of millennial investors and they are willing to put dollars at risk behind it. Listening to that emerging customer class and understanding the way I might view value is very different"

John D'Agostino
Managing Director, DMS

8 "Measuring the Economic Impact of Short Termism", McKinsey Global Institute, February 2017

EXHIBIT 2: THREE WAVES OF PROGRESS IN CORPORATE SUSTAINABILITY

Deeply intertwining sustainability with company strategy

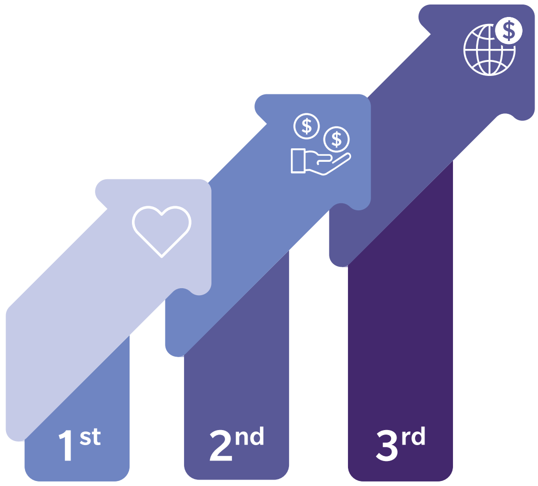
Some companies are making strategic business model choices based on a long-term sustainability lens

Sustainability that provides financial benefits

Companies are taking on sustainability initiatives that make business sense, such as improving supply chain efficiency

Corporate social responsibility (CSR) and traditional social impact initiatives

Traditional CSR programmes have been charitable and isolated from operational considerations



Moving forward, we can expect corporates to continue expanding their sustainability ambitions against a backdrop of increasing pressure from shareholders, governments, and advocacy groups. Sustainability reporting standards will become consolidated and more widely adopted, becoming a key driver of corporate sustainability activities.

However, the discussion at WCMS also highlighted that this development should be facilitated at a conducive and stable pace, so as to prevent any fractious debates which could undermine the progress to date.

At WCMS 2018, it was further acknowledged that while corporate leaders have made good progress in advancing sustainability, this can be further facilitated through clear long-term policy roadmaps, thus reducing uncertainty and further catalysing corporate and investor progress.

ALIGNING VALUES WITH INVESTMENT

Based on: **Aligning Values with Investment** with Dr Steve Waygood, Fiona Reynolds, Georg Kell, Datuk Dr. Mohd Daud Bakar, and Sean Kidney; **Plugging the Gap** with Jose Isidro Camacho, Alan Synnott, Jonathan Drew, Ian Johnston; as well as special addresses by HRH The Prince of Wales and Jin Liqun

One key group of players in the capital markets ecosystem with the ability to drive huge impact are the investors – in particular, their mind-sets towards sustainability and associated investment frameworks. While sustainability leadership by companies and industry standards can shift business activity towards sustainability and inclusivity, capitalism mostly incentivizes performance in line with the expectations of shareholders (or investors).

Fortunately, we see an increasing willingness of private investors to engage more deeply and actively as end investors' return expectations change – Nielsen reported in a 2015 global survey that almost 70% of millennials are willing to pay more for sustainable products and services[9].

9 Nielsen reports, May and Dec 2015 respectively, *Green Generation: Millennials say sustainability is a shopping priority as well as The Sustainability Imperative*

Douglas Flint

This is further aided by increasing volumes of literature debunking the myth of a trade-off between financial returns and sustainability.

However, despite huge advances on the buy-side, there are still multiple un-bankable areas including the provision of basic sanitation, power services to the rural and unbanked, as well as micro-finance which typically falls beyond the realm of the traditional capital markets.

On the intersection between private investors and public institutions as seen in Exhibit 3, the topic of infrastructure financing is often discussed; where the financing of large infrastructure projects (such as power, transport and other social infrastructure) can vastly raise the standard of living of citizens in emerging economies.

While there has been tremendous progress due to both the advent of the Public-Private Partnerships as well as the more nascent 'blended'[10] finance approach pioneered by the World Bank, ADB as well as various IMF-linked institutions, more initiatives are in place to boost the bankability of projects, especially in developing markets.

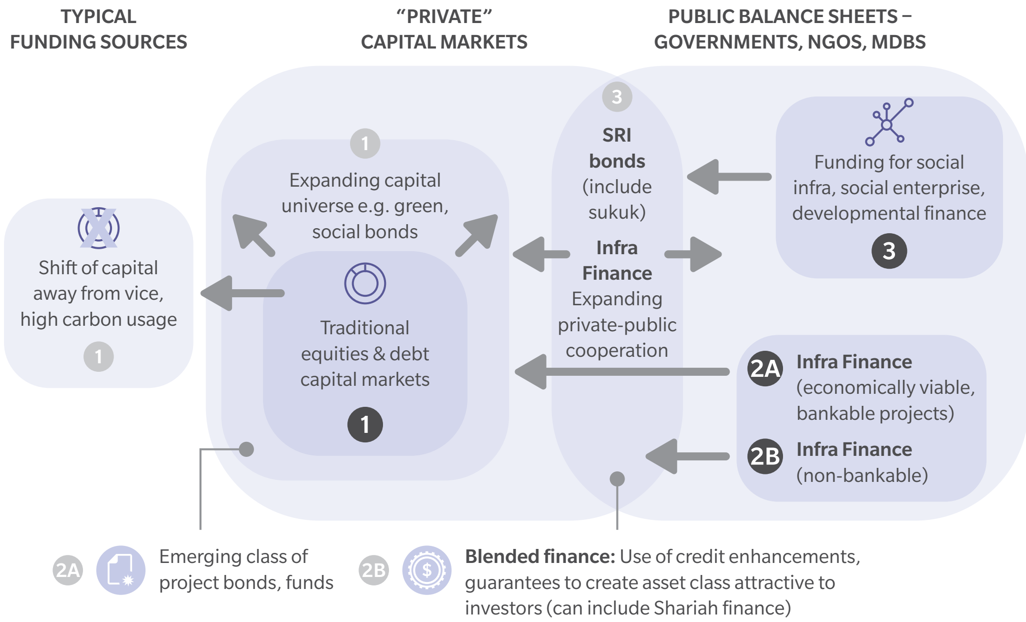
Islamic finance as an emerging investment class, is particularly well suited and aligned to financing of sustainable and inclusive projects, including the role of non-profits and multilateral bodies in driving inclusive financial innovations and making these more attractive to mainstream private investors.

"Finance is the future….If we believe that social harmony is dependent on growth, we better make sure the finance system works"

Douglas Flint
Former Group Chairman HSBC

10 Blended finance, as defined by the OECD, is the strategic use of development finance for the mobilisation of additional commercial finance towards sustainability goals

EXHIBIT 3: THE EVOLVING LANDSCAPE OF FUNDING NEEDS



Legend

- 1 Traditional asset class/use of funds
- Evolutionary path
- 1 Current asset class (include innovation)

Key trends (Covered as sub-sections in 2.3)

1. Shifting (expanding) supply of traditional capital to sustainable areas
2. Facilitating and incentivizing investment into the right areas
3. Revolutionising traditional financing structures for societal good: SRIs (Sustainable and Responsible Investment) and beyond

REVOLUTIONIZING TRADITIONAL FINANCING STRUCTURES: SRI AND BEYOND

Today, while there has been some innovative self-funding[11] developments, including an intelligent sub-leasing model with co-location of commercial real estate and railway hubs by Hong Kong's MTR (similar model adopted by Singapore's SMRT), there is still a pressing need to raise capital to drive inclusive economic growth in capital-starved developing economies.

The advent of Sustainable and Responsible Investment (SRI) funds, of which 34% in Asia is comprised of Malaysian Islamic funds, is thus welcome, with strong momentum reflecting the growing interest of institutional investors to build a sustainable economy generating long term wealth.

According to the Securities Commission Malaysia's Islamic Fund and Wealth Management Blueprint, SRI funds can be used to finance small and local community projects such as for affordable housing, small business creation, development of community facilities, empowerment of women and minorities, education, childcare and healthcare. Under the Capital Market Master Plan 2, the Securities Commission has also developed the Sustainable and Responsible Investments Sukuk framework, as part of the plan to create a facilitative ecosystem for sustainable finance.

Khazanah Nasional, Malaysia's sovereign wealth fund, has been a pioneer, launching various SRI funding programmes with the most prominent being the RM1 billion Sukuk Ihsan Programme, as well as a second RM100 million tranche to fund Yayasan AMIR's Trust Schools Programme, established to enhance accessibility of quality education in Malaysia, via a PPP with the Ministry of Education.

11 "Rail + Property" financing model: Before a greenfield rail project, MTRC purchases 50 year long exclusive land development rights from the government, which it then resells or leases commercially at higher premiums post construction, allowing MTRC capital recovery through the sale of resale rights

Similarly, PNB (Permodalan Nasional Berhad, a government linked investment company) plans to raise up to RM2 billion via a 15 year Merdeka ASEAN Green SRI sukuk programme to fund the development of Warisan Merdeka area as a sustainable project bringing inclusive growth and 10,000 new jobs to Malaysia.

The Securities Commission Malaysia is also part of a broader international effort to support the distribution aspects of Islamic wealth management, via the Labuan International Waqf Foundation – helping to drive the development of **waqf**, an Islamic philanthropic-based vehicle for social development, public good and wealth distribution.

With sufficient launches deepening the SRI capital pools, further capital market development can occur via the launch of investment products such as SRI indices and exchange-traded funds (ETFs), making SRIs more liquid and attractive to investors in general.

Lastly, NGOs and multilateral institutions, such as the UN PRI, have also driven some degree of financial innovation. Interesting new issuances include vaccine bonds[12] as well as diaspora bonds, on top of the more prevalent Islamic finance instruments, seeking to drive inclusive growth through innovative financing schemes. Recent IFFim[13] vaccine bonds have also been issued as sukuks, further riding on the wave of Islamic Finance growth as SRI instruments. There is also interest in GDP-linked bonds as well as counter cyclical bonds, which are more "inclusive" capital instruments helping indebted emerging countries balance economic development and debt repayment via flexible interest payments.

CATALYSTS FOR ALIGNMENT OF INVESTMENT TO SOCIAL AND ENVIRONMENTAL IMPACT

Investor education has been key in shifting the supply of traditional capital towards sustainable causes, with investors moving away from the perception that investing into long-term sustainability erodes returns. To support this increased investor confidence, authorities have to work together to develop a longer term framework similar to the Paris Climate Accord, providing investors with a long term road map and certainty to invest both efforts and funds.

In other nascent areas such as SRI as well as developmental finance, which are typically less economically viable, some degree of commercial or economic support will be required by the authorities. Examples would be capital or tax relief similar to those accorded to corporates and investors' contributions to charitable causes. Governments could also provide some regulatory guidance – for instance, Malaysia has a SRI Sukuk Incentive, where issuers, investors and originators are eligible to receive various financial incentives such as tax exemption and deduction as well as a RM6 million Green SRI Sukuk Grant scheme allowing issuers to offset external review costs.

12 Launched by the International Finance Facility for Immunisation (with support from World Bank), "vaccine bonds" converts long term pledges from donor governments into immediate cash resources. Long term pledges are then used to repay the IFFim bonds, turning good long term contribution pledges by donors

13 International Finance Facility for Immunisation

PLUGGING THE GAP: A CASE FOR INFRASTRUCTURE FINANCING

Based on: **Plugging the Gap** with Jose Isidro Camacho, Alan Synnott, Jonathan Drew, Ian Johnston

One of the key challenges raised by Climate Bonds Initiative was not just the urgency of the 2 degrees climate transition but also the inertia of low carbon infrastructure developments, which are currently low volume and high cost. Public organisations play a vital role in bridging the gap between short-term private costs and long term societal benefits. Governments have a key role to play as both the direct contributor of funds as well as the facilitator channelling private capital and development financing to appropriate projects.

This leads to our next discussion on **Infrastructure and Project Financing** and the critical role of both public and private sector. Significant progress has resulted from excellent synergies between governments, project companies as well as funding institutions. For instance, a mix of better defined concessions, use of blended finance as well as a shift towards use of credit guarantees/enhancements driven by governments and multilateral organizations have improved bankability of projects[14]. Capital market innovations have also increased the size of available funding pools, thereby increasing number of projects financed and built, driving sustainable and inclusive growth.

Asia, for example, will need to invest a total of $26 trillion by 2030 to fully meet its infrastructure needs. This will require countries across the region to double their total annual spending to $1.7 trillion. The effects of infrastructure shortfalls are most prevalent outside China, which is spending more than 90% of the levels it is projected to need. A significant example is China's Belt and Road Initiative, which aims to connect Asia, Europe, the Middle East and Africa with major logistics and transport network and even fibre optic lines. Between 2014 and 2016, China's total trade volume in the countries along Belt and Road exceeded $3 trillion, created $1.1 billion revenues and 180,000 jobs for the countries involved.

However, most of Asia's infrastructure financing is still largely dependent on state budgets with collaboration with multilateral organisations. In Indonesia, where there is a large government push towards driving Economic and Trade growth enabled by infrastructural developments, multiple successful cases of cooperation between state and multilateral organizations such as the IMF, JBIC exist, creating infrastructure guarantee funds as well as streamlined processes for application of permits, concessions and licenses. These success stories allow Indonesia to evolve into an attractive destination for foreign investors, driving more than half of all infrastructure related debt issuances in South East Asia in 2017[15].

14 MMC Asia Pacific Risk Centre report: Closing the Financing Gap, Infrastructure Project Bankability in Asia

15 30 deals worth US$21 billion, not including potential US$1 billion of project bond issuances by PT Pelindo (state owned port operator) to fund several projects

L-R: Alan Synnott, Jose Isidro (Lito) Camacho

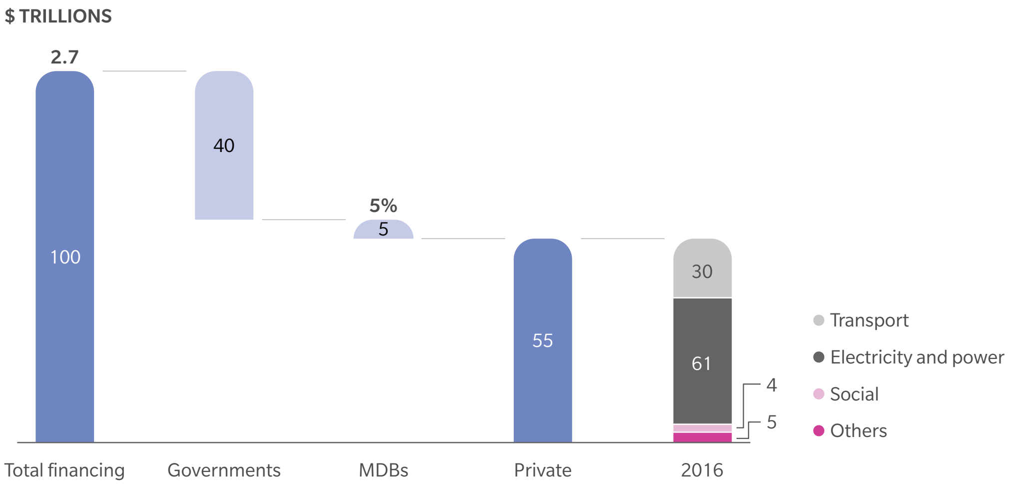
Such collaboration and effective deployment of governments and MDBs' valuable balance sheets have allowed private financiers to step in, successfully driving private financing of infrastructure to more than half of the global infrastructural needs today, as per Exhibit 4.

Investors also often prefer the involvement of national or international development institutions, not only for their expertise but also in their involvement reduces political risk. Such publicly sponsored funds include the Asian Infrastructure Fund, the ASEAN Infrastructure Fund, InfraCo Asia, and the IDFC Indian Infrastructure Fund. Institutional investors have also focused on government led initiatives such as the Asian Infrastructure Investment Bank (AIIB), which since its establishment in 2016 has lent a total of US $2.4 billion for investments in sustainable infrastructure.

MDBs such as the AIIB are focusing on increasing the effective use of capital and increasing velocity of capital (selling debt post construction to other investors, recycling capital into new projects) to make infrastructure financing a bigger success.

However, more can still be done in developing economies in Africa and other less developed parts of South East Asia, where inclusive growth is most challenging, with the World Bank estimating that 80% of infrastructure projects in emerging markets are still financed by government budgets and MDBs.

EXHIBIT 4: BREAKDOWN OF GLOBAL INFRASTRUCTURE FINANCING SOURCES



Source APRC analysis of data from Asian Development Bank, World Economic Forum, World Bank, and InfraDeals

Islamic finance has increasingly emerged as a viable asset class for funding of infrastructure, with Malaysia and Indonesia pioneering green sukuks for financing of renewable infrastructure projects. Examples include Tadau Energy and Quantum Solar Park in Malaysia, as well as plans by Kemenhub (Indonesia's Ministry of Transport) to finance green and brownfield railway projects using sukuk issuances[16].

Given its unique principles such as the prohibition of usury (riba) and speculation (gharrar), this emerging asset class is suitable for financing of both infrastructure and broader societal needs. We will cover more of Islamic finance for societal needs under the next section.

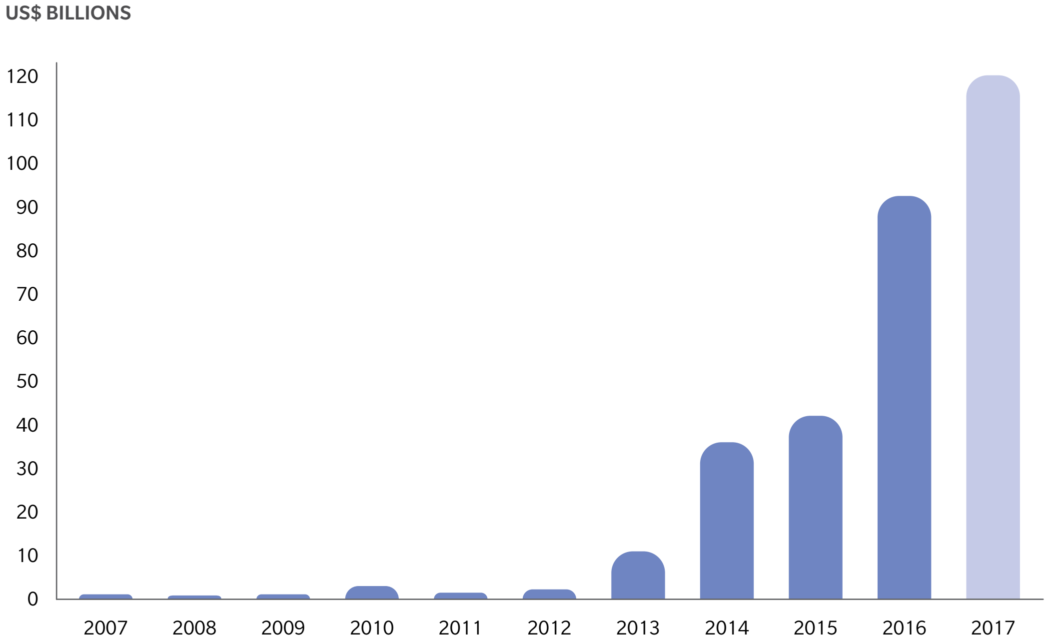
CLIMATE-FRIENDLY BONDS TO BRIDGE THE INFRASTRUCTURE GAP

There has been significant innovation in the debt capital market space, with overall green bonds recording US$118 billion worth of issuance issuances, or an approximate 25% y-o-y growth (see **Exhibit 5**). However, much of the evolution to-date largely pertains only to changing uses of proceeds/ capital raised while the traditional debt financing structure has remained unchanged (as opposed to flexible interest rate repayment models more suitable for inclusive growth).

Thought leadership in this space has been driven by the Climate Bond Initiative, which argue that approximately $10 trillion will be required in the coming decade to fund the *urgent* transition into a low carbon economy, so as to avoid a 2 degree warming threshold as agreed in Paris. When first launched in 2009, climate bonds were a novel form of innovation with sufficient economic rationale for investment, as contrasted to the charity-like CSR funding drives. However, the definition has now broadened from a niche class of "infrastructure bonds" tailored specially for financing climate solutions, to a more mainstream fixed income asset class.

16 Media publication, Indonesia Infrastructure Initiative, 20 Jan 2017: "Sukuk Finances 14 Railway Projects Totalling RP8 Trillion" (about 50% of annual state budget allocated for railway infrastructure development)

EXHIBIT 5: GREEN BOND BOOM



Source Moody's, Bloomberg

More has been done to improve the normalcy and liquidity of green bonds, with Luxembourg Stock Exchange (LuxSE) launching the World's first green bond market platform in Luxembourg Green Exchange in 3Q2016; taking over 114 green bond listings (~US$45 billion face value) from LuxSE including green bonds issued by the European Investment Bank. The additional trading platform will improve trading velocity and liquidity of capital for green proceeds, allowing improved price discovery and therefore cheaper and easier access to capital for low carbon corporates[17]. Big Tech has also been a proponent of sustainability debt issuances, along with a broader inclusivity drive. For example, Apple has signed an open letter to support the Paris Accord after United States' exit, issued USD$2.5 billion of green bonds to finance projects involving renewable energy, as well as set itself a goal of a "closed loop supply" using products made only from renewable resources and recycled materials.

In South East Asia, the Climate Bonds Initiative also announced plans[18] to fund three major Indonesian projects[19]. These green bond issuances are slated to not only achieve alignment with climate friendliness, but also significantly promote inclusive growth, as part of the Indonesian government's Economic Master Plan to drive regional economic growth and development via development of power and regional transport links. Other key developing markets are also exploring Green Bond initiatives, with Mexico City Airport issuing US$4 billion of green bonds in 3Q 2017 and Reserve Bank of India developing a green finance framework to support issuances of green masala bonds.

However, what we have described are at best incremental innovations of capital – traditional capital raised being diverted to a non-traditional usage of capital. These innovations, while important in shifting investor mind sets, ultimately do not increase the pool of deployable capital nor help to solve the issue of inclusive growth.

17 According to LuxSE, green bonds listed on LGX must have disclosures on use of proceeds in line with standards laid out by Climate Bonds Initiative (CBI) and International Capital Markets Association (ICMA)

18 The Jakarta Post, 6 Feb 2018, "EBA-CBI deal to accelerate green bond issuance"

19 Projects are an expansion to Tanjung Priok's seaport, West Java's Kertajadi International Airport and Jati Lahur hydro power plant

WCMS 2018 also discussed innovative financing methods used to support inclusiveness – reaching out to groups and projects which have been excluded from traditional methods of financing on economic grounds.

ALL THINGS BEING EQUAL

Based on: **All Things Being Equal** with Anna Mars, Junko Nakagawa, Sophie Guerin, Vicky Lay, and Sir David Tweedie; and **Future of Finance** with Sir David Tweedie, Douglas Flint, Dato' Sri Nazir Razak, Jacob Hook, John D'Agostino, and Riz Khan

A major theme discussed at WCMS 2018 was the importance of empowering women. Although women make up more than half of university graduates globally since the turn of the century[20], they are still not equally represented in the senior ranks of business. This is one of multiple interrelated challenges women face in the workplace – as highlighted in Exhibit 6. Besides, the world population is still growing and statistically that indicates there are talented people, particularly amongst the youth today.

In financial services, female representation on boards have grown to 20% presently and 16% for Executive Committees, but progress is slow. This is partly a result of mid-career obstacles, which makes it more difficult for women climb up the career ladder. While these obstacles pose an inclusion problem, they are also an economic opportunity – modestly narrowing the gender gap in economic participation could increase global GDP by over US$5 trillion[21]. In addition, research also suggests that gender diversity promotes enhanced decision-making and business performance[22].

As such, businesses are starting to tackle gender imbalances via two trends: counteracting gender biases and implementing structural solutions targeted at working parents.

STRUCTURAL INITIATIVES TO EMPOWER WOMEN IN THE WORKFORCE

The existence of gender biases is not only bad for women, but bad for decision-making as well. Latest research literature has underlined the benefits of gender-diverse decision-making, including disrupting groupthink and promoting innovation as well as gaining new perspectives on customer needs[23]. Although female leadership is an imperative from an inclusion and sustainability perspective, it is also in businesses' interest to create an inclusive and holistic culture in order to reap the performance benefits associated with diversity.

A study that followed business decisions in companies over two years found that inclusive teams with diversity of gender, age, and geography make better decisions up to 87% of the time.[24] Other studies have shown that gender diversity correlates with better return on equity, net profit margins, and earnings per share with 30% outperformance in the long term by companies in the top quartile of gender diversity[25].

Beyond correcting biases via company initiatives and creating awareness, truly embedding this culture into day-to-day business can also be challenging as it depends on attitudes and perceptions of employees rather than principles. In some industries, the bias can be partly removed

20 World Bank, Gender Parity Index for tertiary education

21 Estimate based on reduction in gender gap of 25% by 2025. International Labour Organization (ILO), Economic Impacts of Reducing the Gender Gap (*What Works Research Brief No. 10*), 2017

22 How Stock Exchanges Can Advance Gender Equality, Sustainable Stock Exchanges Initiative, 2017

23 David Rock and Heidi Grant, Harvard Business Review, *Why Diverse Teams Are Smarter*

24 Erik Larson, Forbes, *Diversity + Inclusion = Better Decision Making at Work*

25 Morgan Stanley, *Gender Diversity Investor Guide*

TABLE 2: CHALLENGES AND RESPONSES TO GENDER EQUALITY: PEER CASE STUDIES

CATEGORY	SUSTAINABLE DEVELOPMENT GOALS	EXAMPLE METRICS
FEMALE-OWNED SMALL BUSINESS	70% of women-owned SMEs are under-served by financial instituitions	Brazil offers education programmes including IPO preparation programmes for high-potential female entrepreneurs. Some VCs are exploring gender-blind investment decisions
FEMALE LEADERSHIP	21% of board seats held by women	Australian companies with more than 100 employees are required to disclose gender representation of their governing bodies
EQUAL REMUNERATION	Women earn 70–90% of what men earn	Countries such as the UK and Australia require disclosure of average pay party by gender, the Sustainable Stock Exchange initiative advocates disclosing pay parity across all levels of the organization
SEXUAL HARASSMENT	Harassment reports outnumber racial and ethnic discrimination	Investment firm Pax World avoids companies that tolerate harassment or have a history of mistreating women; it also created an index of highest-rated companies advancing women
FAMILY LEAVE	Only 41% of employed women have a right to maternity leave	Bloomberg's Financial Services Gender-Equality Index (BFGEI) includes consideration of employee policies such as maternity/paternity leave, return to work programme, and childcare services
FLEXIBLE WORK	64% of employers have a flexible work policy	Hong Kong's HKEX supports a "Back to Work Programme" for professionals who have left the workforce for a few years

from the equation – however, in many settings especially in male-dominated white collar professions, a longer process of instilling values and providing enlightened leadership is required.

The notion of gender-blind decision-making also has a place in financial services. For example, blind job applications and *curriculum vitae* reviews can help make gender a smaller factor during recruiting. For instance, during online or application-based funding, gender-related information can be removed to prevent biases. Another relevant area of example is venture capital investments – young female entrepreneurs empirically face more difficulties raising funding as well as securing payments from vendors and customers, but this playing field can be levelled with a gender-blind investment process[26]. Additionally, since only 10% of venture capitalists are female, a related and worthwhile goal is to increase representation of young women in VCs.

Besides gender biases, there are multiple structural factors preventing women from reaching their full career potential. Women in the workforce face a well-documented set of challenges[27], especially at the mid-career stage where they encounter insufficiently flexible working options, insufficient support for family responsibilities as well as for re entering the workforce and a variety of stigmas affecting promotion prospects.

A number of structural initiatives are now being proposed and adopted throughout the corporate world to alleviate these structural frictions. One approach is to strengthen flexible working options at all levels. Although many organisations offer part-time work, job sharing, and working from home, these are viewed as career-limiting options because of a face-time culture in the workplace. Thus, companies have to ensure these initiatives are truly free from stigma and carefully track who uses these options and how they are treated. Another approach is to relieve the burden on women of taking on family responsibilities – both by encouraging fathers to take full parental leave, and by promoting returnship programmes offering parents increasing responsibilities and challenges rather than career limiting positions.

26 Discussed at WCMS 2018 by Vicky Lay of Artesian Venture Partners
27 Women in Financial Services report, Oliver Wyman, 2016

L-R: Sir David Tweedie, Anna Marrs, Junko Nakagawa, Sophie Guerin, Vicky Lay

The regulatory framework has and continues to be a tool to exert positive changes in relation to gender diversity on boards and senior managements. In Malaysia, the Malaysian Code on Corporate Governance encourages listed companies to disclose their gender diversity policies, targets and measures the company has in place to achieve those targets. From Apr 2017, large listed companies in Malaysia are also expected to have 30% women on their boards; a recommendation made in the Malaysian Code on Corporate Governance. Significant progress has been made, as the number of Top 100 listed companies on Bursa Malaysia with all male board members dwindling from 20 (as at end of December 2016), to only 4 as of 28 February 2018.

These initiatives can be supported by setting, as part of a talent pipeline strategy, targets such as percentage of women in senior positions, percentage of new recruits who are women, percentage of fathers taking their full paternity leave, and percentage of women returning to full-time work after having children.

One other promising body driving these types of changes is the Sustainable Stock Exchange (SSE) initiative of the UN, which has brought together the worlds' major stock exchanges for peer discussions and agenda-setting. The SSE has tracked progress on gender equality and generated a set of recommendations, as shown in Table 3.

"We have to have passion, in something that we truly believe, and that we want to do for ourselves."

Nicol Ann David, Eight Time World Squash Champion & National Goodwill Ambassador UNDP Malaysia

TABLE 3: WHAT STOCK EXCHANGES CAN DO TO ADVANCE GENDER EQUALITY

PROMOTING CHANGE		LEADING BY EXAMPLE	
1	Encourage listed companies to report **diversity objectives, diversity metrics**, and performance against gender-specific SDG targets	1	Report **gender equality metrics**
2	Engage the **market securities regulator**	2	Support the development of **women-owned small businesses**
3	Require **disclosure of material convictions or judgements** for violations of human rights rules	3	Use gender equality standards in **exchange-offered investment products**; support others' equality-themed products
4	Offer a **separate listing segment** based on gender metrics, or provide **rankings** on gender metrics	4	**Revisit policies** on remuneration, gender representation, sexual harassment prevention, family leave and flexible work
5	Provide **guidance, training and education**	5	Provide **training and education** to staff
6	**Engage companies directly** on their internal policies	6	Conduct or sponsor **research**

RECOGNISING YOUTH AS THE DRIVER OF THE FUTURE

Research has shown that most youths are not part of decision-making processes due to their age and general perceived lack of experience[28].

To combat this, society needs to appreciate that adequate participation and recognition of youths not only aids their development but is also a crucial element of societal progress and harmony. The youth today are key drivers in improving societies, bringing innovation, optimism and energy. The younger generation deeply understand the importance of diversity, are fully interested and capable of participating in, as well as adding value to national and local decision-making processes, if provided supportive environments and opportunities.

As governments and institutions devise solutions to current global challenges, they need to ensure youth representation, empowering youths to make a difference. After all, these are the generation of the future. As Heidy Quah highlighted during the panel of Youth4change, *"Empowerment and mentorship makes a new difference in pushing young people forward and seeing what else they can do"*. Therefore, rather than excluding youth in key national debates and decisions, governments and institutions should find ways to better engage, empower and mentor the decision makers of tomorrow.

"Unless we set targets and enforce that particularly through the middle-layer management, we won't make progress fast enough. So we publish statistics and talk about targets… the Treasury in the UK has a target of 30% of the top layers of organisation being women and we signed up to that target."

Anna Mars, Regional Chief Executive Officer
Standard Chartered Bank, ASEAN and South Asia

28 Report on Youth Involvement in the Peaceful and Sustainable Development of Nepal, UN Peace Fund Nepal, May 2017

HARNESSING THE POWER OF TECHNOLOGY AND INNOVATION

Based on: **Navigating the Digital Revolution** with Kit Wong, John D'Agostino, Navin Gupta, and Yvonne Man; and **Future of Finance** with Sir David Tweedie, Douglas Flint, Dato' Sri Nazir Razak, Jacob Hook, John D'Agostino, and Riz Khan

Big tech worldwide has already disrupted traditional industries such as accommodation and transport, consumer services, and even financial services due to rapid evolution of business models well aligned to consumers' needs. We expect a similar second wave of digitization and innovation to impact the sustainability and inclusivity agenda – binding the capital markets together, pushing forward their business models and opportunities for collaboration. Opportunities for sustainable growth enabled by technology include lowering the cost to reach underserved consumers, creating more efficient markets that divert financing to the right places, and creating easily accessible and useful services for end users.

DIGITAL FINANCIAL INCLUSION

Speakers at WCMS 2018 emphasized the importance of improving payments and remittances in driving inclusion; highlighting Ripple India's XRP currency as a low cost alternative to small remittances as well as a collaboration between Ripple and the Gates Foundation[29] to develop innovative new technologies.

The Level One collaboration features an interoperable technology helping emerging market financial providers, governments and mobile network operators simplify and reduce the cost of developing inclusive payments platforms – allowing millions of presently unbanked to gain financial access.

Technology is also driving mobile money and agent-based banking. For example, nearly 40% of Kenyans are active users of the M-Pesa mobile payment service, which along with other mobile money services has lifted Kenyan households out of extreme poverty in the past decade[30]. In Cambodia, 33% of adults have received mobile money via the Wing app (contrasted with only 13% having bank accounts); while the Indonesian government's Laku Pandai program with agents supported by technology has onboarded more than 11.8 million new customers since 2015. Separately, Dialog Axiata PLC has launched a Digital Innovation Fund in Sri Lanka, investing into promising start-ups which have the potential to become market shaping digital businesses in Sri Lanka.

29 Other key collaborators include Dwolla, ModusBox, Software Group, Crosslake Technologies; more information available at Ripple's media release Oct 16, 2017 "Ripple & the Gates Foundation Team Up to Level the Economic Playing Field for the Poor", as well as https://www.leveloneproject.org

30 Data provided by Vodafone, Safaricom, and MIT

Sir David Tweedie

Digital financial services can address many barriers including distribution, KYC (Know Your Customer compliance), and credit assessment. In total, about a third of the financial inclusion gap can be closed using digital banking services[31]. Key trends driven by Lufax, Dianrong, and others include the use of new credit scoring tools based on non-traditional data such as mobile phone use, as well as digital verification techniques such as using facial and voice recognition[32], which will allow companies to extend credit to previously underserved consumers. In addition, the use of digital identity databases such as Aadhar in India and e-KTP in Indonesia will help companies to "know their customer" even when the customer does not interact much with formal financial services. Beyond inclusion for the unbanked, the rise of digital platforms such as equity crowdfunding and peer-to-peer lending provides a model and alternative financing solutions for entrepreneurs, thus driving inclusion and long-term growth.

Given increasing mobile phone and internet access, there will be further opportunities to develop innovative business models and products would need to continue being tailored to the needs of vulnerable and underserved segments. Meanwhile, there are financial incentives for private players to extend service to the underbanked mass market; for example, an integrated spending, savings, and credit account for the underbanked can provide attractive profit potential to large banks while generating large savings for consumers[33].

31 Accelerating Financial Inclusion in South-East Asia With Digital Finance, Oliver Wyman and Asian Development Bank, 2017; Reimagining Financial Inclusion, Oliver Wyman and Ideas42, 2015

32 Kit Wong, CEO of Lu International, panellist at Navigating the Digital Revolution, highlighted his firm's pioneering efforts into voice recognition, pointing out a higher accuracy vis-a-vis facial recognition

33 Potential savings for underserved customers could be US$15 billion+ in the U.S. alone. Reimagining Financial Inclusion, Oliver Wyman and Ideas42, 2015

HARNESSING DIGITAL ENABLERS FOR LONG-TERM CUSTOMER VALUE

The primary goal of sustainability is long-term value creation; the creation of profitable business models that provide inclusivity while enduring values throughout society. Sustainable business models embrace innovation to meet customer needs, rather than focusing on short-term profits and business-as-usual practices. This is especially important in financial services and financial markets, where public trust and understanding has eroded in the past decade. Nascent technologies such as big data and cloud, artificial intelligence, as well as digital ledgers (block chain) can help address these issues by enabling innovation[34].

At traditional companies, the adoption of cloud infrastructure, mobile, and big data are major change drivers. Four in ten enterprises have migrated to the cloud to support their IT operations and 93% of enterprises see the cloud being utilized for transactions in the future. This allows customer data to be stored in a more integrated and flexible format. Meanwhile, the pool of data is also growing exponentially as customers increasingly use mobile phones and other internet-connected devices. By applying machine learning and artificial intelligence techniques to this expanding pool of metadata, financial service providers will be able to provide better financial advice, insights and solve more customer pain points.

Meanwhile, non-traditional companies are finding ways to meet a wider spectrum of consumers' financial needs, such as spending more wisely, transferring funds more easily, and increasing earnings. For example, the price comparisons and discounts provided by retailers such as Amazon and Costco help consumers to optimise their spending, while peer comparisons on water and gas consumption by utility firms[35] leverages behavioural science techniques to drive conservation efforts.

The rise of innovative tech giants in other industries provides a model for financial services. Successful innovators such as Netflix and Amazon have targeted key customer pain points and used data and algorithms to relentlessly improve their solutions. The same is starting to happen in finance; for example, robo-advisory companies such as Betterment, Nutmeg, and Xuanji are cutting out intermediaries while applying analytics to improve the value proposition for customers. They are doing this transparently, with plenty of educational resources while charging low fees, thus promoting trust and understanding among end investors.

34 As emphasized at WCMS 2018, "Future of Finance" session by Jacob Hook, Managing Partner of Oliver Wyman Asia Pacific

35 These comparisons typically come in the form of comparative stats, for example, "You are in the top 20th percentile of water consumers in your neighbourhood". Examples could also be more tailored e.g. by number of household members or apartment size

L-R: Yvonne Man, Kit Wong, John D'Agostino, Navin Gupta

In the capital markets, new technologies such as the blockchain and digital ledgers are boosting efficiency and encouraging the adoption of renewable energy. This helps generate value for both the private sector and society at the same time. Directing engineering talent toward sustainable sectors such as renewable energy will create a virtuous cycle that promotes sustainable growth.

Financial institutions can produce innovative services through a process of continual iteration, which is a bigger source of progress than sudden breakthroughs[36]. They will still need to take risks, but the risks institutions take when pursuing better customer experience are more sustainable than risks arising from chasing higher yields[37]. As digital enablers become more powerful, financial services players will have many opportunities to build customer trust by delivering new and improved services.

36 As explained by at WCMS 2018 by John D'Agostino, Managing Director, DMS

37 Touched on at WCMS 2018 by Sir David Tweedie, Chairman, International Valuation Standards Council and Former Chairman, International Accounting Standards Board

L-R: David Wright, Ashley Alder, Masamichi Kono

A CALL TO ACTION: WHAT DOES "REBIRTH OF TRUST AND TRANSPARENCY" MEAN TO CAPITAL MARKETS?

We need a Renaissance of Capitalism balancing the core tenets of the market economy, which creates winners and losers – against societal needs for inclusive and sustainable prosperity. The "invisible hand" of the free market should still be allowed to operate unimpeded, but forward-looking policies and mechanisms must be in place to prevent a winner-takes-all phenomenon. Barriers such as informational asymmetry must be eradicated, and capitalism must not mis-price certain risks such as environmental and social costs presently not incorporated into the investment and capital allocation process.

We are hopeful that Finance can be a leader in driving sustainable and inclusive growth. The momentum built by institutions such as the UNDP, UN PRI and the CECP CEO Force for Good has encouraged more corporates, investors and capital market intermediates to facilitate sustainable and inclusive growth. IOSCO, the global body of capital market regulators, has also focused on work relating to sustainable financing across emerging markets, including the development of sustainability-themed instruments and products.

L-R: Sir David Tweedie, Douglas Flint, Jacob Hook, Dato' Sri Nazir Razak, John D'Agostino

However, more can be done to ensure leaders are aligned to a common agenda, while encouraging laggards to embed long term value creation into their business processes and disclosures. A concerted push by the following key trio of capital market actors can help facilitate economic growth in an inclusive and sustainable fashion, with all pockets of society benefiting from a heightened standard of living.

NATIONAL REGULATORS, MULTILATERAL DEVELOPMENT ORGANIZATIONS, AND INDUSTRY BODIES

Governments and regulators have the ability to both mandate and empower sustainable practices among corporates and investors. By providing a long-term roadmap backed by specific sustainability targets and policy frameworks, these groups can provide the private sector with confidence and longer-term certainty, thus encouraging more definitive efforts and investments.

In facilitating developments according to the roadmap, governments can leverage multiple levers including regulator suasion, mandated requirements, and economic incentives. Beyond providing and facilitating capital into the right areas of the economy, there is also room for governments to collaborate internationally (either government-to-government or with multilateral institutions) to improve the bankability of non-traditional areas such as social infrastructure as well as social enterprises.

1. **Regulators, multilateral organizations, and industry bodies:** Work together to develop a vibrant ecosystem to promote the development of sustainable financing and investments. This includes developing relevant regulatory and policy frameworks, shifting towards the adoption of harmonised international standards, developing requirements to promote effective reporting and disclosure, as well as integrated frameworks for long-term financing e.g. infrastructure, SMEs, investment. Taking inspiration from the Paris Agreement and the development of Islamic capital markets, regulators and governments can publish a forward-looking roadmap that shows how sustainability frameworks fit together to achieve key long-term targets across the whole economy.

2. **Regulators:** Provide **encouragement and facilitation** to corporates and entities on proper ESG disclosure as well as alignment of ESG reporting standards to global best practices. By encouraging standardised reporting, more regulators can ensure more widespread corporate transparency and accountability, which in turn empowers investors to fully incorporate ESG risks and opportunities in their approaches.
3. **Governments: Economic policy and incentives** (including tax policy and capital relief) play an important role in influencing corporates, investors, and capital market flows. This includes grants or tax credits to incentivise sustainability investments as per Malaysia's green sukuk incentives and grants, as well as policies to correct market mis-pricing, as demonstrated by the carbon tax launched recently in Singapore. Governments can also catalyse innovative financing such as SRI bonds by using investments from government pension funds and other investments vehicles.
4. **Policy makers and regulators:** Design **effective internal coordination and governance structures** across ministries and relevant national agencies. As identified by OECD surveys, one of the greatest challenges to pursuing unified sustainability goals is balancing the interests and time horizons of different ministries, departments, agencies and centres of government.
5. **Policy makers, regulators and multilateral institutions: Improve the bankability of non-traditional areas** including social infrastructure financing and developmental finance. This can be accomplished using new models for government-to-government collaboration and public private partnerships, including definitions of concessions and rights as well as leveraging credit enhancement and blended finance approaches.

COMPANIES

Following the lead of governments and regulators, corporates should better integrate sustainability best practices into their business operations; this includes strengthening ESG disclosures, incorporating 'reuse-reduce-recycle' principles into supply chain management, and promoting inclusive growth via fair treatment of smallholders. Beyond reviewing current business activities, corporates could also partner with disruptive tech firms to develop innovative products driving inclusive growth – providing long term economic benefits to the business as well as its communities. In line with the Ceres Roadmap for Sustainability, these considerations fit into four areas applicable to all companies:

1. **Governance:** Provide board-led sustainability governance, management accountability, compensation mechanisms, explicit corporate policies, and public communication tied to sustainability goals. For example, Board-level governance can include creating a Sustainability Committee or appointing a Chief Responsible Investment Officer.
2. **Stakeholder engagement:** Use materiality assessments to identity relevant sustainability issues, hold dialogues with a diverse group of stakeholders, engage investors and the C-suite, as well as collaborate across the private sector and civil society to innovate new solutions. For example, corporates can participate more actively in industry collaboration groups which share knowledge and set shared goals.
3. **Disclosure:** Disclose all relevant ESG information using a global standard such as the Global Reporting Initiative as well as sector-relevant indicators. Provide disclosures in a balanced, harmonised, and integrated fashion, and ensure that key ESG performance data is reviewed by an independent third party. Sustainability disclosures should address key areas recommended by the TCFD such as governance, strategy, risk management, and metrics and targets.

4. **Performance:** Measure and act on sustainability targets across operations, supply chain, transportation and logistics, products and services, and employees. For example, develop innovative products and business models that achieve sustainability goals, such as financial inclusion via digital payments and lending. As an additional example, review the supply chain to prepare for a low carbon future while also promoting inclusion, responsible sourcing, and responsible resource consumption.

INVESTORS AND INTERMEDIARIES

While governments and regulators are able to provide broad policy strokes and minimum requirements to guide corporates towards sustainability practices, corporates are ultimately answerable to their shareholders, customers and employees. As a result, institutional investors and related intermediaries such as stock exchanges serve as the largest collective voice, allowing them a central role in ensuring sustainable and inclusive growth.

1. **Institutional investors and financial institutions:** Develop more effective **investment frameworks and governance** incorporating ESG metrics into sustainability disclosures and investment decision processes. Data providers such as Bloomberg have started and can continue to improve accessibility of disclosures to allow more robust tracking and comparisons. As part of this push, investors can financially support sustainability-related indices, bonds and other products.
2. **Intermediaries** (exchanges, capital markets platforms, and rating agencies): Leverage central roles in capital markets to **drive voluntary corporate sustainability.** Initiatives include a push for minimum 'sustainability' standards as part of listing requirements, developing and promoting sustainability indices, working closely with the national authorities to support listing and trading of sustainable and responsible bonds, and setting up economic innovations such as carbon or renewable trading credits, potentially via distributed ledgers.
3. **Both investors and intermediaries:** Facilitate this shift by taking a more active role with corporates via **investment stewardship.** As coined by BlackRock, this involves reaching out and working alongside corporates to achieve the common goal of triple bottom line growth. In addition, players can find ways to collaboratively drive inclusive growth, such as developing bilateral and regional market connect programmes (e.g. in line with AEC 2020 vision) to support financial deepening, as well as partnering with incubators, providing financial support and mentorship to the next wave of startups.

There is vast untapped potential for capital markets participants to drive inclusive, sustainable growth. These efforts, if successful, can launch a paradigm shift in which capital markets unify behind a common fiduciary duty to achieve economic, social and environmental progress. Achieving this would promote the long-term success of both financial markets and the real economy, and thus restore public trust in finance. There are good reasons for hope, and clear actions to take, in earning this trust and securing a prosperous future for everyone.

Report Contributors

Based on discussions and sessions at the World Capital Markets Symposium 2018, 5–6 February in Kuala Lumpur, this report was co-written by **Securities Commission Malaysia** as well as the *Official Knowledge Partner of WCMS 2018*, **Oliver Wyman**.