



Challenges of ESG Investing: Case of Korea

30, March 2022

Korea Capital Market Institute

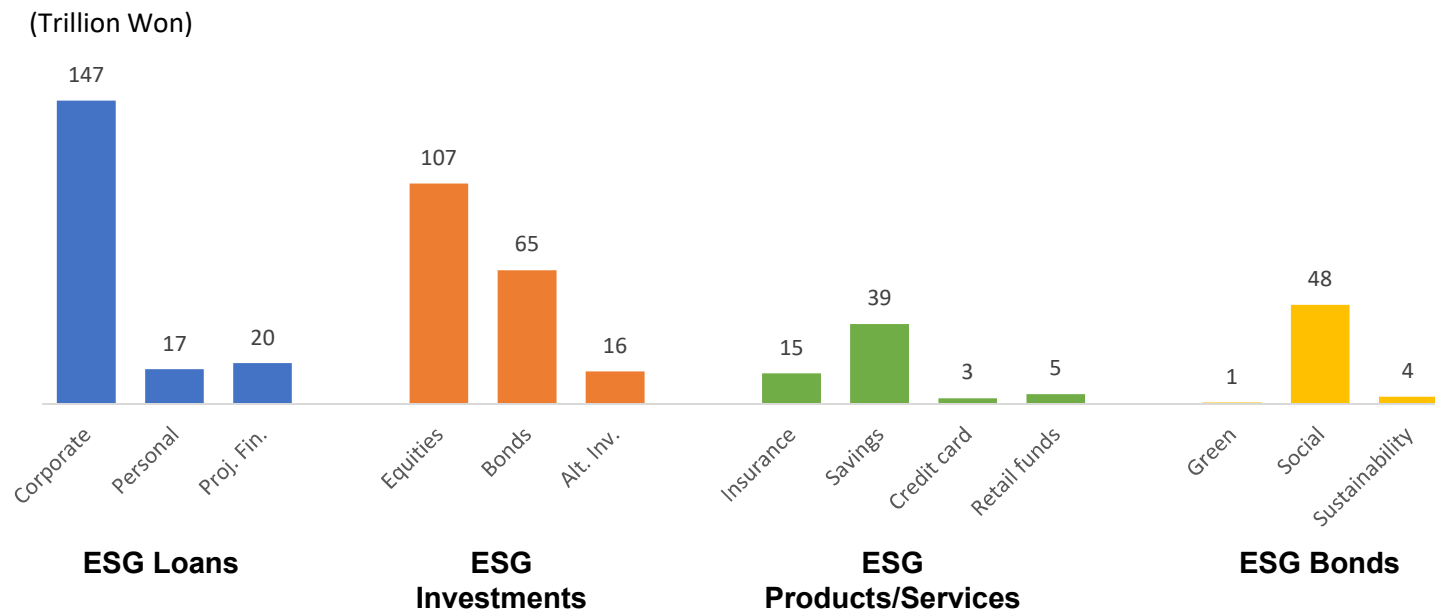
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Sustainable Finance in Korea

○ Sustainable Finance in Korea is expanding across all sectors

- › ESG related finance estimated at around 500 trillion won in 2020
- › Wide variety of financial services/products with ESG label being offered

Korea's Sustainable Finance Market (2020)



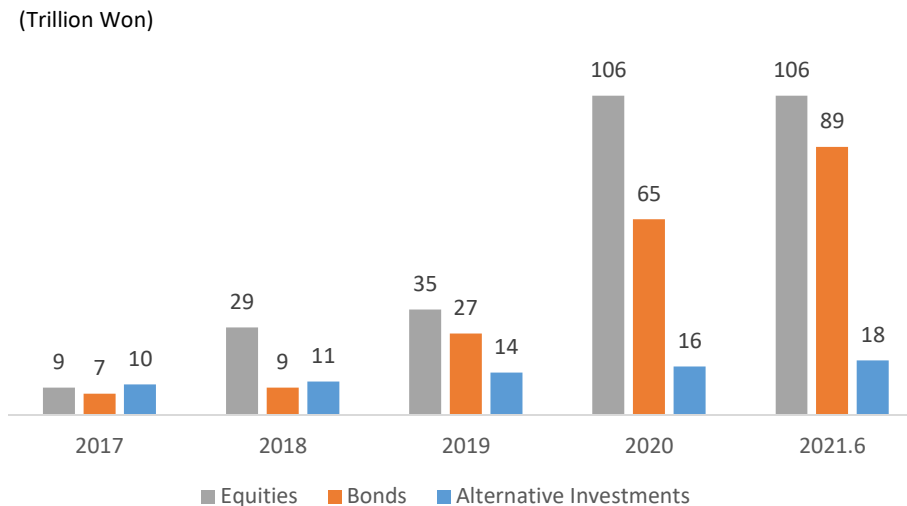
Source: Korea Sustainability Investing Forum

ESG Investments

○ ESG investments have grown substantially in a short period, led by institutional investors

- › ESG investments increased from 26 tril. won('17) to 212 tril. won('21.6)
- › Major investor is National Pension Fund, with ESG mandate in equity

ESG investments



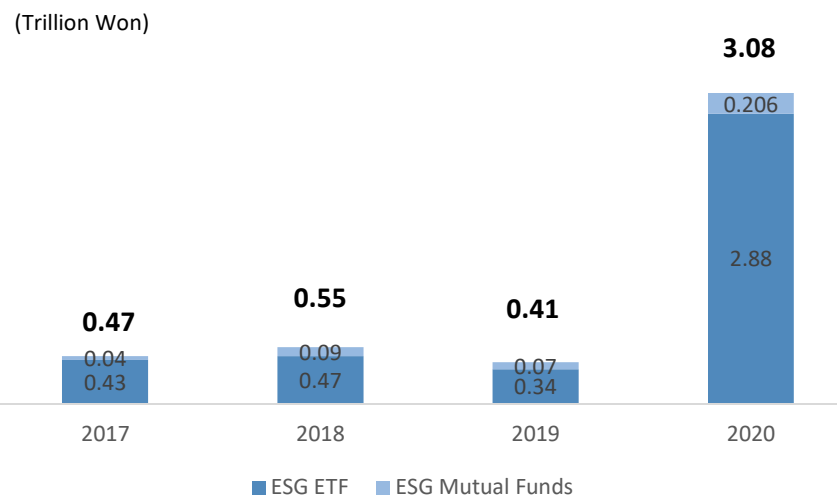
Source: Korea Sustainability Investing Forum

ESG Mutual Funds & ETFs

○ Investment in ESG mutual funds and ETFs is growing, but still only a small share of overall retail funds

- › ESG mutual funds/ETFs have grown to 3.1 trillion won in 2020
- › Share of ESG mutual funds/ETFs only 1% of overall mutual funds

ESG mutual funds and ETF AUM



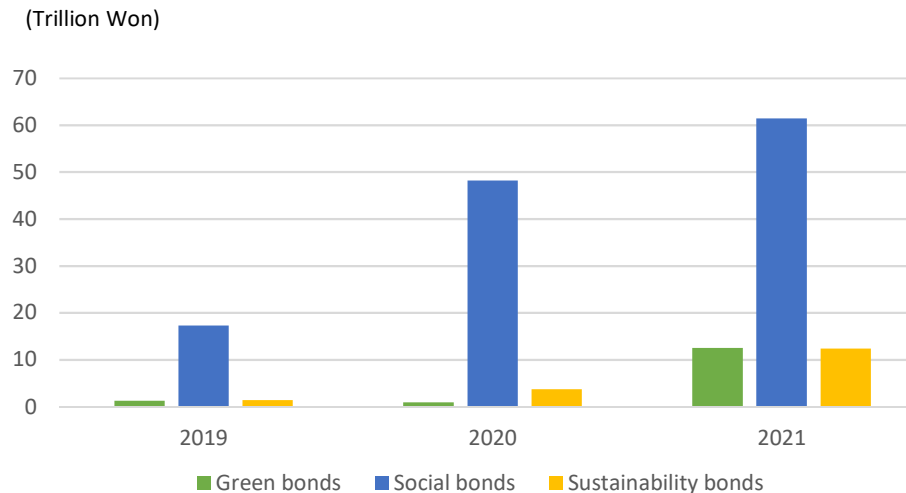
Source: Korea Sustainability Investing Forum

ESG Bonds

○ Issuance of ESG bonds have increased substantially, predominantly in social bonds

- › ESG bond issuance reached 86.3 trillion won in 2021
- › Social bonds share is 71.1%, Korea Housing Finance Corp. primary issuer

Korea's ESG Bonds Issuance



Source: Korea Exchange

Challenges

○ Despite substantial progress, further developments are needed for ESG investment market growth

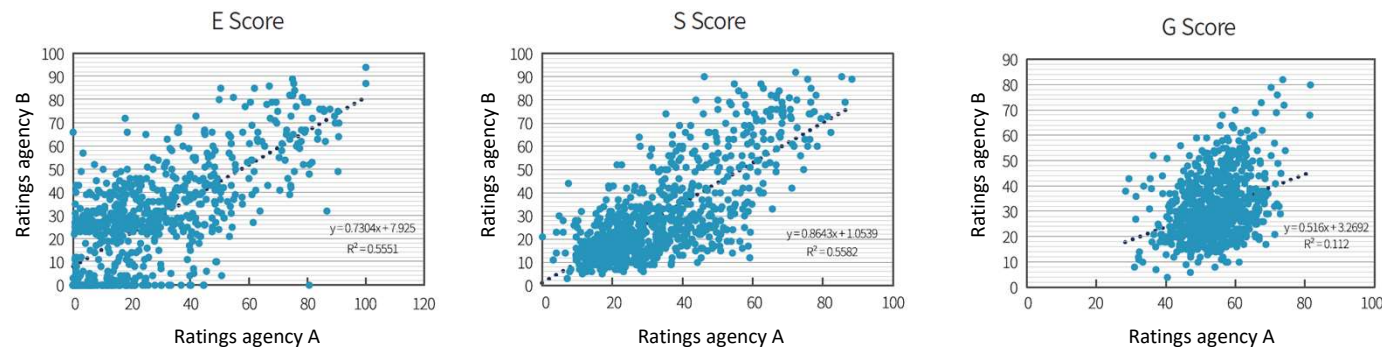
- Consistency of ESG ratings
- Diversity of ESG projects
- Differentiation of ESG investments

Consistency of ESG Ratings

○ Consistency of ESG ratings needs to improve to achieve desired environmental/social goals and enhance investor trust

- › Disparity across ratings agency E, S, G scores and overall ESG rating
- › Better input quality and ratings comparability needed

Ratings agency E, S, G Score Correlation



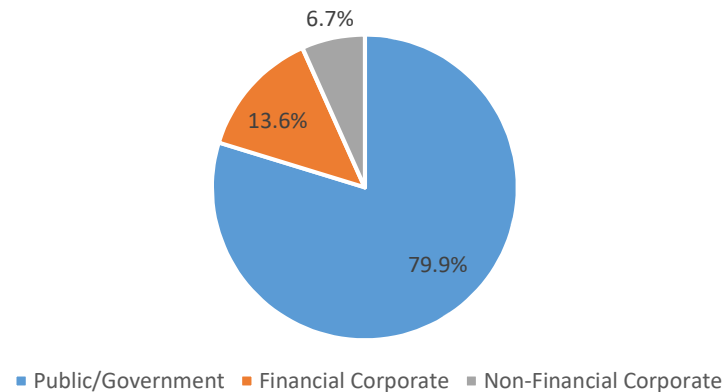
Source: Lee, 2021, "Current state and characteristics of ESG ratings system", KCMI

Diversity of ESG Projects

○ ESG bond market structure shows insufficiency of green projects and lack of diversity of social projects

- › ESG bonds skewed toward social bonds, lack of environmental projects
- › Social bond issuance mainly by a few public/government entities, projects largely in housing/real estate sector

ESG Bond Share by Issuer Type



Source: Korea Exchange

Differentiation of ESG funds

- Currently, insufficient differentiation of ESG ETFs/Funds from general funds or indices in portfolio composition
 - › Undifferentiated portfolio composition vis-à-vis market index/other funds
 - › Investment prospectus lack of specificity of ESG investment criteria, ESG assessment of portfolio firms, methodology and metrics

ESG ETF Portfolio share of top 10 KOSPI firms

| Company | ESG Rating | ESG fund A | ESG fund B | ESG fund C | ESG fund D | ESG fund E | ESG fund F | KODEX 200 ESG | KODEX 200 |
|-------------------|------------|------------|------------|------------|------------|------------|------------|---------------|-----------|
| Samsung | B+ | 3.0 | 1.0 | 0.0 | 24.8 | 21.8 | 24.7 | 24.3 | 29.0 |
| SKHynix | A | 2.5 | 1.4 | 17.7 | 5.1 | 7.6 | 10.6 | 8.4 | 6.2 |
| NAVER | B+ | 0.0 | 0.9 | 9.0 | 3.5 | 4.8 | 4.8 | 3.8 | 2.8 |
| Celtrion | B+ | 0.0 | 0.0 | 0.0 | 0.6 | 1.3 | 0.0 | 0.0 | 2.2 |
| Shinhan Financial | A | 0.8 | 1.4 | 6.7 | 4.5 | 0.05.7 | 0.0 | 2.8 | 2.1 |
| Hyundai Motors | B+ | 1.9 | 0.9 | 0.0 | 0.7 | 1.3 | 0.0 | 2.7 | 2.0 |
| KB Financial | A+ | 0.6 | 1.5 | 6.5 | 2.0 | 2.8 | 4.6 | 2.7 | 2.0 |
| Hyundai Mobis | A | 2.2 | 1.2 | 0.0 | 0.6 | 1.3 | 4.5 | 2.6 | 1.9 |
| POSCO | A | 1.7 | 1.1 | 0.0 | 1.9 | 2.7 | 0.0 | 2.6 | 1.9 |
| LG Chem. | B+ | 0.0 | 1.1 | 5.1 | 1.4 | 2.1 | 4.0 | 2.3 | 1.7 |
| Total | | 12.7 | 10.5 | 45.0 | 45.1 | 51.4 | 53.2 | 52.2 | 51.8 |

Source: Park, 2020, "Current state and characteristics of Korea's ESG Funds", KCMI

Going Forward

- **Challenges of ESG investing multifaceted, solutions require approach from various fronts**
 - › **Continued development of ESG infrastructure, including rules and guidelines**
 - Improvements of disclosure, rating methodology, impact assessment, etc.
 - Development of social taxonomy, social bond guidelines, etc.
 - › **Sustaining investor interest and trust in ESG investing, with a long term perspective**
 - Manage investor communication/expectations, care not to over-promise and under-deliver
 - Stringent due-diligence to mitigate 'washing'



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