

# The RISE of the FUTURE makers



How asset owners are *balancing their fiduciary duties* with pragmatic responses to the *demands of activist stakeholders* was the topic of a recent roundtable, proudly hosted by **INVESTMENT MAGAZINE** and sponsored by **MERCER**.

By Sally Rose

AUSTRALIA'S BIGGEST INSTITUTIONAL investors are fielding more questions than ever about how they are managing environmental, social and governance risks in their portfolios. Campaigns by external activist groups played out in public and over social media are just part of the story, though. A more powerful force is the rising level of engagement among trustees concerned about how the funds they oversee are meeting their fiduciary obligation to consider all long-term investment risks.

A decade ago, it was considered radical for fiduciaries to consider the financial and business risks associated with climate change. Now it is mainstream. Traditionally conservative investment organisations are increasingly thinking about a wide range of

environmental, social and governance (ESG) risks in their portfolio and looking for innovative ways to manage them.

"A concept we have been working with a number of investors on is the idea of being a future maker," Mercer senior responsible investment consultant Alexis Cheang said.

"One of the questions we encourage clients to ask is, 'What kind of future do you want to see that your members will be retiring to or that your endowment would be operating in, and how are you making that future more likely using your influence as an investor and your relationships with your intermediaries and portfolio companies to make that future more likely, and an unsustainable, divided future less likely?'"

Cheang and her team have worked with some of Australia's biggest institutional investors to help them understand the risks in their portfolio, define their investment beliefs, and come up with a strategy for evaluating and responding to stakeholder feedback and demands. She stresses the importance of having a clearly defined responsible investment policy and being transparent about what that is and how it is implemented.

UniSuper, the \$57.5 billion default superannuation fund for the country's largest universities, was an early adopter of such an approach.

"I think UniSuper was probably one of the first funds targeted by activist campaigns. Many of our members are academics, and they are highly educated, engaged, and take a keen interest in ESG issues," UniSuper manager, governance and sustainable investment, Talieh Williams said.

"We're not an activist fund but we are an active share owner and we feel very accountable to exercise our ownership rights with prudence."

Having an integrated ESG policy should not be confused with trying to please

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*Right (L-R):*  
Investment Magazine's **SALLY ROSE**;  
First State Super's **DAMIAN GRAHAM**;  
CFS FC's **JODIE TAPSCOTT**



*Left:* Mercer's **ALEXIS CHEANG**

everybody all of the time, which would be an impossible folly.

“One issue we get a lot of questions about is whether we are invested in companies that participate in stem cell research...some of our members have strong religious or philosophical views against it, while some of our members are researchers in that field,” Williams said.

Framing ESG integration as a risk-management tool means that even if some stakeholders don't like certain investment decisions, they understand the framework in which they were made.

“I think ESG integration can transcend philosophical views at that level,” Williams said.

Balancing conflicting demands from stakeholders was a challenge faced by University of NSW director of treasury Andrew Fellowes last year when he embarked upon developing a responsible investment policy for the institution's endowment fund.

This followed campus demonstrations, including a small sit-in in the chancellery backed by many more supporters on social media, protesting the university's investments in certain fossil fuel producers.

While a handful of vocal protesters were calling for blanket divestment, this would

have been both problematic for the fund's portfolio requirements and inconsistent with the values of many other stakeholders – like mining engineering students.

This sort of conundrum is one of the reasons why it is so important investors clearly define what their own investment beliefs are.

“Something many of the funds we work with have found really useful is to do an Investment Beliefs Workshop,” Cheang said.

This is a chance to articulate what the organisation believes about ESG and integrate it into their investment policy.

“Then even if you can't satisfy everyone's desires or requirements about stem cells or climate change, you can say, ‘Organisationally this is what we believe. This is the approach we've taken. This is how we've taken on-board your overarching concern,’” Cheang said.

Mercer advised UNSW on the development of its new Investment Policy Statement, which incorporates the goals of the Paris Agreement on Climate Change.

NSW Treasury Corporation (TCorp), the \$72 billion funds management arm of the NSW Government, recently worked with Cheang's team at Mercer on the development of its inaugural Investment Stewardship Policy.

One driver for this was the rise in queries coming from external stakeholders, such as universities and local councils, reflecting the general public's growing interest in ESG issues, TCorp senior manager, investment

## PARTICIPANTS

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advisory and stewardship, Kylie Willment said.

“But I’m happy to say that a lot of the catalyst was Treasury itself turning to us and asking what we were doing about things like climate change risks within our investment portfolios.”

Willment said the implementation of the Investment Stewardship Policy would be “a major focus” for TCorp over the “next couple of years”.

“We acknowledge that we are a bit behind where some of the industry is in terms of ESG integration and active ownership but we’re targeting moving ourselves up to best practice very quickly and resourcing and re-structuring ourselves accordingly,” she said.

The move to embed ESG principles into investment policies is also underway inside the nation’s largest banks.

Roughly two years ago, BT Financial Group, the superannuation and wealth-management arm of Westpac Bank, first outlined the organisation’s investment beliefs in regards to managing ESG risks.

BT Financial Group head of customer governance and sustainability Emma Pringle said the move had played an important role in pushing considerations about ESG issues into the mainstream at the organisation, rather than just being viewed as a concern of special label funds.

Pringle said BT Financial Group primarily engages with its investee companies “behind closed doors” and was currently spending a lot of time thinking about how to do that better.

“It comes back to what role we play as the custodian...investing that money responsibly at the highest level that’s going to meet total member interest.”

Around two years ago, the Commonwealth Bank’s wealth-management strategy group started formalising its approach to responsible investment with regards to ESG risks.

Jodie Tapscott recently joined the group in the newly created role of Colonial First State senior manager corporate responsibility. Her job is to implement the group’s Wealth Management Responsible Investing Framework.

Tapscott said the importance of good stakeholder engagement should not be underestimated.



Above (L-R):  
LGS’s **BILL HARTNETT**; Mercer’s **HELEN MURDOCH**;  
AODP’s **DR JOHN HEWSON**

“I think wealth organisations can really do a lot to better communicate with their members and engage them on the [ESG] issues they are interested in.”

Improving engagement on ESG issues with CFS’s external fund managers is another area of focus for Tapscott to meet the organisation’s commitment to encourage the disclosure of ESG risks and impacts.

Cheang said a useful activity for asset owners trying to figure out how to prioritise their ESG engagements with fund managers and the companies they invest in is to undertake a “whole-of-portfolio modelling” exercise. In addition to providing a clear view of where ESG risks are concentrated, this illuminates holdings that may have a positive offset effect – such as investments in clean energy or healthcare.

For many institutions, the push to analyse and disclose the ESG risks in their portfolios is coming from the growing band of advocacy groups dedicated to lobbying them – such as the Asset Owners Disclosure Project, which pushes institutional investors to measure and report the climate risks in their portfolios and ultimately work toward reducing them.

Asset Owners Disclosure Project chair Dr John Hewson said standards had lifted markedly over the almost decade the initiative has been in place.

“The momentum over this time has been very encouraging for us, although it’s been a pretty painful process. We got a lot of pushback in the early years, but it’s changed a lot.”

Hewson said any lingering debate over whether or not it was appropriate for local investors to consider risks associated with climate change in their portfolio decisions, once considered potentially at odds with the fiduciary duty, had now been put to bed.

In February of this year, Australian Prudential Regulation Authority executive board member Geoff Summerhayes said the directors of financial institutions have a pressing obligation to consider the investment risks associated with climate change, which he warned had “potential system-wide implications”.

Local Government Super, a \$10 billion industry fund, has spent the best part of a decade building its reputation as an investor with strong ESG and sustainability credentials. It was ranked by the Asset Owners Disclosure



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Below:  
UNSW's ANDREW FELLOWES



Above: BTFG's EMMA PRINGLE

Project as the number one institution in Australia, and number two globally, for environmentally sustainable investing.

Blacklisting certain categories of investments – such as tobacco, coal, armaments, and nuclear energy – is a central part of the fund's approach. But Local Government Super head of sustainability Bill Hartnett acknowledges that exclusions have their limits.

"You can't keep on divesting of everything. You've got to be invested for the long term and get your long-term goals for your members, for your clients' savings. So you also have to engage, you have to be involved, and you need to be transparent."

First State Super chief investment officer Damian Graham characterised the divestment approach of some smaller funds as "a pretty blunt tool" that becomes less effective the more capital an institution has to deploy.

"At First State Super, we have to consider these challenges from a universal ownership perspective, which is that we know we are always going to have to own most of the listed companies in Australia, and so we need to continue building up a framework that allows

us to have a constructive dialogue with those companies," he said.

"We view ESG risks from a fiduciary perspective, as one type of risk that we need to factor in and consider when we're contemplating a long-term, risk-adjusted, return."

First State Super is the \$80 billion default fund for NSW public servants.

Graham said that it was important funds do the work to discern what matters to the majority of their stakeholders, rather than simply feeling pressured by the noisiest agitators.

He said research the group conducted with Mercer showed that while many members said they believed a well-defined ESG approach was "very valuable" over the long term, virtually none of them would be prepared to pay any more for it.

Michael Walsh, the chief executive of the Uniting Church of Australia's \$1 billion investment arm, UCA Funds Management, said it was important to listen to niche complaints.

"It is important that the investment sector listens to the voices of smaller non-profit organisations that are starting to bleep about issues that may still sound a little whacky but

have the potential to have significant social consequences and may become reputational risks later on," he said.

"I think it really is up to the ESG fraternity to identify and examine these issues, rather than wait until they appear on a Four Corners program."

UCA Funds Management has an integrated ethical investment policy that is aligned to the values articulated by the Church Synod.

Community health problems associated with sugary foods and beverages, the exploitation of slave labour in modern supply chains, and split community values over new industries were just a few of the issues on the ESG radar of the roundtable's participants.

Mercer delegated solutions leader Helen Murdoch said there were "lots of ways" that asset owners could choose to deal with ESG issues that could all be appropriate in different circumstances. However, all institutional investors need to ensure that their behaviour is consistent with their stated strategy and be open about it.

"The disclosure and transparency around that is becoming increasingly important," she said. ✕



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