

Risks come home to roost this summer

February 2020

The big Environmental Social and Governance (ESG) events for 2019 were Westpac's money laundering and child exploitation scandal and Australia's mega bushfires, which represent our most intransigent problem given the lack of an effective policy and preparedness in the face of growing climate change risks.

For the finance community, the Westpac scandal rattled markets, triggering concerns there are systemic failures in their control environment, seeming indifference by senior management, and a lack of oversight by the board (observations by AUSTRAC). The pressure from the scandal has seen the Chief Executive Brian Hartzler step down in the wake of allegations the bank committed 23 million breaches of Australia's anti-money laundering laws.

Following AUSTRAC's announcement, the Altius sustainable funds fully divested of all Westpac senior unsecured and subordinated debt. Westpac was officially moved to the funds excluded list following our December Sustainability meeting.

Beyond financial markets an unusually early and fierce bushfire season spread cancer-like across nearly all states, which has seen large swathes of forests razed, killing masses of wildlife including our vulnerable koala population¹, and costing untold damage to health, homes and the economy², it has also brought the climate crisis conversation to the fore. The devastating immediate deaths and injuries will give way to the longer-term health implications of hazardous air quality and the mental health issues upon impacted individuals. Immediate property and habitat loss, community disruption and evacuations will leave a legacy of damage to previously vibrant holiday destinations and our whole tourism industry. This underlines the interconnected nature of the economy and the environment.

What are the global implications?

Ahead of the UN Climate Change Conference COP25 in Madrid, the European Parliament has declared a climate emergency³. Central banks around the world are starting to manage environmental risks with Bank Negara Malaysia (Malaysia's central bank) and Riksbank (Sweden's central bank) saying climate risk is a source of financial risk. This has led Riksbank to dump their bond holdings by Queensland and Western Australia⁴, as well as bonds issued by Alberta, a Canadian province. The move is a potential concern for the funding for our states, and the Federal government, if other central banks follow suit. In the US, a bill is being proposed for the Federal Reserve to stress test big banks for

climate risks⁵ despite the US President threatening to pull out of the Paris Agreement. The law would help bring US financial regulators in line with other global central banks in the UK and the Netherlands that have recently begun quantifying the potentially systemic risks caused by climate change. The French financial regulator will subject banks and insurers to climate change stress test next year⁶. Singapore's sovereign wealth fund, Temasek, has announced they will also go carbon neutral by next year⁷. Locally, former High Court Judge and Royal Commissioner Kenneth Hayne has warned directors they have a legal duty to act on climate change risk.

The European Investment Bank (EIB) has announced plans to become a greener bank with plans to phase out multi billion-euro financing for fossil fuels within two years⁸. This raises question of other bank's role in financing the climate crisis with Market Forces in Australia lodging shareholder resolutions with Westpac, NAB and ANZ in October calling for a reduction in lending and exposure to the fossil fuel sector, consistent with the goals of the Paris Agreement on climate change⁹. Independently we have written to the major banks asking them how they will achieve best practice of their banking peers in managing down their fossil fuel exposure and demonstrate leadership in aligning themselves with the Paris Agreement.

Sustainable investments closer to home

NSW Treasury Corporation launched their first sustainability bond in November with proceeds to be used to invest in green and social projects across NSW, including water infrastructure and access to essential transport and education services. The state has also announced an emissions reduction target to address climate change and will commit to lowering greenhouse gases by 35% by 2030¹⁰. This quarter also saw our bond fund invest in the green bond issued by Oversea-Chinese Banking Corporation (OCBC), multinational bank based in Singapore. The bank recently dropped out of the last coal financing project that it is involved in¹¹ after announcing in April that it would back away from new coal financing, the first big bank in Southeast Asia to rule out financing new coal-fired power plants.

The bushfires across Australia also raise concerns about above ground power infrastructure and vulnerability of overhead power lines, especially for utility companies. This problem will only get worse as the climate deteriorates¹² with obvious implications for the credit risk of energy companies.

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Chief Investment Officer

Co-founder of Altius Asset Management

Bill is well-known and highly regarded as a 33 year veteran in fixed interest asset management.

Prior to co-founding Altius in 2011, Bill was with Aberdeen Asset Management where he was head of Australian fixed income and chief executive officer. He also has worked as head of fixed income for Schroder Investment Management and Deutsche Asset Management. In his many investment roles, Bill has built successful fixed income businesses by developing proven investment processes and assembling strong investment teams.

Bill's career in investment and financial services began in 1984 with the Treasury Corporation of Victoria as a fixed income portfolio manager. He has a long working relationship with both Chris Dickman and Gavin Goodhand, formed over many years.

Bill holds a bachelor of economics from Monash University.

- 1 <http://theconversation.com/a-report-claims-koalas-are-functionally-extinct-but-what-does-that-mean-116665>
- 2 <https://www.abc.net.au/news/2019-11-22/queensland-bushfire-crisis-nsw-fires-cost-insurance-damage-bill/11725920>
- 3 <https://www.europarl.europa.eu/news/en/press-room/20191121IPR67110/the-european-parliament-declares-climate-emergency>
- 4 <https://www.bloomberg.com/news/articles/2019-11-13/sweden-s-central-bank-ditches-bonds-issued-by-major-polluters>
- 5 <https://www.reuters.com/article/us-usa-senate-fed-climate/big-banks-would-get-climate-stress-tests-under-proposed-u-s-law-idUSKBN1XU2FB>
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- 12 <https://apnews.com/d2c2ea5bcee64a08a52dc06bb4da4337>

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