The Irresistible Momentum for Sustainable Investment

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Introduction - David Maywald

An experienced Portfolio Manager, Analyst and infrastructure investor

- Two decades investing into global listed markets, from Sydney (active, long-only, funds management)
- Worked for four Investment Managers (start-ups, medium-size and national/international firms)

One of the four initial employees at RARE Infrastructure, working with the two founders

- Grew from nothing in 2006 to A$11 billion in 2015, sold to Legg Mason for A$500 million
- Chair of the Investment Advisory Board (IAB) for four and a half years

Attracted to the Australian National University by a National Undergraduate Scholarship

- Studied BCom (Accounting and Honours in Finance) plus BEc

Leadership in ESG Integration and Sustainable Investment since 2010

- Expert contributor to the Australian Sustainable Finance Initiative (ASFI)

“It was clear that 2019 marked a turning point in incorporating ESG factors into mainstream investing”

Morrow Sodali’s 2020 Institutional Investor Survey

Key Points and Summary

Sustainable Investment addresses a wider range of risks and opportunities, compared to traditional finance. Investors are increasingly appreciating the benefits from lower risk as well as outperformance.

ESG matters are becoming embedded into regulation, major corporate processes and investment decisions. Sustainability compliance and transparency are now vital.

It also aligns with the values held by investors, members and beneficiaries. Consumers, staff, media, regulators and politicians are putting far greater emphasis on ethical and sustainable business.

Sustainable Investment is becoming mainstream, taking market share from a low base. This is one of the few long-term growth stories in finance. There will be an even greater focus on ESG in the future.

This presentation contains general info and no advice/recommendations. You are completely responsible for all investment decisions. David Maywald has an interest in three RARE funds and other investments – all of which are both positively and negatively affected by Sustainable Investment issues.

Would you put money into an Unsustainable Investment Fund?

Holding a range of high risk companies, with a good chance of owning stranded assets, short lives for plant and operating licences, unknown reinvestment returns and exposed to regulatory uncertainty (domestic and offshore)…

Ignore corporate governance principles, eschew leading ESG companies, strictly adhere to the minimum required disclosures and barely in compliance with the law

Take no special account of the environment or social issues, since they are "non-financial"…

Ignore the values of their clients, give no information to investors unless it's absolutely required by regulators

Applaud companies and management teams who can get away with the lowest standards, least protections and bare minimum wages that are possible

Homogenous investment team and management, with little diversity

High cost structure (paid upfront by clients, as well as easily-achievable bonuses for fund managers), with misalignment between the manager's short-term remuneration and the client's long-term returns…

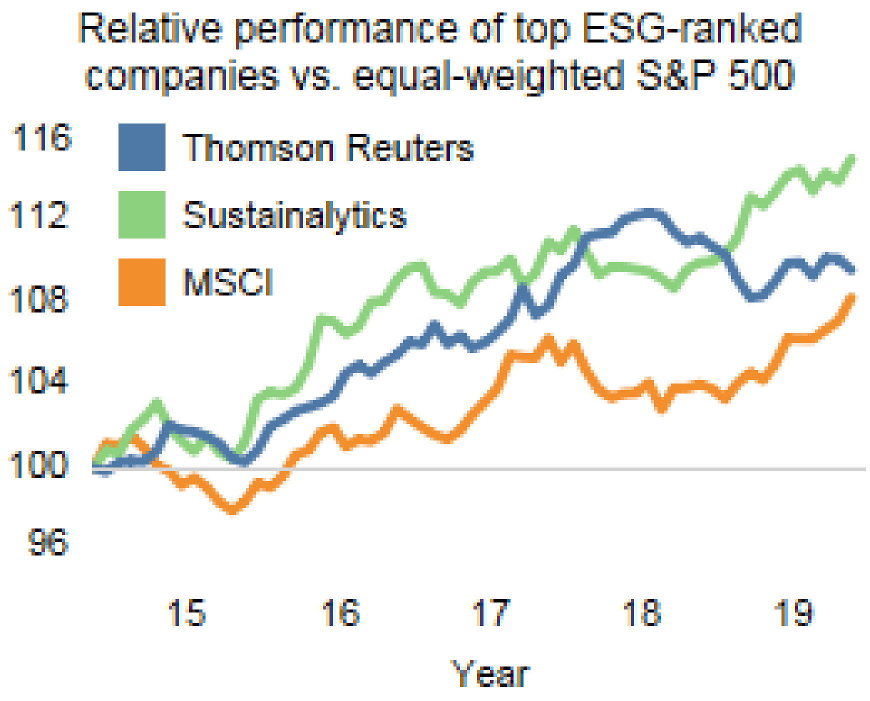
“Sustainable Investment” is the Most Inclusive Descriptor for this Field…

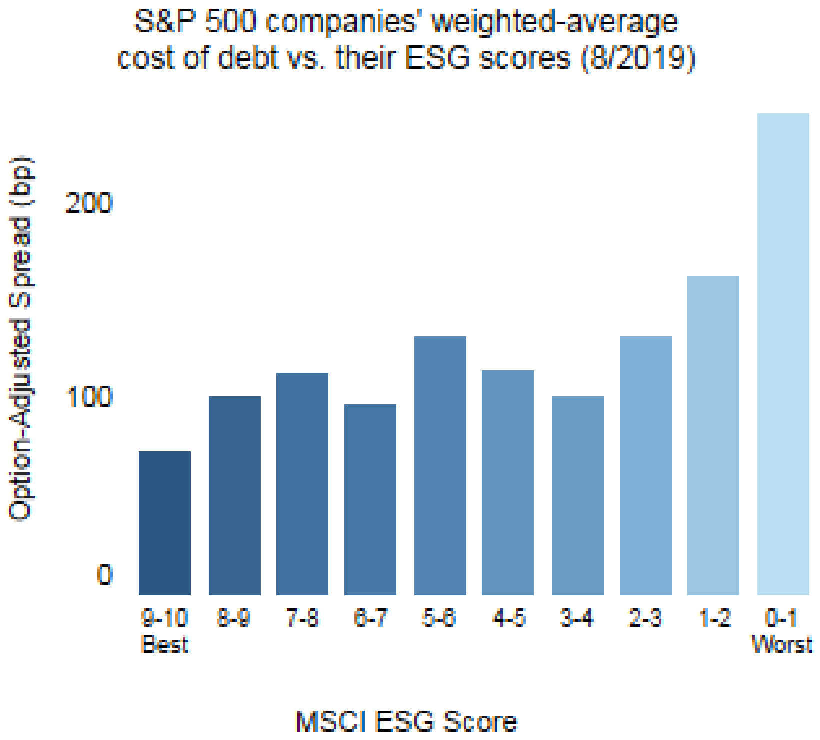
Encompassing the vast majority of these categories and approaches:

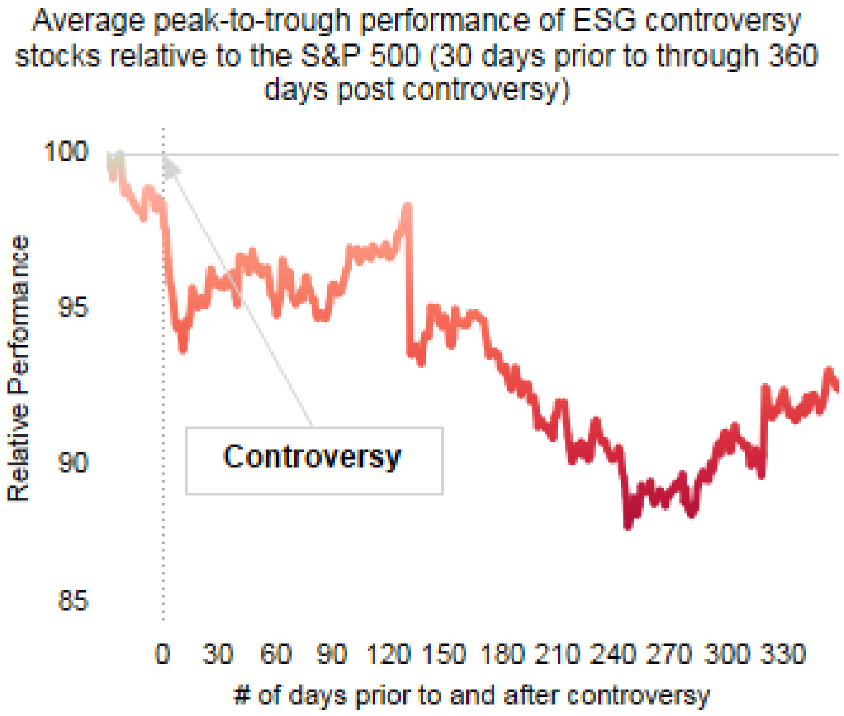
- Responsible and Ethical Investing, Socially Responsible Investing (SRI)
- Green finance (across relevant technologies, and across the capital structure)
- Financing for the transition from Fossil Fuels to Clean/Renewable Energy
- Environment, Social and Governance risks and opportunities (ESG factors/considerations)
- Cross-cutting issues such as licence to operate, inequality, good corporate citizenship, etc
- Applies to all investible Asset Classes, and all countries/regions
- Shareholder activism and engagement, when related to purpose (not for purely short-term financial returns)
- Stewardship (ie active ownership and investment oversight)
- Corporate Social Responsibility (CSR), Conscious Capitalism and Stakeholder Capitalism
- Impact Investing (seeking to catalyse positive change for Environmental/Social causes)
- Forward-looking perspectives for the transformation of the global economy

“The markets are rewarding companies with sustainable business practices”

Jeffrey Jaensubhakij (Chief Investment Officer of GIC, manager of Singapore’s US$100 billion plus foreign reserves)

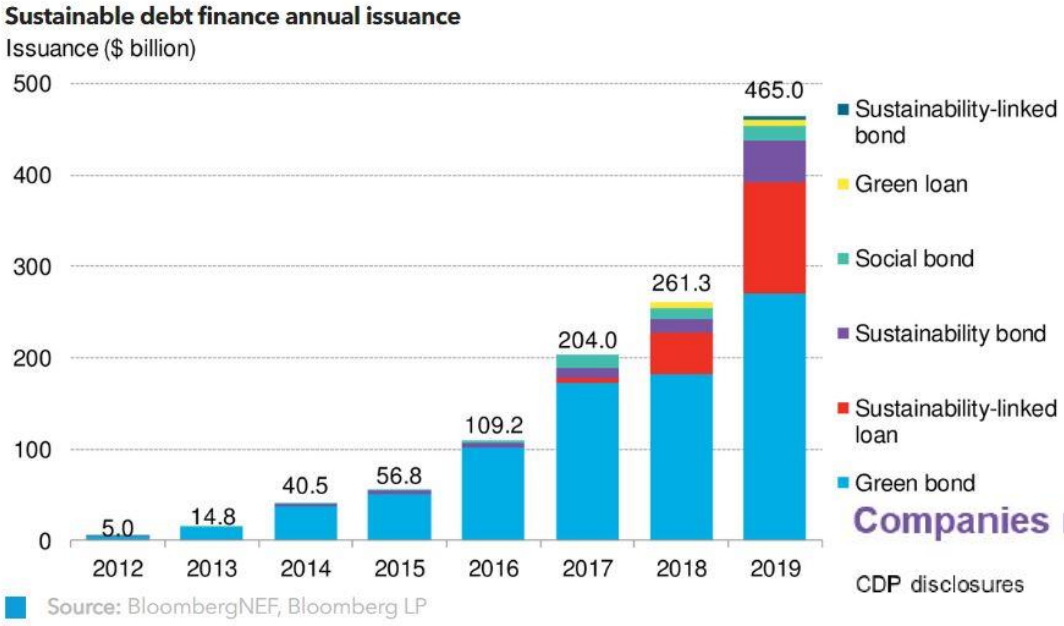


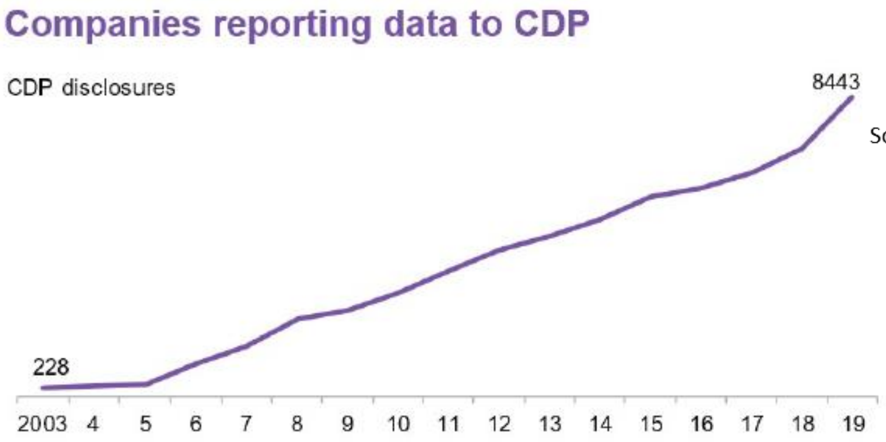


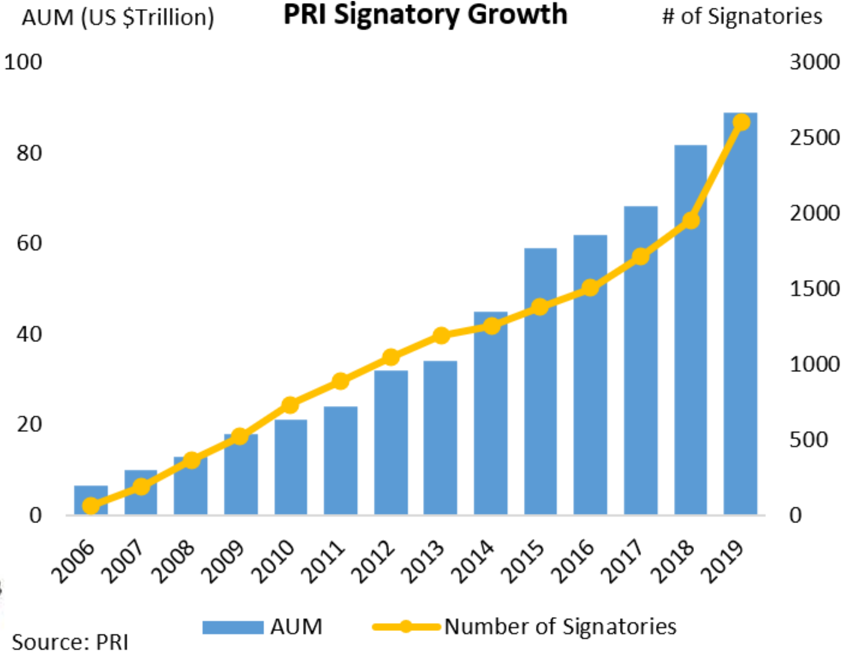


ESG leaders have lower risks, lower costs for debt and equity, plus have outperformed laggard companies…

Sources: Bank of America, MSCI ESG Research, Sustainalytics, Thomson Reuters, FactSet, US SIF







Phenomenal growth in sustainable investors across equity and debt, ESG disclosures, plus signatories and memberships

Sources: United Nations-supported PRI, CDP (formerly the Carbon Disclosure Project), BloombergNEF

Principles for Responsible Investment (PRI) is Driving Sustainability Outcomes

Asset Owners
(who represent members/beneficiaries)

Asset Owners include:

- Pension funds (largest category)
- Insurance companies (investment of customer premiums)
- Sovereign Wealth Funds
- Endowments and Foundations
- Family Offices

Managers and Suppliers
(providing services to intermediaries)

Investment Managers:

- Institutional money from Asset Owners
- Retail money from households

Service Providers:

- To both Asset Owners and Investment Managers

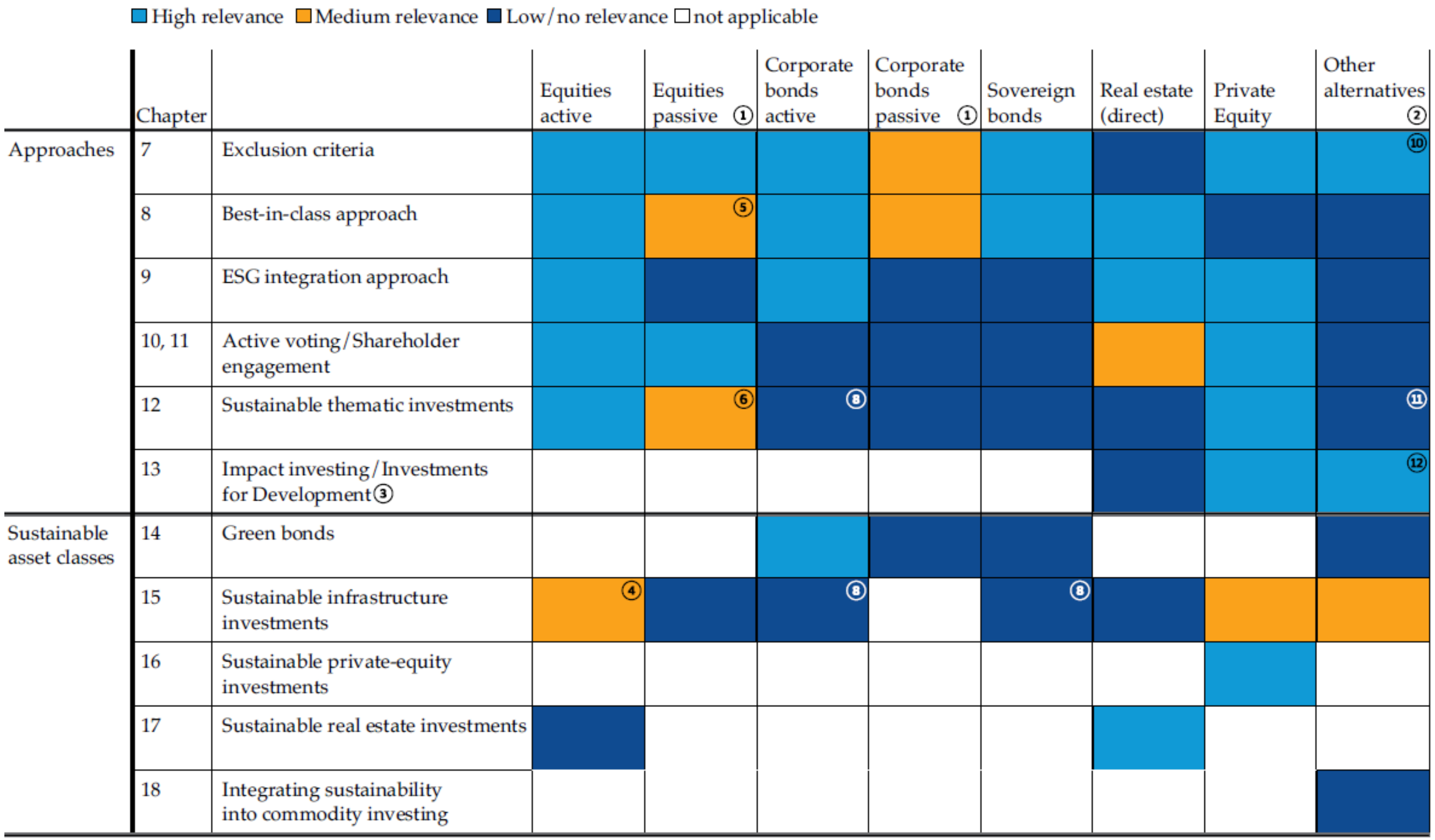
“The largest investors in the world, which control how stocks are ultimately valued, care about this. Endowments and foundations are totally focused on ESG considerations … pension funds care about it, labour unions care about the safety of their employees … the biggest asset managers in the world have now awoken and said ‘ESG matters to me,’ and therefore it’s going to matter to companies”

Cliff Robbins (Founder and CEO of Blue Harbour Group, former Partner at KKR)

Application of Sustainable Investment Approaches in Practice

The Global Sustainable Investment Alliance (GSIA) definitions published in the Global Sustainable Investment Review 2012, have emerged as a global standard of classification:

- Negative/Exclusionary Screening: is the largest with US$20 trillion in 2018, encompasses divestment
- Positive/Best-in-class Screening: well-suited to the deep and liquid public markets for equity and debt
- Norms-based Screening: compares against the minimum standards of business practice based on international norms, such as those issued by ILO and UNICEF, prevalent in Europe and Canada
- ESG Integration: second largest with US$18 trillion, integration is becoming deeper with subsequent iterations, making better use of third-party research/disclosure/ESG ratings…
- Sustainability Themed Investing: such as clean energy/green technology, dominated by the United States
- Impact/Community Investing: least popular strategy, measurement, aspiration versus practical effect
- Corporate Engagement and Shareholder Action: increasingly there is active two-way engagement with companies (can be direct, outsourced, collaborative, or partnering with others)



Sustainable Investment is applicable across all Asset Classes, with several approaches (that vary from less to more relevant)…

Source: *Handbook on Sustainable Investments*, by Swiss Sustainable Finance and CFA Institute

Mini Case Study #1: Melior Investment Management

Active Investment Manager

Impact Investment

Themed Investing

Negative Screening

Best-in-class Screening

Company Engagement

Member of Responsible Investment Association Australasia (RIAA), Signatory of PRI and a supporter of TCFD

In start-up phase, with a single flagship product and a small staff of six people, plus an Advisory Council

Melior does bottom-up research, including a deep assessment of a company’s impact along with its ESG practices

Applies Impact Investing by investing in companies that are having a positive impact, and also influencing companies to do better

“Capital markets and corporations have a central role to play in building a better, more sustainable future. We can help build a better future by investing in companies that are aligned to the United Nations’ Sustainable Development Goals.”

All stocks have been mapped against the SDGs that they are contributing to, and the whole portfolio has been allocated to Impact Investment Themes (with 28% in Health and 24% in Sustainable Infrastructure)

Mini Case Study #2: RARE Infrastructure

Active Investment Manager

Infrastructure Investor

Global universe (DM plus EM)

Third-party ESG Providers

ESG Integration

Sophisticated Engagement

Signatory of the PRI, with half a dozen funds and strategies (including Global Listed Infrastructure, Income, Emerging Markets, ETF and Smart Beta)

Grew from six employees to over forty, with a dozen in the Investment Team at present

RARE does fundamental research, with due diligence of each portfolio holding

Long-term partnership with Sustainalytics, which fast-tracked ESG Integration and was mutually beneficial

"By integrating ESG considerations into our investment process and approaching the ownership of equity in listed infrastructure companies from a long-term perspective, we are exercising our responsibility as an investment manager to act with the best interests of our clients in mind."

Sustainable Investment is applied at all stages of the Investment Process: research; issue discovery; cashflow forecasts; discount rate; portfolio construction; monitoring; active voting; stewardship; reporting to clients…

Mini Case Study #3: Platypus Asset Management

Active Investment Manager

Listed Australian companies

Combines quant and fundamental

Proprietary data collection

ESG Integration

Company engagement

Signatory of the PRI, three funds and A$3.5 billion Funds Under Management

Implementation of their Investment Philosophy within a staff of 15 people

Platypus uses both a quantitative model and their fundamental investment team to construct portfolios

They send questionnaires to ASX200 companies, followed by active engagement with select companies

"Where possible, we use engagement to influence and improve company behaviour across a broad range of issues. We think that a constructive dialogue between investors and companies is the most productive method to effect change."

Platypus Asset Management hold executive management teams accountable for improvements in Sustainable Investment (with a couple of targeted outcomes for each listed company, and follow-up in twelve months' time)

Topical Issues and Current Debates

Global recession and collapsing energy prices are weighing on renewables investment, which peaked from 2015-17 and has since fallen (there were declines following the GFC and European sovereign debt crisis).

Political and corporate leaders are focused on the Covid-19 crisis, amongst hopes for a green recovery… Balancing economic growth with sustainability and climate resilience is in focus for Developed Countries, and will also be vital to China's green leadership ambitions.

Corporate sustainability reporting lacks standardisation, ESG ratings are inconsistent, plus data gaps.

Action on Climate Change is urgent, with Global Warming now impacting the lives of billions of people. California utility PG&E is being referred to as the first of many climate change bankruptcies. Fossil fuel divestment has attracted US$14 trillion of commitments…

Circular Economy and plastics pollution has risen in prominence. China's "National Sword" policy has shaken up the recycling industry (forcing new investment into local recycling capability).

ESG reporting standards and sustainability initiatives have proliferated, becoming more sophisticated and mature over time…

Source: BloombergNEF

Innovations to ESG Reporting Standards and Sustainability Frameworks

- Global Reporting Initiative (GRI) established the first set of global standards for sustainability reporting in 1997: 93% of the largest 250 corporations now report on sustainability performance
- Greenhouse Gas Protocol is the accounting framework for measuring and managing emissions: GHG Protocol was cited nearly 2,700 times in company filings last year
- CDP (previously the Carbon Disclosure Project) is one of the least complex and most popular standards, with 8,443 companies reporting data last year: companies are graded annually by CDP
- Sustainability Accounting Standards Board (SASB) helps guide companies to report ESG data that is most material to investors: with differing risks/opportunities/KPIs across 77 industries

Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) were incorporated into European Commission guidelines in June 2019: there are now more than 1,000 TCFD supporters

ESG Research Houses and Sustainability Rating Providers

Third-party ESG research and sustainability ratings provide independent company, industry and country-level assessments that investors use to identify and understand financially-material ESG opportunities and risks:

- ESG ratings apply a consistent methodology across a sector/market: companies are scored on the quality of their sustainability disclosures, and also on their sustainability performance
- ESG scores reward sustainability performance, while Risk Ratings highlight downside scenarios, and Controversy ratings relate to negative events that have occurred
- Governance is often the key downside risk for listed minorities (especially where there are controlling shareholders, as well as in Emerging Markets), which is supported by literature showing outperformance for Governance leaders

The most widely-used ESG data comes from MSCI (who acquired RiskMetrics in 2010 and Carbon Delta in 2019) and Sustainalytics (formed from a merger in 2009, now owned by Morningstar), followed by S&P Global (who acquired Trucost in 2019 and the ESG ratings business from RobecoSAM in 2019), Moody's (acquired Vigeo Eiris in 2019) and Bloomberg (who acquired New Energy Finance in 2009)… Other notable providers include Truvalue Labs, RepRisk, CDP, Arabesque S-Ray, IdealRatings, Refinitiv and Institutional Shareholder Services (who acquired Oekom Research in 2018)

MSCI makes ESG scores and headline info available for thousands of companies: www.msci.com/esg-ratings

The EU Leads in Disclosure, Carbon, Regulation, Renewables and Taxonomy

- Emissions Trading Scheme (ETS) is a cornerstone of the EU's policy to combat climate change: launched in 2005, the biggest “cap and trade” system, provides a benchmark price for emissions
- Renewable Energy Directive covers electricity and transport fuels with targets of 20% total energy by 2020 and 32% by 2030: targets vary by country, and they are nationally binding
- Aims to be climate-neutral by 2050, with a Net Zero economy consistent with the Paris Agreement
- Non-Financial Reporting Directive went live in 2017, increasing transparency of business impact on ESG factors, and vice versa: applies to large EU corporates (including financial services firms)
- Taxonomy of Sustainable Finance is planned for incorporation into company reports and investor disclosures at the start of 2022: covers more than 6,000 firms; Technical Expert Group (TEG) has recommended that gas, nuclear and some bioenergy are not sustainable activities…

Parallels between MiFID II and the Taxonomy: the EU goes global…

Markets in Financial Instruments Directive

The MiFID law was made in 2004, with implementation from 2007

- Harmonisation of investment regulation, increased competition, consumer protection

It was intended to be reviewed, and MiFID II was approved in 2014 with implementation from 2018

- Unbundling of research costs from trade execution

Significant impact outside of the EU…

Taxonomy of Sustainable Finance

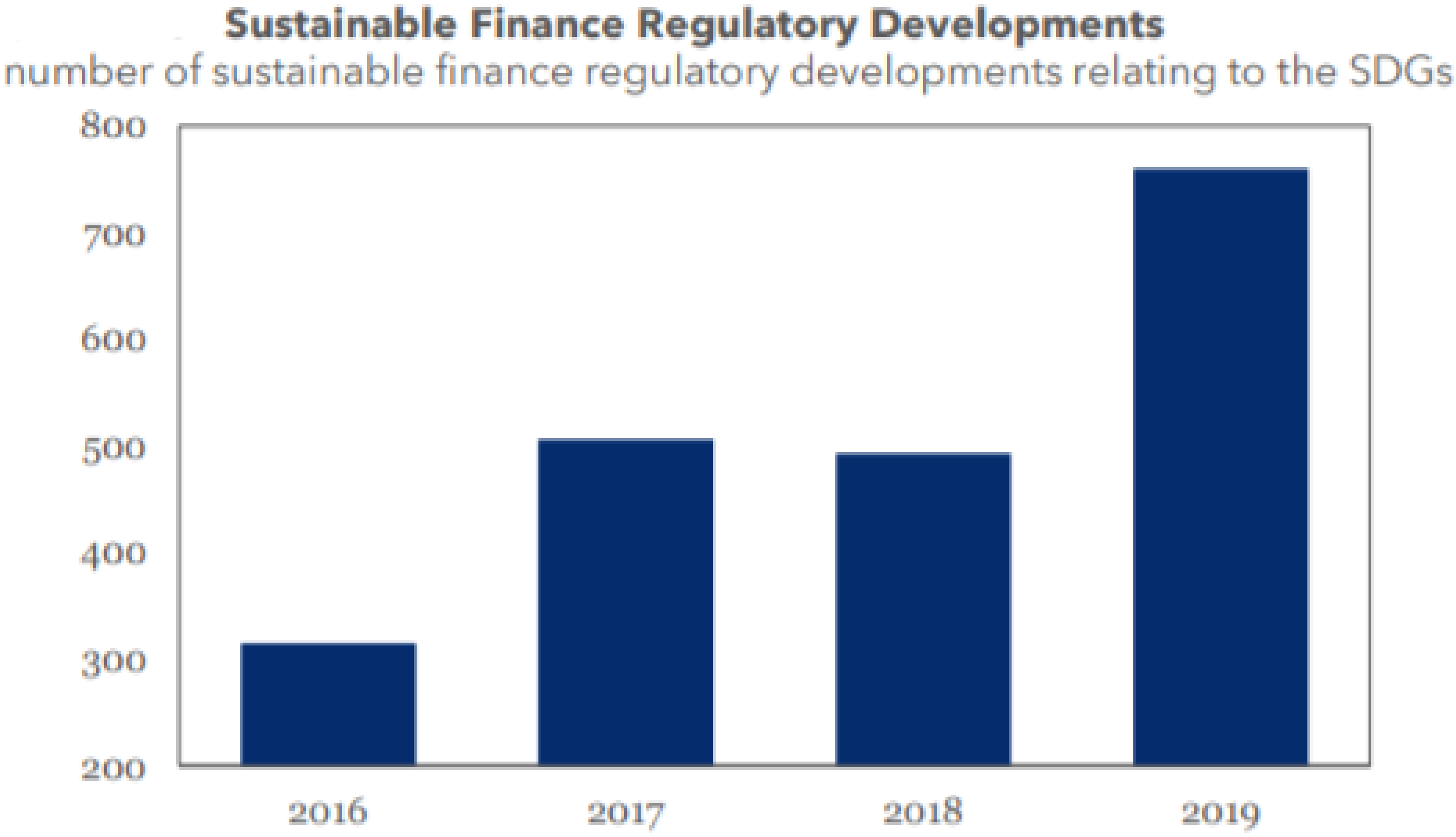
European Commission proposal for regulation of a framework to facilitate Sustainable Investment in May 2018, Technical Expert Group (TEG) established in July 2018

European Parliament reaches political agreement in December 2019

Anticipated passage in late 2020 and implementation from late 2021

“The scale of the ESG regulatory phenomenon is such that it is on the cusp of modifying the traditional categories of financial regulation (Prudential Rules, Conduct Rules, Financial Crime Rules, Payments and Market Infrastructure Rules). With the current pipeline of regulations and proposed initiatives, it seems that ESG will inexorably become the fifth pillar of financial regulation.”

Barrie Ingman (Financial Services Regulatory Lawyer)



The pace of new Sustainable Finance rulemaking (both hard and soft) has been increasing…

Source: ECOFACT and the Institute of International Finance (IIF)

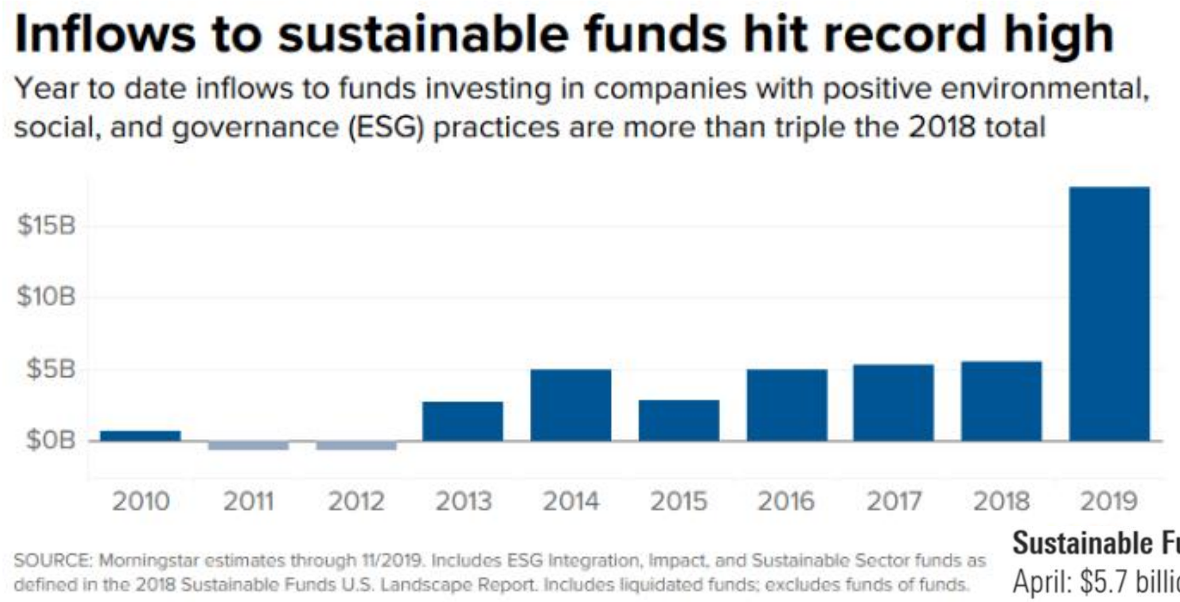
Fund Flows and Allocations are Key: across both Retail and Institutional

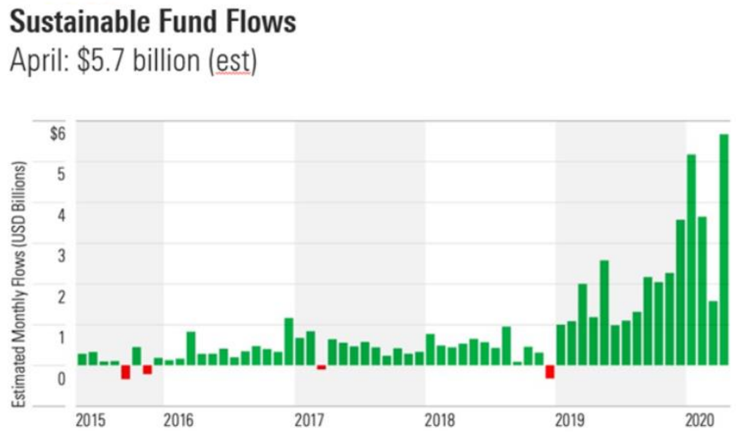
Fund inflows have benefited Sustainable Investment in recent years, and during 2020 year-to-date

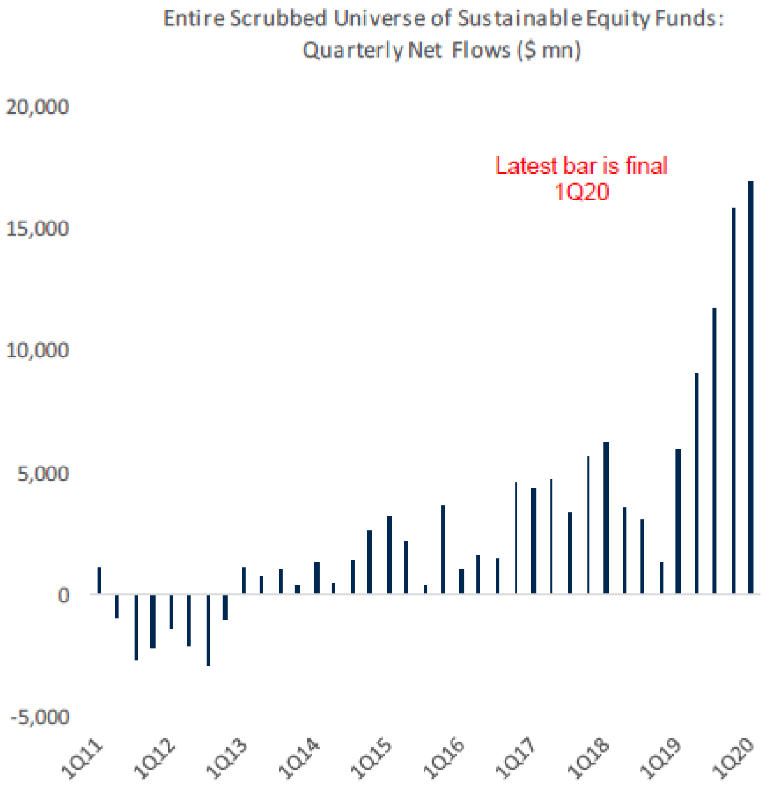
Inflows into the RBC scrubbed universe of active and passively managed Sustainable Equity Funds hit new highs in 1Q20 (though on a monthly basis inflows did fade in March):

- Passive/Quant funds saw the largest inflows in March
- Actively managed fund inflows were still positive throughout the first quarter of 2020
- ESG-focused and Impact funds saw more inflows than Thematic-focused funds during March
- Within the Thematic fund category, inflows were strongest for low carbon/climate change funds
- Inflows into North American funds have lagged Europe, but have been accelerating for six months...

ETF flows for ESG products show that inflows have accelerated in April, with inflows tracking just below January highs...







Inflows to Sustainable Equity Funds reached new highs in 2019, 1Q20 and April

Source: Morningstar, CNBC and RBC Capital Markets

"ESG investing has grown significantly over the past decade and has become an essential part of any investment process… One investment theme that will dominate the 2020s will be ESG investing. Both public companies and asset managers have seen increasing demand from investors, regulators and peers to report/adopt ESG as part of their process. Sustainable investment funds continued to grow with net inflows in 2019 almost four times those seen in 2018."

Alvin Chao (Analyst, Quantitative Strategy at Macquarie Group)

Outlook for Sustainable Investment: Exciting, Robust and Expanding

There is much further growth from the Sustainable Investment sector to come, across companies/investors/customers/data/etc. Slowing of growth rates as it becomes mainstream.

Voluntary disclosures and commitments will become mandatory in many cases, as laws/regulations/listing rules/accounting standards catch-up with the current best practices...

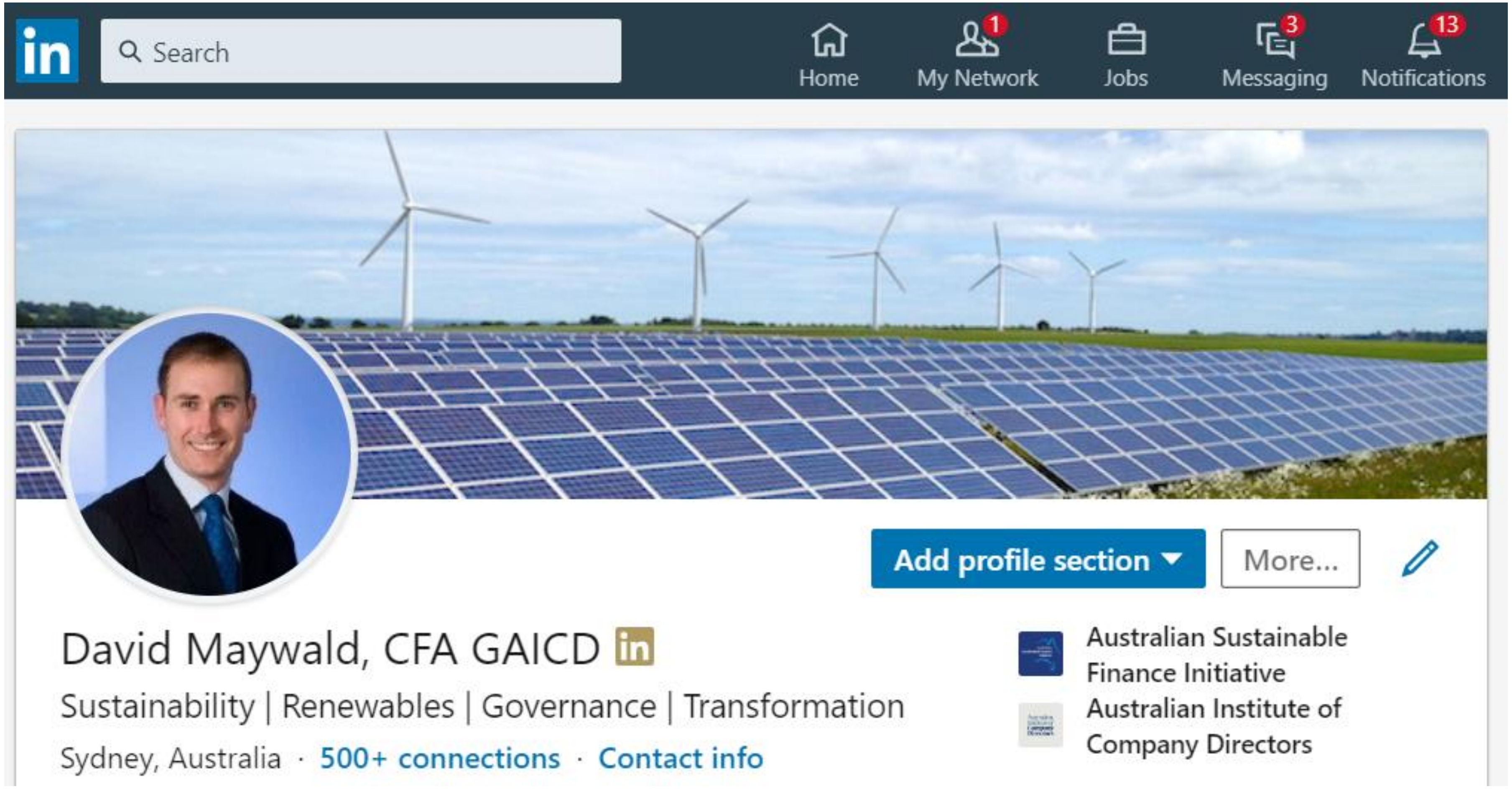
Deeper implementation of Sustainable Investment approaches, as management teams have to fulfil their prior commitments that have been made to stakeholders.

Social issues will grow further in importance (public health, employee safety, workforce flexibility, wages underpayment, supplier payment, supply chain transparency, Modern Slavery, etc).

Rewards and penalties will become sharper, with remuneration linked to ESG/longer-term/qualitative outcomes. Greater dispersion of Cost of Capital from best to worst performers (as well as fines and criminal sanctions).

“Sustainable finance is not simply a new style of investing that fits easily next to one’s hedge fund, fixed income or private equity allocations. Instead, it’s a fundamental re-think of the foundations of sound economic theory and good financial investing practice… Sustainable investing and finance is about reintegration, relating separated parts to new forms of systems thinking.”

Jed Emerson (Strategic Advisor to Family Offices and Wealth Management Firms)



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