ALTIUS ASSET MANAGEMENT

# Altius Guide to responsible investing

June 2023

## Responsible Investing

Responsible investing (RI) is a broad field of investment that has seen significant growth over the last decade.

According to the Responsible Investment Association of Australia's 21st Benchmark report, Responsible investing now represents '43% of the total professionally managed funds' in Australia. The industry growth has come at an increase in the diversity of investment practices and styles. The terminology used to describe the different investment styles can create some confusion, especially for retail investors. This note looks to provide a high-level guide of the most referenced RI strategies and styles in investment markets.

Responsible investment should reflect the beliefs and values of an individual or organisations. It is also widely agreed that a strong governance structure that addresses social and environmental factors is essential to manage risk and generate stable long-term returns.

Some ESG factors that can be addressed as part of a responsible investment framework:

| Environmental | Social | Governance |
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| • Climate change | • Human rights | • Broad structure |
| • Circular economy | • Decent work | • Executive remuneration |
| • Biodiversity | • Diversity, equity and inclusion | • Tax fairness |
| • Deforestation | | • Responsible political engagement |

Responsible investing can be delivered to investors through several approaches. The most common are Negative/Exclusion screening, Positive or Best in Class screening, ESG Integration, Sustainability-Themed Investing, Norms-Based screening, Impact Investing and Active Ownership (stewardship and engagement).

## Negative/Exclusion screening:

Negative screening is one of the earliest techniques used by the investment industry to incorporate ESG considerations into an investment portfolio. A negative screen is simply the removal of an organisation or industry that doesn't align with your investment beliefs. The most common exclusions include tobacco, armaments, alcohol, pornography, and fossil fuels. A negative screen will either have a zero-materiality threshold for a particular industry or a percentage materiality threshold based on an entity's revenue derived from the excluded activity.

## Positive or Best in Class screening:

Best in class will focus on companies that meet a defined ESG hurdle or take an active tilt toward companies that are deemed to deliver better ESG outcomes, often referred to as leaders. The ranking is a commonly used practice. Entities will be assessed against a variety of ESG criteria and ranked either within sectors or across the investment universe.

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A minimum ranking requirement such as being in the top quartile needs to be met for the company to be included in the investment universe. Positive screening may favour investment in entities that are targeting a specific ESG challenge such as climate change. The challenge with positive screening is it often focuses on the best in class and not the industry. An investment in an Oil and Gas company could occur if it has best-in-class emission intensity metrics but overlooks that the industry is a key contributor to climate change.

## ESG Integration

Integration is the systemic approach of incorporating ESG criteria into financial analysis to determine the financial strengths and weaknesses of an entity. Like all financial analysis, it is subject to availability and reliability of data and the values of the Analyst and the Portfolio Manager.

## Thematic Investing

Thematic investing can target a particular environmental or social theme through a top-down investment approach (e.g., a preference for green bonds which provide environmental impact).

## Sustainability-themed investing

Sustainability-themed investing involves investing in assets that specifically relate to sustainability. This commonly involves funds that invest in clean energy, green technology, sustainable agriculture and forestry, green property, or water technology, where the fund has the explicit objective of driving improved sustainability outcomes alongside financial returns.

## Norms-Based screening

Norms-based screening assesses investments against standards of business practice, often in accordance with international norms and conventions, such as those defined by the United Nations (UN). In norms-based screening, companies that violate the UN Conventions (such as Cluster Munitions) may be excluded, while positive screening may use ESG criteria developed by international bodies like the International Labour Organisation (ILO) and United Nations Children's Emergency Fund (UNICEF) that are embedded in the Sustainable Development Goals.

## Impact Investing

According to the Global Impact Investing Network (GIIN) – a worldwide movement aimed at increasing the awareness of impact investing – impact investing takes the concept of responsible investing to the next level, where capital is invested with organisations, projects or funds that are generating measurable and positive social and environmental outcomes, alongside a financial return.

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Impact investing can be split into two distinct categories. The first is what is often referred to as 'true impact'. Investing is often small-scale, and the environment or social outcomes are primary and the financial outcome secondary. Financial returns can be below or above the market rate of return depending on the program that's being financed.

The second category involves investing for impact and a good example in the bond market is the 'use of proceed' bonds, the most common being green bonds. Green or social projects are earmarked against the bond/bond program but are supported by the issuers whole balance sheet. This leads to a significant reduction in risk. What is key for both styles is the issuer's commits to report on environmental or social outcomes.

## Active Ownership (stewardship and engagement)

Active ownership is the broad term used to describe institutional investors' interaction with corporations, in this case, to improve ESG outcomes.

## Stewardship

Stewardship is about preserving and enhancing long-term value as part of a Responsible Investment approach. Stewardship promotes sound corporate governance and business practices that lead to sustainable benefits for the economy, our environment, and our society.

Stewardship activities include[1]:

- Engaging with management with current or potential investments.
- Voting at shareholder meetings.
- Filing shareholder resolutions/proposals.
- Engaging with policy makers and standard setters.
- Contributing to public goods (such as research).
- Engaging in public discourse and disclosures that support stewardship goals.
- Negotiating with, and monitoring others in the investment chain.

## Engagement[2]

While stewardship and engagement are often referred to interchangeably, engagement is just one of many stewardship tools available to investors. It primarily refers to an investor (or an engagement service provider) communicating with current or potential investees/issuers (such as companies), to improve ESG practices, sustainability outcomes or public disclosure. (Engagement can also be carried out with other stakeholders, such as policymakers, regulators, or standard setters).

Engagement typically takes the form of meetings, consultations, emails or letters between the investor and the engagement target during which issues are discussed and investors make clear their expectations. Good engagement identifies relevant ESG issues, sets objectives, tracks results, maps escalation strategies and incorporates findings into investment decision-making.

Engagements (with investees or other stakeholders) can be carried out individually, collaboratively with other investors or via a service provider.

## Greenwashing

As RI continues to grow, and as more consumers expect sustainable choices for their super and other investments, there's been a rush to satisfy demand. Sometimes this can result in misrepresentations and greenwashing — both intentional and unintentional. A product issuer may mislead consumers by not being clear on what standards they use to assess a product's environmental or social responsibility, or by overstating its green credentials. Misrepresentation of such products poses a threat to a fair and efficient financial system. Addressing this threat improves governance and accountability in the market. Users of financial markets must feel confident that product or individual investment claims have substance and appropriate regulation in place to discourage misrepresentation or greenwashing.


**Gavin Goodhand,** Senior Portfolio Manager, Altius

Gavin has an extensive 27-year track record in asset management.

Prior to co-founding Altius, Gavin was the Senior Portfolio Manager at QBE Insurance, Aberdeen Asset Management and Deutsche Asset Management.

**Matthew Moore,** Head of Responsible Investment and Stewardship

Matthew has an impressive 23-year career in Ethical investing.

Prior to joining Australian Unity, Matthew was the head of ethical investments at Uniting Financial Services.


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## Glossary of terms and acronyms that are common in the market

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| **ASIC** | Australian Securities Investment Commission. Greenwashing front of mind for regulators Guidance issued re 'How to avoid greenwashing when offering or promoting sustainability-related products<br>https://asic.gov.au/regulatory-resources/financial-services/how-to-avoid-greenwashing-when-offering-or-promoting-sustainability-related-products/ |
| **SEC rulings** | US Securities and Exchange Commission (SEC) rulings aimed to prevent greenwashing by enhancing disclosure and standards for funds making ESG claims |
| **TNFD** | Taskforce for Nature-related Financial Risk Disclosure (TNFD) – will develop and deliver a risk management and disclosure framework for organisations to report/act on evolving nature-related risks<br>https://tnfd.global/about/ |
| **TCFD** | Task Force on Climate-Related Financial Disclosures was set up by the Financial Stability Board (FSB) to develop recommendations on the types of information that companies should disclose to support investors, lenders, and insurance underwriters in appropriately assessing and pricing a specific set of risks related to climate change.<br>https://www.fsb-tcfd.org/about/ |
| **Science-based targets** | Provide clearly defined pathways for companies to reduce greenhouse gas emissions, helping prevent the worst impacts of climate change and to future-proof business growth targets. Only considered 'science-based' if in line with what the latest climate science deems necessary to meet goals of the Paris Agreement— by limiting global warming to well below 2°C and pursuing efforts to limit it to 1.5°C<br>https://sciencebasedtargets.org/products |
| **ISSB** | International Sustainability Standards Board (ISSB) – intended to deliver a comprehensive baseline of sustainability-related disclosure standards<br>https://www.ifrs.org/groups/international-sustainability-standards-board/ |
| **ASFI** | Australian Sustainable Finance Initiative (ASFI) are developing sustainable finance taxonomy—to make it easier to identify opportunities to create sustainable assets and activities and guide capital to support the achievement of Australia's climate, environmental and social objectives. Provides investors with confidence and assurance of sustainability claims—enabling comparability between products and portfolios.<br>https://www.asfi.org.au/our-work |
| **CSIRO megatrends** | Recent mega trends report = adapting to climate change as one of the key megatrends. Stats include: Impact of natural disasters on Australian economy = $13.2b in 2017, projected $39.3b per year by 2050; FY20 Black Summer bushfires killed/displaced 3b animals, burnt 12.6-19 million hectares; heat-related deaths across Australian major cities predicted to grow by 60.5% from 2020-50; etc.<br>https://www.csiro.au/en/research/technology-space/data/our-future-world |
| **Net Zero** | Refers to a state when anthropogenic emissions of greenhouse gasses to the atmosphere are balanced by anthropogenic removals. Organizations are considered to have reached a state of net zero when they reduce (primary) their GHG emissions following science-based pathways, with any remaining GHG emissions attributable to that organization being fully neutralized, either within the value chain or through the purchase of valid offset credits. |
| **Sustainable Finance Disclosure Regulation(SFDR)** | SFDR is a European regulation introduced to improve transparency in the market for sustainable investment products, prevent greenwashing and increase transparency around sustainability claims made by financial market participants. |
| **EU Taxonomy** | A green classification system that translates the EU's climate and environmental objectives into criteria for specific economic activities for investment purposes. |
| **IEA** | International Energy Agency is a global policy institution committed to shaping a secure and sustainable energy future by providing a variety of programs and initiatives, helping ensure energy security, tracking clean energy transitions, collecting data, and providing training around the world. |
| **SDG** | Sustainable Development Goals are a collection of 17 interlinked global goals designed to be a 'blueprint to achieve a better and more sustainable future for all'. The SDGs were set up in 2015 by the United Nations General Assembly and are intended to be achieved by 2030. |
| **ICMA** | The ICMA Green (GBP) and Social (SBF) Bond principles are voluntary guidelines that are used to improve market transparency, and disclosure and promote the integrity of the green, social, and sustainable bond market. There are four core components that define a green, sustainable, or social bond. |

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| **Scope 1 Emissions** | Covers direct emissions from owned or controlled sources |
| **Scope 2** | Covers indirect emissions from the generation of purchased electricity, steam, heating, and cooling consumed by the reporting company. |
| **Scope 3** | Includes all other indirect emissions that occur in an entity value chain (such as the use of their product). |
| **ESG** | Environmental, Social and Governance |
| **RCP** | Representative Concentration Pathways were used to develop greenhouse gas concentration trajectories. The word representative signifies that each RCP provides only one of many possible scenarios. |
| **CBI** | Climate Bond Initiative is an international organisation working to mobilise global capital for climate action primarily through green bond certification |
| **Green Bonds** | Any type of bond instrument where the proceeds (or an equivalent amount) is exclusively applied to finance or re-finance, in part or in full, new and/or existing eligible Green Projects (see Use of Proceeds section below) and which are aligned with the four core components of the green bond principles. |
| **Sustainability-Linked Bonds ("SLBs")** | Any type of bond instrument for which the financial and/or structural characteristics can vary depending on whether the issuer achieves predefined Sustainability/ ESG objectives. |
| **Social Bonds** | Another use of proceeds bond that raises funds for new and existing projects with positive social outcomes. |
| **Sustainability bonds** | Bonds where the proceeds will be exclusively applied to finance or re-finance a combination of both green and social projects. |
| **IPCC** | Intergovernmental Panel on Climate Change, the United Nations body for assessing the science related to climate change. |
| **PCAF** | Partnership for Carbon Accounting Financials, The Global GHG Accounting and Reporting Standard for the Financial Industry. |
| **IEA Scenarios** | Include several different climate scenarios for decarbonization including:<br><br>**Sustainable Development Scenario**(SDS) aimed at ensuring universal access to affordable, reliable, sustainable, and modern energy services by 2030, aligning to Sustainable Development Goals 7,3 &13.<br><br>**Stated Policy Scenario (STEPS)**reflects policy settings based on a sector-by-sector assessment of the specific policies that are in place, as well as those that have been announced globally.<br><br>**Announced Policy Scenario**- Assumes that all climate commitments made by governments around the world will be met in full and on time.<br>https://www.iea.org/reports/global-energy-and-climate-model |
| **SDA** | Sector Decarbonisation Approach is a method for setting $CO^2$ emissions intensity reduction targets in line with climate science. |

[1] https://www.unpri.org/introductory-guides-to-responsible-investment/an-introduction-to-responsible-investment-stewardship/7228.article
[2] https://www.unpri.org/introductory-guides-to-responsible-investment/an-introduction-to-responsible-investment-stewardship/7228.article
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