March 2023

[redacted]

Code Red!

Call for Action on Responsible Corporate Engagement in Emerging Markets

Discussion paper for policymakers, regulators, investors and other capital market participants

EU-ASEAN BUSINESS COUNCIL

UN-convened Net-Zero Asset Owner Alliance

In Collaboration with the World Economic Forum

Context

Emerging and developing economies (EMDEs) require trillions of dollars of investment to reach the Paris Agreement targets. To achieve net zero by 2050, the International Energy Agency predicts that annual capital spending on clean energy in EMDEs (excluding China) must increase from under $150 billion in 2020 to over $1 trillion by 2030.[1]

To help close this financing gap, investment from developed countries is needed. The EMTI initiative has been created to identify solutions to mobilise the investment required to achieve the transition to net zero in EMDEs. A series of roundtable discussions has been organised with select groups of invited leading experts, with the aim of developing recommendations for the public and private sectors in time for COP27.

The first roundtable by EMTI resulted in the Code Red! Call for Urgent Action on Emerging Markets Transition Investment paper on 12 practical recommendations to accelerate emerging markets transition investment. In the second roundtable, experts discussed responsible and effective engagement in EMDEs. It is apparent that the most important overlap between the two roundtable discussions is the clear need for localised approaches to facilitate the transition towards net zero. Decarbonisation pathways with climate and social goals that are appropriate for EMDEs are needed for both investment and effective engagement to understand feasible and fair asks from companies operating in EMDEs. These discussions during the second roundtable resulted in this second paper in the Code Red! series.

Decarbonising the real economy will be the sum result of hundreds/thousands of companies, both public and private, transitioning their business models towards net zero. Both corporate and policy engagement are highly likely to be a critical aspect of the decarbonisation strategy of an investor. The argument on the importance of corporate engagement by investors has already been firmly established, with research indicating that engagement can have a positive impact on both financial return and sustainability practices[2].

Good engagement practices by asset owners and managers in that context implies actively and knowledgeably interacting with companies in a constructive way, to encourage them to take the necessary steps to pursue more sustainable business models and reduce their transition risk. The discussion on how to increase the effectiveness of engagement has been evolving; e.g. the ‘Future of Investor Engagement’ paper by the Net Zero Asset Owner Alliance offers practical recommendations. However, the discussion around effective engagement rarely includes differences between regions and/or economic development of the country in which the corporate operates, even though this could have a large impact on how the corporate will respond to climate change.

As mentioned above, this was the topic of the second EMTI roundtable and the discussion has resulted in this list of guiding principles and practical recommendations for asset owners, asset managers and regulators.

[1] International Energy Agency. Financing Clean Energy Transitions in Emerging and Developing Economies. June 2021. p. 14
[2] Among others: Bauer, Rob and Derwall, Jeroen and Derwall, Jeroen and Tissen, Colin, Private Shareholder engagements on Material ESG Issues (July 25, 2022) & Dimson Elroy, Karakaş Oğuzhan, Li Xi, 2015, “Active Ownership”, The Review of Financial Studies, Volume 28, Issue 12: 3225–3268.

5 Guiding Principles for Responsible & Effective Engagement in Emerging Markets

Guiding Principle 1

Establish a local approach with an appreciation for the complexity and variation of challenges

Guiding Principle 2

Integrate the 'common but differentiated responsibilities' principle of the Paris Agreement

Guiding Principle 3

Be prepared for ongoing engagement, with sustained dialogue to build trust

Guiding Principle 4

Commit to knowledge sharing between global and local investors

Guiding Principle 5

Be flexible with the engagement ask – consider the practicalities around ambitious target setting

These guiding principles are supplemented with practical recommendations for implementation, which are grouped around the four themes below. All recommendations are relevant for asset owners, asset managers, regulators and other players in the financial sector engaging with companies.

The last set of recommendations are specifically for regulators. Asset owners and asset managers are strongly encouraged to engage with regulators on policy; the asks of regulators on engagement should include these recommendations.

Theme 1
Financial Institutions:
Define an EMDE specific approach

Recommendation	Consideration
1. Integrate the 'common but differentiated responsibilities' principles of Paris agreement in engagement approach	The common but differentiated responsibilities principle means that all states are responsible for addressing climate change yet not equally responsible. The principle balances the need for all states to take responsibility for climate change and the need to recognise the wide differences in levels of economic development between states. These differences in turn are linked to the states' contributions to, as well as their abilities to address, these problems. It's therefore important to be aware of the complexities in seeking commitment to net zero by 2050. Consider the implications based on companies' ability to obtain green energy, the country's overall net zero commitments, and public/private dynamic.
2. Outline realistic asks	Emerging economies deserve the right to grow their economies and support their growth particularly to reach a higher quality of life. Finding the right balance between economic growth and climate action is challenging and this understanding should be reflected in the engagement asks.
3. Start with disclosure	Disclosure is a good starting point for deeper engagement on credible climate strategies and targets in the future. Disclosure on scope 1 and 2 (and scope 3 if relevant) is a practical starting point which can lead to discussions on targets and a transition plan.

Theme 1
Financial Institutions:
Define an EMDE specific approach

Recommendation	Consideration
4. Seek effective engagement over divestment, where possible	Divestment depletes collaborative aspects of engagement. Large scale divestment by large global asset owners and managers leads to a depletion of resources and knowledge, including losing influence on transition plans. Guidelines and policies on escalation after failed engagement should reflect the specific challenges for EMDEs.
5. Consider a partnership approach for family- or state-owned companies	Family- or state-owned companies are more common in EMDEs requiring a different approach to engagement. There is a need to bring together investors, global networks, NGOs, regulators, and other stakeholders to drive change. Local banks should play a key role because they provide most financing in EMDEs and already have a close relationship. Direct engagement with policymakers can also be effective to change state-owned companies.
6. Consider suitability and flexibility of financing mechanisms	Combining debt and equity engagement can be effective. Many companies in EMDEs finance themselves more through debt than equity[3]. Engagement through debt may give easier access to management of corporate. Engagement on sustainable finance – in particular labelled bonds with additional sustainability-linked covenants – can be effective due to the prospect of access to additional capital.

[3] World Bank Group, Corporate Borrowing in Emerging Markets: Fairly Long Term, but Only for a Few, 2018

Theme 1
Financial Institutions:
Define an EMDE specific approach

Recommendation	Consideration
7. Engage with regulators in EMDEs	Closer collaboration between financial institutions and regulators in EMDEs will be beneficial. Knowledge sharing is critical – asks from global investors are not always well understood by regulators, and investors' knowledge about regulatory developments in local markets is often limited. A "consultation approach" can be taken – ongoing informal dialogue so that all stakeholders can contribute to the development of new policies and are aware of their impacts before being implemented.
8. Build confidence	Continued dialogue between institutional investors and all stakeholders in the EMDEs is key to building confidence, long term relationships and mutual knowledge sharing.

Guidance on the 'common but differentiated responsibilities' principles of the Paris agreement

The 'common but differentiated responsibilities' principle of the Paris Agreement says that countries that have historically emitted more GHG emissions have more responsibility to act on climate change. FTSE Russell has created a Net Zero Atlas which estimates the Implied Temperature Rise of countries based on their net zero target and Nationally Determined Contributions. They focus on emissions per capita and assign percentage shares of the global annual carbon budget to specific countries. Through focusing on emissions per capita and estimating cumulative emissions over time, countries with high emissions per capita are expected to set more ambitious targets. Using this approach, FTSE Russell assessed that India's net zero target by 2070 is more ambitious than the 2050 net zero target of The Netherlands.

Theme 2
Financial Institutions:
Develop specific, localised engagement strategies

Recommendation	Consideration
1. Commit to sustained, ongoing engagement	While engagement is perceived to be more difficult in EMDEs, especially given that ESG issues are still novel in companies in emerging markets and many do not have robust Investor Relations teams, dialogue must be sustained to build trust. One-off engagement does not work well in general, but especially in EMDEs. Beyond building trust, sustained engagement is also important because decarbonising itself is a multi-year journey. Through regular engagements, investors are able to track year-over-year improvements and adjust the strategy with the engagement targets.
2. Include local portfolio managers in the engagement team	Local portfolio managers have better knowledge of local context and have better relationships, therefore they are best positioned to lead. They also are more likely to speak the language and understand the culture which benefits the engagement as they have local expertise, knowledge and can convey the message in a more effective manner.
3. Establish knowledge sharing mechanism between local and global investors	Sharing global and local knowledge can elevate understanding and progress. Global investors bring resources, experience with climate and ESG, and frameworks, all of which can be lacking among many local investors, regulators and companies in EMDEs. Local investors provide context and local knowledge of the market practises and on current or emerging regulation. The combined knowledge of local and global investors therefore provides a more robust platform for engagement and ultimately progress.

Theme 2
Financial Institutions:
Develop specific, localised engagement strategies

Recommendation	Consideration
4. Assist in developing the sustainable financing ecosystems within EMDEs	A strong incentive for engagement and sustainable finance is changing the financing ecosystem within EMDEs. Large asset owners and multinational agencies looking for sustainable bonds from banks or corporates in EMDEs will be good incentive for taking steps towards developing a robust and internationally competitive sustainable finance market.
5. Develop understanding of challenges specific to that market with the focus on social aspects	Developing an understanding of the local circumstances and reflecting this in the engagement strategy with the corporate will benefit the interaction. Investors will therefore have to familiarise themselves with the local challenges and consider aspects around a just transition. The just transition is defined by the International Labour Organization as 'greening the economy in a way that is as fair and inclusive as possible to everyone concerned, creating decent work opportunities and leaving no one behind'[4]. Considering the needs for workers in carbon-intensive industries and the challenges for EMDEs in decarbonization, should be understood when engaging in EMDEs.

The EU-ASEAN Business Council published in December 2022 a paper on the **Energy Transition in ASEAN.** The annex includes per country overview of the current state of the energy transition, the key policies and the most important challenges.

[4] Climate change and financing a just and inclusive transition (ilo.org)

Theme 3
Financial Institutions:
Implement a localised approach for collaborative engagement

Recommendation	Consideration
1. Align objectives of global and local investors	Alignment of objectives of global and local investors within collaborative engagement is crucial for involvement. This will require putting effort into finding common ground on the engagement asks.
2. Regulators and asset owners can nudge local investors to participate	Nudges by regulators and asset owners to local asset managers to participate in collaborative engagement are useful. Asset owners should emphasise the importance of collaborative engagement to local investors. Reaching out to regulators to ask them to educate and incentivise local investors might also help to increase local involvement.
3. Include local investors and banks in collaborative engagement	Collaborative engagement can be effective, but local investors are often not consulted in global initiatives and are not asked to participate in collaborative engagement. Launching global initiatives without proper consultation with local investors can be counterproductive. Local investors and fund managers are more likely to be in for the long run compared to foreign investors. Asset owners can be influential through demanding local engagement in their mandates. Having local investors in collaborative engagement programmes is a clear signal to the corporate this topic is also high on the local agenda.

The engagement approach of ClimateAction100+ includes principles on selection of lead engagers, among which is geographical proximity. But local investors from emerging markets are underrepresented in CA100+ making this practice hard to implement. CA100+ is actively approaching local investors from emerging markets.

Theme 4
Regulators: Encourage more stewardship and knowledge sharing in EMDEs

Recommendation	Consideration
1. Regulators to encourage stewardship amongst investors within local markets	Regulators can encourage stewardship amongst investors through stewardship code adherence, capacity-building and informal nudging of local asset managers, especially as the stewardship knowledge pool is not as deep in EMDEs.
2. Explore differentiated stewardship codes	Regulators can explore differentiated stewardship codes (or implementation guidelines) for developed vs emerging markets – each market is unique, and a tiered system could make engagement more meaningful and accessible.

Malaysian Code for Institutional Investors 2022

In 2022, the Institutional Investors Council published the Malaysian Code for Institutional Investors as "the collective voice of institutional investors is an important lever in promoting good corporate governance and sustainability practices by investee companies". The code is based on an 'apply or explain principle' and includes principles on engagement, monitoring, voting, sustainability issues and disclosure. The code also includes expectations, such as the expectation for investee companies to comprise at least 30% women representation on their boards which is aligned to the Malaysian Code for Corporate Governance.

Theme 4
Regulators: Encourage more stewardship and knowledge sharing in EMDEs

Recommendation	Consideration
3. Collaborate closer with (global) financial institutions	Closer collaboration between financial institutions and regulators in EMDEs will be beneficial. In addition to investors engaging with regulators, regulators can reach out to investors to understand their asks from the companies in their market. Regulators can also benefit from collaboration with other regulators to accelerate efforts on sustainability.
4. Provide more clarity on engagement	Investors want more clarity from regulators on engagement on what is allowed in terms of collaborations (acting in concert) and activities.

Collaboration of Regulators

Some of the most well-known collaborations of regulators are global, for example the Network of Greening the Financial System and the cross-regional adoption of and alignment towards TCFD/ISSB to establish a common framework. However, local collaboration can also advance the efforts of regulators. The Green and Sustainable Finance Cross-Agency Steering Group in Hong Kong aims to co-ordinate the management of climate and environmental risks to the financial sector and accelerate the growth of green and sustainable finance in Hong Kong

Call to Action

The members of the EMTI project recommend the following actions for asset owners, asset managers, collaborative platforms and regulators:

Asset Owners & Asset Managers

to raise awareness of and implement the nuances for engagement with corporates in EMDEs with the objective to make engagement more impactful, including engaging with regulators, stock exchanges and other governmental bodies to:

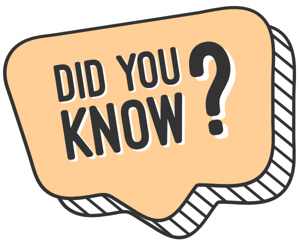
- **Share expectations from companies in the market**
- **Be more efficient in asking for change, for example on disclosure**
- **Learn about local circumstances & challenges on energy transition**

Regulators

to develop and enforce stewardship codes which could include nuances for emerging markets, or use other ways to encourage engagement by local asset managers to speed up the energy transition.

Collaborative Platforms

to facilitate more knowledge sharing between global and local investors both ways. One way to do this is through creating 'safe spaces' in dialogues and online platforms where local investors can learn and share knowledge and practices without having to sign up to the initiative. Another option is to create training programs on engagement.



An example of a **safe space** is, in 2021 the World Economic Forum and its partners explored potential pathways for accelerating the repurposing of coal fired power plants to renewables capacity under an initiative called Mobilising Investment in Clean Energy for Emerging Markets. In a series of roundtables the technologies, financing and policies needed for a just transition were workshopped and the outputs generated the Coal to Renewables Toolkit for open learning especially EMDEs.

About the Emerging Markets Transition Investment (EMTI) project

The Emerging Markets Transition Investment (EMTI) project was organized to identify practical, near-term solutions to accelerate investment towards the net zero transition of EMDEs. The project is supported by the Net Zero Asset Owner Alliance (NZAOA) Nature and Climate Finance under the World Economic Forum (NCF), and the EU-ASEAN Business Council (EU-ABC). The EMTI project organised two webinars on Net Zero in ASEAN and Africa. In June 2022, the project organised the first roundtable on barriers for transition investment in EMDEs, which resulted in this paper with twelve practical recommendations.

The EMTI project organised the second invitation-only roundtable on engagement on 13 October 2022 which was attended by 26 participants across the financial industry, including asset owners, asset managers, collaborative platforms, regulators, rating agencies, and non-governmental organisations (NGOs). Conducted under Chatham House Rules, the roundtable sought to unpack three questions:

- Sharing of best practices between asset owners and asset managers
- Regulatory dimension on engagement
- Collaborative engagement

Relevant Documents with respect to Engagement published by the UN-convened Net-Zero Asset Owner Alliance:

- The Future of Investor Engagement: A Call for Systemic Stewardship to Address Systemic Climate Risk
- Elevating Climate Diligence on Proxy Voting Approaches

Acknowledgements

The three organizations that are collaborating on the EMTI project wish to acknowledge and thank their members and the other individuals and outside organizations who contributed time and ideas in the October 13 Roundtable and writing and commenting that led to this paper. The UN-convened Net-Zero Asset Owner Alliance wishes especially to acknowledge the contribution of Prudential, in particular Don Kanak, Chairman of Prudential Insurance Growth Markets and Liza Jansen, Head of Responsible Investment for leading the NZAOA's subtrack on Financing the Transition in Emerging Markets, of which the EMTI is a key component. The Nature and Climate Finance under the World Economic Forum (NCF) expresses special thanks to Nikki Kemp, Director Asia Pacific. The EU-ABC expressly acknowledges the contributions of Executive Director Chris Humphrey and Advocacy Director Liyana Othman. All three organizations wish to acknowledge the support from Eastspring Investments on this roundtable, in particular Stuart Wilson, Head of Sustainability and Pei Shee Seah, Senior Manager Sustainability.

Feedback

This paper is intended as a living document and feedback is welcomed as the practices around engagement are constantly evolving and investors gain new experiences. Feedback can be shared with Liza Jansen, Head of Responsible Investment at Prudential: liza.jansen@prudential.com.hk