



Sustainability

The Journal of ESG Integration

THE FUTURE IS NOW

The outlook for
sustainable investment



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Editorial

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As this most unusual year draws to a close, this roundtable presented a unique opportunity to gather a panel of experts from a diverse range of backgrounds – asset owners, asset managers, consultants and industry bodies – to discuss how sustainable investing has grown, evolved and responded to profound global shifts in recent years.

Held as an online roundtable, this in-depth panel discussion covered a breadth of topics ranging from standards and definitions to the reasons behind why looking at positive impacts can become a tool for measuring investments as well as engaging with members and other stakeholders.

We would like to thank our panellists and our roundtable partner, FTSE Russell, for their time and the considered analysis they brought to the table.

With the Responsible Investment Association Australasia reporting that in 2019 more than \$1 trillion in assets under management was invested using responsible investment strategies, we hope that this discussion drives more investment professionals to consider best practice in this fast-evolving sector of the industry.

If this is the first time you've come across this publication, *FS Sustainability* is a weekly digital publication that reports on environmental, social and governance (ESG) issues that affect how investors and Australian companies manage, disclose, and communicate their material risks and opportunities. Originally launched in 2011 as *The Sustainability Report*, it was acquired by Rainmaker Information in 2019 and was rebranded *FS Sustainability* in September this year.

Rachel Alembakis

2020 has been the year that sustainable investing not only came to the fore, but outperformed against traditional benchmarks. Mainstream interest in strategies that integrate environmental, social and governance (ESG) information was catalysed to new heights after a horrendous bushfire crisis in eastern Australia. The COVID-19 pandemic further brought prominence to the sector as ESG, responsible investment, and sustainable investment strategies had relatively stronger performance. This was due in part to their lower weighting towards fossil fuels and higher allocations to IT and healthcare.

Evidence from both a quantitative and a qualitative perspective has shown that sustainable finance can walk and chew gum at the same time.

Far from demoting climate change further down the agenda in this year of global health and economic strife, a growing number of asset owners pushed to set targets and goals to align their portfolios to a net zero carbon future.

Analysis and integration of human rights considerations have helped demonstrate the companies that are resilient to the health and safety of their employees, communities and wider society, and what policies are necessary to promote recovery. Announcements like that from the European Union (EU) with its green recovery package provide a roadmap to future investment preferences as well.

At an *FS Sustainability* roundtable recently hosted by FTSE Russell, industry experts discussed how the sustainable finance industry will continue its momentum into 2021 and beyond, with particular reference to meeting the challenge of mitigating, managing and adapting to climate change.

FTSE Russell's head of sustainable investment Asia Pacific Helena Fung noted that the drive for sustainable investment, particularly around climate risk, is rising to a pinnacle through a combination of forces. This includes regulatory and policy settings such as the EU's

green post-COVID recovery plan and its new taxonomy to increase sustainability disclosure amongst financial products, a number of countries setting net zero carbon targets for 2050, the work of institutional investors through collaborative engagements such as the Climate Action 100+ coalition, and wider work leading to a convergence on stewardship of retirement savings and fiduciary responsibility.

"2020 is the year the training wheels came off for the responsible investment sector," Responsible Investment Association of Australasia (RIAA) chief executive Simon O'Connor said.

"I think it's really been a fascinating year. This is a process of professionalising our industry that has been around for 20 or 30 years in some cases, but this is the year where we're now being embedded in regulation, standards, [and expressed in] the need for consistency and frameworks."

This drive is coming across the board, with fund managers and asset owners setting targets around sustainable finance, regulatory bodies such as APRA and ASIC explicitly discussing the risks and material concerns of climate change, and consumers demanding more products and better services from the investment industry across a range of environmental, social and governance issues.

Definitions matter: Being clear on what sustainable investment means

As the sustainable investment industry grows and evolves in sophistication and depth, there is also a push to be clear on what sustainable investment is, how it is communicated, and how it is evaluated in both portfolios and in underlying assets.

"There's a myriad of terms being used in the industry – impact, ESG, ethical, responsible, sustainable," Australian Ethical Investment chief investment officer David Macri said.

"I think people are starting to get a little bit confused and are simply putting everything in the one bucket. It would be good to have consistency and perhaps come up with a taxonomy to help."

Panellists



Joey Alcock
Frontier



Tim Batho
FTSE Russell



Helga Birgden
Mercer



Lou Capparelli
UniSuper



Mary Delahunty
HESTA



Helena Fung
FTSE Russell



Emma Herd
IGCC



Louise Lew
Willis Towers Watson



David Macri
Australian Ethical



Steve Monnier
BlackRock



Simon O'Connor
RIAA



Rachel White
Vanguard

UniSuper's manager, sustainable portfolios and governance Lou Capparelli noted that he is a member of the User Advisory Committee of the Australian Accounting Standards Board which is working on a guidance framework in relation to sustainability reporting for companies, and that many of the issues facing the investment industry are also facing the corporate world at large.

"Ideally we'd love companies to consider all their ESG and sustainability issues as they apply to them individually rather than force them into some sort of cookie-cutter approach," Capparelli said. "We have accounting standards to force [companies] to disclose in a certain way so that things are uniform, but also to avoid gilding the lily and obfuscation."

HESTA head of impact Mary Delahunty said it is useful to think about the language of the ecosystem of sustainable finance.

"ESG is a set of risks that we would consider just business as usual now," Delahunty explained.

"We should stop talking about ESG risk management as though it's some sort of amazing future and just consider it as something good stewards of capital, especially long-term capital, do."

There will never be a Tolkien-esque one framework to rule them all in the sustainable investment universe, but rather a series of tools that support differing goals – ESG risk integration, sustainable investment, and impact investment.

"What you're seeing is different activities, supporting different intent," Investor Group on Climate Change (IGCC) chief executive Emma Herd said.

"We're getting different tools, both from reporting perspective, but also product development and across different asset classes and through different investment activities to support different goals. Some funds are principally focused on impact and performance. Some are principally focused on risk management as in, whether it's carbon or social risk management or sustainability risk management.

Setting the policy then leads to the tools an asset owner or asset manager will adopt, and will determine which frameworks and measurement used to monitor performance, Herd added.

Evolution of indices and benchmarks

As data relating to ESG has increased, and as investors are becoming more sophisticated in product development, investment policy and asset allocation related to sustainable finance, so too have benchmarks and indices evolved.

"I would like to reflect on the incredible race that we've seen among index providers and asset managers to develop climate transition indices," Mercer global business leader, responsible investment Helga Birgden said.

"There's been this transition from first-generation indices, which weighted equity and fixed income indices away from high carbon companies, to second generation. This included the opportunity side and allocation to green revenues... to index solutions that are really progressing allocation to companies with a long term plan on transition and focus on all sectors... aligning to the EU taxonomy if European focused, having some measures around the 1.5 degree economy up to 2050, etc."

This new development of indices is not based on a common consensus around methodology or data sources, which can lead to a wide dispersion of index composition, explained Rachel White, senior manager, product strategy at Vanguard Investments Australia.

"That's challenging, because of data differences and inconsistencies in methodologies, that is going to be something we have to manage," White said.

"By moving to the second evolution and being clear around what the purpose of the product or the strategy is and what it's trying to achieve, and then our ability to actually report on that and provide the value that the product provides to investors is just as important."



The quote

The challenge really now is how do we scale up, and how do we continue to develop solutions which will deliver on sustainable expectations.

Asset owners and asset managers have to set objectives first, before selecting the right benchmark as the end point in investment strategy development, Frontier principal consultant and chair of Responsible Investment Group Joey Alcock said.

“It should be based on the requirements of your broad range of stakeholders,” he said.

“One of the challenges that certainly we've seen across our client base of institutional investors is balancing those different parameters, those different constraints.

“You may well want to decarbonise your portfolio and you've got APRA, for example pushing regulatory direction in that way, to sort of focus on climate, but then you've got Treasury in the last budget pushing towards a standardised approach around traditional benchmarks.”

It is possible to use an index to create the settings for meaningful impact and investment stewardship over a wide base of capital investment, Fung noted, a point that BlackRock Investment Management's sustainability specialist Steve Monnier reinforced.

“We have an independent centralised function for investment stewardship,” he said.

“That group of more than 45 professionals is dedicated to engaging with companies directly, including proxy voting, that sit within the respective indices, and is the voice of the index investor. So, as a fiduciary, the buck actually stops with them when it comes to holding board directors accountable and making voting decisions for those index investors.”

The rise and meaning of impact

As the investment industry evolves beyond integrating ESG risk into investment decisions, there is gathering momen-

turn on linking investment activities to their economic, social and environmental impact on stakeholders and society.

“We've been talking to our clients about the three dimensions of risk, return and impact,” Willis Towers Watson head of sustainable investment, Australia Louise Lew said.

“There's no such thing as a neutral investment portfolio – all have either a positive or negative impact on the environment and on society, but that's something we haven't always measured before. So it comes back to measurement and how we measure the impact of our portfolios.”

Macri noted that measuring impact at an individual actor level is complex and involves activities such as engagement, which can be difficult to quantify.

“As an industry, we might be able to generate some meaningful impact and change corporate behaviour,” he said.

“I think we need to elevate it so that it's an industry wide impact, because the more capital behind an issue, the more chance you have of successful engagement.”

Defining manager skill in generating impact can further be complicated by a lack of metrics, transparency and disclosure because this is a topic that has only garnered mainstream attention in recent years. Birgden explained that she looks to manager skill, traditional financial metrics and how a manager communicates its impacts when assessing them for an impact mandate on behalf of an asset owner client.

The United Nations Sustainable Development Goals (SDGs) can provide a narrative tool with consistent language that can assist super funds who are classifying their investment impact, Delahunty said.

“[The SDGs] help to have a consistent approach in the way decision-making is prioritised,” Delahunty said. “It's a global set of ambitions, but it's also a map of global policy, which you're not going to get in many other frameworks. Underneath that there are different ways you can measure how you're going against those ambitions. Some of the ambitions will be more relevant to our country, our members, our remit, and some of them won't be, so we've identified a subset of seven that we think have a material impact.”

Aligning decision making and communication of that process to members and other stakeholders can also be a sound business decision. O'Connor noted that consumer research from RIAA shows 75% of young people want their funds to take more action on climate change, so being able to communicate the impact of a portfolio towards reaching net zero carbon emissions targets by 2050 can align with burgeoning consumer demand in this area.

If 2020 is the inflection point for sustainable investing – as it appears to be from both a fund performance and new net inflows from institutional and retail investors – Fung concluded that “the challenge really now is how do we scale up, and how do we continue to develop solutions which will deliver on sustainable expectations” by using all the ambitions and goals expressed by the panel to continue forward. **FS**

Sustainable finance and authenticity

Inherent to the risk of greenwashing is a belief that an investor is not matching lofty words around investing to minimise environmental and social harms or maximise positive impacts.

HESTA's Mary Delahunty points out that being a sustainable investor means taking actions across an entire fund that are coherent and aligned.

“It speaks to the maturity of the concepts of sustainable finance, and speaks to the reputation risk or that authenticity risk that we have as stewards and as people who try and prosecute the argument that sustainable finance deserves greater, if not all our attention in terms of the way we assess impact,” she said.

Because Australian institutional investors are universal owners – that is, they own a slice of the entire Australian economy by virtue of the size of their asset base and the makeup of their membership base – collaborative action can be an authentic expression of impact, IGCC's Emma Herd said.

“Part of the reason why we've seen so many investors joining Climate Action 100+ is because it's very much a recognition that there is a core group of companies who are in almost everyone's portfolio that are responsible for the vast majority of carbon emissions in listed markets globally,” she said.

“And if you can get them to transition, the whole market's systemic and portfolio risk is reduced.”