ACGA

ACGA 20th Annual Conference

Asian Business Dialogue on Corporate Governance 2021

Making connections between Governance and ESG in Asia

Conference Report

17 November 2021
Kerry Hotel, Hong Kong
Hybrid Conference

24 November & 1 December 2021
Workshop Webinars

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Preface

For the first time in two years, ACGA was delighted to welcome delegates in person to attend our 20th annual conference at the Kerry Hotel in Hong Kong. Held on 17 November, our first hybrid event, "The Asian Business Dialogue on Corporate Governance 2021", hosted more than 170 participants in the ballroom and virtually. Our panels featured speakers both in the room and via Zoom link from locations across the world including China, Japan and Australia. This flexible format enabled us to invite speakers and members across different markets and time zones and it is a model we intend to adopt for future conferences.

Already 24 months into the pandemic we continue to adjust our traditional work habits and in the case of Hong Kong, endure severe travel restrictions. The emergence of new and more contagious variants into a world with no consensus on how to combat the virus has seen lockdowns come and go around the world—but the overriding international trend has been one of decoupling and varying degrees of national isolation. In that context, the focus on ESG factors which intensified with the onset of the pandemic has not diminished and as a consequence was the core theme around which the conference was conceived.

The conference addressed issues such as climate change and employee welfare and diversity. Specifically, as these issues become more pressing for investors, the panels discussed how to move beyond mere regulatory compliance to foster a corporate culture which considers ESG factors as intrinsic to strategy, not simply as a public relations afterthought.

Organising the conference came against a challenging backdrop and we would like to extend a special thanks to our sponsors, partners and speakers.

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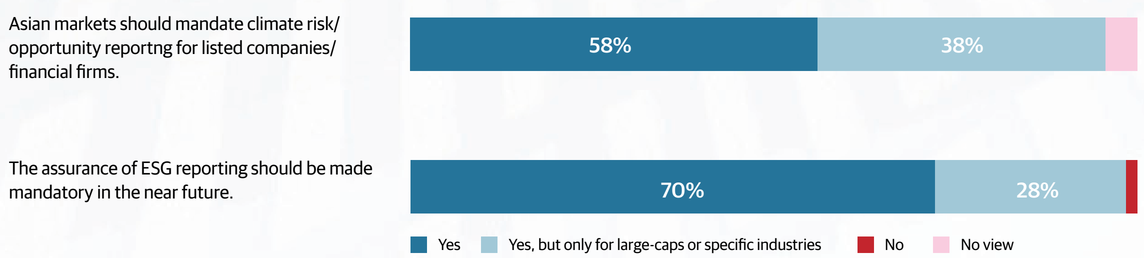
Plenary 1:
Asia Overview—An ESG reality check

Key themes which surfaced in ACGA's CG Watch 2020 market rankings came under the spotlight in this session moderated by **Jamie Allen**, Secretary General of ACGA. New research on board diversity was featured in a presentation by **Jane Moir**, ACGA's Research Director for Hong Kong and Singapore, while **Dr Margaret Burnett**, Programme Director of Sustainability Leadership & Governance at the University of Hong Kong discussed a shift in mindset which is needed in dealing with governance and sustainability.

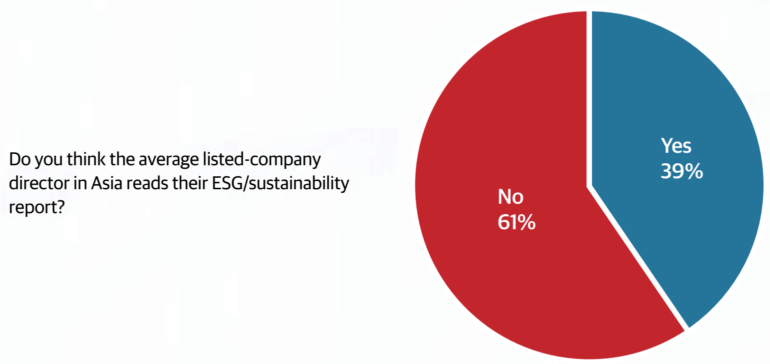
Jamie Allen gave a summary of CG Watch 2020 and noted that despite rising scores compared with 2018, corporate and public governance still need strengthening. In absolute terms rankings still remain low and the gap between Australia and the other 11 markets is particularly wide. ESG may be increasing in prominence but relies on strong "G" foundations, which encompasses a much broader framework.

ACGA Delegate Poll 1

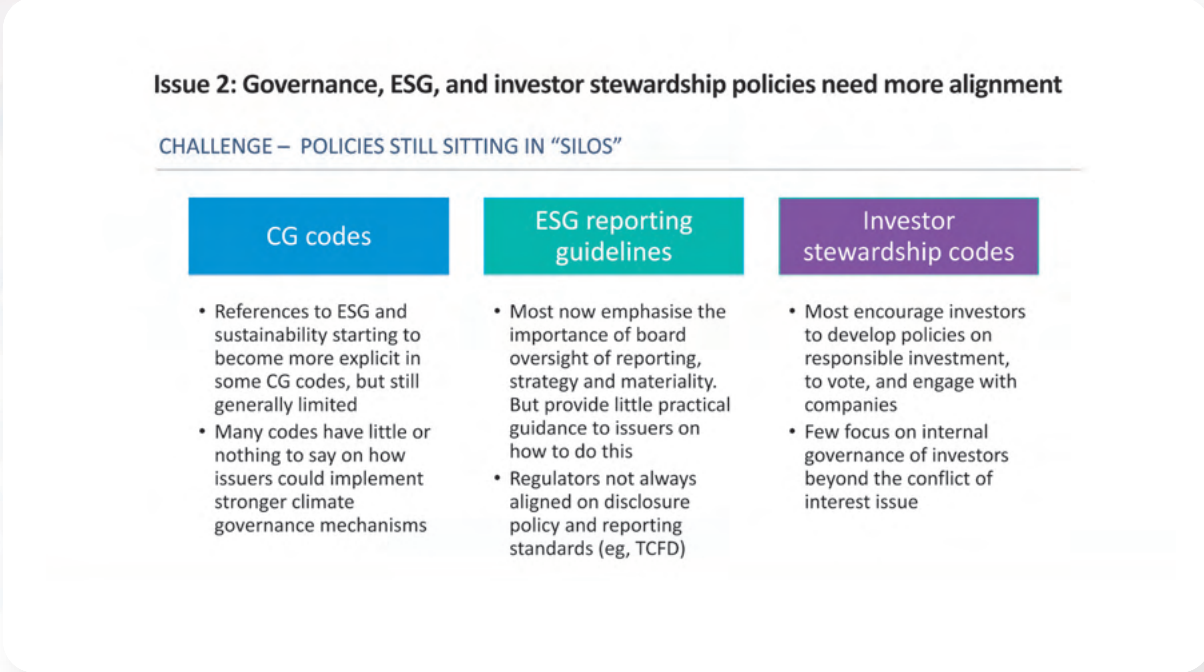
When asked if Asian markets should mandate climate risk and ESG assurance reporting in the next five years, an overwhelming majority of poll respondents were in favour of mandatory climate risk reporting and mandatory assurance for ESG reporting:



Just over half believe that the average director does not read their company's ESG or sustainability report:



Another issue of note is that policies around governance, ESG and investor stewardship need more alignment, illustrated by the "silos" represented below.



ACGA offers some ways in which this could be resolved:

CG Watch 2020 meanwhile offered eight recommendations and showed how markets stack up against them:

On the topic of ESG assurance, while the audience voted overwhelmingly in favour of mandatory assurance for ESG reporting, Asian regulators are still far from requiring this. Across the region, assurance is voluntary and, interestingly, companies in the markets that ranked most highly in CG Watch 2020—Australia, Hong Kong and Singapore—lag almost all the other markets in providing assurance of their ESG reports. Taiwan and Korea lead the pack.

In terms of the quality of reports, both the volume of assurance reports and their scope vary enormously but they tend to be brief and their credibility is questionable since the companies themselves frequently

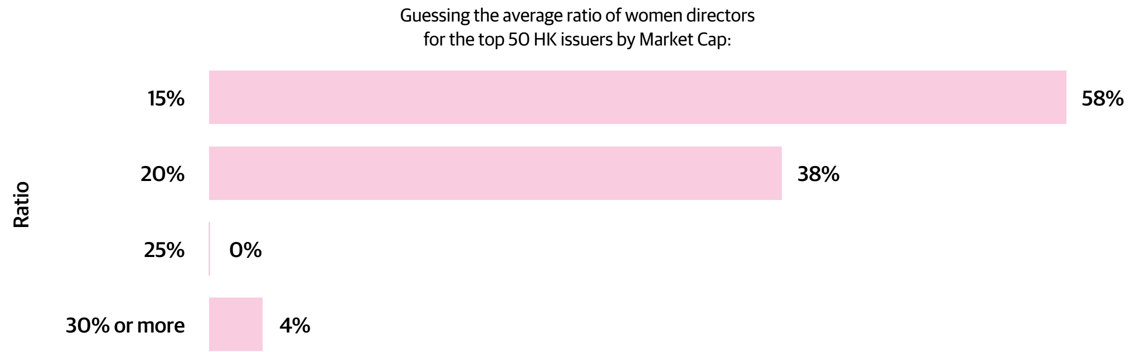
select the metrics for which assurance is provided. Further undermining the utility of the reports, audit firms and specialist assurers use different terminology and methodologies which makes them hard to compare.

Hong Kong and Singapore lagging on gender diversity

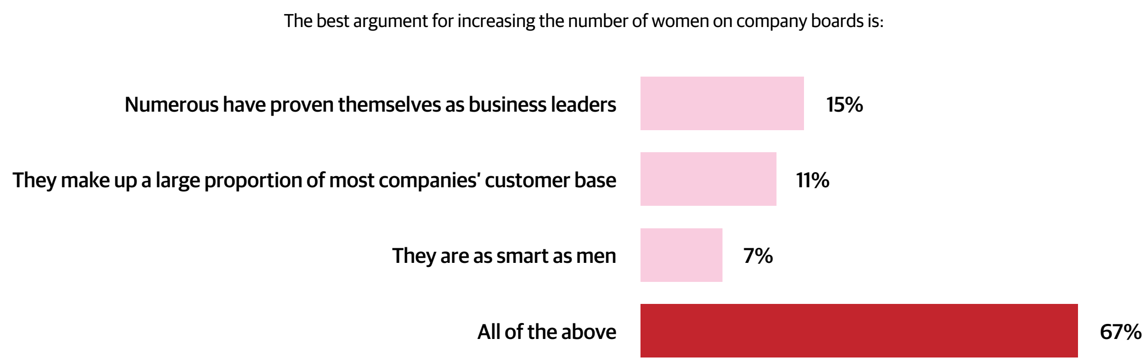
Gender diversity on boards is another area where high-ranking markets such as Hong Kong and Singapore lag their peers. **Jane Moir** noted that at its current pace, Hong Kong will have gender parity on boards by 2161.

ACGA Delegate Poll 2

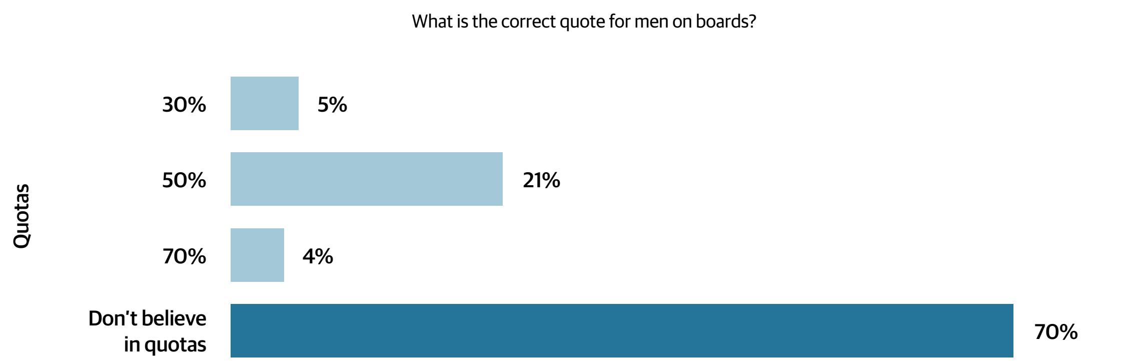
The majority of poll respondents were correct in thinking female directors make up only 15% of the boards at Hong Kong's top 50 issuers:



Two-thirds believe there is more than one compelling reason to increase board diversity:



A quota for MEN on boards? Two-thirds voted no!



Board diversity research by ACGA found 17 male-only boards among the top 100 issuers in Hong Kong, while across the market as a whole the figure is around 37 per cent according to Stock Exchange figures. The top three companies are hardly leading the way: there is one male-only board and there are only three women out of 24 directors in total.

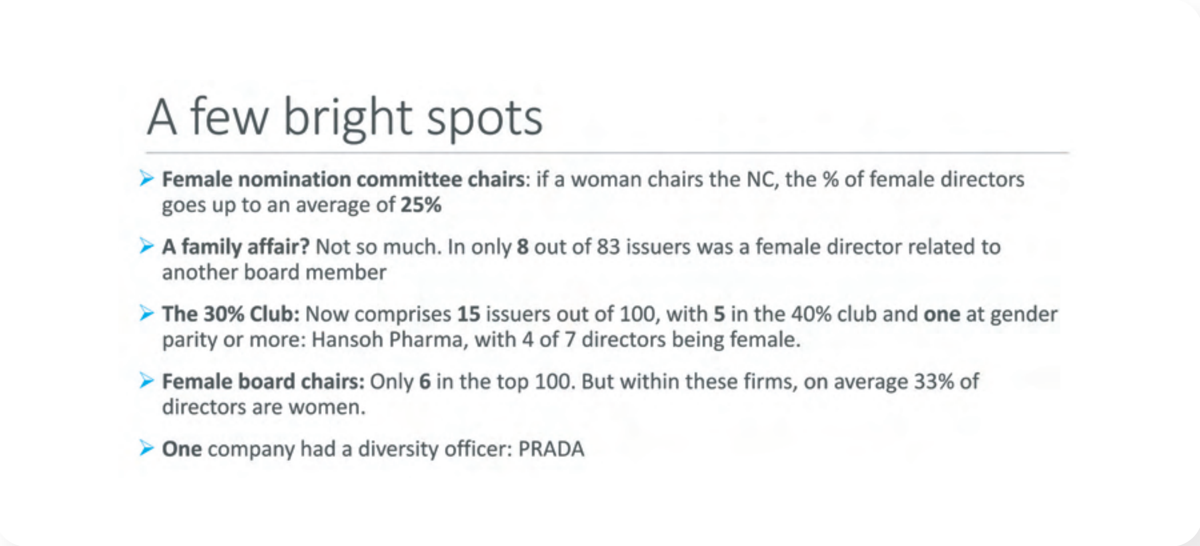
When it comes to the top 50 listed issuers in Hong Kong:

- Their female board representation is just 15 per cent, versus 16 per cent at the top 100 issuers
- The top 50 also have 12 male-only boards, versus just five in the next 50 issuers by market cap

Of the 17 male-only boards:

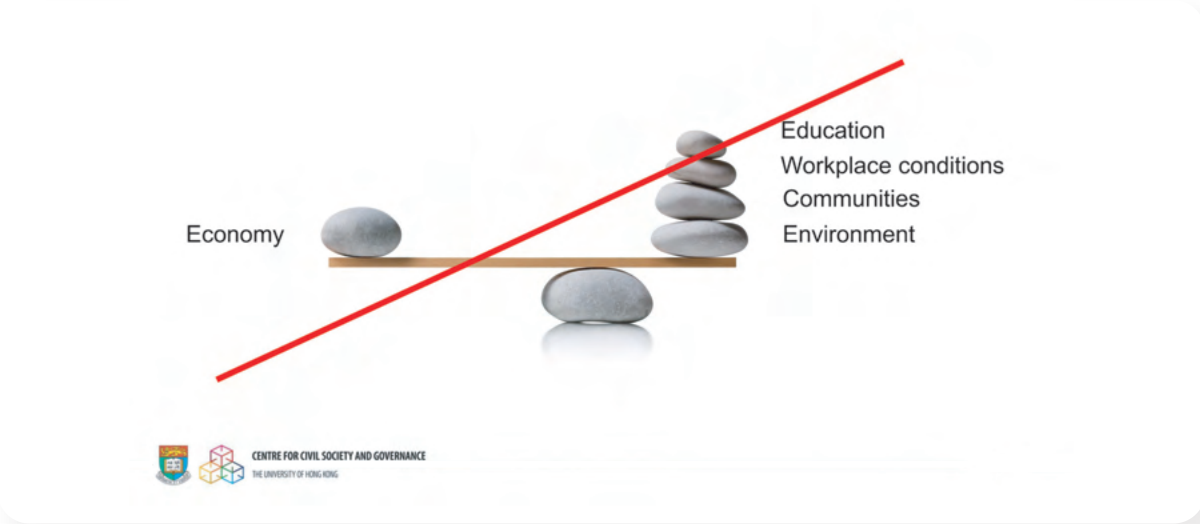
- 10 of these have never had a female director
- They are less likely to have a woman in senior management (eight out of 17 have none)
- The longest tenure for a director at a male-only board issuer is 37 years—and this man is an independent director.

Another finding is that it is not only traditional or old economy industries which have predominantly male boards. New economy tech stocks frequently feature young, male founders who have enshrined weighted voting rights in their structures and recruit in their own image. There were a few bright spots, however, including the finding that having a female chair of the nomination committee leads to greater numbers of women directors on the board.

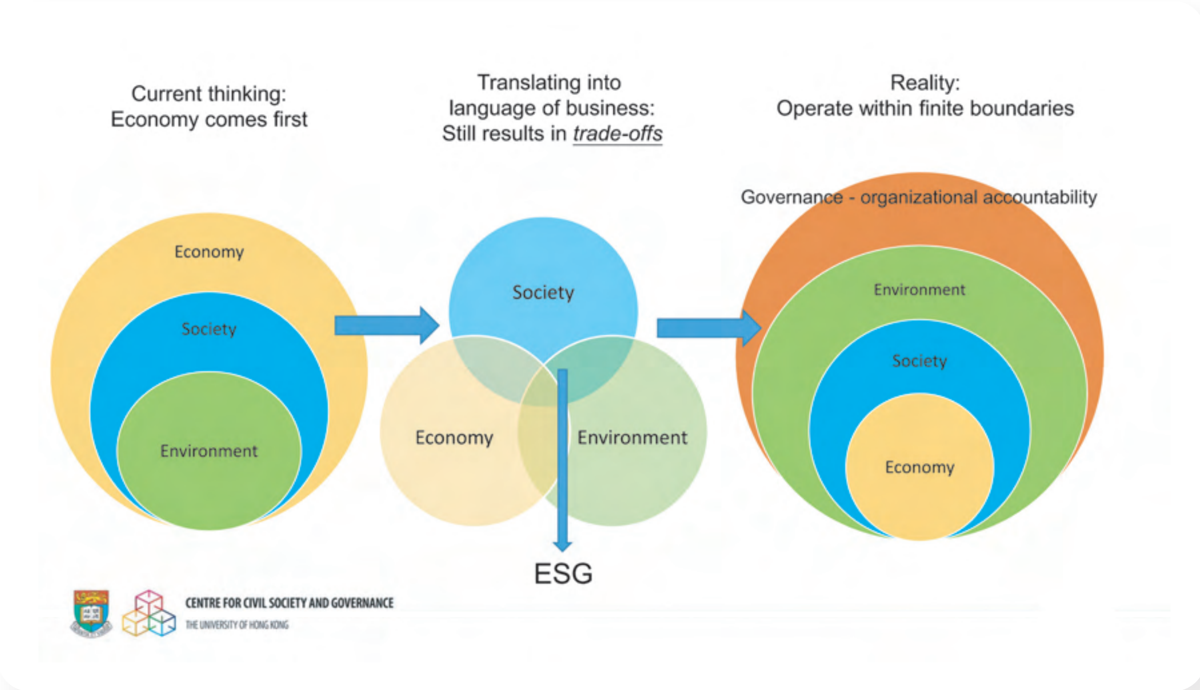


Balancing E and S versus the economy

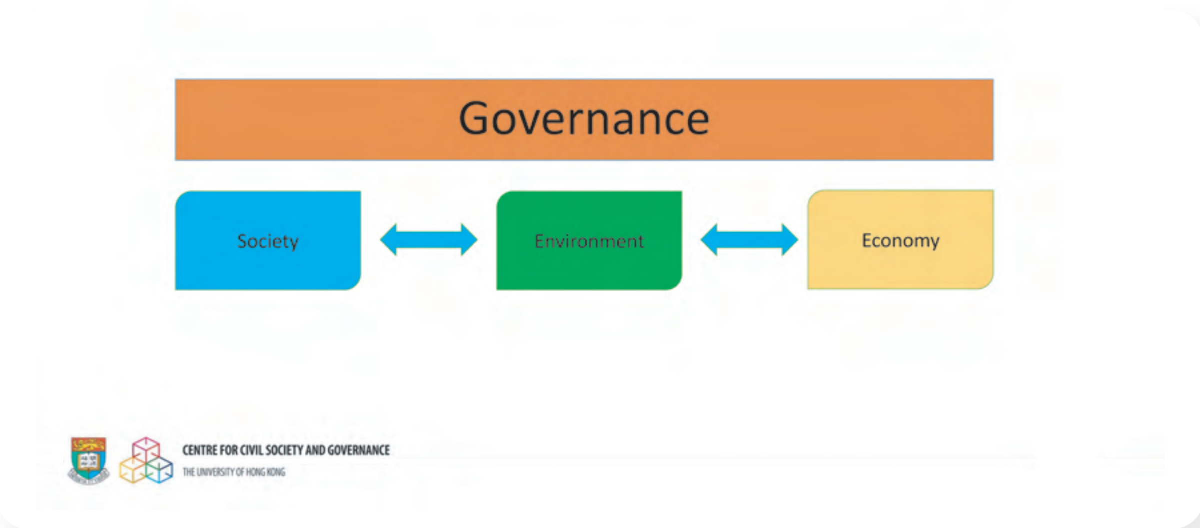
Dr Margaret Burnett presented her thoughts on a shift in mindset required for governance and sustainability to move forward. She noted that there has been progress on ESG and sustainability issues, mostly in respect of reporting frameworks and guidance, but companies are now flatlining. Many do not know how to advance further, perhaps because balancing E and S issues such as diversity, education and community with the economy is a hard task if using traditional frameworks.



Instead of seeing society and the environment through the lens of their impact on the bottom line, which results in trade-offs of ESG factors against financial metrics, a robust economy should be seen as the outcome of good governance, strong society and a healthy environment. The business model of infinite growth does not work once finite planetary resources are considered, as COP26 has revealed.

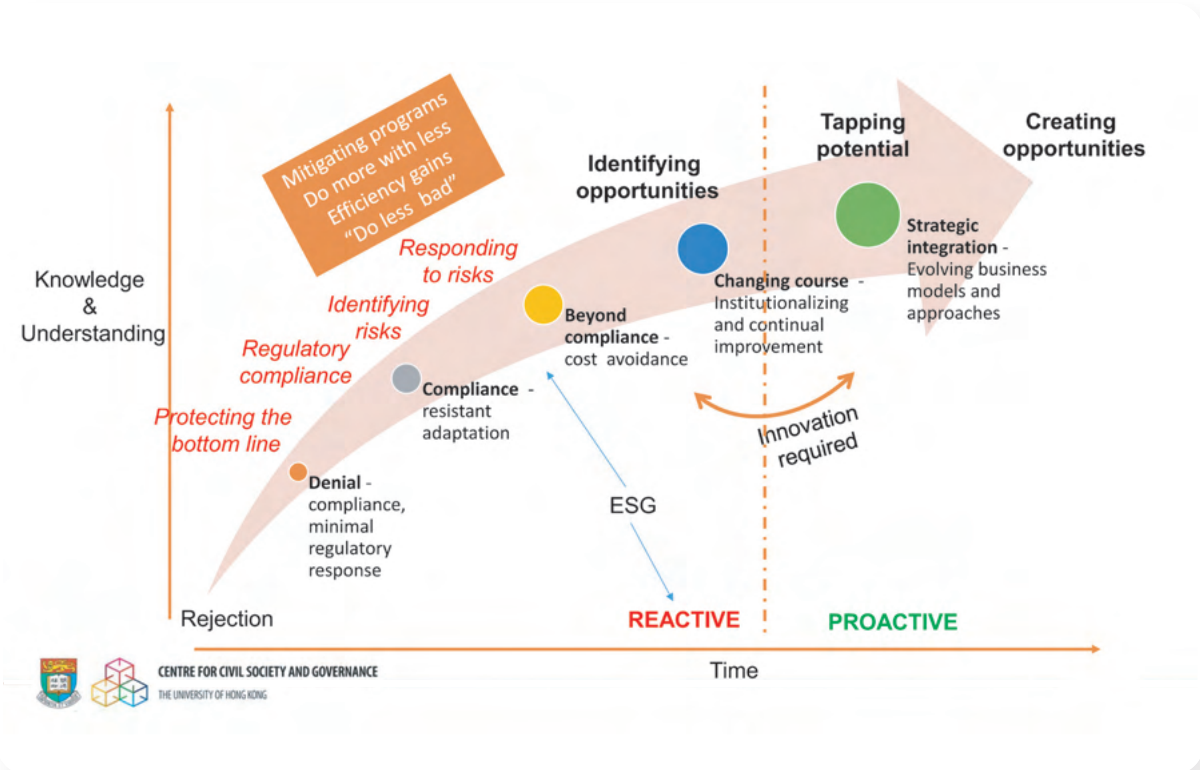


Another issue is that the separation of financial from ESG reporting perpetuates the compartmentalisation of the two. Over the past five to 10 years, academia has continued to hope that integrated reporting would encourage a more holistic understanding that while a company's behaviour affects its bottom line, all external factors (the environment, society) also affect its ability to do business. Society, environment and finance are all interdependent and should no longer be siloed. Governance and governance structures should reflect this, so that sustainability or environmental affairs are not in separate departments or committees. Sustainability principles should be embedded into human resources, procurement and finance—across the board and in an integrated manner.

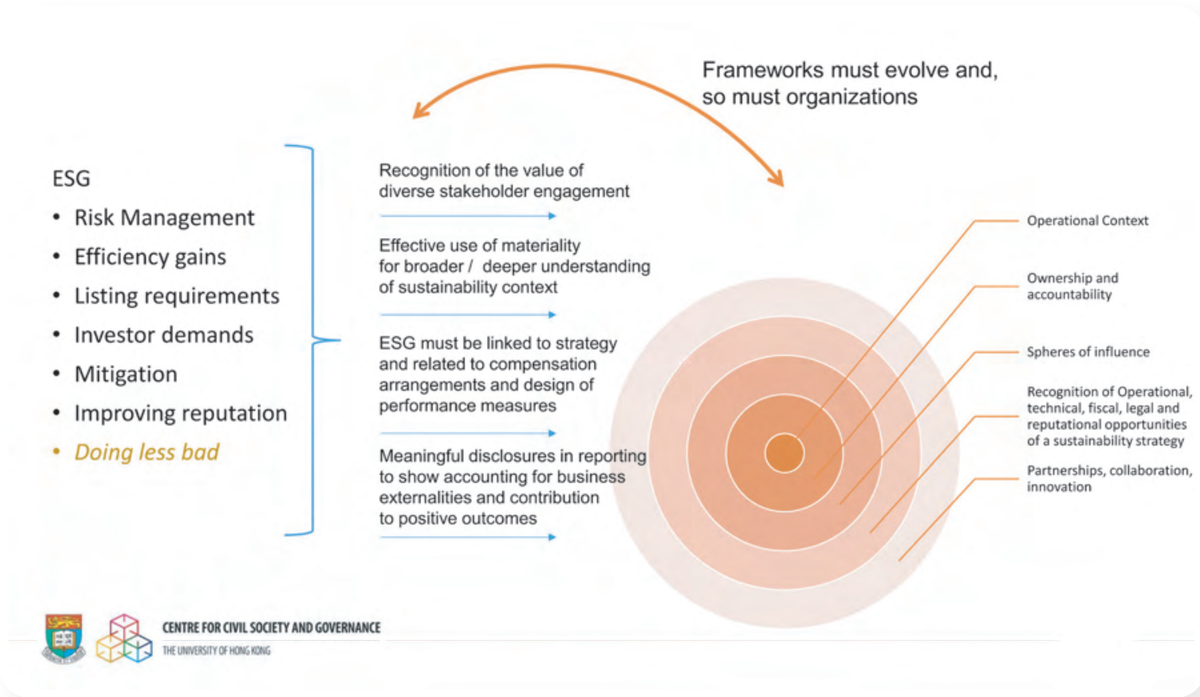


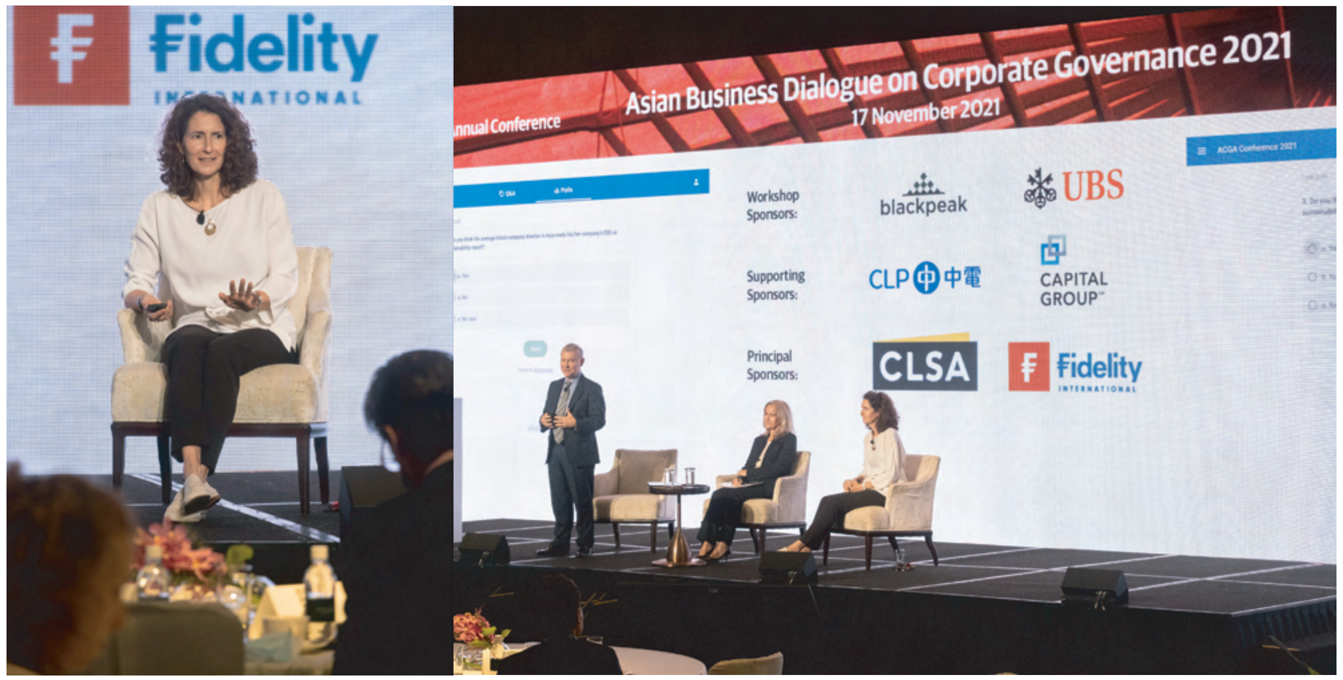
Many companies are beginning to realise this, and are finally moving beyond minimal compliance to try to adapt to what society expects of them. They are still, however, mostly just responding to risk—the strategy is about being "less bad" rather than proactively finding new opportunities. Organisations that are ahead of the game are taking advantage of social as well as technological innovation to create market opportunities, while those that remain reactive struggle within their sectors.

Diversity is critical to innovation, an understanding that the customer base varies in age and ethnicity as well as gender. This needs to be represented across the company from new recruits to management.



Dr Burnett advocates moving away from a check list of ESG requirements which include risk management, "efficiency gains" (which is not the same as sustainability), reliance on compliance with listing requirements and investor demands.





Plenary 2:
Balancing the E, S and G: What smart corporate leaders need to know

Moderated by **May Tan**, Independent Director at Hong Kong issuers such as CLP Holdings, HSBC Insurance and Link REIT, this panel featured boardroom executives **Edith Shih**, Executive Director and Company Secretary of CK Hutchison and **Adriel Chan**, Vice Chair of Hang Lung Properties. **Pru Bennett**, Partner of Brunswick Group in Sydney, joined virtually from Australia. Up for discussion was climate change, employee welfare and board diversity.

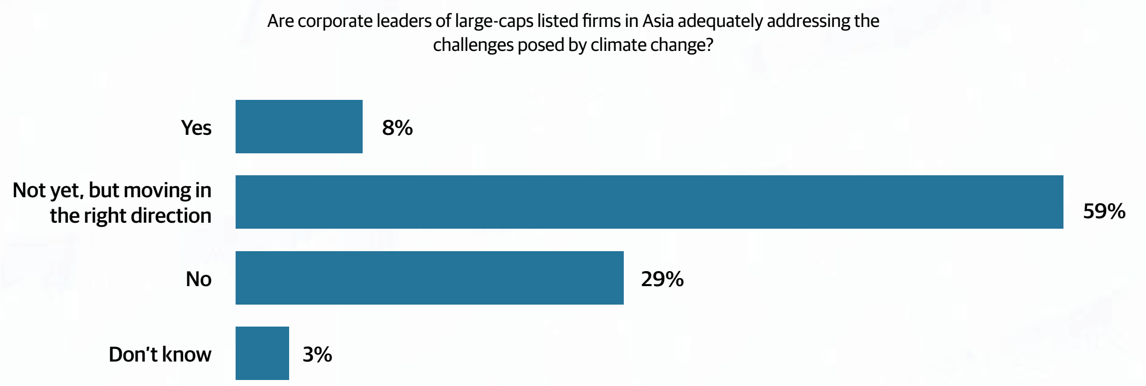
How does a diversified conglomerate such as CK Hutchison balance the E, S & G, particularly with respect to climate change?

Edith Shih noted that identifying a focus for the ESG agenda is tricky for a large and diversified company in which different segments have diverging areas of concern.

Specifically, in striving for net zero in the power generation business, the company intends to replace all of its coal-fired generation with natural gas before 2035, and in Hong Kong ensuring annual emissions do not exceed 0.6kg of CO2e per kWh by 2023. To date, progress has been made and with the commissioning of two new gas-fired plants in the coming two years just over two-thirds of HK Electric's output would be generated by natural gas. HK Electric is also targeting renewable energy, building an offshore wind farm scheduled for completion by 2027 and monitoring other technologies including green hydrogen energy.

ACGA Delegate Poll 3

The majority of respondents believe that mindsets and management are at least beginning to move in the right direction, in respect of addressing climate change challenges, while a quarter still thought that companies are not doing enough:



The company also engages with stakeholders and collaborates with peer CLP. It aims to organise educational programmes for stakeholders in combating climate change and adopting a low carbon lifestyle. In 2020, the company updated its code of practice for suppliers to address climate change issues.

May noted that the electricity companies are well ahead of the government's goal to eliminate coal by 2035 and are working with China to reduce emissions. As a CLP director she believes that ESG compliance has gone beyond box-ticking.

What role does the government play? Is CK Hutchison implementing change irrespective of, or as a result of, the government framework?

Edith believes that it is both. Many corporates—whether in Hong Kong or elsewhere—need to be pushed to behave better. However, a company also must have internal motivation to do the right thing for the community in which it operates.

What ESG considerations are affecting Hang Lung?

Adriel Chan explained that Hang Lung's older properties in Hong Kong, some of which date from the 1950s, have poor insulation and efficiency. Its mainland China properties, the majority of which have come online since 2010, are greener, with more sophisticated technology.

Construction inputs are a focus. The embodied carbon in construction is very difficult to trace—especially in mainland China. In Hong Kong there is a carbon assessment tool, developed by the Construction Industry Council (CIC), which helps to trace emissions inherent in the concrete and steel going into construction. This makes it easier, but it is still not ideal.

The company has laid out clear climate commitments up to 2025, with science-based targets requiring a 70 per cent reduction in carbon emissions by 2030. It is helpful that the Hong Kong grid is decarbonising, however, the company must still make further efforts including, for instance, sourcing renewable energy in mainland China. Progress requires the collaboration of many different parties including the grid, the government and customers.

Adriel noted that he finds the mainland China government more progressive on climate change than that in Hong Kong, with clear targets and key performance indicators (KPIs). Conversely, consumers in Hong Kong are currently more sophisticated than their mainland peers. More education is required in mainland China regarding consumption and sustainability but customers are learning quickly.

Regarding waste related to retail and food, Hang Lung is targeting to cut operational waste going to landfill by around 70% before 2025.

Is there a mismatch between investor and corporate expectations in terms of strategy and timing for decarbonisation?

Pru Bennett feels that the biggest issue is communication. Companies need to be upfront about uncertainty due to the long timeframes involved—they are having to report on strategy with a 15 to 30 year view, and a lot can change. While there is hope for instance that green hydrogen technology will work at scale, boards should only approve strategies based on what is currently available, while acknowledging the potential of new technologies.

The value in companies has shifted markedly. Research shows that in 1975 the average market cap of S&P 500 companies comprised 75 per cent tangible assets and 25 per cent intangible. For many of today's largest companies 90 per cent of the value now lies in intangibles such as human, social and environmental capital. Boards need to understand that climate change and community interaction, for example, are areas where value is created and destroyed and to communicate with investors accordingly.

It is a concern that boards still receive most of their information on balance sheets and profit and loss—representing just one-tenth of the company's value. Human capital and social capital should be at the core of strategy and communicated as such. Simply complying with disclosure requirements is inadequate to explain non-financial aspects of strategy. This approach is equally applicable for asset-heavy companies: human capital involves the attraction and retention of quality people, which is a clear competitive advantage. How physical assets affect the environment and local communities should also be factored into long term strategy. Companies that fail to manage their social license to operate risk value destruction.

Adriel concurred, noting that asset-heavy companies are being discounted by the market as investors emphasise asset-light and data or people-orientated services. He believes the shift is structural, so his company has been ensuring it has the right people and culture to progress in a more sustainability-focussed environment. Data and brand building are also increasingly important, even for a company that traditionally simply built and leased the "box" to the retailers who owned the brand and customer relationship. Developers now need to build their own brand and relationships in order to differentiate themselves.

How much time do your boards spend on staff matters, for instance welfare, succession planning and diversity?

Edith noted that there is a lot of staff loyalty within her company, testament she believes to the care that it takes of them and the amount of time management spends considering staff needs. She is personally involved in ensuring that succession is well planned throughout the company divisions. Staff satisfaction is evident from external endorsements, for instance accolades as a good employer.

How do you marry ESG factors with customer needs?

Edith responded that in retail the customer is the boss—and millennial and Generation Z customers are driving the sustainability agenda. The company is addressing this both in its new products and their packaging, by using more sustainable materials and reducing packaging or encouraging recycling with financial incentives on returned empties.

How do companies outside Hong Kong deal with employee retention and culture?

Pru noted that the three big index managers, BlackRock, Vanguard and State Street are very focussed on human capital. It is important not only to retain good employees but also to communicate to investors that your company has good human capital management. For certain industries there are some key statistics and their trends, for instance injury and death rates in mining, which should be disclosed to assure investors that the issues are being well managed by the leadership.

An audience polling question concluded that markets are not yet rewarding Asian companies which implement long term strategies to address climate change. How can scepticism be reduced?

Pru stressed that all listed companies in Asia should be preparing for transition reporting. The International Sustainability Standards Board prioritises climate change and if industry adopts those standards they will become compulsory. This could be challenging for Asian companies since they are still very compliance-focussed. US and European companies have canvassed shareholder opinions on climate strategy but Asia has not even caught up with investor activism on executive compensation, or "say on pay", which has been around in Europe and North America for well over 10 years. Transition reporting will be unavoidable and it will be important for companies to monitor their international peers' approach to keep up with best practice.

ESG and sustainability strategies and their effective communication can be a commercial advantage—but these functions should not be under the communications department, which reduces sustainability to a public relations exercise. COP26 showed that investors are focussing on greenwashing and can see through public relations quite quickly.

Could the more relaxed regulatory framework in Asia be contributing to the sloth of Asian companies? What might speed things up?

Adriel said that although the regulatory framework and consumer and investor expectations could drive change, companies need to be doing more internally to ensure that the issues are properly understood, addressed and communicated. He wants all Hang Lung employees to be sustainability advocates based on understanding and caring about the issues as they affect society, not just the company. Education and regulation are both important to build a more intrinsic appreciation of the issues.

May felt that corporate leaders could be more supportive of the Hong Kong regulator as it tries to implement change rather than risk being left behind other regions.

Pru observed that in Australia the influence of institutional investors is greater, spurring better disclosure. Under the Australian Securities Exchange (ASX) Corporate Governance Code, companies are required to disclose their material economic, environmental and social risks and how they are managed. Despite this requirement being quite non-specific, the quality of sustainability reporting in Australia is very high. Boards know what they should be disclosing and have not waited for specific mandates.

Edith believes that regulation is a good starting point when it requires compliance. Over the course of 20 years she has noticed that mandates do eventually become internalised, resulting in improved behaviour.

Attendees were polled on the right target for women directors on the boards of Asian listed companies by 2025, with the majority opting for 30 per cent. Hang Lung currently has one female director out of a board of 11. What is the company doing to improve its board diversity?

Adriel admitted that the lack of gender diversity is a problem since it stymies diversity of thought which is critical for a healthy board. However, he posited that his board has a reasonable level of diversity of approach and thought due to the relative youth of its recent three appointments—men in their 50s, 40s or 30s.

Keynote Luncheon Speech: "The Next Frontier: The Promise and Perils of Decentralised Finance"

Keynote Speech by **Greg Medcraft**, Independent director, Australian Finance Group

Currently based in Sydney, Greg is a former Director at the OECD's Directorate for Financial and Enterprise Affairs in Paris and prior to that role he was Chairman of the Australian Securities and Investments Commission (ASIC).

Even if you do not think that the area of financial services you may be involved in today is impacted by "decentralised finance" (DeFi), I suggest you look carefully at the potential of this technology. Its real disruptive potential is not in crypto currencies, but the extension of digitalisation in financing of the real economy—though clearly with more guard rails than currently.

Presently, around US$176 billion is locked by smart contracts in DeFi, of which the Ethereum Blockchain represents US$130 billion. A large part of the value is locked in lending platforms and decentralised exchanges. Obviously, the search for yield has helped catapult explosive growth these markets.

Today, I am going to cover the following topics:

- **What is DeFi?**
- **Growth drivers of DeFi**
- **Key DeFi sectors**
- **Benefits**
- **Risks**
- **Potential policy solutions**

1. What is DeFi?

DeFi is an alternative financial infrastructure that is built on top of a public, permissionless and programmable blockchain.

Public – a participant involved in it can verify the correct execution of any operation in the chain.

Permissionless – transactions on the Blockchain are validated by miners in the network and, in the case of Ethereum, the cost of this authentication is called "gas".

Programmable – Blockchain, usually the Ethereum Blockchain. Rather than an intermediary performing a trusted finance function between unknown parties, this function is done by a set of rules encoded into an algorithm, known as a "smart contract". This is stored on the Ethereum Blockchain that automatically executes when predetermined conditions are met. The Ethereum network facilitates DeFi, a little like apps from the Apple Store facilitate utilisation of the Internet. It does this by allowing the creation of "interoperable decentralized applications", or Dapps, that use a smart contract template known as the ERC20 token. The network sets out the rules for establishing smart contracts and their associated Dapp tokens.

In addition, the contract code is stored on the underlying blockchain and can therefore be publicly scrutinized. In DeFi, Dapp protocols are used to replicate existing financial services in an open, interoperable, and transparent fashion. For example, they are already used in payments, lending, exchanges, derivatives, asset management and insurance.

There are several key defining features of DeFi:

- **Non-custodial:** In DeFi applications, no central authority or other intermediary gets access or control over participants' digital assets. Instead, participants manage their private keys and therefore their digital assets directly. In the event of the need to pledge collateral, this is effected by way of a smart contract that "locks" the collateral.

- **Self-governed and community-driven, akin to a mutual**: Most DeFi protocols are open-source and allow the community to review and further develop the code underlying the protocols.

  In terms of governance, the distribution of governance tokens in DeFi apps to users may allow them to participate in any decision-making related to the application and growth in the value of the token, including sharing of fees for use. The importance of the community of participants is fundamental for the generating of network effects, creating value as the number of participants in the Dapp network grows. A little bit like the Apple or Amazon platforms.

- **Composable:** This interoperability of Dapps is one of the most important innovations brought by DeFi. "Composability" provides the potential to further amplify network effects, increasing the value of DeFi Apps as participation in the network grows.

2. What are the growth drivers of DeFi?

The Covid pandemic has accelerated economy wide digitalisation, with a lot of economic activity moving on-line faster than it would have: for example, business survey research by the OECD shows that 70% of SMEs have intensified their use of digital technologies. Digital solutions have often scaled to meet this demand. At the heart of many of these solutions is the fact that they are based on "data" that can be trusted.

While incumbents have rushed to digitalise, challengers at times start-ups, at other times giants from other digital sectors, have sought to seize profitable product lines, challenge business models and even invented entirely new markets, using new technologies like the internet of things, Blockchain, machine learning and artificial intelligence.

In financial services, this growth in the Blockchain market can be further broken down into Centralised Finance (CeFi) and Decentralised Finance (DeFi). DeFi looks to replicate in an open, decentralised, permissionless and autonomous way, the existing financial services in competition to those being provided using centralised permissioned blockchains. For example, centralised crypto-exchanges like Binance compete with decentralised crypto-exchanges like Uniswap.

3. What are the key DeFi sectors?

Let's look at six of them.

- **Decentralised Lending Platforms** – There are a large variety of protocols that allow people to lend and borrow crypto-assets. Decentralised loan platforms are unique in the sense that they require neither the borrower nor the lender to identify themselves. Everyone has access to the platform and can potentially borrow money or provide liquidity to earn interest. As such, DeFi loans are completely permissionless and not reliant on trusted relationships.

For example, the Aave platform (current TVL US$16 billion) is an open sourced, non-custodial, decentralised lending and borrowing protocol. Here is how it works:

1 You need to hold one of the ERC20 crypto assets that are in liquidity demand for depositing on the platform. The most popular tend to be stable coins, such as DAI, whose value is pegged to the USD. DAI itself can be acquired with Ether (ETH), the native crypto currency on the Ethereum platform.

2 You then lend your DAI in the Aave platform, where it is locked by the smart contract and in return receive Aave DAI (aDAI), which is a token that represents your loaned DAI. The depositor also receives Aave tradeable governance tokens that let holders participate in the governance of the Aave network.

3 Your aDAI balance will increase based on a variable interest rate in that DAI liquidity pool, that is based on the supply and demand in the liquidity pool eg, 4% pa calculated by the second.

4 You can withdraw DAI that is equal to aDAI at any time, subject to liquidity in the pool. Equally you can swap it on a DEX.

5 To borrow on the Aave platform, a borrower deposits ERC20 crypto assets as collateral. Again, it is locked by a smart contract, say at a minimum loan-to-value of 75% of the amount of DAI required from the DAI pool at the variable interest rate for that pool, say 6% at present.

6 In the event the collateral level falls below a set threshold, the collateral is automatically liquidated by the smart contract and the loan repaid. The borrower can top up collateral at any time to avoid liquidation.

7 Repayment can occur at any time by repaying the amount lent with accumulated interest.

- **Decentralised Crypto-Exchanges** like Uniswap (current TVL of US$5 billion) enable almost all ERC20 token pairs to be exchanged atomically without any intermediaries. Holders of ERC20 assets can also act as liquidity providers and in return receive a share of fees for using the platform and UNI governance tokens. Liquidity providers, lending their assets, are locked by the smart contract until withdrawn.

- **Decentralised Derivatives** are tokens that derive their value from the underlying assets performance. They usually require an Oracle or trusted data source to verify the asset price that is referenced. For example, Synthetix Dapp allows creation and trading of synthetic assets tracking currencies, equities indexes and gold. Asset positions are collateralised by locking a percentage of the underlying asset.

- **Decentralised Asset Management**. As mentioned, a common theme of DeFi is the use of smart contracts to replace functions normally performed by an intermediary, in this case a traditional funds manager. For example, Dapps like DeFi Pulse Index, allow users to invest in a diversified basket of crypto assets without having to handle the underlying tokens. The smart contracts are set up to follow a simple strategy of indexing and rebalancing a pool of crypto assets. No need for a custodian, as the crypto is locked up in a smart contract. The Dapp issues a tradeable fund token to the investor and allows them to sell or redeem and liquidate their share of the assets at any time.

- **Decentralised Stable Coins**. As mentioned, a stable coin like DAI is pegged to the USD and issued off the Maker (MKR) Protocol on the Ethereum network and collateralised with Ether (ETH).

- **Decentralised Insurance**. An example of this would be Nexus Mutual, which offers cover against smart contract failure.

4. Potential Benefits of DeFi

Let's look at seven of them.

1 **Faster, cheaper, and frictionless transactions of value** as a result of a lack of centralised intermediaries and automation of processes via the use of smart contracts. Even faster than centralised or permissioned DLT based applications.

2 **Transparency**: All transactions are publicly available and code is open source for anyone to review.

3 **Reduced cyber risk**: The absence of a single point of failure or single attack point in a decentralised setting could enhance resilience, especially to cyber-attacks.

4 **Custodial risk is eliminated** as DeFi users have self-custody of their assets.

5 **Counter-party settlement risk is eliminated** due to atomic settlement. Delivery is made against payment automatically. These benefits are also available in permissioned DLT systems.

6 **Innovative flexibility**: Composability/interoperability and open-source infrastructure, easily allow the creation new financial products and services.

7 **Democratisation of finance**: Governance tokens in a DeFi network decide on its future and share the growth in value of the Dapp protocol.

5. Risks of DeFi

Let's look at four groups of risks.

Regulatory and Compliance Risk

Governance

- DeFi operates in areas that in traditional financial services are generally regulated. Most regulators apply a technology neutral approach to determine whether to regulate. Regulatory gaps may exist that need to be addressed.

- The key policy challenge in DeFi is the absence of a single regulatory access point given the way they operate; while their community driven governance makes it difficult to identify decision-making nodes that can be held accountable. In terms of accountability, thought needs to be given to the role of protocol developers (who often hold a significant percentage of the governance tokens), smart contract providers and so on.

- Another challenge is that they are global in operation with no defined jurisdiction.

KYC/AML
Anonymity-gives rise to the use of money laundering and other illicit use of funds. This can be a major issue with decentralised exchanges.

Market Manipulation
By lending and borrowing to harvest governance tokens and artificially inflating demand, or a "rug pull" like a pump and dump where a scammer creates a token, lists it on a DEX and offers it for Ether, and then withdraws holding from the liquidity pool and the price falls to zero.

Investor and Financial Consumer risk

Theft
Digital money lent and effectively held by software could be hacked and funds stolen, for example Harvest Finance protocol lost US$24m.

Investors have no recourse...
...if something goes wrong, given the decentralised governance of the DeFi network.

Lack of audit and due diligence
DeFi projects can go live without proper due diligence, audit, or other testing. Bugs and technology glitches have occurred, that have left participants with significant monetary losses, for example the Yam protocol.

Investor financial capability
Because of the technical complexity of DLT and the composable nature of DeFi products risk, investors having no idea that they may be exposed to the full loss of their capital.

Asset price volatility of the crypto-asset market is a risk.

Systemic risks

At present DeFi is not a systemic risk, but it could affect overall market confidence in the event of a major meltdown of the crypto currency market, triggered by something like a Black Monday event in March 2020 when uncertainty around Covid-19 caused a severe downturn in capital markets. ETH plummeted by 50% causing a cascading effect across DeFi and Maker/DAI in particular.

Technology related and operational risks

Protocol flaws
Errors in code, can result in transactions executed erroneously. Audits and due diligence may not occur, in DeFi apps, given governance is decentralised.

Network risk

- Scalability: Dapps very much rely on network effects to increase in their value and early adopters take the network scalability risk.

- Congestion: Ethereum can experience congestion in authenticating transactions, resulting in rises of the cost of authentication/gas and delays can occur.

Over-reliance on one infrastructure provider like Ethereum, drives up ETH price/gas.

6. Potential Policy Solutions

For policy makers
Six suggestions to strengthen the guardrails:

1 **The need for a responsible person** who is accountable, for example, the protocol developer or other incentivised parties.

2 **Regulatory/supervisory access** points need to be identified. Blockchain displays the address but not the ID of the person sending or receiving on the chain.

3 **Mandatory audit** of codes of smart contracts by neutral third parties.

4 **Legal clarity** for decentralised autonomous organisations (DAO) as entities, like Ethereum, and with liability as holders of governance tokens. For example, Wyoming DAO law has recognised DAO as a legal entity with a resident agent.

5 **Global regulatory cooperation** is required, given that networks are global, to facilitate supervision/enforcement and regulatory consistency.

6 **Build skills and capacity on Defi** through education and training of regulators and policymakers.

For industry
Six key expectations from policy makers:

[1] **Compliance:** meeting relevant policy, legal and regulatory requirements.

[2] **Governance, accountability, and transparency:** being open and inclusive about the design of network protocols and incentives.

[3] **Digital security:** understanding risks, taking responsibility for business continuity and treatment of any personal data.

[4] **Interoperability** between networks to encourage competition. DeFi wrapping of other networks' tokens facilitates this.

[5] **Education and skills development:** Promoting understanding of DeFi and its potential applications, benefits, and risks amongst all stakeholders, including where and how decision-making takes place.

[6] **Cooperate internationally:** Driving consistency in national approaches and promoting fair and open processes for global industry standards. This is something that is a top priority for industry groups, particularly Global Digital Finance.

Plenary 3: The New ACGA Debate—"ESG investment and engagement: Are the public markets innovating fast enough?"

Steve Watson, Partner at Capital International Investors in Hong Kong and ACGA Vice Chair, moderated a debate between **Sheela Veerappan**, Head of Australia and New Zealand at Principles for Responsible Investment (PRI) in Sydney, and **Kei Okamura**, Director of Japan Investment Stewardship at Neuberger Berman in Tokyo to discuss the role of public markets and investors in promoting better ESG practices both internally and externally.

Steve: Sheela, you believe that investment managers and asset owners need to reinvent their mindset towards consideration of ESG issues. How does one do this?

Sheela: Investment has always looked at the financial aspects of different asset classes. A lot of ESG issues are non-financial but can have both negative and positive impacts on financial returns, it is a "third dimension" of risk and return. The biggest hurdle to acceptance is not the varied terminologies or frameworks, or the lack of available data, it is investor acceptance that ESG issues can and will have an impact on your financial returns.

Steve: I have to admit that as a practitioner I may dwell excessively on the financial. Kei, what is your view on the financial and non-financial aspects of ESG?

Kei: We simply consider ESG as financially material—because whatever we look at in terms of ESG it all has a bearing on corporate value. We pursue these topics because we think that they can lead to the strengthening of business fundamentals and sustainable growth of companies. Once you get into the details, a lot of what we are discussing today is core to fundamental investing. For example, for a software IT company the importance of human capital is obvious. Containing the environmental footprint of products from manufacturers or automakers will enhance their competitiveness. ESG is a core part of our fundamental analysis and we designate a portion of our analytical framework in our scoring system to this—it is part of the fundamental analysis work that should be done by our investment team rather than outsourced to stewardship or responsible investment (RI).

Steve: Sheela made the interesting comment that public and private markets need to work together on ESG. How should that cooperation take place?

Sheela: Relying on public markets alone to resolve ESG issues is very limiting. Particularly on climate change I feel that both the private and public markets must unite in creating solutions so that we can work towards a common goal—currently, to keep the temperature rise to 1.5 degrees C. When it comes to innovative climate solutions, listed companies do have limitations in terms of being able to offer the rapid fix that investors are looking for. This is where the private markets, or pre-IPO companies, can come in, because they are not confined by the constraints of the Stock Exchange, or by public expectations.

There are many different strategies and investment vehicles that allow collaboration. "Blended finance" is one way in which investors or public investors, such as pension funds, can join up with private investors looking for public capital.

Kei: Yesterday, media reported that one of the key Japanese automakers is now going to ask its supply chain to reduce its carbon emissions. This is essentially public and private markets coming together. A lot of these suppliers are not listed, they are mom and pop shops, but they are part of the chain that must work to reduce the carbon footprint of the end product.

The other point is that if pre-IPO companies still in the start-up phase understand from the early stages of their development that good governance is critical to adequate mitigation of E and S issues, the impact will be far more material than just nicely published integrated ESG reports. If this approach is embedded in management philosophy, it makes for a much easier integration of these issues. Younger people understand concepts such as materiality better than their seniors who do not want to learn anything new at the end of their careers.

Sheela: Senior people who are anchored to a particular way of investing and may see career risk involved are less likely to embrace investing with an ESG mindset. If you do not have that mindset and the ability to think long term, then you're going to struggle, especially with sustainability issues that do not involve financial returns.

Steve: What about ESG KPIs for senior management? How do we come up with KPIs that can influence public market companies and their management and hold them to account?

Sheela: Companies and investors will have very different thinking on this and there are already a lot of publications on the topic. The question is do the KPIs genuinely reflect—and hold you accountable for—the decisions that you are making, not only today, but into the future? If you are unable to demonstrate how you are meeting this KPI, without a good governance structure in place those individuals will never be held accountable for falling short.

For investment managers, for example, one KPI is to demonstrate how are you truly integrating ESG into the investment process so it does not come in at the very end as a compliance check. How are you demonstrating the effect on company valuations and cash flows, how long is your horizon? Typically, it is three years. Arguably, for best practice that should go up to a full market cycle, so seven to eight years.

Steve: Kei, you said you do not think investors need to reinvent themselves to address financially material issues on ESG topics because many are fundamental to long term investing. Are these KPIs already intrinsic to the discussion that should take place between investor and investee?

Kei: Many of these financially material issues are fundamental to a company's long term strategy and its business. So if as an investor you intend to hold a company for five or six years or more you should naturally be looking at these topics, whether it is carbon emissions, energy management, or adequate human capital management—turnover ratios, employee engagement, and so on.

If a company's disclosure is inadequate or it is not incorporating mitigation methods then we will go to the management and suggest improvements. We explain why these make sense from a long term value creation perspective. These measures will eventually be well established in the business strategy and the companies can continue to outperform and deliver good returns. Investors are compensated for addressing these issues through outperformance.

Steve: While that it the way things should work, is it the way things do work? How would you grade fund managers and asset owners on fulfilling this best practice?

Kei: It is probably not going to be a high score. That's why we are having these global conferences, why we are having COP26, why global warming is escalating. If we were all doing this properly, then I think the world would be a much different place.

I do believe the industry is changing, but to different degrees depending on how well-integrated this understanding is about the concept of materiality into the investment strategy. If it is purely for marketing purposes—essentially, you have an unchanged product rebranded with an ESG overlay to pander to the current environment—it is not going to be that well integrated, and you are not going to be addressing the issues well. The key is to integrate these considerations into the actual investment decision-making process. If the investment team accepts that and embraces that, then I think investors will have a very different outcome.

Audience Q&A:

If investors are judged quarterly how do we change investor, board, fund managers and asset allocator mindsets, to move to this longer term vision that is required?

Kei: A lot of these issues take time to materialise and for strategies to have a positive impact. So this approach to integrating ESG from a bottom-up long term perspective is aligned with long term investment strategies. Engagement is critical and you cannot just engage with a company for one quarter, it must be mid to long term. You need to establish a relationship with the companies and build trust over several years to get to the point where you are talking to the CEO or Chair or founder. However, quarterly reporting does keep investors under pressure too, holding them accountable to make sure they continue to deliver both on returns and on progress towards the investment objective.

Steve: As a fund manager, I am evaluated on an eight year rolling average of my returns relative to an index. That means that the errors that I make in 2021, and there will be many, will live with me into 2029. So there are compensation methodologies that can help bring a long term focus to investing.

What is the view on double materiality?

Sheela: Double materiality is the latest buzzword. The more commonly used interpretation is that it relates to sustainability outcomes—being mindful when you take investment positions that your decisions have an impact, and that impact can be both positive and negative on society and the environment. Regarding the different frameworks: there are a lot, and although the aim is to encourage disclosure, due to the proliferation companies are unsure what exactly they need to be disclosing and how much. The Task Force on Climate-Related Disclosures (TCFD) is the leader and it is a globally-recognised climate framework. So that is probably the best place to start.

Steve: How do we get consensus on what is material?

Kei: The short answer is the Sustainability Accounting Standards Board (SASB), because it works quite well for us and I think it would work quite well for Japanese and other companies. Unfortunately, SASB has not penetrated this market to the same extent as the Global Reporting Initiative (GRI). I think the latest statistics from a GPIF (Government Pension Investment Fund, Japan) survey was around 18% for SASB adoption for large company respondents and 40% to 45% for GRI.

Materiality is important because, especially for the smaller to mid-sized companies that have limited resources to address ESG issues, it is critical to be able to prioritise what is most pertinent to the business. Of course, materiality may change as the business model evolves. The key point here is that for there to be some focus on topics that are linked to the P&L, the balance sheet, cash flow, materiality is critical ensure that we have a unified approach.

Sheela: Obviously if you are an investment manager you want to be able to demonstrate your competitive edge through how you use SASB's information and how you add your own proprietary framework to that.

Why do markets decide that a material issue such as cyber security and data privacy need urgent resolution even though it has been around for five years? How can we move climate change up the agenda more quickly? Is it to do with the immediacy of the impact?

Kei: We tend to like asset-light, next generation business models with good cash flow generation, making us overweight in information technology, communication services, software-type companies. As a result, the materiality of cyber security, data privacy and topics related to the strength of the IT infrastructure is quite high in our engagements. That said, when we speak with many of the companies, whether it is about cybersecurity or environmental issues, we notice that the speed at which companies tackle this comes down to their governance. If the management agrees that this is a fundamental issue to the business then, whichever issue it is, companies take much quicker action.

In the case of Japan, sloth in dealing with climate issues comes down to two clear factors:

1. Traditionally they were handled as part of the CSR department, like a community relations initiative. From being a back seat issue it is now completely front and centre, so a lot of Japanese companies have been caught off guard by that.

2. Addressing some of these key climate risks will involve a lot of capital investment in some cases, resulting in quite a bit of internal opposition from finance divisions that give precedence to short term profits.

The wave of digitalisation that we have seen has made cyber security core to many companies' growth strategies in the short term, so they take action. On the capex front, it has been more manageable from an annual cash flow perspective. These things have impact, but in the end it comes down to the management buy-in, the quality of governance and the ability to address these issues.

Might we push our investment targets too far so that they become uncompetitive or go private to avoid our demands? Given the high costs involved, say, for carbon mitigation, how do you avoid being penalised for doing the right thing?

Kei: Issues should be addressed over time to avoid unduly compromising a business. As it grows larger it can afford to invest more in sustainability without having to strain the balance sheet to such a degree. However, it is worth noting that as companies become more sustainable businesses, that in turn should naturally feed into a lower cost of capital, which should also affect decisions driving big investments to achieve sustainability. This is why it is so important that the approach to addressing these material issues is closely aligned with the financial strategy. It cannot be a divorce, because otherwise you are going to be making some very expensive decisions for green ideas that might have very brown repercussions.

Sheela: I would like to return to engagement. Blunt tools or blunt objectives are unhelpful. The most sustainable—and perhaps slower burning—approach is engagement. Climate Action 100+ is a great example of a group of asset owners and investment managers uniting to engage companies on the very specific topic of climate change. If we can have something similar for other issues, I feel that we are not leaving companies out in the cold to deal with these issues on their own. We are demonstrating that we are in this together when we take a collaborative approach. The last thing that you want is for these companies to go private so that investors lose that opportunity to engage with company management.

Steve: Engagement is a discussion. I think we need to remember that there is dialogue here, give and take, and there is pushback—and that is what makes a market.

Kei: As a bit of a plug for ACGA—almost 30 asset owners and asset managers of the Japan Working Group have come together to engage with Japan's biggest companies on topics related to capital management, such as corporate governance, board effectiveness, as well as on a more company specific situation on climate change and risk mitigation. This part about it not being one-way communication is critical. Japanese companies generally tend to be suspicious towards foreign investors but the approach that we are taking is to build very long term relationships and become a sounding board for their management to come to us and ask us for feedback on the work that they are doing to address these issues. Through that process of collaboration, companies will be able to make more informed decisions that will have a meaningful impact on all stakeholders, including shareholders.

Sheela: As a final thought, the rapid revolution in ESG has led to greenwashing. I wanted to leave the audience with the advice that you really need to ascertain that the ESG person in front of you knows what he or she is doing. You don't want to meet the compliance or marketing person that tells you a great story at a corporate level and you also do not want to meet someone who has done a six-week executive education course on ESG and comes out and calls himself or herself an ESG expert.

Plenary 4:
China – The Big Issues

Three remote participants joined one speaker live onstage to discuss the recent rapid and unexpected changes to the regulatory and investment environment in China. **Katherine Han**, Head of ESG Research at Harvest Fund Management in Beijing, **Karine Hirn**, Partner at East Capital in Hong Kong and **Arthur Kroeber**, Founding Partner and Head of Research at Gavekal Dragonomics of Hong Kong and Beijing joined **Nana Li**, ACGA's Research Director for China, to share their thoughts on what, above all, the theme of "common prosperity" might mean for investors in the coming years.

In the light of comments made by the US Securities and Exchange Commission (SEC) regarding the risk of investing in Chinese variable interest entities (VIEs), **Nana Li** asked how the panel envisaged China reacting to the threat of delisting of these Chinese firms from the US?

Arthur Kroeber felt that it is inevitable that a large number of Chinese companies will be forced to delist from US indices. The conflict between compliance with the US statute on audit oversight rules and the Chinese national security law seems irreconcilable. A deal could be struck between regulators, but compromise looks unlikely given the geopolitical backdrop. Companies delisting in the US are likely to relist in Asia, mainly Hong Kong, only the timing is uncertain. Some exceptions may be given for large firms, but institutional investors should be preparing for the shift.

Are you optimistic about China's ESG policies?

Katherine Han said she believes China to be ahead in demonstrating political will to address long term sustainability issues. There has been a lot of progress made both by the corporate world in terms of ESG improvements and by policymakers setting new standards. It seems clear that regulators and the real economy are advancing towards a sustainable agenda.

Investors are also getting up to speed, with Chinese asset managers following a rapid learning curve to incorporate ESG issues. In the past year, a number of ESG thematic funds have been launched, while asset managers and asset owners are signing up to PRI and other collaborative initiatives.

When it comes to common prosperity, this is undoubtedly a long term agenda for China and its society which goes beyond mere wealth redistribution. It is an overarching development plan which could reshape China's future over the long range, on issues such as aging population, social inequality, income disparity and health care. The speed of the crackdown on tutoring was perhaps surprising, but there has long been a problem with education disparities and investors should be prepared for other similar measures and policies. These considerations need to be incorporated into long term investments and Harvest is rethinking its ESG and investment frameworks in the context of this new overarching theme.

Karine, what is your view on ESG developments in China and which reform this year was the biggest surprise to you?

Karine Hirn felt quite positive overall regarding ESG in China and highlighted that the country is ahead in some areas and behind in others making a simple analysis of its progress challenging. Like most investors, she had not foreseen any of the specific policy changes coming, but noted that as a rule policy risk in China is far greater than political risk. Leadership decisions have a huge impact on the market and consequently investors need to be paying attention to high level directives. This is different from the broader emerging market universe where government policy tends not to influence corporate behaviour much but political risk may be greater. With this in mind, the recent measures in China were only surprising in their specifics.

Katherine had been bullish on the education sector given parental demand for education services in China, so the "double reduction" policy was the biggest surprise. The online education business model faces significant challenges and needs to realign with the new priority of equal education. Investors meanwhile must identify which sectors will benefit from the common prosperity agenda.

Is there any will from regulators to improve policy transparency?

Arthur felt that 2021 was exceptional in terms of the volume and lack of coordination of regulatory actions. This probably reflected both the political and economic backdrop. A lot of these policies were likely to have been gestating for a while but got held back due to Covid, emerging only once the economy had appeared to stabilise. Regulators might also have been provoked to act faster than they might have chosen due to missteps on the part of Ant Group and Didi, resulting in a perfect storm. While there is official recognition that this caused upset and perhaps some will to avoid a repeat, the overall opacity of policy making in China is unlikely to change.

Information has historically been closely held in China, even before the CCP. Transparency has improved over the past 30 or 40 years but the baseline is naturally lower than in Western countries. That said, one of Xi Jinping's governance objectives is for clearer, stronger laws and regulations with fewer grey areas. Previously, many companies have simply worked around the laws—notably the internet sector. Enforcement should now be far more consistent.

Another bright spot is that Xi Jinping's agenda is clearer and better understood. Consequently everyone is more prepared for regulations to be issued under these broad guidelines.

What would be the biggest challenge for ESG development in China?

Karine believes that common prosperity is actually quite consistent with Sustainable Development Goals (SDGs) but China has an unenviable job, having pulled so many people out of poverty, to ensure that they do not fall into the middle income trap. This needs to be considered together with societal risks such as pollution—where China has also made huge progress in terms of investment in cleantech. Common prosperity arguably advances the ESG agenda in China, even if it makes it trickier for investors to identify winners.

Katherine added that 10 years ago the biggest challenge was raising awareness of ESG among institutional investors and demonstrating that it could enhance returns. The political impetus behind ESG and climate financing has solved the awareness deficit and institutional investors all talk about incorporating ESG into their strategies, but there are new challenges.

The largest currently is the lack of high quality data. In the absence of mandatory disclosure the formats are inconsistent among those that are trying to provide CSR and ESG information and while this has provided opportunities for third party ESG service providers, the investment is still insufficient. Manpower shortage is another issue: it is challenging to find high quality ESG-focussed investment professionals in China's investment community. There is huge demand for stewardship professionals, for example, to implement ESG.

In addition there is conflict between localisation and international alignment. ESG has taken on its own form in China and may not carry the same name. For instance, common prosperity is a Chinese approach to addressing social issues reflective of local social priorities. Environmental issues may be more aligned with global frameworks but governance also follows more local practices and might require a localised framework. However, because there is two-way capital flow, these ESG issues will need to be harmonised and people need to talk the same language. We need a global ESG framework or authority to provide guiding principles.

Arthur thinks convergence will be impossible due to governance disparities. China's governance model is not shared by much of the developed world and will not change any time soon. As a result international investors will struggle to balance the factors.

For instance, certain Chinese investments are very favourable from an environmental standpoint, particularly as China builds more environmental and climate goals into its economic policy. However, Western investors will be unable to justify many investments on a governance basis. In the solar sector China's ability to produce very low-cost solar panels at scale is enormously positive for the environment but a lot of the raw materials come from a place where people have concerns about human rights abuses—a big negative for "G". With US regulation preventing imports of these products based on those human rights concerns there will continue to be tension.

In addition, follow-through is lacking at the local level. The People's Bank of China (PBOC) recently announced a re-lending facility to promote green projects by providing cheaper funding for banks which lend or buy bonds in such projects. However, anecdotally, an international bank with whom Arthur spoke recently said that when they looked into it further, their local office of the PBOC in Shanghai had no idea about it.

Audience Q&A:

Might Evergrande's demise force a change in governance?

Arthur reckons that attitudes to the property sector will change, as the secular boom that has been squeezed to drive economic growth for the past 20 years is over. Use of construction materials must fall to meet climate goals. Tighter regulation will stick.

Karine noted that Evergrande is a perfect example of where you need to pay attention to what the government is saying. The three red lines came out in August 2020 but Evergrande's debt-fuelled spending spree kept going. One cornerstone of her company's philosophy is "know your owner". However large your stake, as a minority your influence on this main shareholder will be limited so you must be confident in their integrity and your interests must be aligned.

Where do VIEs fit into a governance structure with fewer grey areas?

Arthur believes the VIE structure is a classic example of a grey area strategy that has been tolerated for years and widely used in the Internet tech sector to circumvent foreign ownership limits. Existing VIEs may be allowed, but new ones will not. This may not matter, because other officially preferred sectors which will see the next growth push are open to foreign ownership.

Which sectors will be the next to be affected under the common prosperity theme over three to five years?

Karine thinks that due to climate goals, emissions will become more of a focus so there will be stricter requirements for those that pollute.

Katherine believes human and financial capital-intensive sectors such as banking are highly exposed. Real estate, utilities and transportation all touch on both social welfare and climate change so their business models will need scrutiny.

Is China more or less investable since its recent perfect storm?

Karine believes that valuations look interesting but more importantly the markets are becoming more institutionalised. This will hopefully lead to governance and ESG improvements. Local asset managers and owners need to take more responsibility though—there are still only 59 Chinese signatories to PRI.

Katherine remains positive about the outlook for ESG in China. Transparency is improving. The information is there, foreign investors just need to build local teams to have a better handle on developments.

Workshop 1
24 November 2021
Whistleblowing, warts and all

Following the conference, ACGA held two follow-on virtual webinars. The first, "Whistleblowing, warts and all", was held on 24 November 2021. Some of modern history's biggest frauds—Enron, Wirecard, 1MDB—were uncovered by whistleblowers, often at their own cost. **Clare Rewcastle Brown**, Founder of Sarawak Report whose investigations uncovered the 1MDB fraud, and **Arnaud Vagner**, Director of Iceberg Research who blew the whistle on financial engineering at Noble Group in Singapore, joined **Jane Moir**, ACGA's Research Director for Hong Kong and Singapore. The trio discussed topics such as how to spot the red flags of fraud as well as numerous aspects of whistleblowing including the role of the media and regulators and the risks for whistleblowers and their personal safety.

Jane Moir gave the context for 1MDB, noting that Clare's coverage led to the Department of Justice investigation in the US. Former Prime Minister Najib was in December 2021 on his second trial for corruption and misconduct in Malaysia related to the scandal. Arnaud, meanwhile, precipitated the unwinding of Noble Group, the Singapore-listed commodities trader whose value was destroyed by revelations of fraudulent accounting.

How did you come to realise that there was something to be investigated?

Clare Rewcastle Brown: There is a journalistic process. First, you realise something does not look right and then you realise there are serious questions that need answers as the dots start to join up. For 1MDB, it was seeing the Hollywood photographs of Jho Low, the stepson of Malaysian Prime Minister Najib Razak, launching a US$100m movie next to Leonardo DiCaprio—coincidentally about massive fraud and the disgraceful lifestyles of the thieves in *The Wolf of Wall Street*—and seeing that Jho Low was credited in the film.

Following an article I wrote musing over the film's funding, I received huge legal pushback—clear evidence I had struck a nerve. Denials must not be demonstrably contradictable from open source information—which these were. Ultimately, the key is always someone from the inside who has more information and either a conscience or a grudge.

If Clare was inspired by "where is the money coming from", what question inspired you, Arnaud?

Arnaud Vagner: Information within companies committing accounting fraud tends to be restricted so that it does not leak. I only learned of Noble's accounting questionability after I left the company and an ex-colleague, who had also left, told me about a sizeable asset overvaluation which a sell-side analyst had also noticed. Usually, when a balance sheet manipulation is obvious it suggests that the company has done other more subtle things previously but has become desperate.

How do you stay the course when faced with denials? If you keep digging, what is the response?

Clare: I was pursued by lawyers and smeared by websites. I became a wanted person in Malaysia with a terrorist notice out against me and as the story grew, that pushback increased. Any tenacious journalist worth their salt takes this as an inspiration. This sort of resistance also draws public attention and highlights what you are doing, so I got a lot of tips, including notice of a potential whistleblower with documentary evidence.

I had to pursue Xavier Justo, the whistleblower, for six months until he would share his information. Once he bit the bullet he promptly got arrested by the Thai police who banged him in jail in Bangkok until he gave a false confession to a former Metropolitan Police officer. Although this depicted me as a fraudster, a forger and a mad, politically motivated woman, it was the right thing for him to do for his own safety.

Arnaud was the subject of a lawsuit in Hong Kong. What happened first? What about other threats and intimidation?

Arnaud: The initial reaction was somebody following me and I got people knocking on my door all the time. The Hong Kong police was involved. They then tried to hack my computer. Bell Pottinger was looking after Noble's PR and they were pretty aggressive. Ironically that helped me a lot because although they told me I was nobody, they were so aggressive I thought it was impossible that they weren't hiding something. I knew that they were monitoring my movements. For some people, being followed or sent a lawyer's letter can be quite an effective incentive to drop a case.

In terms of lawsuits, Clare, do you still have any outstanding against you? How about legal costs?

Clare: The authorities would like to try me for criminal libel in Malaysia, relating to the book I wrote about 1MDB. I am still being pursued by people who are angry at my coverage.

I lost a lot of money defending myself. I now campaign about this because I think it is ironic that it tends to be people outside of mainstream media—or foundations supported by benefactors concerned about the lack of investigative journalism—who take on these sorts of stories. British laws, the court system and the "reputation laundering" industry in the UK mean major newspapers cannot afford to pursue such stories, even if they are true. With growing awareness of the problem, there is a growing body of pro bono support pushing back at this blatant use of financial muscle to silence the media.

Arnaud: Noble Group Limited is under liquidation. After four years and a lot of money spent, I won because they withdrew. They wanted to convert me into a debt holder—which would have been annoying because they did not have any money left—but my lawyers managed to get the funds before they started their liquidation. The plan was to bankrupt me, but fortunately I won in the end—many, many years after I started.

What was your experience with the mainstream press, did it help you get coverage?

Clare: When I eventually came up with my story after years of work, it had to go through the mainstream media. I have tended to take my stories to the *Sunday Times*, *The Wall Street Journal* or *Financial Times* and offer to collaborate. Some cooperate, others take all the credit. But the greater good is what matters.

Arnaud: The press helped me a lot, especially in Singapore because families there invested their retirement money in Noble. We always forget about those victims, but they are very important. The *Financial Times* also helped me. Their problem was to publish without evidence—although after seven months of the saga they published something based just on talking with several people, which was courageous. Once I had their backing it was difficult for Noble. Others, like Bloomberg, made my life difficult because Noble was a client.

Did you ever think of approaching regulators?

Clare: Yes. I often wrote fruitlessly, based on good evidence, that the US financial regulators ought to be looking into Goldman Sachs given the obvious red flags of their deal with 1MDB. But in my experience, it doesn't matter how big the scandal is, the regulators are there not to look unless they must. This is why whistleblowing and journalism are so important—your role is to shove their noses in it so they have to act, which was my strategy with 1MDB. *The Sunday Times* kicked it off with coverage of Petro Saudi—and had to remove most the planned coverage because six top law firms went after it.

Although I put the detail into my blog it was the headlines that prompted the FBI to act. I couldn't get the British or the Swiss interested, and I didn't even try with the Malaysians. To be fair, once it blew up globally many investigations were started in Malaysia which were crucial in unravelling more of the evidence that eventually brought Najib to book. Political pressures were considerable, so kudos to the Malaysian investigators—once they were allowed to do their job.

Arnaud: I was quite disappointed by the regulators. I talked to SGX and the Monetary Authority of Singapore. Early on I felt the people could not or did not want to understand the accounting, and wanted the problem buried. These so-called regulators have a crucial role in what happened, especially because they allowed Noble to raise money when the market knew it was extremely dodgy. Their plan was to let Noble to rebound and to avoid doing any investigation. The regulator lied, saying I had not contacted them, so I realised that they supported Noble. Instead of having one problem, I had two.

There is a criminal investigation underway (in Singapore), but I think everybody is going to die before anybody gets in front of a judge. Thousands of Singaporean investors lost their money. That is a betrayal of your own citizens. The Noble mess confirmed that there were issues with the Singapore Stock Exchange. A lot of hedge funds felt it was proof they should move from investing in Singapore. It is terrible for business—on the listings side the SGX is dying, it is a tiny exchange now. They have not admitted they have a problem.

Do you think authorities love or hate whistle blowers?

Clare: Once everything has come out they may be pleased but they do not like you to rock the boat. For instance, the German authorities really did not want to be told about Wirecard. Pav Gill's (the former Wirecard lawyer who blew the whistle) mum called me and I was convinced that she had genuine evidence. I got in touch with the *Financial Times* which got huge pushback from the German authorities which didn't want to hear about it. The establishment does not want to be caught out having allowed something dreadful to happen on their watch. There is a problem of indulgence towards the big players who therefore have a growing sense of impunity.

While there is tension, overall these organisations have good people. I think our regulatory authorities are underfunded and that is a political issue. That is where the journalist and the whistleblower are needed to make noise—and we need to be protected.

Whistleblowers need a lot of moral support. Xavier Justo has enormous family support and it makes a difference. Journalists can add to that sense of having someone caring about you and the sacrifices you are making. In terms of company policy, internal procedures don't always help. One lawyer told me that her company's whistleblowing policy required her to extract the incriminating material and then go and tell her boss that she knew he was up to no good, which resulted in her immediate dismissal from the company. But she had first ensured she had the material safely elsewhere and it came out in her Employment Tribunal hearing into her unfair dismissal, which brought the authorities down on the company. Even with "solid" whistleblowing policies you have to look out for yourself and remember that if this information is in the public interest it overrides just about every other consideration. It does not ensure there will not be pushback, but you have a defence.

Arnaud: It takes a lot of time to understand what is going on in a company, so the whistleblower is really helpful to an underfunded regulator, even if they would rather not have the problem. Many regulators do not welcome short sellers for uncovering fraud, often because they are in bed with the perpetrators. South Africa is a good recent example of that, they treated active short sellers very badly. Wirecard is interesting because initially the German regulator made a lot of mistakes. It is a scandal, but at least the regulator could be put on the show by the press, which is not the case everywhere.

Whistleblowers who are emotional about the situation, who fear there is some injustice and something must be done, are useful. There are also whistleblowers driven by money who know they have the best information. The only way to get them to reveal it is to give them enough money to retire, because once you are known as a whistleblower, your chances of employment are gone—if there are too few whistleblowers now it is because of this problem of money. Harassment, lawsuits—you need to have money to deal with these.

Did you expect the action from the Department of Justice (DOJ) in the US in respect of 1MDB?

Clare: I knew we could only get these guys via major authorities. I knew a lot was being done through the dollar, that the money stolen in Malaysia was going into our [developed] economies and that America would have an interest. I was surprised when the FBI so readily responded to my approach. When the FBI and the DOJ get their act together to take up a case, God help you if you have been misbehaving. We need to see them pick up on more such cases.

Audience Q&A:

Arnaud, how difficult would it have been for Noble's board to understand the accounting fraud? This was a board with many people from the financial sector.

Arnaud: The main aspect of the fraud was that Noble was to mis-value some commodity contracts at US$3.8bn net value when the real value was zero—very similar to what Enron did. Nobody on the board had commodity trading experience. It is not difficult to understand, but I am always surprised at how little people outside know about the business, so it was a way for Noble to avoid detailed questions. I don't think the board members knew about the frauds, but after I exposed it, it would have been easy for them to get access to information—but they didn't want to do it, apparently.

Are we becoming immune to large scale fraudulent plundering of companies, particularly where a government is involved?

Arnaud: The regulatory approach of fines has limitations. They are a cost of doing business for professional, serial fraudsters. If regulators are imposing fines it is also a way for them to make money—so they need fraudsters to continue. If you want to stop people preying on investors you need to send them to prison. It is the only effective disincentive.

Clare: I totally agree. Najib would be justified in asking why he has to go to prison when the Goldman Sachs perpetrators simply had a reduced bonus. Corrupt funds from countries of poor governance cause rot in our systems through crooked financiers. Corrupt actors have deep pockets and buy influence—US$100m went into bribing people around Trump and Obama. In Britain there is cash for honours from dubious actors, but equally shocking is that people tolerate this criminality, not least because they feel there are more important issues.

We all benefit from an honest environment, even a little bit of graft damages society. You have to crack down on it.

What would be your advice to someone who had something to expose?

Clare: Get to a jurisdiction where you feel safe. The Wirecard whistleblower and his mother had threats against their lives even in Singapore and an ideal whistleblower programme would have protected them. Safety is paramount.

Workshop 2
1 December 2021
Communicating the energy transformation

Yuelin Yang, Deputy Group Managing Director, IMC Industrial Group and an ACGA Council Member, moderated **Melissa Brown**, Partner at Daobridge Capital, **Hendrik Gordenker**, Senior Advisor to JERA, and **Eugene Cheng**, Group Chief Financial Officer at Sembcorp Industries to discuss the challenges facing companies as they try to transform their business models away from fossil fuels towards a net zero world.

Yuelin Yang began by identifying gaps where there are outstanding issues to be resolved in the energy transformation, as follows:

1 Who pays? The private or public sector, corporates versus consumers, and developed versus developing countries.

2 Government policies. While critical to incentivise climate change mitigation strategies, a lot of governments currently subsidise fossil fuels.

3 Timing. Poor planning for the phasing in of renewables and the phasing out of fossil fuels will affect energy supply and prices during the switch.

4 Infrastructure. Battery or grid storage needs to be in place to match increase in renewable energy supply and consumer demand and behaviour changes, eg electrification like EVs.

5 Data shortfall. An interest in ESG funds has risen markedly but there is still insufficient and unreliable data and few investable companies.

6 Disclosure. Businesses need to set and disclose their transition plans. Only 10% of listed companies that have disclosed plans are on target to meet 1.5 degrees C.

7 Engagement. Investors and businesses need to communicate actively on transition plans and targets.

Despite reports from scientists that the situation is critical, we have a legacy fossil fuel ecosystem which needs to change. Why aren't things moving faster?

Melissa Brown noted that despite the best efforts of the investment community, willing corporates and increasingly focussed governments, this is a technology-driven disruption scenario incompatible with some of the current strategies in place. Net zero nationally-determined contributions (NDCs) in Asia are based on traditional political and financial trade-offs but it is more likely that technology will disrupt at an unexpectedly fast pace.

This is bad news for companies and governments that have significant legacy asset bases and policy structures that are not conducive to managing this type of transition. Factors that separate winners or losers will also consequently shift. This is likely to complicate the dialogue between the investment community, banks, and other sources of funding, with government policymakers, or new generation and old generation firms.

Melissa raised several areas in which investors must be informed and educated:

1 Country-level transition pathways are still too vague and policy processes are outdated. This is especially complicated for listed companies with significant government ownership.

2 Risk reward scenarios will change. There will be a focus on companies that have better odds of mobilising cash, due to favourable corporate structures, less burdensome legacy assets or entrepreneurial management.

3 It is critical to understand grid investment and associated infrastructure—whether from the power company or the power utility infrastructure—and subsidies and policy support.

4 New market structures and associated technical vocabulary will emerge. With dramatic new technology options becoming economic—even deflationary—it is going to change the dynamic of this sector. Markets like India and China are undergoing transformational change in the structure of their power markets.

Hendrik Gordenker added that the main challenge of the transformation will be to achieve net zero by 2050, the global goal resulting from the COP26 conference. This will affect our use of fossil fuels, which are the source of around 85 per cent of the greenhouse gas emissions in the world. More than a century's worth of infrastructure must be replaced or repurposed. While conventional energy spend is around US$1.5 trillion, moving that into cleaner energy means annual investment of around US$5 trillion from now till 2050. On the upside, there is a lot of technology available and in development. It is not clear yet which technologies will win, and some will probably drop very dramatically in cost—as with solar PV cells before. It is likely to be very disruptive and we are just at the beginning. Japan targets net zero by 2050, with clean fuels accounting for one per cent of Japan's total energy supply by 2030. That will probably need to be 20 per cent or more by 2050. It is a huge jump with a lot of uncertainty.

Key focus points:

1 Huge infrastructure investment is required, including increasing capacity of the power grids in developed countries by about threefold. To achieve net zero globally, two-thirds of the investment will be in developing countries. Financing will be a challenge.

2 Supply of clean products, clean energy, clean services must be aligned with demand. We need stable long term visibility on the supply and demand picture to encourage investment. Government policy can give clarity here with mandates for using clean energy or raising prices on dirtier energy.

3 Consumers need to be educated for the change.

4 Companies, developers and providers of finance must collaborate to provide visibility on the new supply and demand situation. We will need new business models to spur investment in repurposing old assets and in creating new ones, and so that the finance side is ready to fund it all.

Eugene Cheng shared the perspective of Sembcorp Industries, which faces some of these challenges across India, China and Southeast Asia.

He identified the following stumbling blocks:

1 Baseload power generation must be stable, but renewables tend not to be. More technology and investment are required for grid stabilisation activities—for example, batteries and storage systems.

2 In many Asian economies the fossil fuel facilities are young but will have to release capital into renewables, where returns are being compressed, and future technologies which can provide the baseload at reduced emissions. The community, governments, industrial players and financiers must unite to find solutions.

Capital expenditure or operating costs will rise. New technologies will take a long time to realise. Are investors prepared for long term strategies with lower returns?

Hendrik said that there has been a tendency to think that with prices high and oil profitable, more money should go into the sector, but new thinking is required. The view was expressed at COP26 that the fossil fuel business has been volatile for a long time, causing disruption and damage, so we need to redouble our efforts to reduce our dependence. Developers, companies, finance parties, government and other stakeholders, must acknowledge that the risks of sticking with fossil fuels are high economically and catastrophic environmentally. Investors need to reprioritise since, for the transition to be successful, a lot of long-term investment is needed. Stable long term returns should be favoured over "big bang" short term fossil fuel trading profits.

Melissa warned that the investment community has yet to invest in necessary software to assess the situation. The tools, particularly in Asia, are not good enough to analyse significant ESG and climate risks and the intellectual challenge has risen dramatically. Power sector experts need six to 12 months off the day job to come up the learning curve. Investors must be asking companies about climate risk fundamentals and disclosure, especially as the range of trade-offs and strategic choices shift and grow.

The burden on investors is heavy. Formerly stable assumptions for power companies and utilities will become very dynamic. As banks withdraw capital and project financing becomes constrained, traditional assumptions about access to debt are obsolete. People need to become expert on science-based targets but there are also more complex issues. If you are an investor in this region, people are going to need more time and resources. Power markets are very different around Asia; you cannot generalise across China and India.

Eugene, you have been transparent in communicating your targets. How do you talk about the phase-out of young fossil fuel assets, for example?

Eugene stressed that clear communication of targets and action plans is essential. Sembcorp discloses its targets, which go into senior executive KPIs—if the company falls short by 2025, Eugene does not get paid. Transparency has benefits, including access to long tenure, and cheaper green financing. Bond investors are willing to pay a premium if there is comfort that the organisation that they are funding is serious about its aims.

Hendrik noted that Japan has shifted its policy position behind Singapore, so is still catching up. He agreed that disclosure is critical for attracting investment and employees—as well as being responsible citizens.

However, he added that disclosure is challenging for JERA and companies like it on several fronts:

1 Carbon intensity targets are easy but not aggregate emission reduction targets—in part because there is a range of technology choices. For example, should JERA invest in zero emission offshore wind power, or renewables, or should it be replacing fuels in an existing fossil fuel power plant with clean or cleaner fuels?

2 Gross emissions disclosure obscures the nuance. As an acquisitive growth company its expansion includes fossil fuel assets, so gross emissions are expanding. It can, however, reduce the carbon intensity and overall emissions of acquisitions and develop longer term clean energy plans with partners. This should be attractive.

3 Disclosure around technology is a dilemma—some early-stage significant projects are confidential. There will be areas where companies are reluctant to talk because of competitive positioning.

Melissa observed that the quality of information for investors is patchy and it is critical to be sure that they are doing the right kind of peer group analysis. Investors will rely heavily on expert networks as norms shift, and people with strong technical backgrounds often have strong views on viable transition pathways. Increasingly, they involve activists in this discussion.

Given these varied sources of information, there will be lot of pressure on IR, the CEOs and CFOs who must be confident to say that there are things you cannot easily talk about. Many power companies cannot and will not in public talk candidly about the regulatory environment due to politics. Companies may need to acknowledge where they are doing "national service" or do not have control. Investors will need to be willing to be more positive about some of the very tough decisions that companies are going to have to make. When CLP withdrew from its coal-fired power projects in Vietnam it was part of a very long process and important for its de-carbonisation. The investment community barely acknowledged this difficult decision. The Asian Development Bank (ADB) proposal about early retirement of coal assets is a complicated, important scenario, but it is really going to force investors and funders across the board to think very carefully.

What are other key issues or challenges that you have seen on disclosure?

Eugene said that it is hard to know at what level to disclose in compliance with TCFD, what disclosure would cost and how difficult it is to assess the risk scenarios to provide that level of a disclosure. It is a lot of work—but is hopefully useful to investors.

Hendrik agreed that disclosure work can be tough and detailed and takes significant resources. Companies will get better at it as the standards develop and become clearer—and it is necessary work. Companies need to understand their climate impact and risks they face with climate change.

The science is also developing. For example, a significant climate impact is methane emissions, for which there is dramatically improved data through airplane flights. In addition, the Global Gas Importers Association has introduced a framework to identify the greenhouse gas impact when JERA buys a cargo of LNG.

Do you worry about accusations of greenwashing?

Eugene hoped that Sembcorp's transparency regarding transition targets, the impact on management of meeting these and its successes and failures along the way illustrates its sincerity.

Melissa noted that while she is supportive of targets, she pays attention to how money is being spent. She likes a company to be open about its degree of control when it comes to regulation and large shareholder interests as this affects which assets it can strand or exit and its investment plans. Activists will ensure that gas is also blacklisted in time which will create new challenges in the region.

Regarding the science, we have a lot to learn about fugitive methane emissions, but that discussion is not going to go away. The discussion about gas will become a focus, which will drive greenwashing claims aggressively simply because so many companies in the region plan to use carbon capture and storage (CCS) as a backstop. Transparency about the next three to five years and how money is actually being spent is key.

Hendrik stated that from now until we get to net zero, there will be emissions and people who criticise the emitters. Some of those emitters will try to have a story and it will be called greenwashing, which is inevitable, but criticism can also be constructive if it pushes change. Companies must have narratives with credibility in terms of the science and fit with national policies and regulatory structures and long term investor returns.

He added that unabated high emission assets are going to become riskier and riskier. Public concern is growing about even ordinary pollutants. Carbon methane emissions are going to be the subject of regulatory oversight with carbon costs and border taxes. The cost of capital is going to increase in this area. It is increasingly risky not to make short term return sacrifices, because in the longer term you may end up with highly risky, volatile and potentially stranded assets. And hopefully we can get enough investors onside to understand that story so we can make our transition.

Do we have those kind of investors out there?

Melissa said that that there are some, but fewer than before. Asia-focussed power sector investors were yield-focussed and do not like that put at risk. Traditional players have to restructure and communicate and develop credibility around scenarios that allow for a changed asset mix and asset write-downs. Companies that have a good track record of communicating with investors can be very effective. It is saying 'this is a nonrecurring loss or this is how we get to a better cleaner strategy'. It does place a burden on management, and not just the one individual who tends to see investors the most.

In addition, we will see new growth-oriented, pure play IPOs. Some of them will do great, a few of them will implode, but we are also going to see a much more diverse menu of investment opportunities around. This is a sector poised for a lot of change and it will not always favour the more traditional asset companies. The opportunity will go to those with engaged significant shareholders and companies who will really do the work necessary to create credibility around the three to five to 10-year plan. Because if the money is not flowing in line with transition then it is going to be very difficult to create credibility.

Audience question: which calculations make investors less positive?

Melissa said that the transition will be costly, with companies writing down assets and investing in new technologies and markets where they cannot yet be certain of full cost recovery. Tariffs will also have to go up. In the energy growth markets of Southeast Asia, this could be very significant. Analysts have lost some confidence because they do not have certainty on tariff forecasts, which makes it difficult for them to see exactly how certain investments will be made.

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