Nippon Life India Asset Management (Singapore) Pte. Ltd

ESG Risk Policy

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Nippon Life india
Asset Management (Singapore)

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1. Policy Introduction

Environmental, Social & Governance ("ESG") Risks has emerged as another major risk as asset managers embrace responsible investing. The global trend of ESG investing is also driven by increasing regulations in leading jurisdictions and the general belief that companies who manage material ESG factors well will outperform in the long run.

While the Social aspect covers social relationships ranging from employee's rights, workplace policies, employee wellness to human rights, Governance encapsulates issues and efforts involving decision-making, and corporate cultures of transparency, accountability, inclusivity, and compliance. This also includes the relationship with stakeholders, such as shareholders, investors, and customers.

Environmental issues include a company's usage of energy resources, policies on waste management, and its impact and efforts towards net-zero emission and climate change. Specific environmental issues include deforestation, water pollution, carbon emission, among others.

As a strong supporter to global ESG initiatives as well as to enhance value of all stakeholders, NAMI as a signatory of United Nation Principles for Responsible Investment ("Unpri") has crafted its ESG Policy Framework setting out ESG mission/principles that all subsidiaries are to align with in conducting business internally and when making investment decisions for clients.

The objective of this ESG Policy ("Policy") is to align NAMS business practice with missions/principles laid down by NAMI, commensurate with the nature and scale of NAMS business. NAMS as a responsible asset manager will seek out investments in ESG compliant companies in respective market that it operates.

While Social and Governance risks are not new topics and many companies have been in scrutiny for overlooking them, the Environmental aspect has started gaining attraction of global communities recently and is worth explaining in detail in latter sections. It is the objective of this Policy to choose a representative and reliable indicator/barometer to help NAMS seek out ESG compliant stocks for investment portfolios under its care.

Having mentioned above, it is important to note that NAMS is primarily a single-market asset manager focusing in India, an emerging economy that is typically lagging in tackling ESG matters.

Even ESG disclosures for the mid and small cap companies is very weak and non-existent in certain cases. NAMS can only make better choices from a pool of predominantly higher risk companies based on criteria set by the West that is ahead of the game. This situation will only improve over time as India transits into a ESG friendly country like any other developing countries.

2. Governance Framework of this Policy

This Policy is to be integrated as a sub-policy in NAMS Risk Management Policy therefore subject to same governance framework/structure. The Risk Management Committee will exercise oversight of environmental risk management, and the Risk and Compliance Manager is tasked for risk identification, monitoring and reporting.

ESG risk management is subjected to regular internal and statutory audits as NAMS is committed to contribute to the society/environment, which will ultimately enhance long-term value of client assets.

3. Environmental Risk

Companies operating in environmental unfriendly sector or adopting production methods that pollute the environment, etc. is expected to have potential adverse impact to the environment. Investment value in these companies is expected to decline due to regulations, investor preference, and responsible investing.

Environmental issues include climate change, loss of biodiversity and pollution, etc. Environmental risks have the potential to financially impact funds/mandates managed by asset managers through physical and transition risk channels:

- Physical risk

Arises from the impact of weather events and long-term environmental changes. For instance, water scarcity and pollution will impair value of companies in the water-intensive sector.

- Transition Risk

Arises from changes in public policies, customer and investor preference etc. For instance, punitive actions against companies that pollute the environment and the transition to low-emission could have a negative impact on valuation of companies operating in the sector.

- Reputational Risk

Negative perception of asset managers who invests in companies that carry out business activities which have a negative impact on the environment.

NAMS as a responsible asset manager will seek out companies that are environmental friendly or contributes to a green economy.

4. Social Risk

Social factors are relevant from both a business and an investment perspective and are increasingly being factored into investment analysis and investment decisions. In many cases, investors expect companies to manage these issues by using a best-in-class approach or in other cases, a social issue can become the focus of an investable opportunity. Companies are increasingly expected to engage with their stakeholders openly, transparently and responsively.

Some of the long term social changes that affect government, societies and economies are :- Globalisation, Automation and Artificial Intelligence (AI), Inequality and wealth creation, Digital disruption, social media and access to electronic devices, Changing demographics, Urbanisation etc. Some of the very important social factors which impact the internal stakeholders in a company are Human Capital Development, Working conditions, Human Rights.

NAMS as a responsible asset manager will try to seek out companies that are socially aware and responsible.

5. Governance Risk

Corporate governance is the process and structure for overseeing the business and management of a company. Corporate Governance has become more complex as the scale of organization and their ownership have evolved. As a result, the role of the board of directors has become more important. The board is responsible for representing the owners of the company and for holding management teams accountable for running the business in the interest of its owners. The effectiveness of the board depends on whether good corporate governance practices are applied. Good corporate governance should lead to strong business performance and long-term prosperity to the benefit of shareholders and the company's other stakeholders Accountability and Alignment are important pillars of corporate governance. Increasingly, investors are expecting companies to disclose their corporate governance structures and processes so that external investors can understand where the company stands on the spectrum of good governance. Some of the areas investors look into while addressing corporate governance are :- shareholders' rights, likely success of company's strategy and quality of leadership, executive pay, audit practises, board independence etc.

NAMS as a responsible asset manager will seek out companies which follow good corporate governance practises.

6. ESG Risk Strategy

The industry's views and ways of managing ESG risk is evolving. It is expected to take some time to converge on standards and methodologies. During this interim, considering the need to safeguard client investment values and the resources needed to aid research on companies in the investment portfolios, NAMS has decided to leverage on available resources in the market and has chosen ESG Ratings, a proprietary rating by Sustainalytics of Morningstar featuring:

- wide coverage, currently covering 16,000 companies and is still growing
- coverage of all Environment, Social and Government aspects of each company
- focus on material ESG issues
- annually refreshed ratings
- absolute ratings that enable comparability across industries and companies

A company's ESG Risk Ratings score is assigned to one of these five categories:

Ratings Score (points)	ESG Risk
0 - 9.99	Negligible
10-19.99	Low
20-29.99	Medium
30-39.99	High
40 and higher	Severe

**The higher the score the higher the risk of material financial impacts driven by ESG factors. Generally speaking, less ESG disclosure implies higher uncertainty and, hence, higher risk from an investment perspective. Consistent with this view, companies with poor disclosure will typically do worse in our ratings.

In view of the situation that ESG issues are only starting to gain attention in India, there are relatively fewer companies that scores well in ESG Ratings. In addition, it takes time for ratings agency to fully cover every single listed company, which will further limit the choice of asset managers. The situation is expected to gradually improve over time.

NAMS as a responsible investment manager will strive to achieve these targets for client portfolios:

1) minimum 75% of NAV invested in companies rated by Sustainalytics;
2) maximum weighted Rating Score of 33 for rated companies;
3) maximum 10% of NAV in investee companies that are rated above 52[#].

[#]currently there are counters in client portfolio rated 52 mainly due to gap in disclosure expectations, which is expected to moderate down over time.

The investment limits abovementioned will be revised as frequent as yearly as India transits into a more ESG friendly market. Over time, NAMS is committed to tighten the limits further in tandem with improvement of ESG issues in India.

It is the commitment of our NAMS to persuade/encourage investee companies to improve or enhance ESG ratings there is opportunity, e.g. discussions during company visit.

7. Fixed Income Investments

The same exposure limits shall apply to fixed income investments, following below sequence to obtain available ESG Ratings:

- ESG Rating of the security
- ESG Rating of the issuer
- ESG Rating of next immediate parent company

The security shall be considered non-rated if the security fails to find any ratings after completing the abovementioned steps.

For clarity, all investment funds consisting purely government securities and/or government securities under client portfolios shall not be subject to ESG Ratings limits and be excluded from the limit/exposure computation.