In Conversation with Jaclyn Seow, *Openspace Ventures*, on ESG & Responsible Investing

*We are pleased to present you the second issue of our Sustainability Update which shares with you insights from our Sustainability Partners as well as experts across sectors and domains on key environmental, social and governance ("**ESG**") developments and trends.*

In this issue, Lee Weilin, our Partner with the Sustainability Practice, speaks with Jaclyn Seow, Vice President of ESG & Impact of Openspace Ventures, a venture capital firm investing exclusively in Southeast Asia. We tap on Jaclyn's experience in helping technology start-ups in the region adopt beneficial ESG practices to understand ESG & impact investing, its trends and pitfalls.

Southeast Asia is home to 10% of the world population and houses about 20% of the world's biodiversity. A report published by Bain & Company highlights that Southeast Asian economies may get annual economic benefits of up to US$1 trillion if we make a transition to a greener economy by 2030.[1] These potentials have by far not been actively pursued but there is an increasing awareness among Southeast Asia's governments, enterprises and investors on the urgency to hasten our sustainability efforts.

To advance Singapore's national agenda on sustainable development, in February 2021, Singapore launched the Singapore Green Plan 2030. The Plan also strengthens Singapore's commitments under the Paris Agreement and to the Sustainable Development Goals ("**SDGs**") that are promulgated in the United Nations 2030 Sustainable Development Agenda. While the governments may lead nation-wide approach in driving sustainable movements, the support from all stakeholders including private enterprises, financial institutions and investors is essential to maintain the momentum for green movements.

Openspace Ventures is one such investor which contributes to green movements in the region as it believes that respect for the environment, communities, employees and other stakeholders builds more resilient companies that deliver more value in the long term. We spoke with Jaclyn Seow, Vice President of ESG & Impact of *Openspace Ventures* to help us get a better sense of ESG investing, the various considerations and concerns surrounding it.

What is ESG investing? How is it different from impact investing?

ESG investing spans a wide range of activities, the simplest of which is exclusionary screening, namely, not investing in activities tied to, for example, weapons or ozone-depleting substances. Norms-based ESG screening goes one step further, and involves conducting due diligence on investments with reference to minimum business standards based on international norms such as the International Finance Corporation Performance Standards on Environmental and Social Sustainability ("**IFC**

[1] Bain & Company, "Southeast Asia's Green Economy: Pathway to Full Potential" (25 November 2020).

performance standards"). This category of ESG investing tends to be more culture- and process-driven.

ESG investing can also refer to thematic investing, in which asset owners or managers focus on certain sustainable themes including social ones (e.g. financial inclusion, healthtech, edtech) as well as environmental ones (e.g. mobility, circular economy, agriculture and food systems). These may or may not include negative screening processes.

Impact investing goes beyond negative screening or thematic investing, and is defined as investments which aim to make a targeted, measurable positive impact on the society. 2018 data shows that while sustainable investing assets totalled almost US$31 trillion globally, the bulk of this comprised ESG investments, with exclusionary screening accounting for two-thirds. Impact investing formed a much smaller segment of the sustainable investing assets but grew rapidly by 60% between 2016 and 2018 and continues to expand.[2]

At *Openspace Ventures*, we conduct norms-based screening of potential investments to identify potential risks such as the presence of forced/child labour in the supply chain, poor employee management, and internal controls around data privacy and accounting. We also look more broadly at risks presented by a particular industry sector or geography. While *Openspace Ventures* is not an impact investor, we do have investments in sectors such as healthtech, edtech and agritech that are making great impact. We encourage our companies to be intentional about their positive outcomes and to establish systems to monitor specific impact metrics. It is particularly important for us that negative impact be considered as much as positive impact is celebrated.

Why should investors consider ESG investing? What should investors bear in mind when considering ESG investing?

I believe all investors should minimally conduct exclusionary and norms-based screening as ESG risks can affect returns, and capitalise on opportunities that can create value. Keen investor interest in ESG has fuelled a growing trend where more companies are taking ESG-related matters more seriously and showing commitment to improve their capabilities to adopt good ESG practices. They see this as a value-creating exercise that can enhance brand building, foster a loyal workforce, and improve access to capital. Some of our portfolio companies have in fact engaged experts to help them implement sustainable and verifiable ESG practices in their businesses.

We think Southeast Asia calls for more investors ready to support responsible enterprises that will drive economic and social developments in this region. Southeast Asia houses 10% of the world population but only generates only 3% of the world's GDP, and a substantial portion of its community still lives below the poverty line. e-Conomy SEA 2020[3] estimates that the size of internet economy will surpass

[2] Global Sustainable Investment Alliance (GSIA), "Global Sustainable Investment Review 2018" (April 2019), a report that sets out data on sustainable investing assets in Europe, United States, Canada, Japan, Australia and New Zealand. It provides that impact investing is "a small but vibrant segment of the broader sustainable and responsible investing universe in all the markets studied".
[3] e-Conomy SEA is a research programe initiated by Google and Temasek, with Bain & Company as the lead research partner.

US$300 billion by 2025, which by our estimates would represent about 8.2% of the region's GDP. With the digital economy playing a growing role in economic development, we absolutely see the need for such growth to be done responsibly, with proper protections for consumers and employees.

Thematic ESG investing is also gaining traction. Emphasising ESG investing in enterprises that are essential drivers of economic development in the region will no doubt help Southeast Asia meet developmental goals such as access to basic services like health, education and finance, and achieve sustainable economic growth.

Some practical issues that investors should think about when considering ESG investing:

- **Type of ESG investing**. There is a broad spectrum of ESG investing, from exclusionary screening to thematic investing, and investors should be clear about what they want to commit to from the start.

- **Sufficient resources for ESG due diligence:** Investors should ensure that they possess sufficient and relevant resources to engage in due diligence. It may not be adequate to rely on self-disclosures. Conducting proper due diligence and follow-up on ESG matters requires manpower, time and effort. It will become harder as more legal frameworks are put in place to regulate sustainability-related disclosures.[4] *Openspace Ventures* uses a due diligence checklist aligned with international standards to screen our investments and develop appropriate action plans for our portfolio companies.

- **Commitment to ESG practices:** Companies' willingness and commitment to adopt strong ESG practices is vital. To strengthen a company's conviction and capability to pursue strong ESG practices, we at *Openspace Ventures* conduct frequent capability building sessions to share ESG developments in the ecosystem and encourage a greater awareness of how good ESG practices add value to businesses.

- **Be practical and focus on material ESG factors:** Instead of placing equal focus on all categories of ESG factors, an investor should identify the material ESG factors specific to the geography and industry of the target company and focus on addressing these issues. For instance, it is largely irrelevant to ask early-stage companies for their detailed policy on board tenure. Labour and supply chain issues would likely be material for an agritech business but less so for a POS platform. An article published by the Harvard Business School shares that helping a company focus on and address *material* ESG factors result in better performance for the company, whereas the focus on *immaterial* ESG factors does not show the same corelation.[5]

- **Verification of impact:** Apart from relying on the "impact story" presented by the target company, investors may ask that a company verify its assertion on the "impact" of the business through

[4] For example, the EU Sustainable Finance Disclosure Regulation that came info force on 10 March 2021.
[5] Khan, Mozaffar N., George Serafeim and Aaron Yoon. "Corporate Sustainability: First Evidence on Materiality." Harvard Business School Working Paper, No. 15-073, March 2015.

supporting data, surveys or reference checks with the target company's customers and stakeholders over a period of time.

How do investors measure ESG success? In terms of bottom line, the age-old concept of "profit" is now changing to the triple bottom line of "profit, people and planet". How do investors quantify "people and planet"?

With regard to social and governance considerations, investors can evaluate the ESG "performance" of our portfolio companies against a set of minimum business practices (e.g. Do they have an employee engagement mechanism? Do they have well-resourced stakeholder management? Do they have processes for vendor due diligence? Do they have solid cybersecurity as well as data governance processes in place?), as well as look at their improvements over time. Other factors to consider include the ratio between full-time and contract workers, whether employees are making a living wage or whether occupational health and safety issues (particularly relevant for manufacturing and production businesses) have been sufficiently addressed. Investors may also refer to established metrics on diversity, ethnic mix, gender pay gap, pay disparity between management and non-management employees, etc. While similar criteria apply to early-stage companies and established companies, investors need to adjust expectations of, and be ready to work closely with, early-stage companies on policy and process development.

With regard to the environment, good strides have been made globally in developing appropriate measurements. The Greenhouse Gas ("**GHG**") Protocol provides guidance on measuring and reporting on Scope 1, 2 and 3 emissions, and the Task Force on Climate-related Financial Disclosures (TCFD) created by the Financial Stability Board recommends best practices in terms of climate governance, strategy, risk management and disclosure. However, much work still needs to be done to bring the adherence to and enforcement of the carbon accounting standards to a level comparable to that of the internationally recognised financial accounting standards.

Closer to home, there is much excitement around the development of Climate Impact X ("**CIX**"), a Singapore-based global carbon exchange and marketplace which aims to scale the voluntary carbon market.[6] There is a large demand for quality carbon reporting and economic incentives will certainly encourage compliance. In the meantime, however, it is critical that an ESG investor understands how emissions numbers are derived and what they mean. Many established investors engage in-house or external ESG consultants to help them make informed and practical decisions in terms of ESG disclosures. There is growing demand for such ESG expertise - global private equity firm KKR, recently agreed to acquire a majority position in Environmental Resources Management (ERM), a UK-headquartered company focusing on sustainability consultancy.

What does ESG integration look like at *Openspace Ventures*?

We have a detailed process at *Openspace Ventures* by which we integrate ESG considerations across our investment process and encourage ESG best practices in our portfolio companies.

[6] When a company pledges to stop climate change by commiting to reduce its green-house gas emissions by a certain target, it may acquire carbon credits to offset the emissions that it is not able reduce in accordance with its target.

We have developed a comprehensive due diligence checklist aligned with the IFC performance standards for reviewing ESG practices of a portfolio company. There are two parts to the checklist. The first comprises general questions, aligned with the IFC performance standards and Corporate Governance Development Framework, that are applicable to all companies. The second part of the checklist contains specific questions that address ESG considerations material to the geography and industry of the target company. The latter are based on standards set out by the Sustainability Accounting Standards Board (SASB) and as well as the Sector Profiles set out by the CDC Group to customise specific material disclosures for each type of company. We often have to refine and adapt the checklist for the early-stage companies. For example, the requirement for a detailed business continuity plan (BCP) or whistleblowing policy may not be relevant for a small-sized start-up.

We also spend a considerable amount of time in discussion with the management team of our portfolio companies to gain a sense of their understanding and appreciation of ESG risks and opportunities, and their commitment to ESG. These conversations form about 50% of our ESG due diligence.

To strengthen accountability, I work with our firm's General Counsel to include ESG clauses in our term sheets and shareholders agreements where appropriate. We try to have the ESG clauses broad enough to cover the essential ESG terms while focusing the companies' attention on the ESG issues most relevant to them.

Regular conversations are key in evaluating and monitoring ESG progress. At *Openspace Ventures*, we gather some information at the initial due diligence stage and follow up with regular enquiries. The frequency of the reporting requirements depends on the track record of a company, with new companies being reviewed more frequently at the start.

In your view, what sectors or business models would benefit from the sustainability drive, particularly in the ASEAN region?

ASEAN has unique and pressing challenges in agriculture and waste management that technology can help solve. We are also seeing a lot of businesses that target mobility, logistics and supply chain efficiency. In this regard, businesses which provide platform solutions that help companies be more carbon efficient in delivering their services and goods will be very much in demand as we move along the decarbonisation trajectory.

We have also spoken with quite a few companies that focus on circular economy solutions. These include those which aim to upcycle agricultural by-products into vegan leather, or that make use of organic waste as an input to produce insect protein to support aquaculture. Some of these solutions have the potential to be deployed on a global scale.

Technology innovations are also increasingly driving energy efficiencies in smart cities (e.g. automated energy saving mechanisms), or enabling higher capital intensity in the renewables space.

What are the factors which can further drive the sustainability investing trend forward?

Easy access to reliable and standardised ESG data – in a way that mirrors today's accounting standards – would foster investor confidence in sustainability investing. The Monetary Authority of Singapore (MAS) is encouraging the development of platforms that would give investors and businesses access to quality and reliable ESG data, although the challenge lies more in standards than in technology. While we move towards having a consistent international standards for accounting sustainability performance, any successful platform would either have to have a niche focus (e.g. on impact debt, where there is some consensus on relevant metrics) or be sufficiently broad and modular to adapt as standards take shape.

Is greenwashing a big concern? Should there be more legislation or regulations in place to curb this problem?

If we take "greenwashing" to mean a business purporting to be more environmentally friendly than it actually is – that is unfortunately going to continue. For years, businesses have claimed to have products that are healthier, better or more nutritious than they are. What will make a difference is the reference points that investors or consumers have access to that allow them to vet these claims for themselves. "Greenwashing" therefore is likely to persist until a detailed and rigorous framework is put in place to certify sustainability claims by businesses. B Corp Certification, for instance, provides assurance to consumers that a certified business fulfils the highest standards of verified performance and commits its business to consider stakeholder impact for the long term by building it into the business' legal structure. However, there are currently only about 4,000 certified B Corps worldwide and it is fairly underrepresented in Southeast Asia. So, it may take a while before there are well-tested and universally recognised sustainability marks.

A bigger concern is how sophisticated greenwashing has become over the years as a result of there being variances in verification quality. Take carbon credits as an example. Consumers who buy carbon credits on a carbon offset platform may not know how to query or verify the quality and authenticity of the carbon credit, for example, whether the carbon credit has been double counted or whether it comes from a reputable exchange. This is exacerbated by the fact that the carbon pricing market is highly fragmented and there is no internationally enforced process for verifying the quality of carbon credits.

To mitigate greenwashing, there needs to be a clear definition of international or regional standards to identify, account for and audit sustainability claims and by-products relating to the sustainability market such as carbon credits, environmental and social impact in a specific industry or a specific country. However, at least for social impact, such standards and benchmarks can only be set with reference to empirical data and information collated from case studies accumulated over a period of time and we are very much at the start of this journey.

The legal industry plays a critical role in this journey by defining the parameters of the legal framework governing accountability on sustainability claims. In addition, specifically, at this stage where the market for carbon credits is being developed, it would be useful to have templates for legal contracts that provide for the standard rights and obligations of the parties in a transaction involving the transfer of carbon credits.

There is still a lot to be done before we reach a stage where there are harmonised rules to address the various issues relating to sustainability investing, reporting, disclosures and greenwashing and the space is very much in its infancy. Having said that, we are moving forward with great urgency and purpose and we at *Openspace Ventures* are glad to be contributing in our own way.

On 1 June 2021, *Openspace Ventures* issued its inaugural Annual Sustainability Report 2020, please click here for more information on *Openspace Ventures*' approach to ESG investing.

Rajah & Tann Sustainability Practice

We are amongst the pioneers in Singapore when it comes to sustainability and ESG issues. On the green and sustainable finance front, our lawyers have worked on transactions covering sectors ranging from real estate and hospitality to energy and agriculture. We have been involved in many "first of its kind" transactions.

With our deep expertise and experience, we can help you unpack and reconcile the different global standards and regulations on ESG factors in green and sustainable finance. We can also advise you on the adaptation of your business to take into account these factors, to facilitate your transition to refreshed modes of operation. We can help you address the commercial aspects and economic objectives of the transactions, and at the same time fulfil the legal and technical requirements set out in the various ESG principles and guidelines.

If you have any questions regarding sustainability, please feel free to contact our team below who will be happy to assist you.

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2021 JULY

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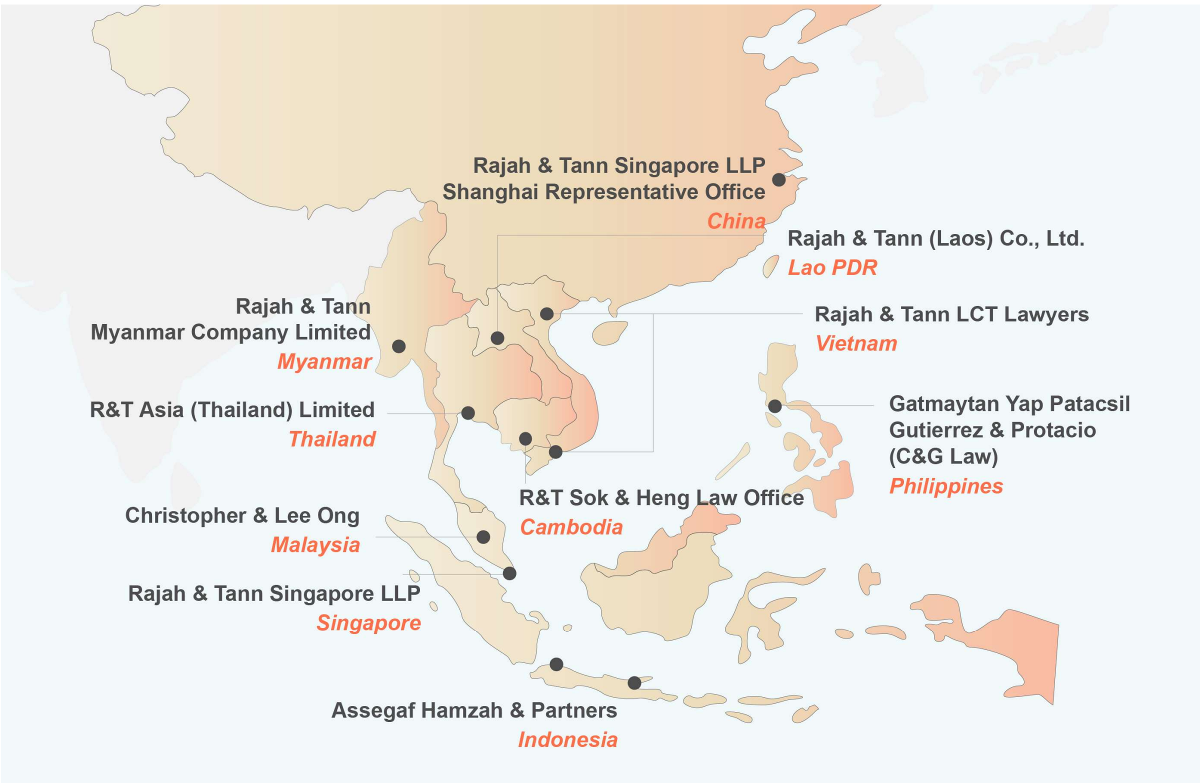

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