INVESTOR OBLIGATIONS AND DUTIES: ESG INTEGRATION IN CHINA
INTRODUCTION

The G20 Summit in Hangzhou in 2016 identified green finance as a key driver of global growth and sustainable development. Since then, China has set up an ambitious agenda to develop green finance and transform its growth model towards a greener economy.

The People’s Bank of China’s Guidelines for Establishing a Green Financial System helped place China as the largest market for green bonds worldwide. At a regional level, China has launched the Belt and Road Initiative, with the aim of contributing to balanced, inclusive and sustainable regional development through financing large-scale infrastructure projects in China, Asia and East Africa. China is now the world’s largest holder of foreign exchange reserves, second-largest economy and second-largest destination for foreign direct investment. China’s ongoing work to promote green growth and green finance strategies is therefore key not only to international efforts to halt climate change but also to the global goals of balanced, inclusive and sustainable development.

As the G20 communique from 2016 pointed out, to realise these goals “efforts could be made to provide clear strategic policy signals and frameworks, promote voluntary principles for green finance, expand learning networks for capacity building”.

Creating an enabling environment to attract the required investment and execute China’s long term strategies implies that regulatory frameworks match policy ambitions. The work of UNEP FI, the PRI and The Generation Foundation on Fiduciary Duty in the 21st Century addresses a major aspect of this challenge: embedding material environmental, social and governance (ESG) factors – specifically those enabling a greener economy – in investor obligations and duties, also referred to in common law markets as investor fiduciary duty.

This project intends to build on our recent work on Investor Obligations and Duties in Six Asian Markets, and on recent developments in China on green finance. Our 2016 report, based on local stakeholders’ feedback, identified for China six themes of progress to further promote ESG integration in the investment decision process.

1 To meet the goals of its 13th Five-Year Plan, China will need to turn to domestic and international markets to provide approximately US$500bn a year.

2 In January 2016, the PRI, UNEP FI and The Generation Foundation launched a three-year project to clarify investor obligations and duties in relation to the incorporation of environmental, social and governance (ESG) issues in investment practice and decision-making. This follows the publication in September 2015 of Fiduciary Duty in the 21st Century by the PRI, UNEP FI, UNEP Inquiry and UN Global Compact. In addition to publishing an international statement on investor obligations and duties, and eight country roadmaps, the project extended research into fiduciary duties to six Asian markets: China, including Hong Kong, India, Malaysia, Singapore and South Korea. This report was published in September 2016.
Investor Obligations and Duties in Six Asian Markets 2016 report:
Recommendations for China

The report, Investor Obligations and Duties in Six Asian Markets, published in September 2016, made the following recommendations for China:

Increase pension funds’ ESG focus: the government could have all state pension funds (Pillars Ia and Ib), the National Social Security Fund (including its licensed fund managers and custodians), enterprise annuity plans and mutual funds take account of ESG issues, encourage high standards in investee companies and report on how they are doing so.

Expand green finance: the government, through organisations such as the People’s Bank of China, is developing comprehensive policies to support a greener financial system in China. Demand from financial institutions for green investment is growing and can be further bolstered.

Support research: the Ministry of Human Resources and Social Security, the People’s Bank of China, the stock exchanges and the investment industry could work together to support high-quality academic research on ESG issues.

Introduce a stewardship code and monitor outcomes: the Ministry of Human Resources and Social Security could work with the investment industry to develop a code setting out institutional investors’ stewardship responsibilities.

Continue to enhance corporate practice: significant steps have been taken by central and provincial governments to reduce pollution and improve energy efficiency among Chinese firms. This should be continued and extended across all sectors and sustainability issues. This will focus investors’ attention on company performance and increase the pressure on companies to adopt environmental management systems and controls to manage their environmental and sustainability impacts effectively.

Enhance corporate disclosure: the Shanghai and Shenzhen stock exchanges, together with the China Securities Regulatory Commission (CSRC), could analyse and report on the disclosures being provided by listed companies.
Building on the recent progress of the national Green Finance initiative, and on the findings of our work on investor obligations and duties, the aim of this project is to support national stakeholders in further developing an investment and regulatory environment that promotes consideration of financially material ESG issues in China, consistent with investor obligations and duties.

The project’s goals are to:

- support national policy development by making available an international evidence base on investor obligations and duties, and ESG integration;
- help investors understand their obligations and duties and promote market adoption of regulations that encourage green finance;
- provide recommendations on options that policymakers and investors could consider to improve risk management and strengthen sustainable capital market development.

The project will:

- Publish joint research with key stakeholders on the current state of ESG integration in investor obligations and duties as defined by existing regulations. This research will discuss how clarifying the role of ESG integration in investor obligations and duties can contribute to achieving China’s long-term vision of balanced, inclusive and sustainable development.
- Incorporate market feedback from interviews with government, regulators and industry stakeholders. The aim is to outline what additional policy reforms and industry initiatives would be needed to strengthen an enabling environment for investors to integrate material ESG issues in their investment decisions.

The project team and Chinese partners will outline priority recommendations and support their implementation. This will include, for example, instruments and tools to support capacity-building, investor education, and exchange of best practice case studies.

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3 ESG integration is defined as the systematic and explicit inclusion of material ESG factors into investment analysis and investment decisions. For detailed discussion of investor obligations and duties, see the Investor Obligations and Duties in Six Asian Markets report.
About the PRI
The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance issues and to support signatories in integrating these issues into investment and ownership decisions. The six Principles were developed by investors and are supported by the UN. They have more than 1,750 signatories representing approximately US$70tn of assets. They are voluntary and aspirational, offering a menu of possible actions for incorporating ESG issues into investment practices. In implementing the Principles, signatories contribute to developing a more sustainable global financial system.
For more information, see www.unpri.org.

About UNEP FI
The United Nations Environment Programme Finance Initiative (UNEP FI) is a unique global partnership between the United Nations Environment Programme (UNEP) and the global financial sector founded in 1992. UNEP FI works closely with over 200 financial institutions who have signed the UNEP FI Statements as well as a range of partner organizations to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realize the adoption of best environmental and sustainability practice at all levels of financial institution operations.
For more information, see www.unepfi.org.

About The Generation Foundation
The Generation Foundation (‘The Foundation’) is the advocacy initiative of Generation Investment Management (‘Generation’), a boutique investment manager founded in 2004. The Foundation was established alongside Generation in order to strengthen the case for Sustainable Capitalism. Its strategy in pursuit of this vision is to mobilise asset owners, asset managers, companies and other key participants in financial markets in support of the business case for Sustainable Capitalism, and to persuade them to allocate capital accordingly. For more information, see www.genfound.org.