

Ausbil - ESG Engagement Report 2018

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Annual Report

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Executive summary

1.0 Executive summary

- In 2018, Ausbil engaged with corporates, governments, and non-government organisations in 22 ESG areas, with significant concentration on four major themes: human rights and modern slavery, climate change, corporate governance, and disclosure.
- Outcome highlights achieved in 2018 included:
 - assisting with policy development with the passage of the Modern Slavery Act (2018); and chairing a subcommittee of the RIAA Human Rights Working Group on producing an investor toolkit,
 - significant engagement focused on adopting TCFD guidelines,
 - education and thought leadership in conferences and seminars, and
 - collaboration across industry ESG working groups.
- In 2018, Ausbil undertook record active engagements on 170 occasions, up from 131 in 2017.
- Ausbil's ESG team engaged in active meetings with companies accounting for over \$1 trillion of Australia's market capitalisation, or 56.1% of the ASX by value as at the end of December 2018.
- 60% of engagement meeting attendees were chairs of the board, executive and non-executive directors, and members of the leadership team (CEOs, CFOs, CIOs, COOs, etc).
- Ausbil maintained our commitment to achieving change through active engagement, education, collaboration and public speaking, here and overseas.
- Ausbil's ESG approach continues to be integrated in our investment management process for all funds, ensuring our investments are aligned with our ESG philosophy and policies.

Figure 1: Active engagement: Key ESG outcomes and achievements in 2018

| Engagement Highlights | Goal | Outcomes |
|--|---|--|
| Engage on eradicating modern slavery | Assist with policy development on modern slavery | The Australian Government passed the <i>Modern Slavery Act</i> (2018). Ausbil was heavily involved through submissions, workshops and consultations with the government before and after the passing of the legislation. |
| Promote human rights in supply chains | Investor education on human rights issues to reduce systemic risk and promote progress by companies on human rights risk management | Ausbil chaired a subcommittee of the <i>RIAA Human Rights Working Group</i> that, in 2018, produced an investor toolkit on human rights in supply chains. A number of companies have adopted key recommendations as suggested by Ausbil to strengthen their labour rights practices. |
| Climate change disclosure | Improved disclosure on climate change to facilitate better informed investment decisions | Ausbil engaged on adoption of the TCFD (Task Force on Climate-related Financial Disclosures) reporting guidelines on 30 occasions. Significant progress on company climate change disclosure was achieved in 2018. |
| Education and leadership on ESG integration | Lead knowledge and change in ESG | Undertook presentations / panel discussions: <i>PRI in Person</i> in San Francisco, the <i>CSR Asia Conference</i> in Hong Kong, the <i>ACSI Conference</i> , the <i>RIAA Conference</i> , <i>Thomson-Reuters Stop Slavery Summit</i> in Hong Kong, and the <i>Australian Circular Fashion Conference</i> . |
| Corporate governance | Improve alignment between shareholder interests and executive remuneration | A number of companies have adopted changes to executive remuneration structures with input from Ausbil. |
| Leadership through collaboration | Collaborate across industry, government and policy to achieve change and increase impact across ESG issues | In 2018, such cooperation included <i>Climate Action 100+</i> , RIAA's ESG engagement working group and <i>Human Rights Working Group</i> the <i>Investor Alliance for Human Rights</i> , and the <i>Investor Statement on Bangladesh</i> , signing global investor statements to governments on climate change, and more. |

Key engagements and outcomes achieved in ESG in 2018

2.0 Key engagements and outcomes achieved in ESG in 2018

2018 was a big year in ESG, and Ausbil was engaged across all the major issues, participating in the key conferences, seminars, and actively engaging companies in the sectors where ESG matters came to the fore.

2.1 Social Engagement

In social engagement, one of the biggest issues this year was that of modern slavery. In 2018, the United Nations strongly urged states, universally, to protect the rights of workers subject to modern slavery conditions. Some 40 million people are subject to modern slavery conditions, mostly in the private sector. Approximately 25 million of these people are in forced labour. It has been estimated that there are some 15,000 Australians living in conditions of modern slavery. The UN Sustainable Development Goals (SDGs) include the goal to eradicate modern slavery by 2030.

The United Kingdom introduced their *Modern Slavery Act* in 2015, which brought in disclosure requirements on modern slavery. In 2018, Australia passed similar legislation, the *Modern Slavery Act 2018* (MSA), further strengthened with mandatory reporting requirements. The MSA mandates that companies disclose their risk exposure to modern slavery across their operations and supply chains, what they have done to redress this, and how effective those actions have been.

Ausbil has been pivotal in actively engaging on modern slavery, participating in consultation with the Government on the development of policy and legislation, and engaging companies on modern slavery in supply chains; on how to monitor, measure and eradicate modern slavery, and other human rights abuse across their sourcing networks, to all degrees of relationship. Ausbil will continue to consult on the guidance for the MSA, and the integration of MSA requirements by companies in 2019.

Human rights and labour conditions in the supply chain has been a long-standing engagement theme for Ausbil's ESG team. Pleasingly, a number of companies have taken up practical advice we have given on responsible sourcing, which could limit the risk of adverse labour and human rights impacts. Ausbil's engagement in this area has typically focused on encouraging industry best practice. Ausbil chaired a subcommittee of the *RIAA Human Rights Working Group* that, in 2018, produced a new investor toolkit to help other investors reduce the systemic risk in this area.

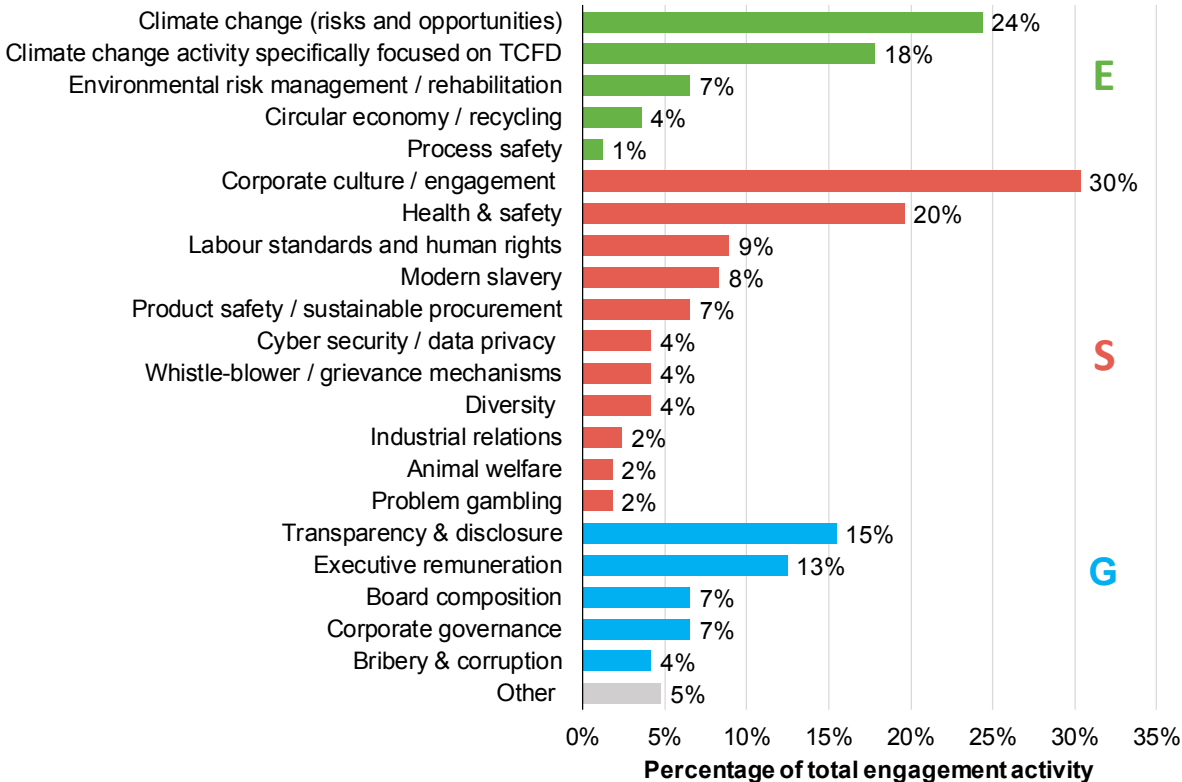
In addition to current engagements on labour rights, Ausbil visited Cambodia to observe garment factories, with focus on the costs of sexual harassment in the workplace, and expanded learning around industry best-practice for engaging with companies.

This year, though modern slavery formed a major ESG platform for Ausbil, as outlined later in this report, we also engaged in depth across many other social issues, as outlined in Figure 2.

Key engagements and outcomes achieved in ESG in 2018

Figure 2: Depth in the ESG issues Ausbil has engaged in 2018

ESG engagement - key themes in 2018



Source: Ausbil Investment Management 2019. Please note that meetings often cover more than one theme.

On social themes, corporate culture and staffing practices accounted for the majority of engagements, followed by occupational health and safety, labour standards and human rights, modern slavery, product safety, whistle-blower and grievance mechanisms, diversity, cyber security and data privacy, problem gambling, industrial relations and animal welfare.

Key engagements and outcomes achieved in ESG in 2018

2.2 Environmental engagement

It was also a big year for climate change as an area of major engagement in 2018. The World Economic Forum (2018) announced that climate change was the biggest risk to the world, together with technology, in their survey of global risk. In their top-five risks, extreme weather events, natural disasters, failure of climate change mitigation and adaptation, and water crises were named, behind weapons of mass destruction, which topped the list.

In 2018, the Intergovernmental Panel on Climate Change (IPCC), the UN body for scientifically assessing the impact of climate change, issued a landmark report urging for action on climate change. Ausbil actively engaged on climate change across industry, and collaborated with other investors on the *Climate Action 100+* initiative. *Climate Action 100+* is asking companies to reduce emissions, set emissions targets, adopt robust goals to reduce the impact of climate change, and achieve disclosure in line with TCFD (*Task Force on Climate-related Financial Disclosures*) guidelines. Ausbil engaged specifically on the TCFD reporting guidelines 30 times in 2018, and will continue to engage in this area in 2019.

Ausbil's activity in all these areas contributed to a number of listed companies adopting these guidelines, and improving their disclosure, including providing better disclosure to investors on the risks and opportunities in engaging on climate change. The *Climate Action 100+* initiative has grown to a major engagement initiative with significant scale.

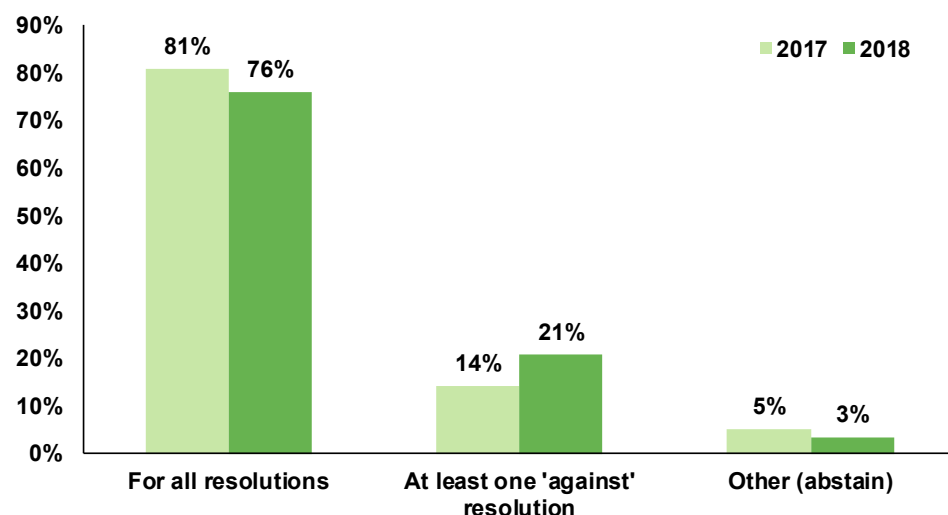
In 2018, Ausbil also engaged on general environmental risk management and rehabilitation, circular economy and recycling, and process safety.

2.3 Governance engagement

On governance issues, 2018 witnessed a historically high number of strikes against remuneration reports at AGMs as shareholders took a particularly hard line on misalignment between remuneration and outcomes. A number of these strikes were related to the *Royal Commission on Misconduct in the Banking, Superannuation and Financial Services Industry* as banks, insurers, advisers and financial services companies accounted for a range of failures in governance, culture and disclosure. Ausbil continued to take an active approach to engaging with boards, and actively exercised our rights to vote on many occasions.

In terms of corporate governance, some companies have made significant changes to their executive remuneration structures. However, during the AGM season in 2018, Ausbil still voted against a number of remuneration reports, including for three of the four major banks. In addition, Ausbil did not support the election or re-election of directors in companies whose practices fell short of expected ESG standards. These large 'against' votes, combined with continuous engagements, will hopefully lead to further improvements in governance in 2019.

Figure 3: Proxy voting 2018 vs 2017 (by AGM)



Source: Ausbil Investment Management 2019.

Key engagements and outcomes achieved in ESG in 2018

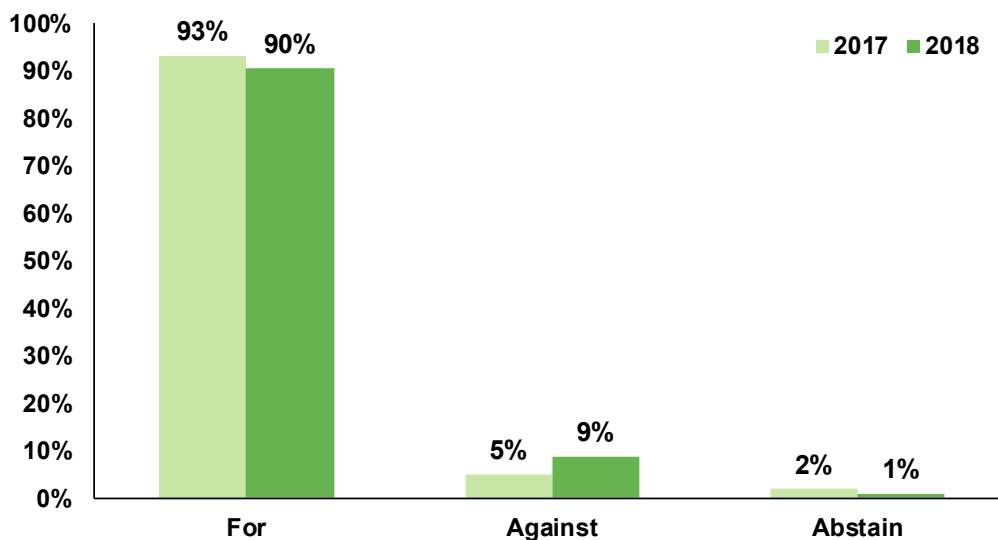
At Ausbil, we back our active approach to engaging on governance issues by actively voting at company meetings. This helps us maintain active alignment with our values, and signals to companies that we are prepared to back our ESG conviction and policy by exercising our votes. See Figure 3 and Figure 4 for a summary of Ausbil's voting in 2018.

In 2018, Ausbil voted on 881 resolutions at 145 annual or extraordinary general meetings (AGMs and EGMs) for domestic securities. Of those, Ausbil:

- voted against management (differently to the recommendation by the company) on 78 resolutions,
- voted differently to our proxy advisor (where this was available) on 27 resolutions, and
- abstained on a small number of votes due to conflicts of interest, for example, where Ausbil was participating in share issues that were subsequently put up for ratification.

As a result, Ausbil supported approximately 90% of the resolutions, voted against 9%, and abstained on 1%.

Figure 4: Proxy voting 2018 vs 2017 (by resolution)



Source: Ausbil Investment Management 2019.

On corporate governance themes for individual company engagements in 2018, transparency and disclosure, and executive remuneration dominated. However, these were followed by engagements on board composition, bribery and corruption, and other corporate governance issues.

In addition to these major ESG engagement themes, Ausbil also engaged in a number of other major areas, including:

- corporate culture,
- sustainable fashion and recycling,
- diversity,
- bribery and corruption,
- occupational health and safety,
- cyber security and data privacy,
- community relations and operations in high-risk locations,
- environmental risk management,
- compliance, and
- animal welfare.

A number of companies have improved their disclosure in these ESG areas as a result of these engagements.

Looking ahead—where are we engaging on ESG in 2019?

3.0 Looking ahead—where are we engaging on ESG in 2019?

As we step into 2019, first and foremost, Ausbil will maintain continuity in monitoring and engaging on key ESG themes from 2018. We believe consistent monitoring and engagement over time provides continuity in Ausbil's approach to both ESG issues, and their implementation in our investment process.

Consistent engagement also provides continuity in transparency and exposure that helps influence companies where we seek improvement, and rewards and recognises companies whose scores in ESG are improving through measurably better behaviour and disclosure. The end-game is to guide companies towards more sustainable earnings within a larger ESG context, achieved with lower risks that account for ESG in their assessment and mitigation.

In 2019, we will maintain our active engagement in ESG, across the issues, here and overseas, with the aim of improving society, and improving the reliability and sustainability of earnings for the companies with which we engage.

Each year, Ausbil issues an ESG engagement plan, including targets and milestone objectives. Some of the key topics we will be monitoring in 2019 will likely include, but are not limited to, the following areas.

3.1 Social issues

- The continued transition away from low-skill manufacturing in China, coupled with continued regulatory enforcement on environmental and labour rights issues, plus increased wage inflation, will increasingly push manufacturing out of China towards other South-East Asian countries (often backed with Chinese capital). This will change Australian companies' supply chains, and potentially lead to new types of human rights risks. We will work to identify these and bring them to the attention of companies we monitor.
- Ausbil will continue to consult with the Government regarding guidance on the Australian *Modern Slavery Act 2018* (MSA), including investor and company reporting obligations. Ausbil will continue to encourage companies to adopt industry best-practice on labour risk management. Ausbil will also prepare for its own MSA reporting, including continued enhancements to Ausbil's proprietary slavery risk assessment tool for portfolio constituents. Ausbil will continue to collaborate with peers, for example, through the *RIAA Human Rights Working Group*.
- Ausbil also envisages continued engagements on sexual harassment at supplier level, which we believe is an issue that deserves more attention, not the least because of its associated costs. We expect this to become a bigger engagement theme for the investment community going forward.
- In regards to collaborative engagements, Ausbil will continue to be an Australian investor voice in the *Investor Statement on Bangladesh* and also the *Investor Alliance for Human Rights*, contributing with inputs and sharing insights with investors globally. The continuation of the *Transition Accord in Bangladesh* will depend on political factors beyond Ausbil's control, however we will monitor and advise on the best response to events as they unfold.
- We will also continue engagement on labour issues in Australia, including the agricultural supply chain and the franchise industry. Underpayment of workers will remain a key theme. Research in 2018 shows wage theft and underpaid workers remains very prevalent in Australia. *The Parliamentary Joint Committee on Corporations and Financial Services inquiry into the Franchising Code of Conduct* is expected to publish its final report in early 2019.

Looking ahead—where are we engaging on ESG in 2019?

3.2 Environmental issues

- Ausbil will continue to assess investment risks and opportunities in relation to climate change, which we expect will become a central topic of the political debate ahead of the Federal election in 2019.
- We expect companies to continually improve their TCFD-based reporting following early adoption in 2017/18 as TCFD reporting will increasingly become the norm.
- Ausbil will continue to engage on the three cornerstone areas of *Climate Action 100+* (a strong governance framework, action to reduce greenhouse gas emissions, and enhanced disclosure), not only with companies where Ausbil is an investor, but with others, in a similar fashion to our engagement activities in 2018.
- We expect there will be increased focus on the circular economy, recycling and waste. Ausbil presented at the inaugural *Australian Circular Fashion Conference* in 2018 and will seek further opportunities to engage in this space in 2019.
- The tailings dam disaster in Brazil in early 2019 highlights the importance of tailings dam risk management. Ausbil will engage with companies in the mining industry about their risk management procedures and achieving better transparency.

3.3 Governance issues

- Ausbil will continue to proactively engage with companies ahead of AGMs, and provide feedback and input to companies in terms of executive remuneration as well as board composition and diversity. A large number of companies received a strike on their remuneration reports in 2018, and we expect significant changes from these companies to avoid a second strike in 2019, which would automatically trigger a board spill resolution.
- We expect the trend in shareholder resolutions on ESG issues to continue in 2019, both on climate change and human rights issues.
- Ausbil will continue to engage with companies on improved ESG disclosure by providing stakeholder feedback and input on sustainability reporting, and will continue to seek enhanced disclosure in areas of high ESG risk materiality, especially where reporting remains particularly weak.
- We expect many other themes discussed in this report, for example, culture and conduct risk, diversity, bribery and corruption, cyber security and data privacy, animal welfare, and recycling and the circular economy to remain key topics in 2019.
- We also expect the UN Sustainability Development Goals to become a major focus point in 2019, with companies seeking to understand how the various goals relate to their business, and how they can work towards achieving these goals.

In summary, Ausbil had a big year in ESG in 2018. We expect 2019 to be even bigger, and we hold greater hopes and expectations for the improvements in ESG that can be achieved across the board in the corporates with whom we monitor, measure, and engage.

This following section, *Our 2018 engagements by theme*, outlines the detailed rationale for selecting these engagement themes, the key activities and engagement strategies we followed, and the outcomes achieved.

Our ESG approach: Action speaks volumes

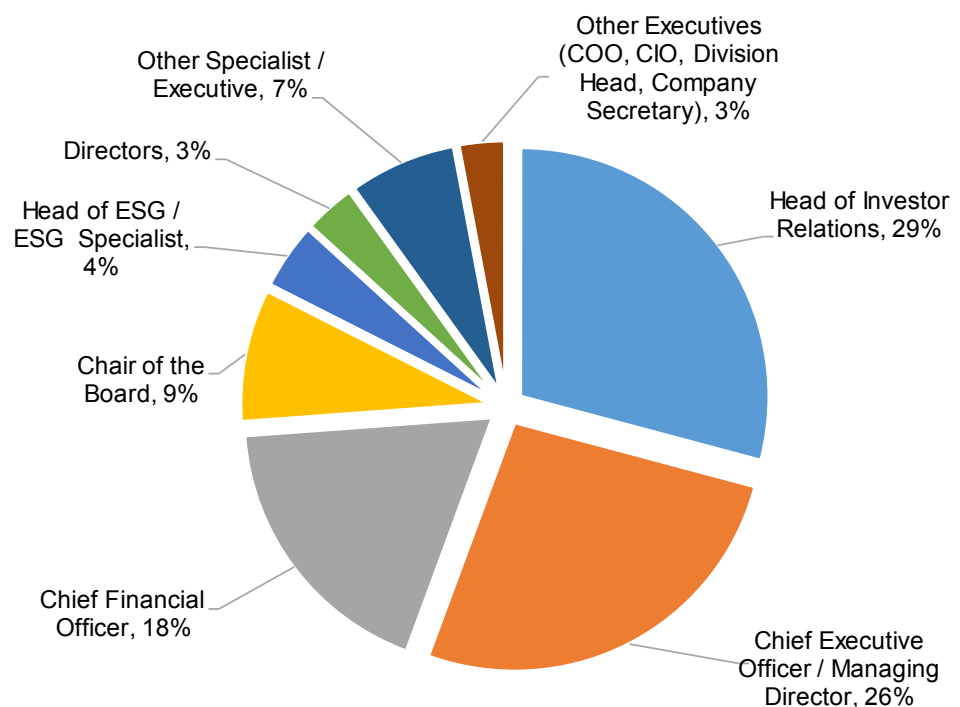
4.0 Our ESG approach: Action speaks volumes

Ausbil has integrated ESG into our overall investment process for all funds. Our ESG team is part of the investment team and reports ongoing ESG ratings reviews, changes, and recommendations at Ausbil's investment committee, asset allocation and stock selection committees. When Ausbil meets with companies, we typically do so represented by a portfolio manager, a stock analyst and a representative from the ESG team.

Our reach and influence with company leaders and decision makers is deep, with over 60% of our ESG team engagement meetings in 2018 conducted with chairs, directors, non-executive directors, CEOs, CFOs, CIOs and COOs, as illustrated in Figure 5. This means the incorporation of ESG within our investment process, when combined with our active engagement and collaboration on ESG issues, has the power to influence and change listed company behaviour for the better.

Figure 5: Reach to the leaders and decision makers in corporate Australia

Reach: ESG engagement meetings by attendee, 2018



Source: Ausbil Investment Management 2019.

Our ESG approach: Action speaks volumes

In addition to individual company engagements, Ausbil also engaged with policy makers, industry and interest groups through industry thought leadership at investment conferences in 2018. Conference engagement offers speaking and impact-networking opportunities to test and socialise ideas in ESG, educate, and extend the dialogue in areas where we are seeking change.

2018 conference engagements included roundtables on modern slavery, presentations at the *PRI in Person* in San Francisco, the *CSR Asia Conference* in Hong Kong, the *ACSI Conference* in Sydney, the *RIAA Conference* in Melbourne, at *UN Global Compact Australia* member meeting in Sydney, the *Thomson-Reuter's Stop Slavery Summit* in Hong Kong, and the inaugural *Australian Circular Fashion Conference*.

We also collaborate with other investors on active engagements to increase our impact across ESG issues. In 2018, such cooperation included *Climate Action 100+*, *RIAA's Human Rights Working Group*, the *Investor Alliance for Human Rights*, and the *Investor Statement on Bangladesh*—with Ausbil signing global investor statements on climate change and human rights issues, and collaborating with other investors on engagement with governments, companies and others.

This year, Ausbil engaged in a multitude of such ESG issues, across 22 ESG areas, with 80 companies, on 170 occasions during the year. Figure 6 outlines Ausbil's action-orientated approach to deep and broad engagement on ESG issues.

Figure 6: Ausbil ESG, action speaks volumes

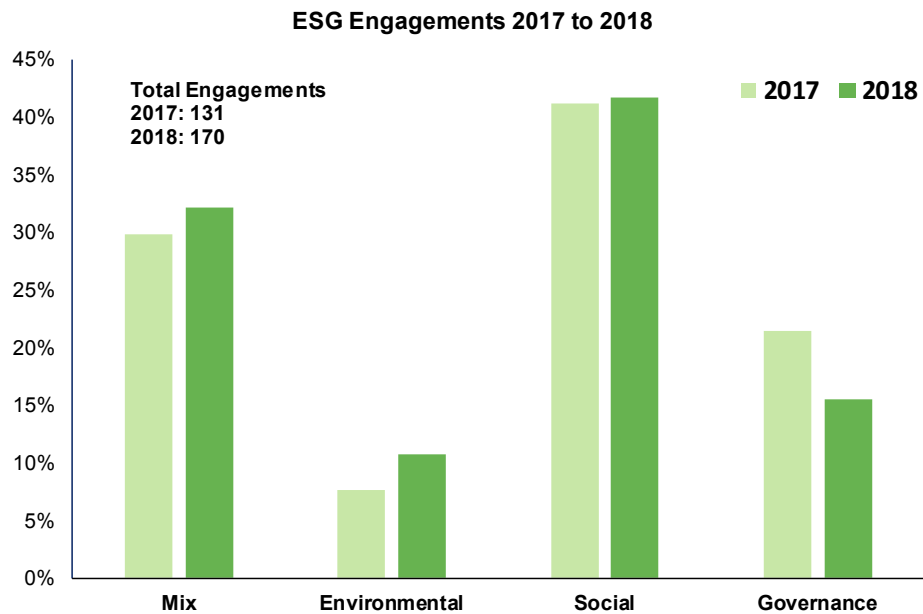
| | Key 2018 achievements |
|-------------------|--|
| Depth | Deep, action-focused engagement across 22 major ESG areas |
| Engagement | 170 focused ESG engagement meetings with company leaders responsible for over 56% of total ASX market-cap |
| Leadership | 60% of engagement meetings were conducted with chairs, directors, CEOs and executive leadership teams |
| Reach | Ausbil travelled to Cambodia and Hong Kong to investigate, first hand, human rights and labour conditions in manufacturing and supply chains |
| Breadth | ESG engagements covered over \$1 trillion (56%) of Australia's market capitalisation, across 17 different GICS sectors |
| Continuity | Continuity in approach across issues to achieve sustained improvement in ESG practices over multiple years |
| Votes | 881: The number of individual resolutions considered by Ausbil's ESG team 145: The number of AGMs and EGMs at which Ausbil's ESG team voted |

Source: Ausbil Investment Management 2019, ASX GICS.

In terms of Ausbil's ESG engagement with individual companies, social issues accounted for 42% of activity, corporate governance accounted for 15%, and environmental issues comprised 11% of engagement, while a mix of two, or all three ESG components accounted for 32% of engagements. These numbers echo those in 2017, as illustrated in Figure 7.

Our ESG approach: Action speaks volumes

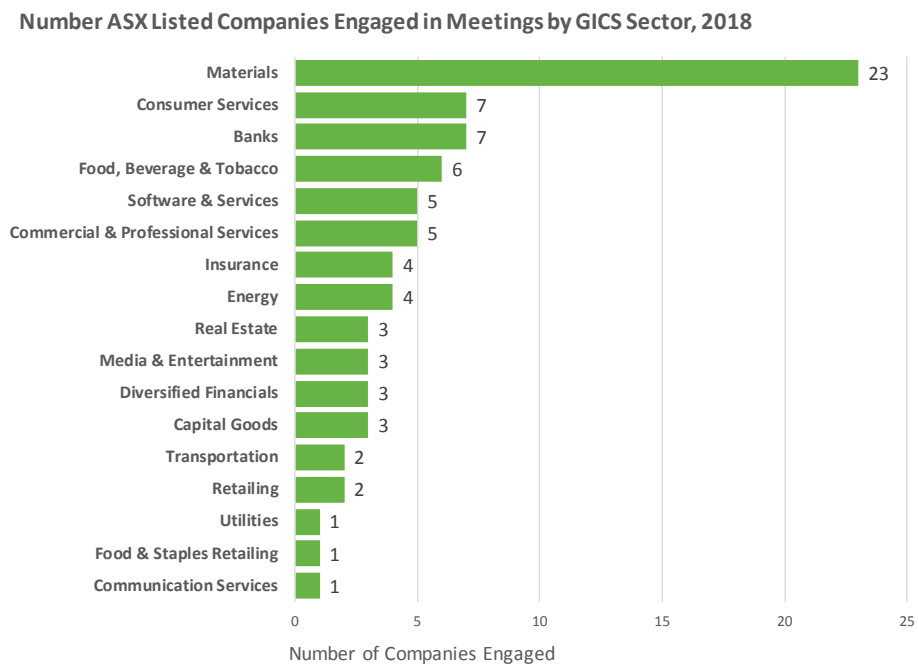
Figure 7: Increasing ESG engagements—2017 to 2018



Source: Ausbil Investment Management 2019.

In 2018, Ausbil was engaged in ESG issues across multiple industry sectors, as illustrated in Figure 8. The Materials sector was an outlier for engagement given the significant ESG issues faced by mining and materials companies worldwide. Banks and diversified financials figured particularly with the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*. For more detail on our engagements at the sector and company level, please see the second part of our report, *Our 2018 engagements by theme*.

Figure 8: Frequency of engagement across industry type in 2018

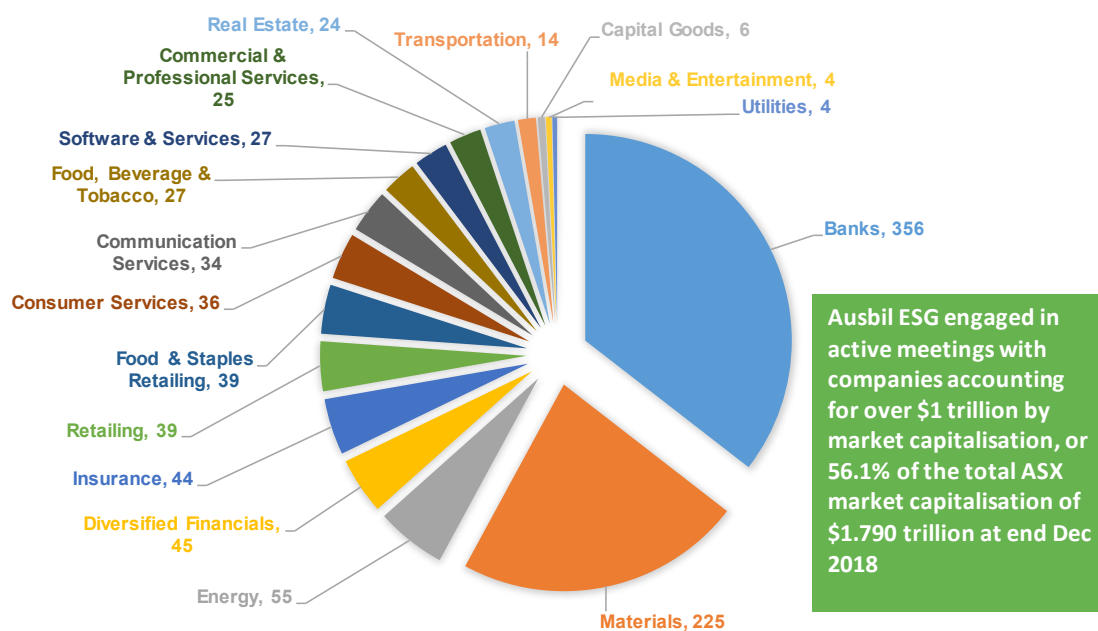


Source: Ausbil Investment Management 2019, using GICS classifications.

Our ESG approach: Action speaks volumes

Figure 9: Breadth across the market place by sector

Company Engagements by Sector and Market Cap \$bn in 2018



Source: Ausbil Investment Management 2019.

Ausbil's reach in 2018 on ESG extended to companies with combined market capitalisation of over \$1 trillion, or some 56% of the total market value of the Australian Stock Exchange (ASX), as illustrated by sector in Figure 9.

As discussed in our engagement report in 2017, company culture is a cornerstone in Ausbil's ESG analysis. Our views on momentum in cultural factors, positive or negative, and how they impact company performance on ESG, and in general, have contributed to our investment decisions this year.

Many of the risks we flagged in 2017, including concerns about cultural factors in the banking industry, became very topical in 2018. The importance of conduct and cultural risks were discussed in our paper [Conduct risk—assessing intangible and cultural risks in the financial sector in 2016](#).

A number of the ESG engagement topics are directly aligned with the UN's *Sustainable Development Goals* (SDGs), such as eradicating slavery by 2030, climate action, good health and wellbeing, and more. However, while Ausbil's engagements are guided by, and aligned with, the SDGs, Ausbil does not currently report against the SDGs.

ESG: Our beliefs drive our engagement and investing

5.0 ESG: Our beliefs drive our engagement and investing

In our many interactions with the leaders and executives of companies, we believe that an active, outcome focused engagement program—one that collaborates rather than criticises—has the most potential for drawing people towards better ESG practices, which in turn can improve earnings sustainability. Figure 10 illustrates Ausbil’s core ESG beliefs which guide how we approach our active engagements, and what we believe in terms of the place of ESG in our investment process, and its power to effect positive change.

As investors, we have incorporated ESG into our investment process for all the funds we manage as we believe good ESG practices improve the sustainability of earnings, and materially reduce the risks to those earnings.

ESG is increasingly important to equity markets and investing. Figure 11 highlights the importance of ESG on share prices from the results of the UNPRI /CFA Institute Survey (2018), *ESG integration in the Americas: markets, practices, and data*.

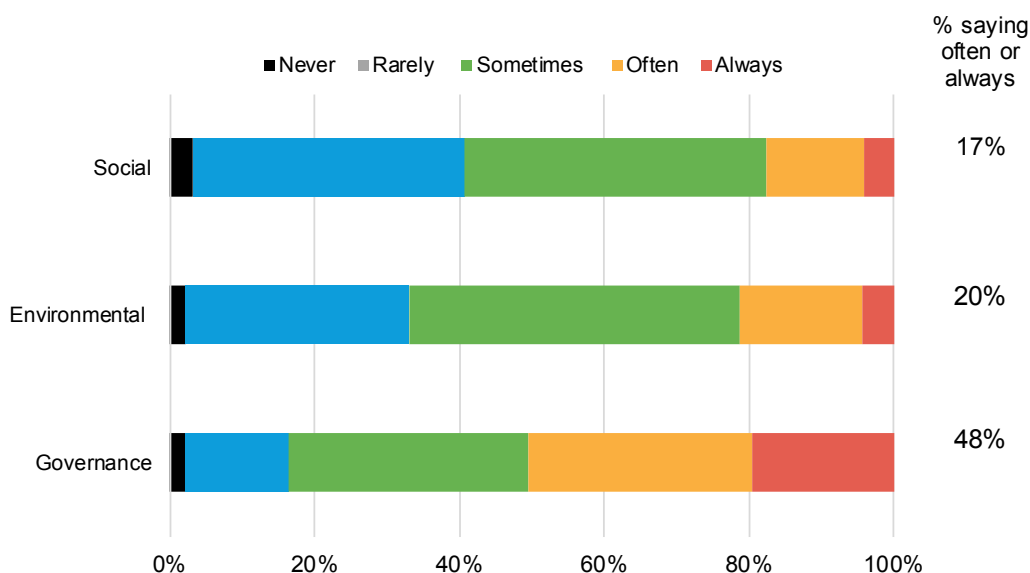
Figure 10: Investment beliefs and the power of ESG



Source: Ausbil Investment Management 2019.

ESG: Our beliefs drive our engagement and investing

Figure 11: Important already: The impact of ESG issues on share prices



Source: UNPRI / CFA Institute Survey (2018), *ESG integration in the Americas: markets, practices, and data*. Based on surveying 1,100 financial professionals, predominantly CFA members, around the world, analysis of case studies, interviews with practitioners, and data analysis of company ESG scores.

Here, 81% of respondents believe governance issues affect share prices (sometimes, often or always), with 63% stating that environmental issues affect share prices, and 57% claiming social issues impact share prices.

In the same survey, respondents say the impact of ESG on share prices, fixed income and sovereign debt would only grow over time, with increasing belief across the board as illustrated in Figure 12.

Figure 12: The impact of ESG issues in 2017, and the impact on asset prices 5-years later

| | Affected in 2017 | Will affect 2022 |
|---|------------------|------------------|
| ESG issues impact on share prices | | |
| Governance | 48% | 54% |
| Environmental | 20% | 33% |
| Social | 17% | 37% |
| ESG issues impact on corporate bond yields/spreads | | |
| Governance | 34% | 41% |
| Environmental | 13% | 30% |
| Social | 12% | 27% |
| ESG issues impact on sovereign debt yields | | |
| Governance | 33% | 38% |
| Environmental | 11% | 24% |
| Social | 15% | 25% |

Note: Percentages represent respondents who answered “often” or “always”

Source: UNPRI / CFA Institute Survey (2018), *ESG integration in the Americas: markets, practices, and data*.

ESG: Our beliefs drive our engagement and investing

Engagement on ESG issues contributes to better informed investment decisions that can help preserve invested capital, and, potentially, expand the investible universe.

As an active investor, Ausbil can directly influence corporate ESG behaviour in a way that can be difficult for passive investors to achieve given that they are constrained to holding index weights in companies, regardless of their behaviour.

Active investors, by contrast, have many more avenues through which they can engage and influence ESG behaviours such as capital allocation, active meetings with boards and management, direct company engagement and advice, and the active exercise of voting rights.

Ausbil has extensive corporate access at the highest levels of governance and management, and regularly engages with companies on ESG issues, either directly with executive management, boards, or other company representatives, advisers and shareholders.

In addition, Ausbil occasionally participates in collaborative engagements with other investors, and engages with policy makers. For more information on how Ausbil integrates ESG, please read [ESG integration at Ausbil: Why, how and what are the benefits?](#)

The importance of ESG for investment outcomes

At Ausbil, we believe share prices are driven by earnings and earnings revisions. We prefer to invest in companies with assessable and sustainable earnings. Ausbil believes that the integration of proprietary ESG research can add significant advantages in the investment process, including:

- in the pre-emptive identification of earnings risks;
- for greater insight when forming a view on earnings versus consensus forecasts;
- as a deeper and broader assessment of management quality and effectiveness;
- in identification of fundamental weaknesses or threats to a company's business model, operations and ESG impact; and
- in holistically assessing the sustainability of company earnings, and a company's true value.

For example, if a company's business model relies on underpaid labour, misinformed customers, or weak regulation, we believe current earnings may not be sustainable. This idea applies across any of the 22 ESG areas in which we engaged in 2018.

Ausbil has integrated ESG specialists within its investment team, generating proprietary ESG research, and working closely with stock analysts to derive unique insight into the sustainability of investment earnings of the companies we analyse, and in which we invest.

Embedding ESG within Ausbil's investment process offers two critical benefits:

- better informed investment decisions, which can lead to better investment outcomes; and
- active ownership and engagement on ESG issues that help improve company performance, and achieve better investment outcomes.

Deep dive by theme: Social engagements

6.0 Our 2018 engagements by theme

6.1 Social (S): Promoting better outcomes through active engagement

| Rationale | Objective | Strategy |
|---|---|--|
| Business models that rely on underpaid workers, modern slavery, or weak regulation, for example, will likely lead to unsustainable earnings. Brand damage can be costly and time-consuming to restore. Good labour practices can lead to economic benefit. | Encourage industry best practice to reduce risk of capital destruction and improve quality of companies in the investible universe. Pursue initiatives resulting in positive financial and social outcomes. | a) Monitor high-risk areas, build knowledge on industry best-practice and apply this to company engagements, b) investor / company education / participate in collaborative engagements to address systemic risks and c) influence regulators. |

6.1.1 Targeting modern slavery

- Ausbil issued an initial investor statement on modern slavery (2016).
- In 2017, the Australian Government announced its intention to enact a *Modern Slavery Act (2018) (MSA)*.
- Ausbil actively participated in consultations with the Department of Home Affairs, as well as the Opposition in 2017, and these engagements continued into 2018.
- In 2018, Ausbil consulted with the Department of Home Affairs on the guidance for the MSA. This work will continue in 2019.

Engagements

- **Policy:** Consultations with the Department of Home Affairs on the *Modern Slavery Act* ahead of introduction to Parliament and consultations in regards to the MSA guidance draft.
- **Field trips:** Cambodia, Hong Kong. Met with member of Woolworths' sourcing team in Hong Kong.
- **Company:** engagements with, for example, BlueScope Steel, Woolworths and Wesfarmers.
- **Conferences, panels and workshops:** *PRI in Person conference in San Francisco; RIAA Conference; Thomson-Reuters Stop Slavery Summit in Hong Kong; Stop the Traffik, ACSI member meeting, UN Global Compact Network Australia, Corrs Chambers Westgarth, ACSI member event, and more.*
- **Publications:** [The Modern Slavery in supply chains – investment implications](#), [RIAA's Investor Toolkit - Human Rights with focus on supply chains](#)
- **Collaborative engagement:** *Investor Alliance for Human Rights, RIAA's Human Rights Working Group*

Ausbil's investment philosophy of engaging on human rights in supply chains is fundamental as labour practices can be directly linked to earnings sustainability. Brands are key assets, particularly for consumer-facing businesses, and brand damage from adverse human rights findings can lead to loss of sales, difficulty in winning new business, and distraction for management. Moreover, a business model that relies on underpaid workers or a supply chain that does not fully cover its true environmental and social costs will not be sustainable in the long term. How a company deals with its suppliers and labour rights in the supply chain can also be a good proxy for management quality.

Deep dive by theme: Social engagements

The UN Sustainable Development Goals have a goal of eradicating slavery by 2030. This will likely lead to increased regulatory change and growing pressure on companies to reform their practices in this area, or risk their futures.

Our main objective within this ESG theme is to pursue engagements that can lead to both economic and social benefits by encouraging best practice. For example, through field trips Ausbil has undertaken in South-East Asia we have been able to learn industry best-practice and encourage other companies to adopt that within their processes. This helps improve the quality of companies in Ausbil's investible universe, and reduce the risk of capital destruction.

As part of our approach, Ausbil also seeks input from various civil society and non-government organisations on best practice ESG approaches globally.

In terms of strategy, in addition to company-specific engagements, many human rights issues in the supply chain are of a systemic nature. Ausbil encourages the formation of multi-stakeholder frameworks and collaborative efforts for more impact in promoting improved human rights across all participants in the supply chain, for example the *Investor Statement on Bangladesh*.

We believe an important part of this work is to educate the market in general, and influence investors, through open knowledge sharing—achieved with altruistic cooperation that rises above competition and self-interest.

Ausbil also believes that engagement with policy makers is an important element in leveraging the power of investors, and actively allocating capital to bring about positive change.

Human rights: Supporting the formulation and implementation of the Australian Modern Slavery Act

Ausbil issued an investor statement on modern slavery in 2016. Our rationale was based on the sheer number of people estimated to be living under modern slavery conditions. It was recently estimated that over 40 million people live subject to modern slavery conditions, globally, including some 15,000 in Australia.

Ausbil wanted to flag how this is more than just an 'ethical' issue for investors, but rather, an economic concern that has a widespread multiplier impact on social well-being and economic growth.

While the risk of exposure to modern slavery is relatively low in listed Australian companies' direct operations, many are subject to potentially high-risk exposure across their global supply chains, particularly in Asia.

In 2017, the Australian Government announced its intention to enact a Modern Slavery Act (MSA), similar to that which was introduced in the United Kingdom in 2015.

In a nutshell, the Australian MSA mandates that organisations above \$100 million in annual revenue disclose, each year, their risk exposure to modern slavery in their operations and across their supply chains, outlining what actions have been taken to reduce those risks, and how effective those actions have been.

While there are no explicit penalties, increased transparency, and a 'race-to-the-top' could lead to significant progress on modern slavery, which remains a highly complex and poorly understood issue. Separately, the Government of NSW also passed a Modern Slavery Act with similar features.

Ausbil actively participated in consultations with the Department of Home Affairs, as well as the Opposition in 2017, and these engagements continued into 2018. This included presenting the professional investor perspective at a roundtable hosted by the Department of Home Affairs, with a wide range of company representatives in attendance to take these messages back to Australian industry.

Deep dive by theme: Social engagements

Ausbil also engaged directly with companies and other stakeholders on the issue of modern slavery in 2018. For instance, Ausbil presented the professional investor perspective on MSA at the *Thomson-Reuters Stop Slavery Summit* in Hong Kong (this presentation can be viewed here: <https://www.youtube.com/watch?v=7YeHZqSvQzc>).

Ausbil also presented at a member meeting for the *UN Global Compact Network Australia* (where more than 10 listed company representatives, and representatives from the Federal and NSW Governments attended), and a panel discussion at Corrs Chambers Westgarth, an ACSI member roundtable event, and more. Presentations focused on why slavery is a risk for investors, our perspective on the MSA, and practical points on what we would like to see from companies in terms of managing labour rights within their global supply chains. This is also covered in our Ausbil publication, *The Modern Slavery in supply chains – investment implications* which can be read here www.ausbil.com.au/research-insights/research/the-modern-slavery-in-supply-chains-investment-i.

The MSA passed into legislation in late 2018, and will take effect in early 2019. Ausbil was pleased with this outcome given our engagement efforts and consultations in the development of this legislation.

The Australian MSA will have relatively greater enforceability than its UK counterpart. While there are no penalties for non-compliance, the MSA has mandated reporting requirements that apply to investors and not-for-profit organisations.

Engagement has focused on general reporting requirements for investee companies, but also on greater clarity around investor reporting requirements. Ausbil has also had meetings with *Stop the Traffik*, and provided input for an educational video about the MSA that will be published in 2019.

Ausbil has already had a number of meetings with listed companies (such as BlueScope Steel, Woolworths, and Wesfarmers) in terms of how they are preparing for the MSA, mapping out the supply chain, and how they intend to engage with suppliers to effectively reduce these risks.



Måns Carlsson-Sweeny, Head of ESG Research at Ausbil (pictured third from left), addresses the panel at the Thomson-Reuters Stop Slavery Summit in Hong Kong, August 2018.

Deep dive by theme: Social engagements

In 2018, Ausbil presented on a panel at the ACSI conference about the 'S' in ESG, highlighting examples of how the 'social issues' can be a major value driver in Ausbil's investment decisions, and the importance of engagements on these issues. Ausbil also presented on this topic at the annual *PRI in Person* conference in San Francisco, and at the *RIAA Conference* in Melbourne.

Ausbil also participated in meetings for the *RIAA Human Rights Working Group*, and chaired a subcommittee tasked with producing an investor toolkit focused on constructive and productive engagement on human rights issues in the supply chain. *RIAA Investor toolkit: Human rights with focus on supply chain* was published in August 2018, and can be read here <https://www.ausbil.com.au/Ausbil/media/Documents/Research%20and%20Insights/HRWG-Investor-Tool-Kit.pdf>

The RIAA Investor Toolkit outlines the relevance of human rights in supply chains, how investors can spot red flags, common traits for leaders versus laggards in human rights risk management, and suggested engagement areas to achieve improvement. It has a practical focus with examples of best practice. This helps investors to engage more productively. The RIAA Toolkit focuses on five key points:

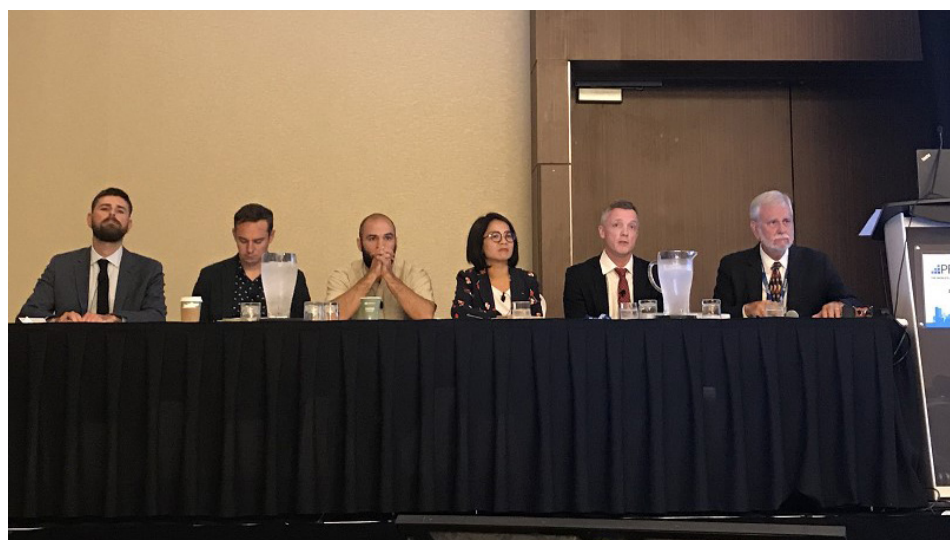
- Know your supply chain: transparency, traceability, complexity and risks.
- Adopt a robust ethical sourcing policy, covering underlying issues and grievance procedures.
- Know your supplier and build closer relationships with suppliers.
- Provide training on human rights to staff and suppliers.

It also takes a deep-dive on key underlying issues, including:

- living wages,
- freedom of association,
- grievance mechanisms, and
- use of certified labour-hire companies.

These are issues that Ausbil has a long history of engaging with companies and industries on, based on expertise gathered through various field trips over the years.

In 2018, Ausbil also joined the *Investor Alliance for Human Rights* <https://investorsforhumanrights.org/>, which is a global, collaborative engagement initiative especially focused on human rights. As part of this, Ausbil has shared a number of insights on effective engagements in practice, and ESG intelligence from the field trip we undertook in Cambodia.



Måns Carlsson-Sweeny, Head of ESG Research at Ausbil (pictured second from right), addresses the panel at the *PRI in Person* in San Francisco, September 2018.

Deep dive by theme: Social engagements

6.1.2 Human rights: Investor Statement on Bangladesh

Engagements

Policy: continued active participation in the *Investor Statement on Bangladesh*

Policy: Ausbil co-signed a statement by the ICCR (Interfaith Center on Corporate Responsibility) calling for companies to support the extension of the Accord

Company: engaged with Woolworths about Big W signing this Transition Accord, which they did in early 2018.

Ausbil continued to be an active signatory to the *Investor Statement on Bangladesh* www.iccr.org/investor-statement-bangladesh. The Bangladesh Accord on Fire and Factory Safety (the Accord) came into effect in 2013 following the Rana Plaza tragedy that saw over 1,100 workers perish in Dhaka, Bangladesh.

The Rana Plaza tragedy became a catalyst for change in the garment sector in Bangladesh, and the Accord was a 5-year multi-stakeholder commitment between retail brands, NGOs and unions, established to prevent similar accidents in the future. The Accord expired in May 2018 and a new 'Transition Accord' was established to ensure the progress continues as many of the issues have not been resolved. Ausbil believes companies signing the extension of the Accord help reduce their brand risk.

Ausbil co-signed a statement by the ICCR (Interfaith Center on Corporate Responsibility) calling for companies to support the extension of the Accord, and had engagements with Woolworths about Big W signing this Transition Accord, which they did in early 2018. Most other Australian companies that signed the original Accord signed the Transition Accord as well.

Deep dive by theme: Social engagements

6.1.3 Targeting sexual harassment in the Cambodian garment industry

Engagements

- **Field trip:** travelled to Cambodia to visit factories that work together with CARE.
- **Key stakeholders:** met with the Cambodian Children's Fund to discuss key ESG issues in Cambodia, met with the International Labor Organisation (ILO) in Phnom Penh.
- **Company:** raised the issue with, for example, Woolworths and Wesfarmers, and discussed approaches to manage the issues.

Ausbil participated in the *CSR Asia Conference* in Hong Kong, focusing on industry best practice in supply chain risk management. The conference reinforced our view that factory audits can be very limited in terms of effective human rights risk management at the supplier level. While audits might identify human rights issues, they might not necessarily solve them as many issues go unnoticed by factory audits.

One such issue is sexual harassment in the garment industry. In September 2018, Ausbil travelled to Cambodia to visit factories that work together with CARE, which is an international development organisation fighting global poverty with a special focus on working with women and girls.

CARE has published research on productivity loss from sexual harassment. Through interviews and focus groups, CARE found that nearly one in three female garment factory workers report experiencing sexually harassing behaviours.

The estimated productivity cost of sexual harassment in the garment industry in Cambodia is US\$89 million per year (equivalent, for example, to around 0.52% of Cambodia's GDP in 2015 – source, Care International 2017). This is caused by indirect cost drag from lower productivity, revenue loss, and lower productivity through missed days of work, and lower worker well-being.

CARE provides training on sexual harassment, hygiene and nutrition for workers. Tangible benefits from improvements in these areas include reduced sick leave, lower absenteeism and higher productivity. After our trip, Ausbil also met with the *Cambodian Children's Fund* to discuss key ESG issues in Cambodia.

Following this trip, Ausbil engaged with a number of Australia-based retailers, such as Wesfarmers and Woolworths, to highlight the issues, as well as highlight leading practice in how companies can reduce the risk of sexual harassment in their supply chains. Ausbil also participated in a roundtable discussion in Sydney on this topic together with CARE.

Deep dive by theme: Social engagements



Working towards well-being: Care trains workers in Cambodia on eradicating sexual harassment, and on hygiene and nutrition. Photos: Workshop on sexual harassment in a garment factory, training of garment workers on nutrition and health at another garment factory, and meeting with the International Labor Organisation (ILO) in Phnom Penh, Cambodia, September 2018 (Ausbil field trip)

Deep dive by theme: Social engagements

6.1.4 Targeting human rights in Australian franchising, agriculture and retailing

Engagements

- **Policy:** engaged with the National Union of Workers (NUW) about labour rights issues in the Australian supply chain.
- **Company:** engaged with Woolworths and Wesfarmers, for example, working with Woolworths on launch of its new responsible sourcing program, discussed ideas on best practice on labour rights, and company specific programs.
- **Roundtables:** with Woolworths, Coles, Costa Group, suppliers and civil, and non-governmental organisations on labour rights in the Australian agricultural supply chain. Deloitte about the issue of underpaid workers in Australia, and likely implications from the Franchise Inquiry, key trouble spots for underpaid workers in Australia, and ideas for engagement with companies that need to implement effective remediation measures.
- **Company:** engaged Domino's Pizza on the Fair Work Ombudsman's investigation, and Domino's Pizza's internal investigation into alleged underpayment of workers.

In early 2016, Ausbil's proprietary ESG research uncovered significant anecdotes about underpaid workers in Australian franchise businesses. This became a significant topic in the media in 2017, affecting a number of large private and listed franchise businesses.

In 2018, the Australian Senate referred an inquiry into the operation and effectiveness of *the Franchising Code of Conduct* to the Parliamentary Joint Committee on Corporations and Financial Services for report by 30 September 2018. The final report is expected in early 2019.

During the year, Ausbil engaged with Domino's Pizza on the Fair Work Ombudsman's investigation, and Domino's Pizza's own internal investigation, into alleged underpayment of workers. This engagement included discussions on the use of whistle-blower channels, and internal store audits going forward.

Ausbil also participated in a lunch discussion with Deloitte about the issue of underpaid workers in Australia, and likely implications from the Franchise Inquiry, key trouble spots for underpaid workers in Australia, and ideas for engagement with companies that need to implement effective remediation measures.

Ausbil also had a call with the *National Union of Workers* (NUW) about labour rights issues in the Australian supply chain. Ausbil also engaged with a major contracting company regarding the risks of underpaid workers in the hospitality industry.

In 2017/18, a number of research papers have highlighted the issues of exploitation of workers in the Australian agricultural supply chain. During the year, Ausbil was invited as the investor voice to a roundtable discussion on this topic, and the MSA, hosted by Woolworths. Other participants included Coles, Costa Group, and a number of suppliers and civil, quasi and non-governmental organisations. This gave Ausbil an opportunity to outline the investor perspective on labour rights in the supply chain as well as outlining what we believe constitutes industry best practice on risk mitigation and reporting.

In 2018, Woolworths launched its new responsible sourcing program. Ausbil participated in a video highlighting the importance of responsible sourcing from an investor perspective. The video was distributed internally to Woolworths' purchasing teams. Ausbil also met with Woolworths' sourcing team in Hong Kong, and undertook a series of meetings with Woolworths about responsible sourcing during the year.

Ausbil also had two meetings with Wesfarmers during the year to discuss the latest responsible investment efforts by Wesfarmers/Coles, including the scope of the SEDEX platform, and Wesfarmers' risk-based responsible sourcing program, the development of ACT (action, collaboration, transformation), and efforts on addressing the living wage issue.

Again, these engagements focused on leading industry best practice, including content discussed in the Investor Toolkit discussed above, as well as discussions about the MSA.

Deep dive by theme: Social engagements

6.1.5 Understanding and improving corporate culture

Engagements

- **Company:** corporate culture, cultural transformation and cultural integration (in the cases of mergers and acquisitions) were also central topics in many other company meetings, such as with Australian Finance Group, Aristocrat Leisure, AMP, BHP, Beach Energy, Boral, CSR, Domain Holdings, Fairfax Media, Insurance Australia Group, IOOF, Independence Group, JB Hi-Fi, Medibank Private, Origin Energy, Stockland, Santos, Seven West Media and Telstra.

Corporate culture is one of the most intangible drivers in ESG analysis but identification of cultural momentum or cultural issues can have significant impacts on investment performance.

Ausbil closely tracks culture and staff engagements for Australian companies and frequently engages on the topic of culture. In 2016, we published a research report called *Conduct risk – assessing intangible and cultural risks in the financial sector*, www.ausbil.com.au/research-insights/research/conduct-risk-assessing-intangible-and-cultural-r where we highlighted the link between corporate culture and compliance / conduct risk, and in 2017, we flagged the risk of a Royal Commission into the banking sector. A number of those issues, and many other cultural factors, became very topical in 2018.

Technology disruption is causing a major change to human capital as greater automation is leading to redundancies in many industries. During 2018, Ausbil participated in a group meeting with the Financial Services Union and discussed social issues in regards to re-training of bank staff as well as grievance mechanisms applied by the banks. Staff transition and re-training was a topic discussed with Westpac and National Australia Bank during the year. Ausbil also continued its engagements on staff engagement, risk culture and general corporate culture with the major banks, both before and after the start of the Royal Commission into banks, including product risk controls, culture and accountability, the nature and responses to breaches of the code of conduct, and increased action from regulators, amongst others.

Corporate culture, cultural transformation and cultural integration (in the cases of mergers and acquisitions) were also central topics in many other company engagements, such as with Australian Finance Group, Aristocrat Leisure, AMP, BHP, Beach Energy, Boral, CSR, Domain Holdings, Fairfax Media, Insurance Australia Group, IOOF, Independence Group, JB Hi-Fi, Medibank Private, Origin Energy, Stockland, Santos, Seven West Media and Telstra. These also included engagements on whistle-blower policies and grievance mechanisms, retention strategies, staff training, staff engagement and impacts from staff cuts, productivity measures, and more. In one case, one company that did not have an external third-party operated whistle-blower channel is establishing such a channel in 2019.

6.1.6 Promoting greater diversity in the workforce

Engagements

- **Company:** engaged with Challenger on how it builds, develops and promotes greater female participation and leadership.
- **Company:** Ausbil also discussed gender diversity, workforce participation and gender diversity in leadership and governance with, for example, BlueScope Steel, Clydesdale Bank and QBE Insurance.

Ausbil believes diversity of thought is an important driver of strong financial outcomes, and helps protect against group-think and downside risk. When it comes to diversity, including gender diversity, Ausbil is particularly interested in understanding how companies are managing this issue from a bottom-up perspective, and evidence of operational or financial improvements from improved diversity.

During 2018, Ausbil had in-depth discussion with Challenger on how it builds succession for female talent, and its approach to parental leave and pay gap analysis. This year, Ausbil also discussed gender diversity, including the business benefits, with BlueScope Steel, Clydesdale Bank and QBE Insurance.

Deep dive by theme: Social engagements

6.1.7 Widespread adoption and improvement in occupational health and safety

Engagements

- **Company:** Companies where Ausbil had engagements on OH&S in 2018 included Alumina, BlueScope Steel, Bingo Industries, Boral, Brambles, Cleanaway, Domino's Pizza, Independence Group, Iluka Resources, Galaxy Resources, Lendlease, Metals X, Qube Holdings, Rio Tinto, South32, Service Stream and Woodside Petroleum.

The majority of companies we monitor reported improved headline occupational health and safety (OH&S) statistics during 2018. In some cases, the quality of reporting has improved, for example, Aurizon is now, following engagement in the past, disclosing contractor safety statistics.

However, a number of companies still have deteriorating safety trends and / or experienced fatalities in 2018. While OH&S statistics are a lag indicator, Ausbil's engagements focus lies on lead indicators, including understanding a company's OH&S risk management and how companies proactively work towards risk minimisation.

6.1.8 Improving community relations and operations in high-risk locations

Engagements

- **Company:** engagement with Santos on land access and indigenous engagements, with traditional owners and interactions with NGOs included in the agenda.
- **Company:** engagement with Syrah Resources on relationships with the local government in Mozambique and employment from local communities.
- **Company:** engagement on potential legal risks in relation to glyphosate with Nufarm.
- **Company:** engaged on local recruitment, interaction and procurement with Rio Tinto regarding their Mongolia operations.
- **Company:** continued engagements with Incitec Pivot regarding sourcing of rock phosphate in disputed land areas. Incitec Pivot did not source anything from the disputed land area of Western Sahara during 2018.

The 'social licence to operate' became a contentious topic in the new ASX guidelines on corporate governance during 2018. From Ausbil's perspective, ESG issues can impact this 'licence' to operate and lead to difficulty in attracting new contracts, but they can also have a direct impact on current operations, ultimately impacting the sustainability of earnings.

6.1.9 Promoting animal welfare

Engagements

- **Company:** Ausbil continued its discussions with Australian Agricultural Company in relation to live export. Live export represents a very small proportion of the company's total revenue. Ausbil discussed the company's animal welfare standards and the accreditation program in use.

Animal welfare, particularly in relation to live exports, is a contentious topic. We will continue to monitor animal welfare going forward.

Deep dive by theme: Environmental engagements

Our 2018 engagements by theme

6.2 Environmental (E): Promoting better outcomes through active engagement

| Rationale | Objective | Strategy |
|--|--|--|
| <p>Failure to meet climate change mitigation and adaptation has been highlighted as the number one environmental risk by the World Economic Forum. Ausbil believes climate change presents investment risks and opportunities. Managing climate change is critical for many companies in terms of the sustainability of their earnings.</p> | <p>Improve resilience of companies and seek improved climate-change related disclosure to help investors identify risks and opportunities in relation to climate change.</p> | <p>Company-specific engagements focused on adoption of the TCFD (Task Force on Climate-related Financial Disclosures) recommendations. Participation in <i>Climate Action 100+</i> and membership in IGCC.</p> |

6.2.1 Climate change

- In 2018, the new IPCC (*Intergovernmental Panel on Climate Change*) report made it clear that limiting global warming to 1.5°C will require large-scale, far-reaching and unprecedented changes in all aspects of society.
- According to the IPCC, the *Paris Agreement* alone will likely not be sufficient to meet the 1.5 degrees warming target.
- *Climate Action 100+* has become a major global engagement initiative. As of December 2018, 310 investors with more than US\$32 trillion in assets under management have now signed-on, giving this initiative significant scale and leverage.

Engagements

- **Policy:** Continued participation in IGCC (Investor Group on Climate Change).
- **Policy/Company:** Ausbil joined the collaborative engagement initiative, *Climate Action 100+*.
- **Policy:** met with new CEO of the Minerals Council of Australia to discuss their climate change position as well as trends in responsible investments.
- **Policy:** Ausbil signed a global investor statement on climate change, calling for governments to achieve the *Paris Agreement's* goals, accelerate private sector investment into the low carbon transition, and commit to improve climate-related financial reporting.
- **Company:** engaged on climate change initiatives (such as BHP, Rio Tinto, South32, STO, Origin Energy, BlueScope Steel, BOQ, Woodside Petroleum, Insurance Australia Group and Boral), to implement a strong governance framework that clearly articulates the board's accountability and oversight of climate change risk and opportunities, take action to reduce greenhouse gas emissions across the value chain consistent with the goals of the *Paris Agreement*, and provide enhanced disclosure in line with the final recommendations of the TCFD.
- **Keynote:** *CSR Asia Conference* in Hong Kong on investor perspectives on climate change.

Deep dive by theme: Environmental engagements

Climate change

The rationale for engagement on climate change is linked to its financial materiality. Failure to meet climate change mitigation and adaptation has been highlighted as the number one risk by the World Economic Forum in terms of impact, risks from extreme weather events, biodiversity loss, food and water crises, and more.

In 2018, the new IPCC (*Intergovernmental Panel on Climate Change*) report made it clear that limiting global warming to 1.5°C will require large-scale, far-reaching and unprecedented changes in all aspects of society. According to the IPCC, the *Paris Agreement* alone will likely not be sufficient to meet the 1.5 degrees warming target.

Ausbil believes climate change is presenting 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—which in turn could have impacts on investments from physical climate change, impacts from regulatory changes, and technology changes.

The main objectives of this engagement are to improve the resilience of companies in the face of climate change, and seek improved climate-change related disclosure to help investors make better informed investment decisions in relation to company performance in this area.

Climate change is a systemic issue which ideally requires government action and / or in the absence of that, collaborative effort across industry, and in collaboration with investors. Ausbil's engagement strategy is to engage collaboratively with policy makers through the IGCC (*Investor Group on Climate Change*).

In terms of company-specific engagements, on top of existing company engagements, Ausbil joined the collaborative engagement initiative, *Climate Action 100+* www.climateaction100.org/ for more leverage.

Climate Action 100+ is a 5-year initiative launched in December 2017 to engage systemically important greenhouse gas emitters and other companies that can drive the clean energy transition, and help achieve the goals of the *Paris Agreement*.

From Ausbil's perspective, global collaborative investor-led engagement can be a powerful tool, sending a strong signal directly to companies, particularly as climate change risk is systemic in nature, and is difficult for investors to diversify away from in their portfolios.

In 2018, Ausbil signed a global investor statement on climate change, calling for governments to achieve the *Paris Agreement's* goals, accelerate private sector investment into the low carbon transition, and commit to improve climate-related financial reporting.

A key insight from the *PRI in Person* conference in 2018 was that many large investors are moving away from the divestment of fossil fuel to a hold-and-engage strategy as divestments can lead to other unintended consequences.

Climate Action 100+ has become a major global engagement initiative. As of December 2018, 310 investors with more than US\$32 trillion in assets under management have now signed-on, giving this initiative significant scale and leverage.

Internationally, in late 2018, Royal Dutch Shell announced comprehensive commitment to carbon emissions reductions with *Climate Action 100+*. Domestically, Ausbil is a support investor for six company engagements on climate change initiatives. The engagements call for companies to implement a strong governance framework that clearly articulates the board's accountability and oversight of climate change risk and opportunities, take action to reduce greenhouse gas emissions across the value chain consistent with the goals of the *Paris Agreement*, and provide enhanced disclosure in line with the final recommendations of the TCFD (Task Force on Climate-related Financial Disclosures).

The TCFD highlights that climate change is a risk to financial systems, and that investors need better disclosure. The TCFD provided recommendations in four key areas: governance, strategy, risk management, and metrics and targets.

Deep dive by theme: Environmental engagements

Progress towards the *Climate Action 100+* goals have been made by companies that Ausbil has engaged with, either through *Climate Action 100+* or as stand-alone engagements. For instance, almost all those companies now report in line with TCFD. BHP was a pioneer in climate-change related scenario analysis. Santos and Origin Energy have released their reports and Ausbil provided feedback on those. BlueScope Steel released its first climate change report in late 2018, and Rio Tinto is expected to launch its climate change report ahead of the AGM in 2019. In addition, Ausbil encouraged a wide range of other companies across various sectors to report in line with TCFD. Ausbil discussed TCFD with companies, including, for instance, Bank of Queensland, Woodside Petroleum, Insurance Australia Group and Boral.

Other points of discussion with companies have been around setting emissions reductions targets, carbon sequestration, the impacts of a carbon price, and climate change risk modelling, particularly in the insurance industry.

Another point of engagement in relation to climate change in 2018 was companies' membership of industry groups where the company and the industry groups had divergent views on climate change. This is an issue that also led to shareholder resolutions in 2018. A number of companies have subsequently addressed this by issuing statements where differences in views have been better articulated, for example, Origin Energy, Rio Tinto and BlueScope Steel.

Ausbil also met with the new CEO of the *Minerals Council Australia* to discuss their climate change position as well as trends in responsible investments.

At the industry level, Ausbil also presented on investor perspectives on climate change at the *CSR Asia Conference* in Hong Kong in September 2018. The conference had over 150 delegates from 23 countries, including representatives from Australian companies. The session discussed engagement versus divestment, carbon foot-printing, the *Climate Action 100+* engagement, and disclosure along the TCFD guidelines.



Måns Carlsson-Sweeny (far right), Head of ESG Research at Ausbil, participated in the panel presentation on climate change at the *CSR Asia Summit 2018* in Hong Kong.

Deep dive by theme: Environmental engagements

6.2.2 Promoting sustainable fashion and recycling

Engagements

- **Company:** engagement with Cleanaway.
- **Site tour:** visited Cleanaway recycling plant.
- **Keynote:** Ausbil presented the investor perspective on circular fashion at the inaugural *Australian Circular Fashion Conference* in Sydney.
- **Conference:** Ausbil participated in the Macquarie Waste Management Conference with attendees from the Waste Management Association of Australia and the consulting group MRA.

In 2016, following a field trip to China, Ausbil published a report called *Is the fast fashion industry at an inflection point?* <https://www.ausbil.com.au/research-insights/research/is-the-fast-fashion-industry-at-an-inflection-poin>. This report outlined how China, which has been the main manufacturing engine in global garment production, is shifting away from low-skill manufacturing to high-end manufacturing which, combined with new environmental laws, could have a number of impacts on the global fast fashion industry and Australian retailers. In particular, the concept of circular fashion and China's dominant role in textile manufacturing were discussed.

As China's government is enforcing environmental legislation, this will impact textile manufacturing which is water-intensive (competing with food and energy production for scarce water resources), and highly polluting. In turn, this might impact the fast fashion industry globally as many garments are cut and sewn in China, but also elsewhere, such as Bangladesh, Vietnam and Cambodia.

In 2018, Ausbil presented the investor perspective on circular fashion at the *inaugural Australian Circular Fashion Conference* in Sydney through three different workshops focused on: responsible investment and circular fashion, regulatory changes in China, and overlap with labour rights and the rise of the ethical consumer. The event was attended by a number of private and public Australian retailers.

Waste and recycling is a major ESG issue that Ausbil believes will receive increased attention going forward. In the past, Ausbil has engaged on the *Container Deposit Scheme* for beverage packaging. During 2018, Ausbil participated in the *Macquarie Waste Management Conference* with attendees from the Waste Management Association of Australia and the consulting group MRA.

6.2.3 Environmental risk management and compliance

Engagements

- **Company:** engaged on rehabilitation provisions, closure costs, tailings risk management with companies including South32, First Cobalt, BHP, OZ Minerals and Independence Group.
- **Company:** continued engaging with BHP on the aftermath of Samarco and BHP's remediation activities to date, mitigation strategies for future issues, and future remediation plans.
- **Company:** engagements with Independence Group in regards to Tropicana and certification to the International Cyanide Management Code.
- **Company:** engaged with Fortescue Metals about ending the use of asbestos in imported ore carts.
- **Company:** actively engaged with South32 in regards to a major court case on environmental and human rights issues in South America.

In addition to climate change, Ausbil's proprietary ESG research also captures general environmental risk management. Failure to meet regulatory standards can lead to fines and loss of licence to operate, as well as costly production disruption.

Moreover, even when there is no impact on a company's bottom line, environmental performance can be seen as a proxy for management quality. Engagements with companies also improves Ausbil's understanding of how companies deal with issues such as rehabilitation provisions, and estimations for closure costs. This, as well as tailings risk management, was discussed with companies including South32, First Cobalt, BHP, OZ Minerals and Independence Group during 2018.

In regards to BHP, Ausbil continued its engagement and discussions around the aftermath of Samarco and BHP's remediation there. In regards to Independence Group, we are pleased to see that Tropicana is now certified to the *International Cyanide Management Code* (an issue that Ausbil has engaged on in the past). Ausbil also engaged with Fortescue Metals about asbestos in imported ore carts, and with South32 in regards to the court case on environmental and human rights issues in South America.

Deep dive by theme: Governance engagements

Our 2018 engagements by theme

Governance (G): Promoting better outcomes through active engagement

| Rationale | Objective | Strategy |
|---|---|--|
| <p>Corporate governance is a key component in Ausbil's proprietary ESG research, which includes, for example, assessment of management quality, alignment between executive remuneration and shareholders' best interest, board quality, board independence, solid risk management frameworks, and more.</p> | <p>Better alignment between executive remuneration and shareholders' best interest as well as strong board quality in the companies in which we invest.</p> | <p>First preference is to engage with companies on contentious issues.</p> |

6.3.1 Governance

- 881: The number of individual resolutions considered by Ausbil's ESG team.
- 145: The number of AGMs and EGMs at which Ausbil's ESG team voted.
- In 2018, Ausbil had 28 meetings with company boards, the majority of which were pre-AGM meetings.
- Focused engagements on governance and culture, and how culture is critically important to company performance.
- Reviewed 'whistle-blower' policies, procedures and protections, ESG disclosure practices and transparency.

Engagements

- **Active voting:** Ausbil voted against management (differently to the recommendation by the company) on 78 resolutions. Ausbil voted differently to our proxy advisor (where this was available) on 27 resolutions. Over all resolutions, Ausbil supported approximately 90% of the resolutions, voted against 9%, and abstained on 1%.
- **Company:** In 2018, Ausbil had 28 meetings with company boards, the majority of which were pre-AGM meetings. Key topics discussed during those meetings included executive remuneration, transparency and disclosure, board composition, and bribery and corruption, risk management, occupational health and safety, performance and risk management, climate change and adoption of TCFD, gender diversity, culture and human capital development, modern slavery, the Royal Commission into banks, etc.
- **Company:** engagements with companies like QBE Insurance, Santos, Rio Tinto, Origin Energy and Woolworths about shareholder resolutions on ESG topics.
- **Company:** engaged on staff transition training and culture with Westpac and National Australia Bank.
- **Conferences:** Ausbil presented on ESG integration at *Bank of America Merrill Lynch's ESG Series*.

Deep dive by theme: Governance engagements

Corporate governance is a key component in Ausbil's proprietary ESG research, which includes individual company ESG scores, and an important consideration in Ausbil's investment process.

Our corporate governance analysis includes assessment of management quality, alignment between executive remuneration and shareholders' best interests, board quality, board independence, the state of risk management frameworks, and other governance practices.

Each year, Ausbil engages with a significant number of company boards ahead of AGMs, which also gives Ausbil an opportune time to discuss other ESG issues. While Ausbil's preference is to engage with companies, when the outcome of an engagement is unsatisfactory, Ausbil may, and does, vote against resolutions at the AGM. Ausbil subscribes to proxy advice but ultimately decides how to vote independently.

In 2018, Ausbil had 28 meetings with company boards, the majority of which were pre-AGM meetings. Key topics discussed during those meetings included executive remuneration, transparency and disclosure, board composition, and bribery and corruption risk management.

Other topics discussed as part of those meetings include occupational health and safety, performance and risk management, climate change and adoption of TCFD, gender diversity, culture and human capital development, modern slavery, the Royal Commission into banks, etc. A number of these engagements resulted in changes to individual ESG company scores, which in turn impacted Ausbil's investment view on those companies.

A number of meetings also included discussions around shareholder resolutions companies were facing. In 2017, companies started to face shareholder resolutions around climate change, specifically around adoption of TCFD guidelines. This trend continued into 2018 with companies like QBE Insurance, Santos, Rio Tinto, Origin Energy, Qantas Airways, Whitehaven Coal and Woolworths receiving shareholder resolutions on ESG topics. These were typically two-part resolutions, including a resolution to amend the constitution to allow for additional resolutions, to be presented to an AGM.

Ausbil generally does not think it is necessary to change the constitution as we can, and do, express our views directly to boards and the management of companies in which we invest. However, we believe shareholder resolutions and engagements are complementary and offer transparency for all shareholders in leading change in corporate behaviour.

In cases where such engagement does not lead to desired outcomes, Ausbil may vote for a contingent resolution. In 2018, Ausbil believed the response by one company in regards to a shareholder resolution on climate change was inadequate and supported the exercise of a protest vote. In other cases, we believe progress and / or commitment to progress by the company in question were satisfactory, and therefore did not warrant protest votes.

In terms of proxy voting in calendar year 2018, Ausbil voted on 881 resolutions at 145 annual or extraordinary general meetings (AGMs and EGMs) for domestic stocks. Of those, Ausbil voted against management, differently to the recommendation by the company, on 78 resolutions. Ausbil voted differently to our proxy advisor, where this was available on 27 resolutions. Ausbil also abstained on a small number of votes due to conflicts of interest, for example, where Ausbil was participating in share issues that were subsequently put up for ratification. As a result, Ausbil supported approximately 90% of the resolutions, voted against 9%, and abstained on 1%. See Figure 3 and Figure 4 for a summary of Ausbil's voting in 2018.

In contrast, in 2017, Ausbil supported 93%, and voted against 5% of all resolutions. Note that included among the 'against' votes lodged there were a number of contingent shareholder resolutions (contingent on constitutional changes) that did not get up for voting at the AGMs.

Put differently, Ausbil voted against at least one resolution at 31 meetings, or approximately 21% of all AGMs/EGMs in 2018, versus 14% in 2017. The 'other' category includes AGMs where there was at least one abstain vote.

One of the reasons for the slight increase in against votes in 2018 mainly relates to a higher number of votes against remuneration reports in 2018 where Ausbil deemed that the executive remuneration outcomes were not commensurate with performance.

Deep dive by theme: Governance engagements

In the main proxy season 2018 (September to December), almost 20 companies received a 'strike' against their remuneration report, including three major banks (ANZ, Westpac and National Australia Bank). Other companies that received a strike included Mineral Resources, Karoon Energy, Telstra, RCR Tomlinson, Harvey Norman, Goodman Group, Tabcorp, Myer, Austal, Computershare, Healthscope, Brickworks, Automotive Holdings, Clean TeQ, Emeco and APA Group. With the exception of the major banks, Ausbil did not hold many of those companies and, therefore, did not vote at their AGMs.

In addition, in some cases, directors seeking re-election faced significant against votes. Ausbil also voted against a number of director re-elections during the year, in one case for the director's role in structuring an executive remuneration framework that we deemed suboptimal. That particular vote was despite a recommendation to vote for the director by Ausbil's proxy advisor.

While voting is important, constructive engagement is even more important. For instance, Ausbil has provided feedback and suggested changes and alterations to the executive remuneration structure and / or disclosure for a number of companies during the year. In one particular case where Ausbil voted against a remuneration report in early 2018 we have already seen the company acting to change the remuneration structure. Ausbil has engaged with the company and provided feedback on the suggested changes for 2019.

6.3.2 Improving ESG disclosures across the market

Ausbil's proprietary ESG research uses a wide range of information, including corporate disclosure, field trips, independent staff reviews and much more. We believe better ESG disclosure by companies can help investors to make better informed investment decisions. We also believe strong external reporting requires strong internal ESG reporting processes and, therefore, better ESG risk management frameworks.

In addition to engagements on adoption of TCFD and modern slavery (see above), Ausbil has a long history of providing stakeholder input on companies' sustainability reporting, participating in materiality reviews, and providing constructive feedback on disclosure. This is done on both an ongoing basis and an ad-hoc basis, often at a company's request.

In 2018, Ausbil presented on ESG integration at *Bank of America Merrill Lynch's ESG Series* to an audience of corporates and investors. The event addressed how investors incorporate ESG and what disclosures investors prefer.

Ausbil also discussed sustainability reporting or provided feedback on sustainability reporting for companies including Bank of Queensland, Galaxy Resources, Lendlease, National Australia Bank, Nearmap, Origin Energy, Spark Infrastructure, Telstra, Tabcorp and Wesfarmers. Ausbil gave specific feedback on climate change disclosure by Santos, and encouraged a number of companies, such as Domino's Pizza and Metals X, to publish specific ESG data points, such as occupational health and safety statistics in 2018.

During 2018, Ausbil saw continuous improvement to sustainability reporting by a number of companies. Pleasingly, as discussed above, a number of companies have adopted, or are working towards the adoption of, the TCFD guidelines on climate change related reporting.

As part of the *CSR Asia Conference* in Hong Kong, Ausbil also participated in a workshop together with a number of international companies on the adoption and reporting against the UN SDGs (Sustainable Development Goals). The conference also discussed improvements in disclosure on human rights issues in the supply chain. The main outcome in 2018, however, is the *Modern Slavery Act*, which will improve transparency on how companies identify and deal with modern slavery in their operations and supply chains.

Deep dive by theme: Governance engagements

6.3.3 Other: bribery & corruption, cyber security and data privacy, and more

Bribery and corruption is a key ESG risk, which can lead to fines and loss of licences. Ausbil's ESG research aims to understand how this risk is managed, particularly in high-risk geographies. In 2018, Ausbil engaged with Rio Tinto at multiple levels about the OT mine in Mongolia as well as bribery and corruption allegations in Guinea (ongoing albeit referring to events in the past), and with Iluka Resources in regards to allegations against Sierra Rutile (events prior to the takeover by Iluka Resources). With Syrah Resources, Ausbil also discussed the company's zero political donation and anti-bribery policy.

As flagged in our engagement report in 2017, cyber security and data privacy are becoming increasingly important topics, especially following new legislation in Australia to strengthen the protection of privacy and personal information, and improve organisational transparency in regards to data breaches. Also, we believe the fast pace of technology change risks regulators being left behind. Internationally, a number of companies have been subject to costly data breaches. During 2018, Ausbil engaged on risk management in terms of cyber security, data privacy and anti-money laundering risk management processes with, for instance, Afterpay Touch, Computershare and Challenger.

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About Ausbil Investment Management

About Ausbil Investment Management

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 January 2019, Ausbil manage over \$11 billion in funds under management.

Ausbil is a signatory to the Principles for Responsible Investment (PRI) and has a dedicated environmental, social and governance (ESG) research team who provide an in-house service. ESG research is integrated into Ausbil's investment process. Ausbil believes that a consideration of ESG issues as developed by well-founded ESG research can identify mispriced stocks and assess a company's earnings sustainability. Similarly, engagement on ESG issues can drive long-term value and reduce the risk of value destruction.



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