Ausbil: responsible management of climate risks and opportunities

Climate policy 2022

January 2022

Introduction

As an institutional investor and responsible entity, Ausbil Investment Management Limited ("Ausbil") has a duty to act in the best interests of our beneficiaries. In this fiduciary role, we believe that Environmental, Social and Governance (ESG) issues are not only an important part of this approach, but can also affect the underlying performance of investment portfolios.

Ausbil fully supports the commitment to achieve net zero greenhouse gas (GHG) emissions by 2050 and will engage with our investee companies to encourage an achievement of net zero emissions on a more accelerated timeline where possible.

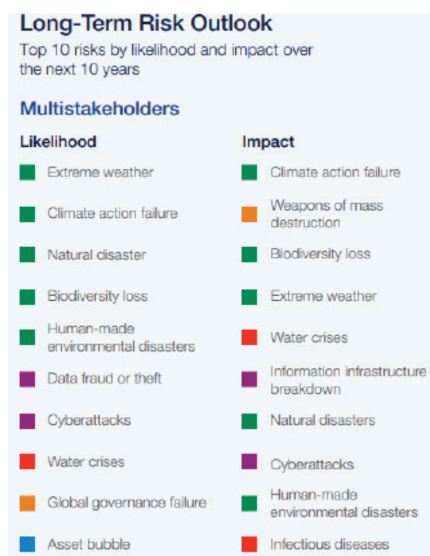
Ausbil has a dedicated ESG research team that provides proprietary ESG research that is embedded in our investment process. The ESG research team works closely with the equity analysts to factor-in climate change risks and opportunities in investment recommendations. Further, Ausbil believes that advocacy and engagement (individual company engagement or collaborative engagement with other investors) is an important step in managing climate-change related risk. Ausbil has a formal governance policy, which explicitly outlines the framework, decision making structure and procedures around proxy voting as well as a broader ESG policy.

Ausbil is a signatory to the Principles for Responsible Investment (PRI) and recognises the Task Force on Climate-Related Financial Disclosures (TCFD) framework.

What is climate change and why does it matter?

The United Nations calls climate change the defining issue of our time.[1] Ausbil recognises climate change as a major global issue and that the majority of scientific opinion supports the view that climate change is caused by increased levels of greenhouse gases, which in turn are a result of human activity[2].

In 2020, the World Economic Forum names "failure to mitigate and adapt to climate change as the key concern for the Forum's network of business leaders, NGOs, academics and others. The group places it as the number one risk by impact and number two by likelihood over the next 10 years,"[3] as illustrated below:



Source: World Economic Forum

1. United Nations. (2020). Climate Change [website]. Retrieved from https://www.un.org/en/sections/issues-depth/climate-change/
2. Source: Nasa, retrieved from https://climate.nasa.gov/scientific-consensus/
3. Source: World Economic Forum, retrieved from https://www.weforum.org/agenda/2020/01/top-global-risks-report-climate-change-cyberattacks-economic-political/

Climate change is not only an environmental issue, it is also highly inter-related with social and demographic issues.

While climate change presents a number of major investment risks, it also brings some major investment opportunities.

Our climate approach

Ausbil fully supports the commitment to achieve net zero greenhouse gas emissions by 2050 and will engage with our investee companies to encourage an achievement of net zero emissions on a more accelerated timeline where possible.

Ausbil's ESG research closely monitors international and domestic developments with regard to regulatory changes, technology changes, climate change science and other relevant aspects of climate change in order to identify key investment risks and opportunities. Also, climate change is a central issue covered in Ausbil's proprietary ESG company-specific research.

Ausbil expects, and actively encourages, companies to measure, mitigate and manage climate change risk. As a manager of major pools of equity capital, we also seek appropriate disclosures on climate change issues in investee companies and in prospective investments. As part of this, we encourage companies to adopt the TCFD framework.

Ausbil supports the Paris Agreement framework from 2015 and the general direction of COP-26, which calls for global emissions reduction with the aim to keep global warming below two degrees Celsius, and at net-zero emissions by 2050.

Ausbil believes climate change presents a number of investment risks and opportunities, which can broadly be divided into physical climate change risk and economic transition to a low carbon economy, as follows.

- The impact on investments from physical climate change, which may include, for example:

  - The increased risk and severity of extreme weather events, such as bushfires, hail, storms, flooding, and more.

  - Changes to weather patterns, such as change to rainfall, rising mean temperatures and rising sea levels as well as increased water risk.

This can lead to a direct and an indirect impact on company valuations and earnings volatility, for instance from operational disruption, increased input costs for water, increased capital costs from physical damage to facilities and higher insurance costs on assets in high-risk areas, impacts on human health, and more.

- The impacts on investments from a transition to a low carbon economy may include, for example:
  - Regulatory changes, such as the pricing of carbon emissions, an increased reporting burden and exposure to litigation.
  - Technology changes, including lower emissions technology and substitution of existing products.
  - Increased costs (as well as revenue opportunities) from a gradual transition towards a circular economy, such as mandatory recycled content, and waste levies, amongst many others.
  - Other impacts include, for instance, changing customer behaviour and increased demand for products with a lower carbon footprint, reduced demand for other goods and services, increased production costs due to changes to input costs, such as energy and water, and the costs of certain raw materials, amongst others. This may impact the valuation of companies and their value chains due to changes in the revenue mix and sources, as well as changes to costs, re-pricing of assets, and increased capital investments in technology development.

  - There are also opportunities from, for example, resource efficiency related to more efficient buildings, reduced resource consumption, and increased recycling, as well as reduced operating costs from use of lowest cost abatement.

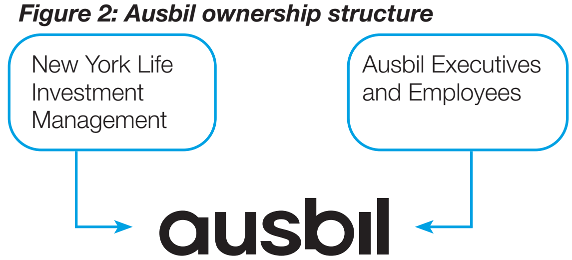
The timeframe of these impacts can vary greatly.

- In term of physical climate change, short-term impacts may include weather volatility, while longer term impacts might represent a permanent and significant shift in global or local weather patterns as well as rising sea levels.
- In terms of the transition to a low carbon economy, short-term impacts may include regulatory changes to carbon pricing, domestically, or in key markets overseas, while longer term, we foresee a relative shift in the world's energy mix and technological breakthroughs can be major game changers.

Climate - our corporate governance

Ausbil is a leading Australian based investment manager. Established in April 1997, Ausbil's core business is the management of Australian equities for major superannuation funds, institutional investors, master trust and retail clients. Ausbil is owned by its employees and New York Life Investment Management a wholly-owned subsidiary of New York Life Insurance Company. As at 31 December 2021, Ausbil manage over $16.9 billion in funds under management.

Figure 2: Ausbil ownership structure



Ausbil's board has oversight of all business and related risks via our corporate and investment structure. Ausbil's current board of directors is as follows in Figure 3.

Figure 3: Ausbil's Board of Directors

Board Member	Board Position	Title	Company
Yie-Hsin Hung	Chair	Chief Executive Officer	New York Life Investment Management
Paul Xiradis	Vice Chair / Executive Director	Executive Chairman, CIO, Head of Equities	Ausbil Investment Management
Ross Youngman	Executive Director	Chief Executive Officer	Ausbil Investment Management
John Grace	Executive Director	Co-Head of Equities	Ausbil Investment Management
Mark Knight	Executive Director	Head of Distribution	Ausbil Investment Management
Frank Harte	External Director	Chief Financial Officer	New York Life Investment Management
Jae Yoon	External Director	Chief Investment Officer	New York Life Investment Management
Jay Giacco	External Director	Senior Managing Director	New York Life Investment Management
Naim Abou Jaoudé	External Director	Chief Executive Officer	Candriam Investors Group

Day-to-day management of Ausbil is overseen by the Ausbil Executive Committee (ExCo), comprising Paul Xiradis, Ross Youngman, John Grace, Mark Knight and Jane Lamming.

Ausbil's Executive Committee has determined that, as an investment manager, the key impact on Ausbil's business from climate change is the impact on the investment portfolios we manage on behalf of our investors.

Climate - our investment strategy and risk management

Ausbil's broad investment philosophy is that active management of our portfolios facilitates consistent and risk controlled outperformance. Rather than focusing just on growth or value investing, our investment approach allows us to exploit the inefficiencies across the entire market, at all stages of the cycle and across all market conditions. We are a top down, bottom up investment manager.

Our process seeks to identify earnings and earnings revisions at an early stage, and hence to anticipate stock price movements. We seek to position our portfolios towards those sectors and stocks which we believe will experience positive earnings revisions and away from those we believe will suffer negative revisions. At any time, our portfolio will be tilted toward stocks which afford the most compelling opportunities for appreciation over the coming twelve months.

Identification and assessment of climate change risk is done through three primary, interrelated means:

1) Ausbil's proprietary ESG research and integration
2) Ausbil's proprietary Climate Model
3) Engagement on climate change

ESG research and integration

Ausbil has an in-house ESG research team that is part of the investment team. The ESG research team carries out proprietary ESG research that is integrated in the investment process.

Ausbil has a top-down, bottom-up investment process consisting of four stages: macroeconomic analysis, sectoral analysis, stock selection and portfolio construction. ESG can be an input into all the four stages although most of the integration takes place at the stock selection phase.

Each company has an ESG-related SWOT analysis as well as company-specific and industry-specific ESG scores. Climate change is a key component in that analysis, both from a short-term and long-term perspective:

- Industry ESG scores reflect potential climate-change related regulatory change and what risks or opportunities they mean for the business. For instance, what would a price on carbon in the key export market for a mining company mean? What are the physical climate change risks for an agricultural company?
- Company ESG scores mainly relate to how a company is responding to the risks and opportunities in the external environment. For instance, how does a mining company address the risk of potential water scarcity? How is an insurance company addressing reinsurance risk for natural perils? How is a company managing climate change risks and opportunities?
- The ESG SWOT summarises key ESG-related strengths, weaknesses, opportunities and risks applicable to Ausbil's investment philosophy of earnings revisions driving share prices and a preference for quality management and sustainable earnings.

Ausbil's proprietary ESG research is based on a variety of sources, including company reporting, corporate access, and independent research on climate change, NGOs and industry analysis. Ausbil's ESG research also benefits from membership of various industry associations and initiatives, such as: the Investor Group on Climate Change (IGCC), the Principles for Responsible Investment (PRI), the Responsible Investment Association Australasia (RIAA) and its engagement working groups, as well as the engagement initiative, Climate Action 100+.

The key outputs are incorporated in the analysis by Ausbil's equities analysts and form part of the final investment recommendation. ESG research is discussed directly with relevant analysts, as part of regular investment team meetings and more formally through the monthly stock selection meetings. In addition to Ausbil's in-house proprietary ESG research, the investment team also has access to external research.

Climate Model - identifying climate risks and opportunities

The Ausbil Climate Model assesses the climate change risks and opportunities over various investor outlook periods. The results are then calibrated to 3 different climate scenarios that envisage the global temperature around a central scenario of a 2 degree increase.

Ausbil generally does not apply discounted cash flow (DCF) analysis for individual stock analysis. Instead, Ausbil mainly use earnings multiples, such as P/E ratios for valuation. As a result, we have chosen not to apply a DCF analysis on climate change but to focus on the concept Ausbil refers to as Net Climate Change Risk or 'NCCR' by looking at physical climate change, revenue and costs using a heat map system. We believe the concept of NCCR (negative or positive) is well suited to our investment process, and we believe any DCF valuation would be very sensitive to minor changes in assumptions.

The NCCR covers the following elements:

- Physical climate change: The impacts on asset valuation, disruption to supply chains or operations, impacts on input prices, and impacts on human health, etcetera.
- Revenue: Opportunities from climate-friendly products / services or risks of revenue shortfall from regulatory changes in export destinations.
- Costs: Impacts from a price on carbon (direct or passed through), increased insurance costs, impacts on input prices, impacts from regulation on recycling, and other such risks.

The NCCR output scores represent the net-effect of such impacts on a company's earnings and risk outlook, and on the sustainability of their business model.

Three scenarios have been built-out and developed for input into Ausbil's proprietary climate change analysis tool,

- Above 2 Degrees (A2DS): expected to result in average temperature increases of +2.7-3.0 degrees by 2100

- 2 Degrees (2DS): 50% chance of limiting average temperature increase to +2 degrees by 2100

- Below 2 Degrees (B2DS): 50% rapid decarbonisation with a 50% chance to limit global warming to 1.5 degrees by 2100.

The scenarios build on a number of sources, such as the International Energy Agency and the UN PRI.

Ausbil's analysis includes three timeframes that relate to investor outlook periods. These are:

- Short Term, over a rolling 12-months:

  - At any given point in time our portfolio will be tilted toward the stocks which afford the most compelling opportunities for appreciation over the coming twelve months, and which have passed our ESG scoring hurdles.

- Rolling 5-year periods to 2025:

  - Ausbil's stock analysts make sector recommendations on a strategic basis (covering 3-5 years ahead).

- Long Term, out 30-years to 2050:

  - The third time-frame, out to 2050, whilst not in line with our investment time horizon, provides a long-term view on risks and opportunities, particularly with respect to the quality of a company's business model, and the fundamental issue of survivorship. We believe a long-term scenario is useful when we assess how companies are fundamentally and materially preparing for the decarbonisation process.

The output from the Climate Model is an input into the ESG industry scores, highlights key investment risks and opportunities in the short, medium and long term and helps Ausbil to prioritise future engagement activities. It also enables Ausbil to measure risk by portfolio versus the benchmark.

Engagement on climate change

In addition to the risk assessment described above, engagement plays a major role in risk management. Engagement on climate change can help drive better informed investment decisions and help preserve invested capital.

Every year, Ausbil draws up an ESG engagement plan, which details key ESG advocacy and engagement themes, as well as objectives and milestones, as appropriate. Each year Ausbil produces a publically accessible ESG engagement report, which outlines key ESG engagement activities and outcomes. As an active investment manager, Ausbil's engagement activities are mainly focused on portfolio holding companies. Climate change remains a key engagement theme that Ausbil has engaged on with companies for years.

The objective for engaging with companies on climate change is to improve the resilience of companies, and seek improved climate change related disclosure to help investors identify risks and opportunities in relation to climate change. This information creates a feedback loop that hopefully results in ever higher expectations and accountability, and genuine change in behaviour, planning, ambition and performance around climate change, ultimately to the benefit of society and the environment.

Additionally, Ausbil maintains carbon footprint data for ASX 300 companies, that is tracked over time. Further, Ausbil monitors company statements regarding Net Zero commitments to both 2030 and 2050, encouraging all companies to develop accelerated GHG reduction strategies against both 2030 and 2050 target dates. Notwithstanding the Australian Government's commitment currently only references a 2050 target, many individual companies have now established targets for 2030 as well.

The strategy for our climate change engagement has been (and continues to be) to pursue company-specific engagements focused on adoption of the TCFD (Taskforce on Climate-related Financial Disclosures) and to participate in collaborative engagements, primarily through Climate Action 100+. Company engagements have largely focused on three main themes: a) governance, understanding how companies are overseeing climate change; b) strategy, encouraging companies to have climate-change strategies in place, including GHG emissions reduction targets to both 2030 and 2050; and c) disclosure.

Climate change is a systemic risk, which means it makes sense for Ausbil to engage on a collaborative basis together with other investors. For example, Ausbil was an early signatory to Climate Action 100+ because we believe the goals of this framework are aligned with our existing climate-change related engagements. Ausbil signed up to become a support investor to six different company engagements in early 2018. These companies were in the diversified mining, oil & gas and steel industries. At the time, these companies were selected because of: a) Ausbil's holdings in these companies; and b) the companies' climate change risk exposures. Ausbil believes those engagements have been productive and have resulted in better climate-change-related disclosures in line with TCFD guidelines. Also, some of the companies engaged with have shifted their asset mix away from thermal coal, with some increasing their use of renewable energy.

Ausbil has also engaged with a wide range of other companies about climate change risks and opportunities. These engagements are with companies in the utilities, contracting, banking, retail, insurance, food and beverage, mining and infrastructure sectors. In addition, Ausbil engages with industry associations across sectors such as the Mining Council of Australia.

Voting activities

As an active investment manager, Ausbil can have an influence on the companies that it invest in and as a general rule we prefer to engage directly with them through meetings with their governors and leadership, as opposed to engaging through voting activities alone.

Ausbil has supported shareholder resolutions on climate change against the company in cases where we have not been satisfied with the engagement outcomes achieved by the company.

Climate - metrics and targets

Ausbil acquires carbon data in order to run carbon footprint analysis for its portfolios. This aids the identification of climate risks and opportunities.

This approach has been seen as a standard metric in the industry. We note however that there is not always a direct link between risk or materiality, and a company's estimated carbon footprint. Investment risks come from cost and revenue changes and the carbon emissions of a company are only one of many inputs into that equation.

When looking at this equation, assessment of a company's entire value chain (including supply, manufacturing and distribution) is needed. It also needs to factor in a company's ability to adapt.

The Ausbil Climate Model allocates a conviction score to relevant companies based on their net exposure to climate risks and opportunities across 3 separate investor timelines and a range of climate scenarios. This allows us to compare the climate characteristics of the portfolio to the relevant market index. Our carbon footprint analysis is embedded into this work and informs our research and conclusions. Such analysis is also embedded into our overall proprietary ESG research.

Importantly, the carbon footprint of a portfolio masks any engagement activities carried out on portfolio holdings. Divesting from high emitters means the shares might be held by another investor who does not engage and, as a result, there is no investor pressure for positive change on climate. Ausbil firmly believes that a hold-and-engage strategy can be more productive than other negative screening and carbon footprint measurement strategies.

This Policy will be reviewed at least annually and updated where necessary

Version Control	
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