The Inside Network

INVESTOR ACADEMY

ESG Masterclass

Summary Report

24 March 2021
Collins Square, Melbourne

Fundamentals and applications of ESG in portfolios

ESG Masterclass 2021

INTRODUCTION - NAVIGATING THE ESG JOURNEY

2020 consolidated ESG into mainstream asset management, with the pandemic response becoming integral to the environmental challenge ahead. The timing couldn't have been more appropriate for The Inside Network's industry-first ESG Masterclass. Whilst bushfires have been removed from the front page, they remain front of mind for clients and advisers alike, as does an energy sector facing long-term disruption. Key social issues have been accelerated by the pandemic with gender and inequality a key focus of many governments.

Company executives have touched on their obligations to both society and shareholders, a debate that will likely play out for much of this decade. Governance problems persist. Wage underpayment proved to be regrettably common, while executive remuneration at a time of rising unemployment and income disparity, is ever more challenging. Accounting problems return again and again, mostly driven by blind ambition to drive a share price.

Despite the options available, implementing an ESG overlay to a portfolio is far from easy. Simply selecting investments that claim to screen holdings will not pass muster. Clients are likely to challenge exposure to stocks that transgress society's expectations and hold their advisers accountable. The case for investments will need to weigh into the inevitable compromises and judgemental decisions.

These issues and many others were raised and discussed in detail, by thought leaders at The Inside Network's ESG Masterclass. This report provides a short summary of each presentation and the key learning outcomes.

DURING THE MASTERCLASS, WE COVERED EVERY ASPECT OF ESG INCLUDING:

1. The evolution of ESG and key trends to watch in 2021;
2. Nuance required – the role of data in ESG investing;
3. Outside the box – moving beyond screening;
4. With power comes responsibility – company engagement;
5. Social license and impact – looking beyond the 'E';
6. Measuring success – active ownership and proxy voting.

Education Partners

EVERGREEN

Evergreen Consultants is an independent investment consulting business, working with financial advisory firms to provide a range of bespoke investment solutions designed to deliver flexibility, efficiency and an enhanced client experience. We provide traditional end to end investment consulting services.

INVESCO

Invesco is an independent investment management firm specialising in differentiated and complementary investment solutions. Founded in 1935 and with over 8,000 employees worldwide, Invesco manages over A$1.7 trillion of assets under management around the globe, serving clients in more than 120 countries.

PENDAL

Pendal is an independent, global investment management business focused on delivering superior investment returns for our clients through active management. Pendal's proven and experienced fund managers have the autonomy to make decisions with conviction, built on a philosophy of meritocracy that fosters success from a diversity of insights and approaches to investment.

AUSBIL

Ausbil Investment Management is a leading Australian investment manager. Established in 1997, Ausbil's core business is the management of Australian and global equities for major superannuation funds, institutional investors, master trust and retail clients. Ausbil manage over $13.7 billion (as at December 2020) in active Australian and global equity investments.

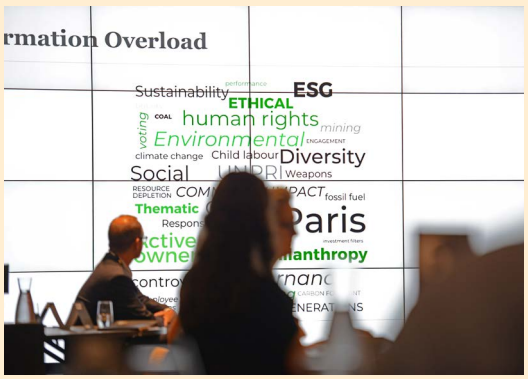
MARTIN CURRIE

Our stock-focused approach is driven by in-depth fundamental research and skilled portfolio construction. We invest for the long term to capture equity growth, but only when high-quality opportunities are identified at sensible valuations.

AUSTRALIAN ETHICAL

While we do believe a small group of people can change the world, the opportunity is far bigger than that. The more people that invest ethically, the more significant the positive change we will create. Imagine the impact of all that money invested for good. There's never been a better time to take control of your own financial wellbeing and the wellbeing of families, communities and the planet.

A snapshot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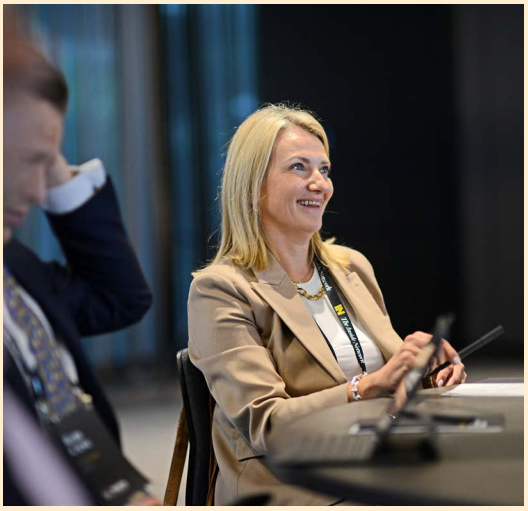

Module 1:

The Evolution of ESG

The first module was presented by Angela Ashton, founder of Evergreen Consulting, and an independent investment consultant to financial advisers.

Angela provided a detailed assessment of the current backdrop for ESG investing, identifying the key trends and themes emerging in institutional and wholesale markets. According to Ashton, ESG investing has been around for hundreds of years, dating back to both Sharia principles and those of the Catholic Church; it simply garners more publicity today. The biggest issue facing investors, however, is the incredible amount of information available and the lack of a single body or information source to assist in guiding investment decisions.

Having recently launched the Evergreen Responsible Investing Grade Index (ERIG), Angela was well positioned to compare the difference of bottom up and top down ESG assessments of managers. She highlighted the issues with a bottom-up approach, that relies on assessing the companies within a portfolio, rather than the fund's approach. Specifically, she was concerned with the question of 'intent vs. action'. Does the manager or executive do what they say they will, or is a portfolio 'ESG' simply because those companies offered the best returns?

Data remains a key issue for all professional investors, with the inconsistency of approaches and lack of clarity, resulting in huge variation in ESG scores for the same companies, large and small. Whilst ESG may be the issue du jour according to recent surveys, 44% of responsible investment managers still remain at the starting line, having only adopted ESG considerations into their investment approach.

The outperformance of ESG-focused strategies was the strongest contributor to capital flows, after years of concerns that the approach would detract from returns. The carbon-intensiveness of portfolios will be a key focus, as will the impact of our food and supply chains, inclusiveness and exploring humanity's planetary boundaries.

THE KEY LEARNING OUTCOMES FROM THE PRESENTATION WERE:

1. Top-down assessments which consider manager intent vs. action are most powerful;
2. Carbon intensiveness and food supply chains will be the key focus of investors;
3. True ESG integration remains in its early stages despite recent publicity.

Module 2:

Nuance Required

The second module was presented by Andre Roberts, a member of the Invesco Quantitative Strategies team, a specialist data-driven Australian equities manager.

Following on from Angela's presentation, Andre reiterated the role that data and its inherent quality plays when it comes to ESG investing. Roberts highlighted the expansive range of ESG data providers that include Specialist, Fundamental and Comprehensive options, spanning both objective and subjective assessments of ESG criteria. The consistency of data was identified as a key issue for investors and advisers alike, with most options far from perfect.

The quality of ESG data was compared to the availability of consensus earnings estimates, as much as twenty years ago, with both professional and self-directed investors facing challenges in collating this information. Roberts explained the detailed assessment process used by the likes of MSCI with ten 'pillars' of ESG assessment broken into a further 35 subgroups, each with their own subjective assessments. According to the data provided, the correlation of ESG ratings between providers was as low as 33% for many major global companies.

Those in attendance voted climate change, human capital and corporate behaviour as the key focus of their clients, inadvertently covering each of the E, S and G subgroups. In dealing with each of these issues, Roberts put forward a three-pronged approach as the most appropriate solution. Defining what it is you are seeking to avoid or target, he says, is the most important starting point. Once achieved, investors should then pinpoint the specific characteristics that guide this target before determining the appropriate data provider, not the other way around.

A comparative approach to ESG was advised, with the speaker challenging delegates to discuss the ranking of two Australian leaders, Cochlear and Resmed on the basis of their ESG credentials.

THE KEY LEARNING OUTCOMES FROM THE PRESENTATION WERE:

1. There are significant challenges and inconsistencies in available ESG data;
2. A purpose driven approach is required to determine appropriate datasets;
3. Both proprietary and publicly available data are key whilst consensus remains divergent.

Module 3:

ESG Outside the Box

The third module was presented by Leah Willis and Dr Stuart Palmer, at Australian Ethical, one of Australia's few dedicated, responsible investment managers.

Leah Willis introduced the concept of 'responsible investing', identifying its position on the spectrum that is ESG-related investment. Some 86% of Australians expect their superannuation to be managed responsibly, and nine in 10 investors expect their advisers to offer ethical investment options according to the presentation; a strong starting point for a discussion. Willis offered an introduction to the key stages of responsible investing, including the preference to provide 'capital for good' investments, engage and advocate rather than simply divest, and the importance of having measureable outcomes.

Dr Palmer, Head of Ethics, then focused on offering an insight into responsible and ESG-driven investment strategies using a number of recent and highly relevant case studies. He noted that some 60% of ASX 200 companies were excluded from their investable universe. Global insurer Marsh & McLennan was highlighted as a group that had committed to the Paris Climate Goals, but whose business decisions did not pass muster. Palmer detailed the investment thesis and decision-making framework after the company obtained insurance for the maligned Adani Carmichael coal mine.

On the positive side, was Sundrop Farms, a Port Augusta-based greenhouse that supplies 15% of Australia's tomatoes, utilising an onsite desalinisation and solar plant to reduce its impact.

Palmer and Willis challenged delegates to consider the social implications of popular social media and streaming services including Tik Tok, Facebook and Twitter, leading to thought provoking discussion around social responsibility and their license to operate. Property developer Lend Lease and insurer Suncorp were also assessed on their credentials, with both seemingly striving to minimise their harm to the community and environment.

THE KEY LEARNING OUTCOMES FROM THE PRESENTATION WERE:

1. Clients are demanding responsible investment solutions, now is the time for action;
2. Investors must look beyond size and style in order to build responsible portfolios;
3. Understanding clients' personal values will support closer, long-term relationships.

Module 4:

With Power Comes Responsibility

The fourth module was presented by Chris Fayers and Jeremy Dean, from Pendal subsidiary and activist investor Regnan. Regnan is widely recognised for its commitment to working on behalf of institutions to engage with company management and boards.

Chris and Jeremy engaged in an expansive fireside chat, drawing on the extensive experience of the Regnan and Pendal teams investing into domestic and global markets for several decades. 'No company is a bad company, and no company is a perfect company' suggested Fayers, as he highlighted the important role that company engagement has in setting and guiding expectations.

Pendal-owned Regnan is considered a pioneer in responsible investing, having guided institutions and companies on ESG issues since the late 1990's. They define engagement as interactions that have the purpose of improving business practices on ESG issues, changing outcomes or at the very least improving company disclosure. They make the clear distinction between those 'meeting management', suggesting that if change is not being sought, then engagement it is not.

The interview was distinct from previous sessions, stressing the need for engagement from both passive and active investors and that it isn't solely for 'bad' companies. Highlighting wind turbine manufacturer Orsted, Fayers flagged concerns about the sustainability of turbines at the end of their useful life, which were ultimately overcome. Regnan's primary focus in recent years has been on disclosure, informing and engaging with business including fossil fuel and energy companies on investor expectations and the importance of bodies like the Task Force on Climate-Related Financial Disclosures.

The session culminated in a case study in which delegates were asked to assess the ESG credentials of the maligned Cleanaway Waste Management and insurer QBE. The former was seen as an improver, with strong sustainability credentials associated with recycling practices, offset by corporate governance issues. The latter, struggling to convince investors as they continue to underwrite fossil fuel projects. Finally, they highlighted the inability to create change by simply divesting.

THE KEY LEARNING OUTCOMES FROM THE PRESENTATION WERE:

1. No company is perfect on every ESG criteria, improvement is possible;
2. Investors need to think beyond divestment, back managers to engage;
3. Engagement is the responsibility of all investors, passive and active.

Module 5:

Focusing on Social License and Impact

The fifth module was presented by Mans Carlsson, Head of ESG Research at Ausbil Investment Management, a specialist global equity manager and outspoken expert on social and Modern Slavery issues.

Carlsson drew upon his experience leading ESG assessments on 200 ASX-listed companies, and in his various roles consulting with government and business on Modern Slavery and related issues, to focus on the S or Social considerations of ESG investors. The UN Principles of Responsible Investment now encompasses some 3,000 signatories, but the level of commitment is varied. Societal values are changing quickly, he suggests, driven by the increasing reliance of businesses on human capital, rather than the tangible assets of the past.

The speaker delivered an at times challenging presentation for delegates, suggesting there are some 1,500 to 15,000 modern slaves in Australia, and 40 million around the world. This is important not only for human rights, but also for the sustainability of company earnings and therefore a key consideration for investors. The proliferation of social media has been both a boon and threat for large businesses, with platforms like Glassdoor offering an outlet for concerns, but also a trigger to identify broader company issues.

Carlsson was outspoken on the issues regarding Rio Tinto's destruction of Juukan Gorge, with Ausbil making an early decision to divest, citing the lack of proactiveness from other major shareholders as a key issue. The session highlighted recent case studies including that of underpayment scandals at franchisee companies including Domino's Pizza and Retail Food Group. These were identified through qualitative research, speaking with franchisees and ultimately supported investment decisions by the group's portfolio managers. Whilst the issues were clear, Carlsson highlighted that

THE KEY LEARNING OUTCOMES FROM THE PRESENTATION WERE:

1. Social license is no longer a given in an intellectual capital-led economy;
2. Patience is required when issues are identified, results are never immediate;
3. Social considerations are increasingly important to investors amid growing inequality.

Module 6:

Measuring Success

The final module was presented by Will Baylis, of Martin Currie, an experienced, domestic and global equity manager with an active ESG approach.

Industry veteran Baylis, drew upon extensive meetings with company management, executives and boards over several decades to offer an insight into Martin Currie's unique approach to ESG investing. ESG considerations must be considered material valuation factors in 2021 and beyond said Baylis, with anyone not embracing the approach to be left behind.

That said, Baylis highlighted the importance of materiality when it comes to making ESG assessments and considering the net sustainability benefit of the companies they consider. Similar to the likes of Regnan and Pendal, he highlighted the risk of simply divesting from companies and the fact that this effectively denies the investor the opportunity to enact change at so-called 'bad companies'.

Stewardship is a critical element to every investment approach, but must be entrusted to company management. Reflecting on Martin Currie's 1,000 company meetings in 2020, Baylis confirmed 91 individual engagements were made with an overwhelming majority focused on improving corporate governance.

Putting concepts into practice, examples were raised ranging from the health implications of sugary drinks sold by Coca-Cola Amatil, to BHP's tailing dam failures and the actions of the banking sector which ultimately led to the Royal Commission. Reflecting the importance of these social and governance issues, were a series of robust table discussions on the investabiity of these companies.

With somewhat of a leadership position in the sector, Martin Currie highlighted Carbon Value at Risk as an emerging trend for their research analysts, helping to identify those companies truly committed to change. Woodside Petroleum was identified as an example where engagement can overcome divestment, with the company delivering $100 million in carbon offsets via the planting of 40 million native trees in Western Australia.

THE KEY LEARNING OUTCOMES FROM THE PRESENTATION WERE:

1. Divestment alone does nothing, purposeful change requires engagement;
2. Nuance is required in considering the materiality and 'net sustainability benefit' delivered;
3. Carbon value at risk will be a key measure, with Scope 3 emissions still poorly reported.

The Inside Network

The Inside Network | Level 4/125 Flinders Lane, Melbourne, VIC 3000 | Level 2/75 Elizabeth Street, Sydney NSW 2000 | **theinside.network**