DRIVING ESG INVESTING IN ASIA
THE IMPERATIVE FOR GROWTH
KEY TAKEAWAYS

1. ESG Investing is a holistic approach to investing that incorporates critical environmental, social, and governance (ESG) factors into the investment analysis and decision-making process for an organization.

2. There is growing evidence that ESG-aligned funds perform at par with benchmark indices. This incentivizes investors to integrate ESG factors into their investment strategies, where ESG is incorporated as enhanced risk management responses to the evolving complexity of global systemic risks. Certain demographic groups, such as millennials and women investors, are also asking for investments that are both good for society and the environment, aside from their portfolio returns.

3. However, Asian investors still fall behind their global counterparts in the take-up rate of ESG Investing – this low take-up rate is indicative of a less mature ESG Investing environment, but can also be attributed to legacy issues, short-termism, lack of awareness, and talent gaps.

4. Fortunately, the mindsets and perceptions of Asian investors toward ESG Investing are changing owing to the wide sharing of successful ESG Investing-related experiences. Moreover, regulators and institutional investors are increasingly committing to internationally-recognized principles for ESG Investing and national stewardship codes.

5. In general, investors in Asia are represented across a broad spectrum of practices, perspectives, and experiences of the different maturity stages along their ESG Investing journey; each facing their own challenges while playing different pivotal roles.

6. To begin the ESG Investing journey, investors must first challenge the status quo and generate evidence for change. Identifying key knowledge gaps and areas to upskill are essential next steps to becoming ESG Investing experts. Finally, investors must identify ESG Investing champions who are leaders within their respective fields who can share their approaches and inspire others.

7. In this paper, we suggest six practical recommendations for advancing stakeholders in their ESG Investing journey. Implementing these suggestions at each stage will support the steady development of ESG capabilities, and chart a path for sustainable investing, growth, and development across Asia.
FOREWORD

Since 2011, Asian Venture Philanthropy Network (AVPN) has been working to increase the flow of financial, human, and intellectual capital into non-profits and social enterprises – collectively referred to as Social Purpose Organizations (SPOs) – in Asia to tackle social challenges. AVPN sees the social investment landscape populated by multiple organizations such as family offices, foundations, impact funds, corporates, banks/wealth management organizations, private equity and venture capital (PE/VC) funds, and intermediaries. These organizations practice different social investment methodologies such as philanthropy, venture/strategic philanthropy, impact investment, and ESG Investing. They ultimately provide financial and non-financial support by giving grants and debt as well as public and/or private equity. These actors with their different investment methodologies build a continuum of capital for SPOs and hence solve social issues in Asia.

All investing methodologies and actors, as well as the corresponding social issues and SPOs evolve constantly. Against this backdrop of an evolving investment landscape, AVPN has observed an increase in ESG Investing practices by family offices, wealth management teams in banks, and PE/VC funds. As such, AVPN has collaborated with Oliver Wyman and Marsh & McLennan Companies’ Asia Pacific Risk Center (APRC) on this report Driving ESG Investing in Asia – The imperative for growth to inform investors in Asia about their role in channeling capital to improve social and environmental wellbeing along with achieving desired financial performance.

The report captures the experiences and insights of a sample of AVPN members based in Asia who are at different stages of their ESG Investing journeys, and provides key learnings and recommendations for those aiming to embark on similar journeys.

We are grateful to the following members for providing valuable insights:

- BNP Paribas Wealth Management
- Credit Suisse
- LGT
- Northstar Group
- Quadria Capital
- RS Group/Sustainable Finance Initiative by RS Group
- Schroders
- Standard Chartered
- Treïs Group
- Anonymous PE fund
WHAT DOES THE ESG INVESTING LANDSCAPE LOOK LIKE?

DEFINITION AND HISTORY OF ESG INVESTING

ESG Investing is a holistic approach to investing that comprises tools to incorporate critical environmental, social, and governance factors into the investment analysis and decision-making process (Exhibit 1). It relies on companies to be compliant with ESG standards and investors to invest in these companies. These investors can be family offices, wealth management firms and banks, as well as PE/VC funds using equity and debt instruments.

The beginnings of ESG Investing were rooted in religious and ideological values. Tenets like the Torah and Sharia led followers to exclude selected sectors, companies, or practices that they believed they had a negative impact on the environment and the society at large when making any investments or conducting any business. The first of many ESG Investing products, the

<table>
<thead>
<tr>
<th>Investment Philosophy</th>
<th>Focus Description</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Traditional</td>
<td>Limited or no focus on ESG factors of underlying investors</td>
<td>Focus on ESG risks ranging from a wide consideration of ESG factors to negative screening of harmful products</td>
</tr>
<tr>
<td>Responsible</td>
<td>Limited or no focus on ESG factors of underlying investors</td>
<td>Focus on ESG value creation through investment selection, portfolio management and shareholder advocacy</td>
</tr>
<tr>
<td>Sustainable</td>
<td>Focus on one or a cluster of issue areas where social or environmental need creates a commercial growth opportunity for market-rate or market-beating returns</td>
<td>Focus on one or a cluster of issue areas where social or environmental need requires risk-adjusted returns</td>
</tr>
<tr>
<td>Thematic</td>
<td>Focus on one or a cluster of issue areas where social or environmental need requires almost 100% financial trade-off</td>
<td></td>
</tr>
<tr>
<td>Impact-first</td>
<td>Focus on one or a cluster of issue areas where social or environmental need requires almost 100% financial trade-off</td>
<td></td>
</tr>
<tr>
<td>Impact-only</td>
<td>Focus on one or a cluster of issue areas where social or environmental need requires almost 100% financial trade-off</td>
<td></td>
</tr>
</tbody>
</table>

Source: Mercer Responsible Investment, MMC APRC analysis
Pioneer Fund, was launched in 1928 and practiced negative screening of investments based on social exclusions against industries, such as tobacco, gambling, and alcohol.

This was followed by several internationally profiled disasters involving multinational corporations, such as the Exxon Valdez oil spill and the Bhopal disaster in the 1980s, the Deepwater Horizon oil spill in 2010, the Fukushima Daiichi nuclear disaster in 2011, and the Rana Plaza collapse in Bangladesh in 2013, among others. These incidents accelerated the momentum for responsible business practices as environmentalism, human rights movements, and the network effects of social media have propelled this momentum onto a global platform, enhancing and enabling international cooperation in favour of more rigorous scrutiny and towards ESG Investing. Today some of the world’s biggest asset managers boast large and successful ESG funds.

ESG Investing has seen a surge in volume across the world, with US $23 trillion of ESG assets under management (AUM) being deployed as of 2016.\(^1\)

The investment amount is aggregated across the seven responsible investment strategies, which the Global Sustainable Investment Alliance (GSIA) has devised to classify forms of responsible investing.\(^2\)

**GSIA INVESTING STRATEGIES**

1. **Negative/exclusionary screening:** Exclusion of certain sectors, companies or practices based on specific ESG criteria
2. **Positive/best-in-class screening:** Selection of investments based on positive ESG performance relative to industry peers
3. **Norms-based screening:** Screening of investments against generally accepted minimum standards of business principles and practices
4. **ESG integration:** Systematic inclusion of ESG factors into financial analysis
5. **Sustainability themed investing:** Investment in themes such as water, clean energy or sustainable agriculture
6. **Corporate engagement and shareholder action:** Private markets investment aimed at solving specific social or environmental problems
7. **Impact/community investing:** Influencing company behavior about ESG practices and policies through direct corporate engagement, and proxy voting among others.

ESG Investing is often used synonymously with socially-driven finance, with terms such as Socially Responsible Investing (SRI), Sustainable Investing (SI), Responsible Investing (RI) and mission-related investing used. For the purpose of this report, we focus on GSIA strategies 1 to 6 that are defined within the ESG universe. Impact/community investing is considered a separate practice, not part of our scope of study.
FACTORS DRIVING ESG ADOPTION

The last decade has seen significant developments in the ESG Investing landscape globally. Investors are becoming cognizant of the fact that competitive financial returns can be generated alongside social and environmental progress, and are beginning to embrace international standards of sustainability. The launch of the Principles of Responsible Investing (PRI) network in 2006 by the United Nations (UN) and more recently the UN Sustainable Development Goals are exemplary milestones in this evolution.

Since the launch of the PRI, there has been rapid growth in AUM and the number of signatories in the PRI network (Exhibit 2). As of 2017 there were more than 1,700 signatories to the UN PRI accounting for a total of US $68 trillion in AUM; this value grew at 15 percent compound annual growth rate (CAGR) between 2014 and 2017. Investment managers represent around 70 percent of signatories, while the rest consists mostly of asset owners. Among asset owners, pension and retirement funds lead in the signatories, followed by insurance companies and foundations.3

There are both demand and supply factors driving the adoption of broader environmental and humanitarian issues in investment decisions.

Exhibit 2: Development of UN PRI signatories and AUM over time

Source: UN PRI dataset, 2017
Demand – Growing consciousness and recognition of financial merits

ESG Investing is gaining attention because of the resilience it can offer in times of uncertainty. A 2018 global perception risk survey by the World Economic Forum\(^4\) indicates that most business leaders are widely concerned about the year ahead, which is largely on account of intensifying global risks emanating from political tensions, environmental threats, and cyber vulnerabilities. Fortunately, ESG Investing can overcome this issue, according to another global survey of institutional investors on responsible investing.\(^5\) This survey found that more than half (57 percent) of all respondents believed that the incorporation of ESG criteria had a positive impact on risk-adjusted returns, and building more resilient portfolios. Only nine percent thought otherwise.

Indeed, some of the world’s most influential institutional investors – investment management corporations,\(^6\) pension funds,\(^7\) and tertiary education endowments\(^8\) among them – appear to be especially proactive in insisting their investment managers adopt a long-term mindset to sustainable growth.

As such, there is also growing recognition among asset owners and investment managers of the financial merits of ESG Investing. As shown in Exhibit 3 (on the next page), public equities and indices that consisted of ESG-compliant companies largely performed at par with the benchmark index over different investment periods.\(^9\) Another study by Deutsche Bank\(^10\) found that 89 percent of these had observed companies with high ESG ratings outperformed the market.

Reliable empirical evidence has emerged that companies with better ESG practices are more profitable,\(^11\) trade at premium valuations to competitors,\(^12\) and are associated with long-term financial value creation.\(^13\)

Brighter financial prospects and outcomes are not just the only factors driving this push towards greater integration of ESG into business practices and investments strategies – investors belonging to specific demographic groups are also increasingly asking for investments that are good for both the society and environment, and their portfolios. For instance, millennials are twice as likely to invest in companies or funds that target social or environmental outcomes.\(^14\)

About 35 percent of Asia’s wealth will be in the hands of millennials in the next five to seven years, the highest rate of change in any global region.\(^15\) Controlling a greater share of wealth will allow today’s millennials to advance the ESG Investing agenda.

Further, gender also has a key role to play in this regard. Four in five (80 percent) women are observed to be keen investors in ESG as opposed to 60 percent of men, and the trend will continue with woman’s rising financial independence.\(^16\) Employees have also started expecting their companies to disclose their sustainability initiatives and performance, in addition to incorporating ESG policies into the companies’ investment processes.\(^17\)
Supply side – Emerging maturity of the ESG market

Recent years, ESG data and rating providers have proliferated to measure and track impacts. In a watershed move for sustainable investing, Bloomberg launched a dedicated ESG data service in 2009. This service allows subscribers to evaluate the ESG performance of thousands of companies, enabling institutions and individuals to develop their own strategies for ESG investing. Similarly, other financial data providers have stepped up their sustainability-related offerings: Mercer assigns strategy level ESG ratings on individual investments strategies, while market intelligence firm Morningstar launched an ESG fund scoring platform, as did information firm Thomson Reuters. Several leaders in the industry such as MSCI and Dow Jones now also have indices dedicated to ESG investments.

This has been accompanied by the availability of new, innovative ESG financial products. Instruments such as climate and green bonds are being made widely available by leading financial institutions. New and developing financial markets – such as those for Exchange Traded Funds – are also incorporating ESG criteria into their products. These products address an increasingly diverse range of issues: in the US, for example, funds that abstain from gun-friendly investments have been developed in recent months. The expansion in the opportunities for investing sustainably is a key driver of growth in ESG investments.
Globally recognised brands including Apple, Starbucks, and Unilever have also taken big strides in their efforts to adapt operations and processes to comply with ESG criteria by adopting Global Reporting Initiative (GRI) standards, for instance. Between 2011 and 2015, the share of companies in the S&P 500 issuing corporate social responsibility reports increased from 20 percent to more than 80 percent. These initiatives have contributed to the growth in the supply of sustainable products and offerings. It has also increased awareness among consumers.

Today, institutional and private investors are seeking to create financial, social, and environmental benefits by allocating capital to responsible and sustainable businesses. An important characteristic of the ESG Investing landscape has been the introduction of standards and guidelines to promote, measure and track ESG impact and processes. We have listed some of the landmark initiatives below, including the respective years of establishment.
SLOWER ESG INVESTING UPTAKE IN ASIA

Despite these global drivers, adoption of ESG Investing in Asia has been comparatively slow. Assets devoted to ESG Investing as a proportion of total managed assets are much lower for Asia as compared to Australia, Europe, and North America. As shown in Exhibit 5, Asia ex-Japan has the lowest ratio recorded (less than one percent), in contrast to Europe and Australia/New Zealand (both over 50 percent) in 2016.

Exhibit 5: ESG Investing as percent of total managed assets by region 2012-2016, in percent

<table>
<thead>
<tr>
<th>REGION</th>
<th>2012</th>
<th>2014</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Europe</td>
<td>49.0%</td>
<td>58.8%</td>
<td>52.6%</td>
</tr>
<tr>
<td>United States</td>
<td>11.2%</td>
<td>17.9%</td>
<td>21.6%</td>
</tr>
<tr>
<td>Canada</td>
<td>20.2%</td>
<td>31.3%</td>
<td>37.8%</td>
</tr>
<tr>
<td>Australia/NZ</td>
<td>12.5%</td>
<td>16.6%</td>
<td>50.6%</td>
</tr>
<tr>
<td>Asia (ex-Japan)</td>
<td>0.6%</td>
<td>0.8%</td>
<td>0.8%</td>
</tr>
<tr>
<td>Japan</td>
<td></td>
<td></td>
<td>3.4%</td>
</tr>
<tr>
<td>Global</td>
<td>21.5%</td>
<td>30.2%</td>
<td>26.3%</td>
</tr>
</tbody>
</table>

Source: Global Sustainable Investment Alliance

Exhibit 6 illustrates the growth of ESG Investing assets (equivalent to ESG AUM) for different geographic regions from 2012 to 2016. Total ESG AUM in Asia ex-Japan pales in comparison to the size of total assets in other regions. Despite starting from a lower base, the ESG AUM growth rate in Asia ex-Japan is significantly slower than the growth seen in most other regions.

Exhibit 6: Growth of ESG Investing assets by region 2012-2016, in $US BN and percent

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<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Europe</td>
<td>8,758</td>
<td>10,775</td>
<td>12,040</td>
<td>37.0%</td>
</tr>
<tr>
<td>United States</td>
<td>3,740</td>
<td>6,572</td>
<td>8,723</td>
<td>133.0%</td>
</tr>
<tr>
<td>Canada</td>
<td>589</td>
<td>729</td>
<td>1,086</td>
<td>81.0%</td>
</tr>
<tr>
<td>Australia/NZ</td>
<td>134</td>
<td>148</td>
<td>516</td>
<td>285.0%</td>
</tr>
<tr>
<td>Asia (ex-Japan)</td>
<td>40</td>
<td>45</td>
<td>52</td>
<td>16.0%*</td>
</tr>
<tr>
<td>Japan</td>
<td>7</td>
<td>474</td>
<td></td>
<td>6,771%*</td>
</tr>
<tr>
<td>Total</td>
<td>13,261</td>
<td>18,276</td>
<td>22,890</td>
<td>73.0%</td>
</tr>
</tbody>
</table>

*The figures represent growth between 2014 - 2016
2016 assets are reported as of December 31, 2015, except for Japan, which reports as of March 31, 2016, and currencies are converted to US dollars at the exchange rate prevailing on December 31, 2015, for comparability. Historical 2014 data are reported as of December 31, 2013, except for Japan which is reported as of September 30, 2014. The 2014 and 2012 data has been converted into US dollars at the exchange rate prevailing on December 31, 2015, in order to avoid introducing currency exchange rate trends into the calculations.

Source: Global Sustainable Investment Alliance
Notably, Japan has made significant strides in expanding its ESG Investing efforts and is a frontrunner in Asia: ESG AUM grew almost seventy-fold by 2016, albeit from a low base and a sliver to the total global share in 2014. Japan’s high CAGR (724 percent) was made possible by a combination of revised reporting standards, the emergence of a Japanese stewardship code and a growing focus on ESG among Japanese institutional investors, especially pension funds such as the Japanese Pension Investment Fund (GPIF).22

Regulators across Asia ex. Japan have started implementing public policies to address the low uptake of ESG Investing in the region. An example of Japan’s early adoption of public policies on sustainability and stewardship is compared alongside a brief overview of current regulations in China, Hong Kong, and Singapore below:

**Japan**

Building on the energy around ‘Abenomics’, Japan’s Financial Service Agency (FSA) launched the Japanese Stewardship Code in 2014. This Code paved the way for corporate reform by encouraging sustainable investing practices, encouraging dialogue between investees and clients, and espousing a ‘comply or explain’ approach to the code for signatories. Following this, in 2015 Japan released a Corporate Governance Code and amended its Japan Revitalisation Strategy to further strengthen requirements and align with international standards. These reforms are widely credited for encouraging the world’s largest pension fund (the GPIF) to become a PRI signatory.23

**China**

China’s 13th Five-Year Plan, which will guide Chinese government policy from 2016 to 2020, outlines a series of reforms and targets to aid in greening China’s economic development. It has been estimated that approximately US $274-468 billion of green investment each year from 2014 to 2020 will be required for China to transition into a green economy.24 To ensure the development of the requisite financing channels, the Plan includes commitments to encourage a green bond market, recommendations for the establishment of market-based green development funds, and expectations that the banking sector restrict lending to entities with industrial over-capacity (such as steel and coal mining).25

**Hong Kong**

In May 2016, the Hong Kong Financial Services Development Council released a series of recommendations for transforming Hong Kong into a Regional Green Finance Hub. The recommendations include developing a green bond market, developing green labelling and project accreditation schemes, and providing support to the private equity sector through funds and tax exemptions.26 After emphasizing the need for more green finance in the 2018-2019 Budget Announcement, the Hong Kong government went on to announce a pilot Green Bond Grant Scheme (offering a HK $2.5 million (US$ 320,000) per bond grant to those eligible) to be formally implemented in 2018.27

**Singapore**

In a speech at the 2017 G20 Green Finance Summit held in Singapore, the country’s Minister for National Development Lawrence Wong stated that Singapore was eager to push for deeper ESG integration in its financial institutions. This statement reflects a wider push across the
financial sector in Singapore towards greener practices, encouraged by Singapore’s central bank (MAS) and its main stock exchange (SGX). In 2016 SGX joined the UN Sustainable Stock Exchanges initiative as a partner exchange, and laid out ‘comply or explain’ rules for its listed companies. In 2017, MAS launched a Green Bond Grant Scheme to encourage the development of the green bond market in Singapore.

Despite the implementation of these policies in pockets across Asia, many challenges remain in the widespread adoption of ESG Investing in Asia:

- The combination of limited knowledge and a skill resource gap has made ESG a daunting prospect for some Asian investors. Apart from their lack of awareness and misconceptions about ESG hampering financial performance, these investors do not have the requisite expertise and team to interpret the multitude of ESG standards.
- Moreover, there has been a slow adoption rate of ESG Investing among investors in Asia, a heterogeneous region comprising of numerous emerging markets that prioritize economic growth and traditionally focused on short-term returns.
- These issues are further exacerbated by the lack of consequences for inaction and the lack of collective efforts by Asian regulators and governments in enforcing ESG policies as opposed to their peers in Europe.

This report aims to better understand the challenges and opportunities of ESG Investing in Asia for investors. Anecdotal insights and key findings are presented in the next section.
HOW EXPERIENCED ARE ASIAN INVESTORS IN ESG INVESTING?

The findings presented in the subsequent chapters are based on interviews held with family offices, banks, and PE firms. Overall, these groups of investors are a growing segment among AVPN members and are a key enabler of ESG investments according to AVPN. They are pivotal in driving funds from institutional investors, retail investors, and high net worth individuals (HNWI), thereby acting as a catalyst for ESG Investing.

The insights for this report stem from interviews with AVPN members with explicit ESG Investing experience. Due to the sample size of interviews conducted, the following anecdotes should reflect as peer insights for other aspiring and existing ESG investors.

THE ESG INVESTING JOURNEY

Given the wide range of investor knowledge, expectations and goals, we find that there is no one archetype ESG investor. Today, investors in Asia exist across a broad spectrum of practices, perspectives, and experiences at different maturity stages along their ESG Investing journey. While some investors have started only recently, others have been active for several years. Consequently, they face different challenges and leverage different opportunities. Wherever relevant, we have reflected these nuances in the sections to come.

Exhibit 7: Roadmap of the ESG Investing Journey

<table>
<thead>
<tr>
<th>Call to action</th>
<th>Early-stage “Embark on the ESG Investing journey”</th>
<th>Intermediate-stage “Become an ESG expert”</th>
<th>Advanced-stage “Advocate ESG Investing”</th>
</tr>
</thead>
<tbody>
<tr>
<td>ESG adoption</td>
<td>Low</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Return expectation</td>
<td>F=Financial, E=Environmental, S=Social, G=Governance</td>
<td>F VS. G</td>
<td>F + G</td>
</tr>
<tr>
<td>Investment approach Based on GSIA investment strategies</td>
<td>Negative screening (i.e. exclusions)</td>
<td>In addition to early-stage: positive screening, ESG integration and thematic investing</td>
<td>In addition to intermediate-stage: corporate engagement (direct or through investment manager)</td>
</tr>
<tr>
<td>Guiding principles</td>
<td>Limited, some consideration of external resources</td>
<td>Internal frameworks combined with external information as overlay</td>
<td>Sophisticated analytical models and frameworks built in-house</td>
</tr>
<tr>
<td>Challenges</td>
<td>Mindset, knowledge, awareness</td>
<td>Performance track record, education</td>
<td>Supply, e.g. investment managers and products</td>
</tr>
</tbody>
</table>

Source: AVPN-Oliver Wyman Analysis
The framework in Exhibit 7 was developed based on observations from these interviews. It illustrates how organizations can be categorized into three differentiated stages:

**Early-stage ESG investor:** Investors who have yet to or have just recently embarked on the ESG Investing journey

Early-stage ESG investors tend to have relatively lower ESG adoption within their investment process and approach it with a more opportunistic view or take a negative screening approach, by avoiding fossil fuels, for example. They are usually characterized by limited knowledge and awareness, viewing ESG and financial performance as trade-offs. One key challenge is changing the mindset of key stakeholders and senior management.

**Intermediate-stage ESG investor:** Investors who have collected considerable experience in ESG Investing in recent years

Intermediate-stage investors have higher ESG adoption and internally defined principles to guide their investment strategies. They believe ESG and financial performance are complementary and hence adopt a larger variety of approaches, such as ESG integration, thematic investing and positive screening.

**Advanced-stage ESG investor:** Investors who are well-versed in the field of ESG Investing and have an ESG-focused investment philosophy

Advanced-stage investors are the most mature in their adoption and understanding of ESG Investing. They integrate ESG factors into their risk management and due diligence functions with no compromise on financial performance, leading to more sustainable, long-term value creation. They have constructed sophisticated frameworks and models to guide investments and, depending on the nature of the investment, are able to engage their investee companies to advance their ESG strategies.

**INTERVIEW INSIGHTS**

This section summarizes the insights from our interviews. First, we share findings that are applicable to all interviewees, regardless of them being family offices, banks or PE firms. Next, we discuss key takeaways and highlight some case studies for the different stages of maturity.

The commonalities observed across the three adoption stages of the ESG Investing journey are as follows:

**Multiple paths to successful ESG Investing:** Despite the long-standing history of ESG Investing globally, there is still no consensus over ESG definitions, investment approaches or strategies among investors. There is no one-size-fits-all solution in ESG Investing across investor groups and asset classes. Rather than searching for the silver bullet, it is more
expedient to guide the ESG Investing journey with the firm's vision and mission. For instance, many investors we interviewed adopted their own unique approaches to ESG Investing which, over time, have proven to be successful.

While ESG integration, thematic investing, and negative screening are observed to be the most commonly adopted ESG practices, we noticed Impact Investing becoming increasingly popular among our interviewees. Family offices often invest directly into impact projects, utilizing investment managers whose values are aligned with theirs, or even alongside specialized PE firms. With the goal of channeling capital from traditional investments, some banks are setting up their own impact funds to gain a competitive edge while others collaborate with boutiques or investment managers. In line with market observation, PE firms are increasingly raising Impact funds themselves.

ESG adoption driven by demand-side factors: Family offices and banks are increasingly incorporating ESG factors due to the passions and motivations of ultra HNWIs or family patriarchs. Separately, PE firms are adopting ESG investments due to increasing demand from their clients, both private and institutional. More generally, our findings suggest that ESG adoption is often closely linked to personal as well as corporate culture and values, and is driven by a top-down desire to change the way business is run and how it is perceived.

Regulators starting to push ESG agenda in Asia: Some interviewees are of the view that more can be done on the regulatory front in Asia to encourage ESG Investing. While some Asian investors have managed to get ahead of the regulatory curve in implementing ESG strategies by responding to global trends and taking cues from their global peers, others are still relatively inactive in terms of ESG. Recent regulatory changes across Asia are a duly welcome development and could further push ESG adoption in the region.

Value-add through ownership and shareholder engagement: Due to their large shareholdings and accompanying board seat positions, PE firms are less likely to wholly reject investee companies that do not entirely fulfill ESG standards during the screening process. Instead, they can work with their investee companies, and roll out ESG practices post-acquisition. Some leading PE funds work alongside the management of their Asian investee companies to resolve governance and sustainability issues, while initiating ESG integration and policies for longer-term value creation and improved risk management. Banks and larger investors, such as family offices, are also using similar investment strategies to advance their ESG agenda.
KEY CHALLENGES FOR EARLY-STAGE ESG INVESTORS

Globally, ESG Investing is a growing business imperative for investment managers, banks, and PE firms, evident from the increasing demand for ESG-related financial products from institutional and private wealth clients. The growing business imperative is also a result of success stories of trailblazers in the ESG Investing landscape.

In Asia, however, investors are often faced with the following challenges as they embark upon this journey:

Traditional mindset of separating business and impact: Private investors in Asia have traditionally viewed investment and their social activities as separate and distinct. While philanthropy and foundations have flourished and delivered great social impact, there remains some resistance to translating this philosophy into an integrated lens that incorporates these social impact factors into investment decisions and financial performance.

This mindset manifests itself across the Asian investing universe and is not solely applicable to private investors. For example, family offices have largely separated philanthropy from traditional investments, while PE firms set up foundations, and banks focus on offering philanthropy services to their private wealth clients.

Knowledge and capability gap cause investors to shy away from ESG: ESG considerations are broad, evolving, and differ by industry, making it difficult and cumbersome for investors to find the suitable strategy and vehicles. Some interviewees noted that they do not have the human capital resources with the requisite expertise or a standardized approach to measure ESG factors and considerations. Thus, they are discouraged and daunted by the range of responsibilities that accompanies ESG Investing. Given these complications, some capital owners think that they “may as well stick to philanthropy”, as one interviewee remarked.

Although interpreting and benchmarking ESG information is challenging, many investors are not letting their limited knowledge deter them from embarking on the ESG journey. For instance, a leading PE firm decided to integrate ESG due diligence using an internally developed checklist. Over time, this checklist was improved and made more sophisticated through collaboration with an international development organization. Similarly, a leading bank began to seek advice and knowledge from external ESG specialists and began taking training courses and development programs to teach themselves about ESG Investing.

In line with many of our interviewees, we believe that as more success stories become publicized among the investment community, ESG considerations will become more mainstream. We recognize that while the foray into ESG Investing may seem challenging, as investors learn from their peers, and as they experiment and gain more experience, they are likely to find their bearings and adopt an approach that works for them.
CASE STUDY 1
HOW ONE FAMILY OFFICE EMBARKED ON THE NEW PATH TO ESG INVESTING
Tres Group, a European Family Office, began its ESG Investing journey a decade ago by investing in environmentally-friendly companies and high ESG-rated funds. Six years later, it entered Asia with the same ESG Investing philosophy. While its foray into ESG Investing was motivated by family values, it has also become a means to preserve wealth for their next generation through investing in companies with sustainable businesses models. Heads of this family office have taken important measures to ensure that over time and generations, the importance of ESG investing is enhanced.

There are instances, however, where family values may diverge from socio-environmental awareness. To counter this, Tres Group believes that the next generation should be empowered by setting aside discretionary funds for experimenting with ESG investments. These funds serve as a dedicated sandbox for family investors so that they may generate important learnings and produce evidence behind the merits of ESG investing.

CASE STUDY 2
ESG SUCCESS STORY IN EMERGING ASIA
Founded on the principles of responsible healthcare investing, Quadria Capital is one of Asia’s largest private healthcare investors. By leveraging its financial capital, operational capabilities, and ESG systems, Quadria has been able to develop a sustainable and profitable business model that creates equitable healthcare access and affordability.

Quadria and its ESG investment in Asia

For example, Quadria acquired a leading pharmaceutical company in Asia, and was able to in-license, at an affordable price point, life-saving drugs that were previously not available in the Emerging Asia market. Quadria also influenced the company to become fully ESG-compliant, making it the preferred strategic partner for global healthcare companies. Ultimately, this resulted in significant social impact while generating superior double digit annual profit growth for Quadria – reflecting the important fact that proper social governance does not have to come at the expense of financial returns.
KEY OBSERVATIONS OF INTERMEDIATE-STAGE ESG INVESTORS

Intermediate-stage ESG investors, while motivated by the merits of ESG Investing, are still experimenting and gaining more confidence and comfort in this space as they increase their exposure.

Think big, start small: Given that ESG Investing is still unchartered territory for many Asian investors, it is imperative that investors take baby steps and not overstretch themselves. One ESG pioneer took years to completely restructure and refocus its portfolio to meet their new ESG-compliant focus. A learning-by-doing approach has been adopted by many intermediate-stage investors. They began by investing a small amount of capital in instruments like ESG and impact funds as well as green bonds so that they could better understand the sector and gain confidence.

Over time, they have ramped up their efforts to include positive screening and to incorporate the UN PRI principles and SDGs into their investment themes. For instance, some family offices’ journey into ESG Investing started by reflecting on their family story. They evaluated the path they had taken and revisited the implications of their decisions on the next generation. After challenging the core principles behind the purpose of their wealth and redefining their aspirations, they derived their ESG investment approach. Similarly, a bank explained that its journey into ESG Investing successfully took off only after it revisited its values first. As such, the process to a sophisticated ESG investment approach often requires research and time.

CASE STUDY 3
INTEGRATING ESG INTO VALUE CREATION FRAMEWORK
A leading global PE firm has built an extensive framework to find value creation opportunities and reduce risk by identifying and managing critical ESG issues. For instance, the PE firm invested in a dairy farm in China amidst poor consumer confidence in the safety of their food, owing to a scandal involving the presence of melamine, an industrial compound used in fertilizers, found in food.

1. Diligence phase
   Leverage internal ESG experts to assess a range of risks and opportunities.
   In the case of the Chinese dairy farm, the PE firm identified an undervalued asset and used ESG initiatives to assess their impact on future value and the potential to turn it around.

2. 100 Day plan
   Begin by identifying material issues and earmark problems, support from external advisors or the portfolio company’s management is required.
   In the example, the PE firm addressed the quality control and governance gaps by establishing an external advisory board, improving nutrition and breeding practices, and implemented stricter procedures for disease prevention in cattle.

3. Post-acquisition management and monitoring
   With greater influence through board seat and ownership, address material ESG risks and value creation opportunities by initiating relevant policies and processes. These can range from enhancing employee safety to working with vendors and suppliers in reducing wastage.
   For example, the initiatives have improved milk yield by more than 50 percent and reduced disease rate among cattle. Moreover, bacteria count in the milk improved to international standards, helping the company gain a market leading position.
Use a values-based approach to select the ‘right’ investment managers: Some asset owners are choosing investment managers not solely based on returns, but by identifying managers whose investment philosophies and convictions reflect those of the asset owner. Working together to devise a values-based framework for ESG Investing, managers and asset owners are often able to construct a robust ESG investment strategy without getting lost in complex and ever-evolving standards, guidelines, and ratings.

Invest in education and knowledge creation: Many intermediate-stage investors are also trying to develop their capabilities in ESG Investing through bespoke training programs. One global asset manager devoted time, effort and resources towards building an in-house specialist team with its own ESG rating tools and frameworks. Others are also following suit, with a leading Asia-focused bank taking a holistic approach in educating both relationship managers as well as wealthy clients on ESG Investing, often focusing on the next generation of clients. Interestingly, this bank is not only designing and delivering ESG Investing workshops for its ultra HNW and family office clients but also for its retail clients; the demand for such products is rising across all investor classes.

BEST PRACTICE EXAMPLES OF ADVANCED-STAGE ESG INVESTORS

Advanced-stage ESG investors have gained extensive knowledge and experience and are looking to share their expertise with others. We see that some of these investors propagate ESG Investing and are actively pushing ESG adoption among fellow investors, existing and potential clients as well as other stakeholders. As they play a key role in catalyzing action towards ESG Investing, it is also imperative for advanced-stage investors to share their approaches, findings, and solutions to inspire the wider community and generate a critical mass interested in ESG Investing.

Adopt a Total Portfolio Approach (TPA): Some investors have reached a level of sophistication in the ESG Investing journey such that they have defined a vision and purpose for which they will dedicate their AUM. Based on this goal, these types of investors employ their capital across a range of instruments: debt, equity, private and public markets in conjunction with grants to fund businesses that are having a positive impact on society and the environment.

This framework transcends wealth management and philanthropic practices by enabling investors to leverage all assets at their disposal to meet financial targets while simultaneously effecting social and environmental change. In doing so, it empowers investors to overcome the rhetoric of trade-offs between economic returns and social impact and instead look at value as a whole.

Master external standards while setting internal selection criteria: As ESG investors become increasingly sophisticated, they are able to utilize global standards and public policies to enhance their internal investment criteria when selecting ESG-related financial products. For example, the UN PRI and MSCI ratings are often used as screening tools by banks, PE firms, and family offices, many of which subsequently develop their own internal rating system. The goal is to provide an extra layer of screening and gain competitive advantage, ensuring the investment selection matches their own investment objectives.
CASE STUDY 4
MIGRATION TOWARDS A 100 PERCENT SUSTAINABLY INVESTED PORTFOLIO
RS Group, a Hong Kong-based family office, migrated its portfolio from a traditional allocation to 100 percent impact-alignment over five years. The following approach was used:

1. Setting the guiding principles and mission: RS Group started the exercise by agreeing on the purpose of the portfolio and setting asset allocation bandwidths, performance targets by asset class, risk tolerance and liquidity requirements. This was an iterative process and the family office spent this time refining it by interacting with like-minded investors, ESG specialists and experts.

2. Crystalizing an approach: Next, RS Group decided to adopt a ‘core and satellite’ approach for its liquid and illiquid assets. ‘Core’ investments were lower risk, globally well diversified, cost-efficient, transparent and liquid strategies, and RS Group moved its liquid assets (predominantly public equity and fixed income) into these ‘core’ strategies. ‘Satellite’ investments have higher risk and less liquidity, and include private equity, real assets, and direct investments. RS Group directed its illiquid allocations into these ‘satellite’ strategies.

3. Migrating liquid assets: RS Group sought fund managers with demonstrated long-term commitment for sustainable and impact investing at both the organizational level (for example, PRI signatory) and implementation level (for instance, integration of ESG and impact considerations in investment decisions and active shareholding). RS Group then migrated its liquid assets into SRI strategies managed by these managers.

4. Migrating illiquid assets: the family office also transitioned out of its legacy illiquid assets with no ESG-alignment. This was more opportunistic in nature when compared to the systematic implementation of its liquid asset strategy, and RS Group spent considerable time networking and exploring the space so it could become acquainted with new deals, funds and intermediaries.

5. Monitoring the market: As part of its portfolio management, RS Group has over the years, continued to monitor the market for fund managers and direct investment opportunities that are aligned with its mission and values.

CASE STUDY 5
PRIVATE BANKING AND ASSET MANAGEMENT GROUP DEVELOPS PROPRIETARY ESG ASSESSMENT TOOL
Over a decade ago, LGT, a private banking and asset management group, began pioneering impact investments, sustainability funds and ESG integration. Inspired by the positive correlation between an ESG focus and financial performance, LGT integrated ESG considerations into its investment processes and portfolios across various asset classes. It also developed its internal proprietary ESG assessment tool called the ESG Cockpit while sharing best practices in ESG implementation in private equity. Different financial instruments (ranging from equities, bonds, funds, and ETFs) and their underlying key environmental, social, and governance considerations across regions and companies are assessed using the ESG Cockpit.

The firm is confident that its internal ESG assessment contributes to the sustainable allocation of capital. LGT has been a signatory to the UN PRI since 2008 and in 2018 one of its partners joined the UN PRI board to share the firm’s experience of ESG integration and to shape global standards.
A CALL TO ACTION: HOW CAN INVESTORS INCREASE THEIR ESG INVESTING EFFORTS?

In the past few decades, nations across Asia have achieved remarkable economic progress. However, this growth has not come without its challenges, and protracted social and environmental issues remain. Insufficient access to healthcare and education, widening income inequality, and recurrent climate disasters continue to affect millions of people across the region.

Around the world and in Asia, national regulators, multinational as well as local companies and institutions such as UN PRI and the Climate Bond Initiative are doing their part to encourage sustainable and inclusive growth through various initiatives.

We believe that investors in Asia can make a significant contribution to ESG Investing adoption across the region. The following action items provide some practical advice on how investors can increase their efforts reflecting the different stages along the ESG Investing journey.

EARLY-STAGE: EMBARK ON THE ESG INVESTING JOURNEY

1. Challenge the status quo: Identify the values, vision, and mission the firm would like to pursue and be held accountable for. These should be aligned with the needs and long-term ambitions of beneficiaries and other relevant stakeholders.
   Create a mindset shift that market-rate financial returns can be generated alongside social and environmental progress and challenge the status quo. Broaden your knowledge on the topic through related conferences, events and speaking with players who are already prominent in the industry as well as those interested in expanding their capacity in the industry. Talking to peers, pioneers, and competitors ensures that ideas are shared and momentum is created.

2. Learn along the way: Motivate and incentivize team members with the ample evidence supporting ESG and sustainable investing in terms of comparable financial performance in combination with social impact generation. As discussed above, the personal belief of the senior management or a family patriarch instills a value culture that is supportive of exploring new investment opportunities such as a dedicated ESG or impact fund or a small direct (impact) investment.
   Start with small stakes and increase your positions as you gain confidence in these investments. Initially, a more experimental ‘trial and error’ approach can be taken before calibrating and tailoring to the risk appetite and knowledge gained over time. And be mindful that the transformation will not be achieved overnight but requires a longer time horizon.
In the next step, try and perceive ESG as an integral mechanism to deploy capital, instead of a standalone issue. Apply this additional ESG risk assessment filter lens when considering all investments:

- Identify an investment manager whose convictions match your own. While the supply of dedicated investment managers is still rather limited in Asia, investors can look further and consider managers in Europe and North America with a global mandate. We also observe that some banks work as intermediaries matching capital owners with dedicated ESG specialists such as boutiques and impact funds. Other banks have developed in-house ESG investment teams to structure and develop offerings for their clients.

- Expand your investment approach by including ESG screening factors as part of the normal due diligence process as an important strategic and operational move towards value creation. This is a common practice we observe among all our interviewees.

**INTERMEDIATE-STAGE: BECOME AN ESG EXPERT**

3. Upskill your organization: The proliferation of information on ESG Investing can be an advantage if handled the right way. Leverage global standards such as UN PRI and UN SDG, for instance, to derive your own standards, approaches and frameworks. A simple and efficient way to educate yourself is by starting conversations with external ESG specialists such as fund managers and other investment professionals. Upskill by assessing the educational state of the organization and identifying key knowledge gaps that are essential next steps to becoming an ESG Investing expert. Set up training programs in conjunction with both internal and external resources, such as business schools and industry associations. Additionally, advise practitioners with regular updates to the ESG Investing strategies and/or public policies that are mandated in the regions. And lastly, start training the most critical stakeholders first before rolling out to the entire organization.

4. Implement a holistic investment approach: Use the full range of capital instruments available – from pure philanthropic instruments such as grants and charities or venture philanthropy to debt capital and direct equity investments. Separately, align your capital deployment with your mission of creating sustainable impact and financial performance. Understand how the deployed capital yields both competitive financial and non-financial returns and reflect these values in performance reports.

**ADVANCED-STAGE: ADVOCATE ESG INVESTING**

5. Communicate the benefits: Our interviews revealed that significant interest in ESG is based on the conviction that it does not dampen, and often improves the financial performance of the underlying assets. Consequently, share your success stories with peers. Potential investors in this space are most likely to be convinced by the positive experiences of their peers. The most effective medium is face-to-face interactions.

6. Educate and inspire: Sharing the experiences of your ESG Investing journey with the broader investment community (including general public and investee companies) through thought-leadership and knowledge development. ESG champions who are leaders within their respective fields can educate and inspire their peers by leveraging different channels such as sponsorships of reports, conferences, topical workshops, and sharing best practices through media like speeches, events, panel sessions, interviews and newspaper columns.
IN CONCLUSION

Integrating ESG factors into investment or business decisions is no longer an option, but a growing imperative. Done right, the integration of ESG factors into investment decision processes can drive long-term value creation, integrate Asian businesses into international networks, and encourage sustainable business practices across the region.

Moreover, close collaboration with key stakeholders such as regulators and policy-makers can resolve the financing gaps that still exist in Asia’s sustainable financing ecosystem, and can align Asia’s future growth to a path of sustainability and stability.
AVPN’s mission is to channel financial and non-financial resources for the solution of social issues.

These resources
• Can be financial, human and intellectual capital;
• Are invested with the expectation of measurable results and cover the entire spectrum of social investing, from impact only over a combination of impact/ESG themed investing and financial returns to risk minimization through ESG screens and integration;
• Flow from social investors (foundations, impact funds, family offices, banks/wealth management, and PE/VC funds) to their investee organizations (non-profits, social enterprises and ESG-compliant businesses (collectively referred to by AVPN as Social Purpose Organizations (SPOs)).

Investees receive a variety of funding ranging from grants, debt, equity and tailored financing coupled with non-financial support throughout their maturity cycles. However, they often experience a dearth of funding in their growth stage, a phenomenon commonly referred to as the missing middle or valley of death.

AVPN aims to address this missing middle funding gap with the Continuum of Capital, wherein social investors are encouraged to either provide more sustainable funding or to collaborate with others to provide continuous funding.

AVPN’s research into the Continuum of Capital found that social investors employ many different approaches to achieve their social impact objectives as well as in support the investees in their portfolios with funding and resources tailored to best match their needs.

Increasingly, AVPN observes a trend of social investments moving into ESG compliant entities. The investors driving this move are institutions such as the wealth management and retail arms of banks, PE/VC Funds and family offices. One characteristic of ESG Investing is that investors utilize and often build upon accepted standards by third parties such as TruCost, Sustainalytics, BCorps Impact Assessment, UN PRI and GRI, thus reducing the risk of investing in ESG. Investors’ strategies include screening, integration and value creation. Based on these characteristics, ESG Investing presents another strategy for social investors towards a total portfolio approach providing a Continuum of Capital for SPOs while maximizing impact.

**AUTHORS**

JACLYN YEO  
Senior Research Analyst  
Asia Pacific Risk Center  
Jaclyn.Yeo@mmc.com  

MARTINA METTGENBERG LEMIERE, PHD  
Head of Insights  
AVPN  
Martina@avpn.asia

DENIS LENZ  
Associate, Oliver Wyman  
Denis.Lenz@oliverwyman.com  

MEETA MISRA, CFA  
Associate  
Meeta@avpn.asia

MANAS PUNHANI  
Consultant, Oliver Wyman  
Manas.Punhani@oliverwyman.com

**INDUSTRY CONTRIBUTORS**

We would like to thank the following industry practitioners for their valuable input:

BNP Paribas Wealth Management: Kanol Pal, CFA; Credit Suisse: Joost Bilkes; LGT Impact: En Lee; Northstar Group: Chris Flosi; Quadria Capital: Mervin Teo, Rahul Agarwal; RS Group: Joan Shang; Sustainable Finance Initiative: Andrea Leung; Schroders: Kate Rogers, Caroline Liew; Standard Chartered: Eugenia Koh; Treïs Group: Stéphanie David; And an anonymous PE fund

**MARSH & MCLENNAN COMPANIES CONTRIBUTORS**

Asia Pacific Risk Center: Wolfram Hedrich, Meghna Basu; Oliver Wyman: Peter Reynolds, Jeremy Lim; Mercer: Helga Birgden

The design work for this research paper was led by Igor Lasocki Design Specialist at Oliver Wyman

**ASIAN VENTURE PHILANTHROPY NETWORK (AVPN) CONTRIBUTORS**

Kevin Teo, Naina Subberwal Batra, Allison Hollowell
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AVPN is a unique funders’ network based in Singapore committed to building a vibrant and high impact social investment ecosystem across Asia. AVPN’s mission is to catalyze more strategic and collaborative social investment in Asia from philanthropy to impact investment, ensuring that resources are deployed as effectively as possible to address key social challenges facing Asia today and in the future.

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For more information, please email the team at contact aprc@mmc.com.

www.mmc.com

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