4 Strategic Enabler: Responsible investment

As a significant allocator of capital in financial markets, our commitment to responsible investment encompasses our role as both asset owner and asset manager. In that capacity, we play a vital role in the transition to a lower carbon economy. We seek to apply ESG considerations more broadly in our investment decisions and our fiduciary and stewardship duties, including ensuring that our investment decisions are aligned with our values around diversity and support our primary focus on healthy lives.

Governance

As with other ESG matters, responsible investment activity is overseen by the Group ESG Committee. More information on the Group ESG Committee is provided in the report introduction. Operational responsibility for responsible investment activity is delegated to the Group Responsible Investment Advisory Committee (GRIAC). The GRIAC is constituted as a sub-committee of the Group ESG Committee and provides a forum for Group and business units to consider responsible investment approaches.

The GRIAC is co-chaired by Prudential Corporation Asia's Chief Investment Officer, Insurance Investment and Co-CIO, Eastspring, respectively senior executives within our main asset owner and asset management businesses. Other permanent members include the CIOs of the major life businesses and the President, CEO and CIO of PPM, as well as representatives from the Group Finance and Group Risk functions.

Asset owner/asset manager relationship

Historically, Prudential has adopted a principles-based approach to coordinate responsible investment activity across the Group. These principles have been codified into standards, which are set out in the Group Responsible Investment Standards (GRIS) and govern the conduct of responsible investment activity across the Group.

These principles set the tone and parameters under which the Group's asset owner and asset manager businesses develop responsible investment policies appropriate to the markets in which they operate.

During 2021, we will seek further to develop our asset owner Responsible Investment Policy and align expectations across our asset manager mandates, including how ESG considerations will be monitored and measured over time.

Our approach to responsible investment reflects our belief that the quality of corporate governance practices, and how companies manage the environmental and social aspects of their operations, are material to reducing risk and delivering superior financial returns and, ultimately, longer-term shareholder value. It also recognises that responsible investment requires a patient approach and an understanding that changes in corporate behaviour should support shareholder value over time.

Asset owner level	Asset manager level
Direction	**Direction**
Apply principles, standards and decision-useful framework to implement Group ESG strategy.	Apply investor-specific policies and processes to meet requirements of principles-based framework.
Activity/implementation	**Activity/implementation**
Interpret Group ESG strategy with respect to responsible investment principles. Identify and consider alignment to global standards and frameworks to inform the Group-level approach. Define how frameworks will apply Group-wide.	Asset manager to clearly articulate RI policies and approaches to Group-level approaches. Asset manager demonstrates process consistency.

ESG integration

We seek to integrate ESG factors into our investment decisions, alongside traditional financial analysis, to better manage risk and generate sustainable, long-term returns for our customers.

Within Eastspring, the Singapore-based equity team focuses on exploiting opportunities where risk perceptions and expectations have become misaligned. ESG issues are incorporated into the fundamental analysis and decision-making process to the extent that the team believe they could have a material impact on a company's valuation and financial performance. Similarly, for the fixed income team, only ESG issues that are material to the issuer's credit fundamentals and the valuation of the bond are factored into the analysis. For both equity and fixed income, companies are not excluded solely on perceived ESG issues.

This approach to integrate only material ESG factors into investment decision making does not preclude investment in sustainable investment opportunities. For example, in August 2020 Eastspring invested THB 1 billion ($30 million) in the Thai government's inaugural THB 30 billion sustainability bond. The bond carries a 15-year maturity, with proceeds divided between a project to expand the Mass Rail Transit System and to support various expenditures under the government's Covid-19 Rehabilitation Package.

PPM follows a broadly similar approach to Eastspring. ESG factors are incorporated into the investment process where it is believed they may have a material impact on the financial performance of the investment. Investments are not automatically excluded at strategy or fund level on ESG grounds. Rather, the manager works with clients, who will specify exclusion lists unique to their ESG values and requirements.

Stewardship and engagement

As custodians of our customers' assets, it is important that we act in ways consistent with our stewardship responsibilities. This means seeking to maximise the long-term capital growth of the assets entrusted to us, while remaining accountable to our customers for our actions and being aware of our duty to uphold their best interests when carrying out investment activities. We aim to meet these requirements in several ways, including:

- Pursuing an active investment policy that aligns engagement activity with the long-term investment thesis to hold the asset in the portfolio;
- Treating shareholder voting rights as a valuable asset and seeking to vote all holdings;
- Developing and adhering to principles of conduct governing our stewardship activities, including the fiduciary relationship with customers; and
- Ensuring that our approach to stewardship is aligned to best practice. Notably, Eastspring is a member of International Corporate Governance Network (ICGN) and its stewardship approach is aligned with the ICGN Global Stewardship Principles and ICGN Global Governance Principles. It is also a member of the Asian Corporate Governance Network, which seeks to promote high standards of corporate governance across the Asia-Pacific region.

Case study

ESG integration case study: Multinational car company challenged to meet new regulations

ESG consideration

During the review of a multinational automotive corporation headquartered in Europe, PPM's research analyst noted concerns about the company's ability to meet European carbon dioxide emission standards, which could lead to meaningful regulatory fines and negative consumer views given the increasingly environmentally conscious consumer. Despite what PPM believed was a solid company balance sheet (strong net industrial cash position and significant gross liquidity), its analyst viewed the company as behind other automotive corporations in its investment in and development of electric vehicles.

PPM analysis

Electric vehicle penetration gained momentum in early 2020 at the onset of Europe's tougher emissions rules. Effective 1 January 2020, the rules imposed more stringent targets for passenger cars and vans – based upon average fleet-wide carbon dioxide emissions (g/km).

PPM's research team discussed the issue in detail during an investment grade review of the automotive industry that assessed the company's positioning among its peers. The research revealed that the company had one of the largest percentage gaps in reducing its year-on-year average fleet-wide carbon dioxide emissions versus its peers and was at the most risk of not meeting standards. While the potential monetary fines were viewed as manageable, the company would be required to undertake significant investment in research and development to catch up with the leaders in the industry, or risk losing meaningful market share.

Outcome

Considering all factors related to the risk and return of the company, the changes to regulations, and the company's progress in developing electric vehicles and increasing its mix to meet emissions standards, PPM downgraded its internal rating. Its analysts will continue to monitor the company's improvements toward emissions goals alongside company fundamentals.

Engagement

Engagement is a core part of providing effective stewardship and an important means of generating long-term value. We seek to encourage business and management practices that support sustainable financial performance through constructive interaction, based on our in-depth knowledge of the companies and their business environment.

Our approaches to engagement vary across our asset owner and asset manager businesses, reflecting differences in local investment practices and norms, and consistent with the Group's principles-based framework to coordinate its responsible investment activities. However, within this broad framework, some common principles and practices apply. These include: that engagement is an important way to identify material risks and opportunities to investment; that maintaining a continuing and open dialogue with management is key to building relationships, and thus effective influence; and, that collaboration with other investors (through bodies such as Climate Action 100+ or the Asia Investor Group on Climate Change (AIGCC)) is a helpful way to amplify the effectiveness of our engagement activity on ESG issues. The use of voting rights is also an important means to signal investor preferences to company management and it is the Group's policy to vote on their holdings (see Proxy voting below).

The level of conviction to hold a particular investment can be impacted by the results of engagement. Where conviction levels fall below an appropriate level, the position may be divested. This was the case, for example, with a recent engagement by Eastspring with a company providing education services. During our engagements, the company did respond with some improvement to their initial proposed corporate governance reforms. However we did not have a sufficient level of confidence in the standard of governance or controls in place to avoid future contentious proposals. Given the lower level of conviction around the range of potential outcomes we felt there was insufficient valuation support to compensate for observed risks and Eastspring exited the position.

Both Eastspring and PPM undertake company engagements focused on both financial and non-financial matters on an annual basis. With respect to specific engagements related to material ESG issues, Eastspring's equity and fixed income teams have conducted over 300 unique engagements in 2020, in addition to engagement on financial issues with companies.

Proxy voting

Alongside engagement, voting is considered part of the investment process and the pathway to value realisation. It is therefore integral to our stewardship responsibilities. By exercising our votes, we seek both to add value and to protect our interests as shareholders. We consider the issues, meet company management if necessary and vote accordingly. Where possible, we seek to discuss any contentious resolutions with investee companies before casting our votes in order to ensure that our objectives are understood, and our votes will be cast in the best interests of our investors and clients.

Where appropriate, we use third-party investment advisers to aid the process of making proxy voting decisions. Both Eastspring and PPM engage Institutional Shareholder Services (ISS), a fellow signatory to the United Nations-supported Principles for Responsible Investment (PRI), to provide administrative assistance in connection with voting proxies.

The policies and guidelines of the proxy advisers are periodically reviewed to understand the nature of their recommendations and test their compatibility with our requirements. However, specific policies and advice from the proxy adviser are not applied mechanically. We always apply our judgement and decide how to vote on each resolution on its merits in the context of the principles of our proxy policy.

In Asian and emerging markets, proxy voting activity is commonly focused on governance matters, with fewer shareholder resolutions focused on environmental or social matters. However, our equity team actively vote and take any material ESG issues that have been identified into consideration.

While our equity teams are typically supportive of company management, where applicable we use proxy voting actively to signal to management our expectations for improvement in behaviours.

In 2020, Eastspring voted on 99.63 per cent of the total number of proxy votes in which it was eligible to vote. Eastspring voted with management recommendations 90.33 per cent of the time and voted against management recommendations 9.67 per cent of the time. Please refer to Eastspring's website for more information on its proxy voting record.

Engagement activity through 2020: Notable examples

In order to highlight the breadth of topics and engagements that have taken place, we provide a selection of recent engagement case studies under the 'Environmental', 'Social' and 'Governance' headers. Often, the engagements span more than one ESG dimension, and where this is the situation, the case study is allocated to the ESG category on the basis of a judgement as to which dimension is more material.

Environmental

Case studies

Global Emerging Markets Equity Team, Singapore: Environmental engagement

Company A, a Korean power company, is a valuation outlier and has been a long-term holding, with which we have maintained ongoing engagement.

Objective: Our engagement is aimed at understanding its long-term strategy around transition to a low-carbon economy, to enable us to perform our fiduciary duties and decisions around proxy voting from a well-informed position.

Scope: In 2020, we engaged with Company A in a discussion about the company's long-term strategy for dealing with carbon emissions. It shared that it has a long-term plan to increase renewable energy and to reduce dependence on coal-fired power generation. We discussed the future of the power company's overseas coal power projects and its commitment in October 2020 to not build any overseas coal plants going forward, but only energy-efficient, renewable-type plants. This is aligned with its commitments to grow renewable energy domestically, add no new coal power plants, start to close coal-fired capacity, and to invest in technology to reduce carbon emissions. Notably, the company's overseas coal project plants in South Africa and the Philippines are being converted to liquefied natural gas (LNG) or terminated.

Subsequently, we engaged with the company on its anti-corruption policies. In response to corruption issues, it has responded by putting in place governance structures that include enhanced processes, training and monitoring.

Outcomes: Demonstrating a response through restructuring and capital allocation towards renewable energy, and improvement to governance structures.

Japan Equity Team, Singapore

Company B is one of the world's largest steel producers.

Objective: Our ongoing engagement since 2017 is aimed at understanding the company's position on three key issues: carbon emissions and energy usage (including disclosure policies), board governance and structure, and workplace safety.

Process: In 2020, our three engagement meetings focused on potential structural change in the industry and the need to reduce capacity, and progress in implementing new (hydrogen-based) steel-making technologies. The team also discussed the potential impact of recent regulation by the Japanese government aimed at reducing coal-fired power generation capacity. The engagement was also undertaken in fulfilment of our obligations as a member of the Climate Action 100+.

Outcome: We observed that management was making good progress towards finalising specific medium and long-term climate change targets, as part of the ultimate target of becoming carbon-neutral by 2050. In terms of board governance and structure, the company sought and received approval from shareholders in June 2020 to transition its governance model. The dialogue has supported the case for continued investment in the company.

Social (labour rights, health and safety)

Case study

Malaysian Equity Team, Malaysia

Company C is a large global glove manufacturer.

Objective: To determine whether the company was putting processes in place to improve labour practices.

Process: In June, we engaged with Company C following allegations of forced labour practices from a UK Channel 4 report. We noted that these allegations, which were brought up in December 2018, had resurfaced and that the company had made progress in rectifying these claims.

In July, we sought further clarification from management when the US Customs and Border Protection (CBP) placed a detention order on disposable gloves manufactured by some of the company's subsidiaries. Management shared that they had remedied some of the key issues, such as retention of identification documents, and were looking into the reimbursement of recruitment fees.

We engaged again in November, following an accident that resulted in the amputation of a worker's arm. The purpose of this engagement was to remind the company to take remedial actions to keep workers safe and close gaps that may contribute to accidents. Subsequently, it was uncovered that the worker had not followed the company's standard operating procedure, which the company will investigate remedying with extensive education. It has continued to improve its training programmes by adding training in native languages, revamping on-site training to include accident-prone areas, and increasing training hours.

Outcome: While we recognised that the company had made significant improvement in labour market practices, we continue to stress to management that, as one of the largest glove manufacturers in the world, it needs to set better standards and be vigilant about ESG issues, and we will continue to engage with it on labour issues into 2021.

Governance (Board composition and diversity)

Case studies

Japan Equity Team, Singapore

Company D is a Japanese international chemical manufacturing company.

Objective: Gain a better understanding of the corporate governance structure and practices to perform our fiduciary duties and decisions around proxy voting from a well-informed position.

Process: In January, we conducted a discussion with the company on its broad ESG approach and its specific positioning for meeting environmental product demands (eg bioplastics). We also highlighted the need for improvements in board structure and function and the nominations and succession process.

We continued our engagement in July, when we conducted a discussion of the ongoing evolution of its governance structure and approach and its oversight and management ownership of ESG-related matters. In our ongoing engagements, we have noted that the company's board and broader governance structures have shown a significant step forward (eg improving board independence, voluntary committee structure).

The company has noted that these changes are, partially, in response to our ongoing engagement. It also detailed its increased focus on ESG with a new ESG committee that reports directly to the board. We were satisfied that ESG governance and management ownership appear to be improving.

Beyond this progress, however, we have also discussed that we would like to see continued progress in terms of board independence, diversity, and change to an independent committee system.

Outcome: Gained clarity on timeline for implementing PRI framework and the company's efforts on ESG.

Japan Equity Team, Singapore

Company E is a credit card issuer and transaction processing company.

Proxy Voting Objective: Proxy vote signals the accountability of chairman and CEO for the delivery of poor longer-term returns.

Process: The current chairman has been both chairman and CEO since 2000. Over this period return on equity (ROE) has been weak and has further deteriorated over the past three years. Although the company's management did seek to buy back some shares, we did not feel this was sufficient to address the issue. We felt a clear strategy needed to be articulated to grow the business, amid fierce competition from other traditional credit card players and new cashless players.

A vote was due to be held at the company AGM to re-elect the chairman (and other directors). While our proxy adviser recommendation, and company management vote was 'For' the re-election of the Chairman, we decided to vote 'Against' re-election on the basis of his accountability for the poor historic performance of the company.

Outcome: In addition to acknowledging the company's historic delivery of poor trend returns, our analysis suggests the company has a good platform and there is sufficient valuation upside to support our level of conviction around the overall governance of the company. However, our vote 'Against' the re-election of the chairman signals our position in relation to accountability for historic performance and the need for a change in leadership to support a clear strategy for growth.

Capacity building, collaboration and industry and regulatory engagement

We continue to seek opportunities to build capacity and enhance capabilities within our responsible investment practices. In August 2020, Eastspring participated in a sustainability benchmarking process and capacity-building exercise with the World Wide Fund for Nature (WWF), one of the world's largest independent environmental organisations. WWF works with industry associations, regulators, stock exchanges and investors in Asia to support ESG risk analysis and opportunity identification. The benchmarking process is being used as an enabler to further embed sustainability into the business and is aligned with the Group's strategic focus areas. As part of an ongoing focus on continuous improvement to meet our sustainability ambitions, Eastspring has incorporated actions from the benchmarking exercise into four sustainability work streams focused around purpose, governance, climate strategy and responsible investment. Eastspring also participated in the Asia Investor Group on Climate Change (AIGCC) Climate Change Training Project Advisory Committee, the region's first accredited climate change training.

Collaboration
We continue to view collaboration with investors through collective initiatives and industry bodies as another way to build capacity and to amplify the effectiveness of our engagement activity. Two examples of collective bodies in which we participate are Climate Action 100+ and the AIGCC. Climate Action 100+ is an investor-led initiative to engage systemically important greenhouse gas emitters across the global economy. The AIGCC aims to raise awareness and encourage action among Asia's asset owners and financial institutions about the risks and opportunities associated with climate change and low-carbon investing. Where appropriate, some of our engagements are coordinated through these bodies.

We have aligned our responsible investment approach to industry best practice through our support for the United Nations Principles of Responsible Investment. Ninety-nine per cent of Prudential Hong Kong's investment portfolio is managed by asset managers that are PRI signatories. Prudential supports PPM's and Eastspring's membership as PRI signatories.

Eastspring has been a PRI signatory since February 2018. In 2020, it submitted its first official PRI Report and achieved A+ scores across two categories and A scores across four categories, well above the median scores for the PRI's asset management signatories. An A+ score was achieved for Strategy and Governance and ESG Integration in Listed Equities modules; and an A rating was awarded for Listed Equities – Active Ownership, Fixed Income – SSA, Fixed Income – Corporate (Financial), and Fixed Income – Corporate (Non-Financial).

PPM became a signatory in October 2018 and received an A score for its approach to Strategy and Governance, placing it among the top tier of asset managers in this category.

Regulatory and industry engagement
It is important that our strategic approach to responsible investment develops in line with broader thinking around the issue. Therefore, we seek to engage with policy bodies and regulators in the markets in which we operate to both shape the debate and to align our approach to evolving best practice on the topic.

Some examples of notable industry engagements and collaboration undertaken during 2020 are:

BU	Theme	Regulatory/industry initiative
Group (Prudential plc)	Global/ regional initiatives	At a Group level, our compliance and government relations functions provide input to regulatory consultations and engage with international bodies, such as the Sustainable Development Investment Partnership (SDIP) – an initiative of the World Economic Forum (WEF) – and the Institute of International Finance (IIF) that are active in setting standards for responsible investment. Notable examples of Group engagement activity through 2020 include the monitoring of the work of the Network for Greening the Financial System (NGFS) and input into the International Association of Insurance Supervisors (IAIS) paper on the Supervision of Climate-related Risks in the Insurance Sector, jointly with the Sustainable Insurance Forum (SIF).
Prudential Hong Kong Ltd (PHKL)	Sustainable insurance	PHKL participates in the Green Insurance task force established in 2020 by the Hong Kong Federation of Insurers. This supports the Green and Sustainable Finance Cross-Agency Steering Group, of which the Hong Kong Insurance Authority is a member. Discussions are at an early stage, but the focus of the taskforce will be on generating industry-wide actions to promote sustainable and environmental business practices, as well as to develop regulatory, green product and investment frameworks.
Prudential Assurance Company Singapore (PACS)	Sustainable insurance	PACS is a member of the Sustainable Insurance Taskforce. It is working with the MAS (Monetary Authority of Singapore), LIA (Life Insurance Association), GIA (General Insurance Association) and SRA (Singapore Reinsurance Association) to develop a set of sustainable insurance guidelines.

BU	Theme	Regulatory/industry initiative
PCA Life Assurance Taiwan (PCALT)	Stewardship	PCALT is a signatory to the Taiwan Stock Exchange's 'Stewardship Principles for Institutional Investors'.
Eastspring	Risk management	Eastspring contributed to a consultation paper by the Investment Manager Association of Singapore which consolidated industry feedback to MAS on proposed guidelines for environmental risk management.
	Responsible investment	Eastspring participated in an online seminar hosted by the UNPRI and Korea Financial Investment Association (KOFIA). The event aimed to help educate Korean institutional investors on socially responsible investment/responsible investment concepts, both ensuring a basic level of understanding of responsible investment and providing the opportunity to learn how investor peers have been undertaking responsible investment.
	ESG funds	Eastspring participated in a group meeting with The Securities and Futures Commission of Hong Kong (SFC) on key proposed enhancements for ESG funds, which sets out the expectations on how the existing Code on Unit Trusts and Mutual Funds and disclosure guidance would apply to ESG funds.
	Responsible investing (fixed income)	Eastspring Singapore co-hosted a virtual roundtable with Asian Investor discussing key opportunities and challenges in incorporating ESG within Asian fixed income portfolios.

Product development and client engagement

We are continuing to expand our ESG offering to clients to meet the growing demand for responsible investment products in our markets. In December 2019, Eastspring launched the Asia Sustainable Bond Fund, which supports sustainable objectives, as well as meeting client needs for an ESG-themed investment product. Our Singapore and Hong Kong-based life businesses are anchor investors into the fund. While the fund's AUM remains modest at $73 million, during 2020 Eastspring continued to engage with interested gatekeepers from both retail and institutional investors on the Asia Sustainable Bond Fund strategy, as it builds its performance track record with a view to increasing third-party investment. The fund follows an absolute-return targeting strategy and does not target a specific benchmark. Notwithstanding this, recent performance compares well with broadly similar indices, such as the JPMorgan Asia Credit – ESG Index.

In November 2020, Prudential Hong Kong, through its participating life fund, provided the cornerstone funding for a new ESG ETF provided by BlackRock through its iShares unit. The fund tracks the MSCI USA Minimum Volatility ESG Reduced Carbon Target Index, which reduces greenhouse gas emission intensity by 63 per cent and exposure to fossil fuel reserves by 95 per cent, relative to the parent benchmark.

Other significant ESG-themed asset owner initiatives through 2020 include the adoption by Prudential Assurance Malaysia Berhad of sustainable investing strategies for local equity investment within its PRULink Strategic Fund, and the initiation of a project by PT Prudential Life Assurance (PLAI) to publish ESG scores for all its investment-linked product (ILP) funds. PLAI is also in the process of changing the benchmark for one of its existing ILP funds to a new ESG index (the IDX ESG Leaders) developed by the Indonesia Stock Exchange.

Outlook for 2021 and next steps

Prudential recognises that strengthening our approach to responsible investment is an ongoing and long-term process that we expect will evolve over time.

For 2021, as an asset owner, we expect to take further steps to expand and make more explicit our expectations of asset managers in the areas of ESG integration and engagement. The recent establishment of Eastspring Portfolio Advisers (EPA) will help to facilitate and implement our asset owner requirements with asset managers. EPA is our investment centre of excellence for tactical asset allocation, model portfolio construction, manager selection, liability-driven investments and solutions and derivative expertise. From an asset owner perspective, EPA will integrate ESG in all relevant processes within its remit. EPA's complete view of the asset owner portfolio will contribute to a holistic and coherent approach on ESG. The establishment of EPA has also created a platform where the asset owner and the asset manager can discuss, monitor and advance the ESG initiatives.

As well as these steps to improve the alignment of asset owner and asset manager objectives, we will continue to develop our overall approach by identifying and aligning with selected global standards and initiatives that help to frame and inform our principles-based approach to the impacts and opportunities of ESG. In this context, our Asian business is investigating becoming a PRI signatory as an asset owner in 2021.

By taking ESG issues into account, we can meet our clients' financial expectations, serve their other long-term interests and meet the expectations of society.