Key responsible investment trends and drivers

Responsible Steel Forum II, 2 December 2019

Måns Carlsson-Sweeny – Head of ESG Research
Ausbil Investment Management Limited

Ausbil Investment Management Ltd

- Sydney-based investment manager
- Approximately $12 billion in funds under management
- Part-owned by New York Life Investment Management / employees
- Top-down / bottom-up investment process
  - Four-stage investment process integrating ESG (Environmental, Social and Governance) research
- Predominantly investing in listed Australian equities but also manages global equity funds.
Agenda

- Evolution of and growth in responsible investment
- ESG integration in practice – examples and recent trends
- The steel industry from an ESG perspective
- The decarbonisation of the economy
- The increased focus on the ‘S’ in ESG
- Emerging trends in responsible investment
- Q&A

The growth and evolution of RI

Rapid growth in responsible investment (RI)
- UN-backed Principles for Responsible Investment (PRI)
  - Global network of investors signed up to six principles on responsible investment.
  - 2019: More than US$80 trillion in funds under management and 2,300 signatories

The six principles of the PRI

- Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.
- Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.
- Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.
- Principle 5: We will work together to enhance our effectiveness in implementing the Principles.
- Principle 6: We will each report on our activities and progress towards implementing the Principles.

Source: www.unpri.org
The growth and evolution of RI

Rapid growth in green bonds

- Green bonds sales > US$135bn in 2018

Responsible investment has ‘evolved’ over time

- From ethical values-based investments to incorporation of ESG to drive better informed investment decisions.

Examples of intangible drivers:

E: environmental risk management, climate change risks and opportunities…
S: staff culture and engagement, safety performance, community relationship…
G: board and management quality, code of conduct, executive remuneration…

Analysis by E&Y on the components of S&P500 market value shows that the majority of a company’s value comes from intangible drivers and that the proportion of a company’s value that comes from intangible drivers has increased over time.

Source: www.ey.com
The rationale for ESG integration
Increased research on links between ESG and value

- Various recent research papers support the value of ESG:
  - Citi Research 2018 – Searching for Alpha: The ESG Edge
  - Macquarie Research 2019 – ESG Equity Strategy
  - AQR – Assessing Risk Through ESG Exposures

- Ausbil’s own experience:
  - Successful short positions based on ESG and better-informed investment decisions in general
  - ESG contributing to investment decisions through additional insights

ESG integration in practice
Key considerations

- Proprietary ESG research vs externally sourced research
  - Information sources:
    - Company disclosure,
    - Corporate access,
    - Conversations with other stakeholders,
    - Independent staff reviews,
    - Social media,
    - Field trips and more…

Ausbil has chosen to do proprietary ESG research tailored to its investment philosophy.
ESG integration in practice
Ausbil Investment Management Limited

• Proprietary ESG research from specialists within the investment team:
  • A) Sustainability drivers and B) ESG risk management
  • Key outputs (company-specific):
    • ESG scores and
    • ESG SWOT analysis (strengths, weaknesses, opportunities and threats).
  • ESG research integrated in stock analyst’s investment recommendation

• Alignment with investment philosophy (and examples):
  • Focused on
    • A) earnings revisions driving share price performance,
    • B) preference for companies with sustainable earnings and
    • C) quality management.
  • ESG momentum as lead indicator for operational performance

Recent trend in responsible investment
Increased focus on ESG engagements

• Switch away from divestments to ‘hold-and-engage’ strategies:
  • Driven by e.g.
    • Difficulty to diversify away systemic risk
    • Unintended consequences
    • Risks of restricting investible universe
    • ESG momentum argument

• Benefits of engagements on ESG topics
  • Better informed investment decisions
  • Protect invested capital
  • Potential expansion of the investible universe
Assessment of company in the steel industry

Key ESG considerations

• Macro drivers:
  • GDP growth, supply / demand, steel spreads…

• ESG considerations for companies in the steel industry:
  • Sustainability drivers (the ‘what’):
    • Climate change, geopolitical risk, technology change, regulatory change…
  • Key ESG metrics (the ‘how’):
    • Corporate governance: Board composition, executive remuneration, accounting risk, sustainability governance, bribery and corruption, political lobbying, whistle-blower mechanisms…
    • Social: OHS&S, employee wellbeing, staff engagement / culture, diversity, human capital development, industrial relations, community relationships, supply chain risk management…
    • Environment: response to climate change, environmental risk management systems, EPA compliance, process safety risk management…

Climate change

Decarbonisation of the economy

• IPCC report -> increased urgency

• Global challenge: balance population growth, economic growth with increased demand for affordable energy.
  • Australia: resources-based economy and policy uncertainty.

• Companies moving ahead in preparation of policy change?
  • Examples: companies targeting scope 3 emissions, companies supporting Paris Agreement, calling for price on carbon / using carbon shadow prices…

• Investor considerations on climate change
  • Investment time horizon
  • Play the transition to a decarbonised economy – various options available, e.g.
    • Avoid high emitters, invest in companies on a glide path to a 2-degree world, opportunities in e.g. renewable energy / electrical vehicles, gas as a transitional fuel, increased engagement on climate change…
Climate change
Decarbonisation of the economy

- Climate Action 100+
  - Launched in 2017
  - More than 370 investors with more than US$35 trillion in assets under management engaging companies to:
    - Curb emissions
    - Improve governance
    - Strengthen climate-related financial disclosures.
  - TCFD reporting
    - New norm for climate change reporting

- Shareholder resolutions
  - Theme: misalignment on climate change between companies and industry associations.

- Investor expectations on the steel industry

Increased focus on the ‘S’ in ESG
The Modern Slavery Act will be a game changer

- Historically, more focus on the ‘E’ than the ‘S’ but changing.
  - Increased importance of intangible drivers
  - UN Sustainable Development Goals (SDGs)
  - The Australian Modern Slavery Act

- The Australian Modern Slavery Act (MSA)
  - Transparency Act, based on UK MSA: reporting on risk of slavery in operations and supply chains.
  - Applies to organisations with > A$100m in revenue and operations in Australia.
  - More powerful than the UK version: 1) mandatory reporting requirements, 2) applies to the Federal government, 3) central database and 4) investors and investment portfolios.
Increased focus on the ‘S’ in ESG
The Modern Slavery Act will be a game changer

• Key risk sectors: mining, garments, electronics, construction, building materials, cleaning and more…

• Learnings from other industries, e.g. the garment industry (Rana Plaza tragedy).
  
  • Learnings from ESG field trips (China, Cambodia, Bangladesh, etc) and conversations with a wide range of stakeholders:
    
    • Consolidation of supply chain → incentivising suppliers, reduced complexity and improved visibility.
    • Building long-term relationships with suppliers.
    • Aligned KPIs for ethical sourcing and procurement teams
    • Transparency and collaboration
    • Multi-stakeholder solutions
    • Grievance mechanisms and worker voice

• Investor considerations on the steel industry in relation to modern slavery:
  
  • Pockets of high risk, progress will take time, use MSA statements as basis for further discussion, broader scope than just slavery in isolation…

Looking ahead
Emerging trends in responsible investment and implications

• Data privacy and cyber security risks
• War on plastics and push for circular economy
• Shareholder activism on ESG issues
• Changing preferences among younger generation
• Changes within the investment industry
• From ESG integration / ESG insights to impact investment
• Increased focus on the UN Sustainable Development Goals (backed by the PRI)
DISCLAIMER
Important information for presentation recipients

The information contained in this presentation has been prepared for general use only and does not take into account your personal investment objectives, financial situation or particular needs. Before you make any decision about whether to invest in a financial product, you should obtain and consider the Product Disclosure Statement of the financial product which is available at www.ausbil.com.au. Ausbil is the issuer of the Ausbil Active Sustainable Equity Fund (ARSN 623 141 784) (Fund).

The information provided by Ausbil Investment Management Limited (ABN 26 076 316 473 AFSL 229722) has been done so in good faith and has been derived from sources believed to be accurate at the time of compilation. Changes in circumstances, including unlawful interference and unauthorised tampering, after the date of publication may impact on the accuracy of the information. Ausbil Investment Management Limited accepts no responsibility for any inaccuracy or for investment decisions or any other actions taken by any person on the basis of the information included. Past performance is not a reliable indicator of future performance.

Ausbil Investment Management Limited does not guarantee the performance of the Funds, the repayment of capital or any particular rate of return. The performance of any unit trust depends on the performance of its underlying investment which can fall as well as rise and can result in both capital losses and gains. Consequently, due to market influences, no assurance can be given that all stated objectives will be achieved.

Contactus@ausbil.com.au