Climate Risk Report 2021

Task Force on Climate-related Financial Disclosures (TCFD)

ethical
investing with purpose

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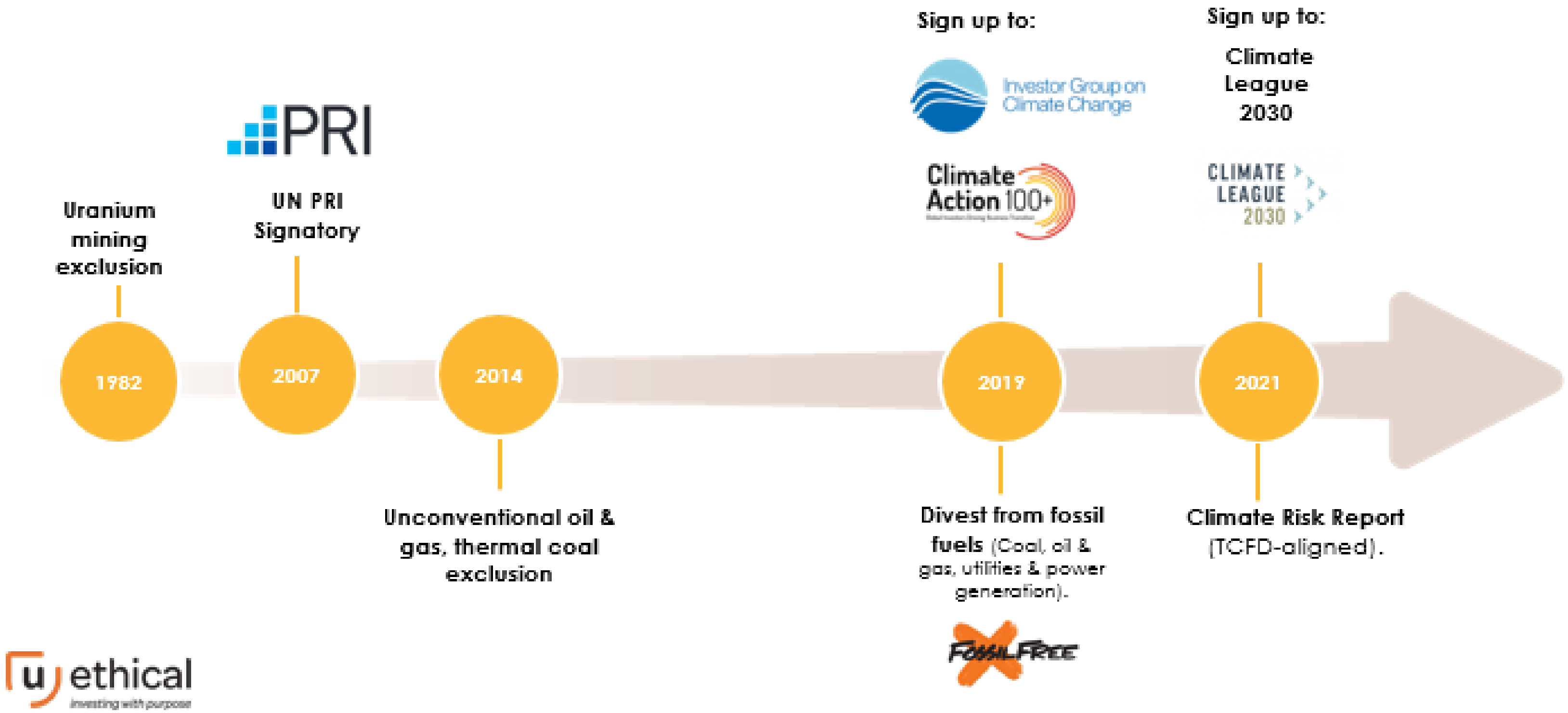
Summary of U Ethical's climate risk management approach

	Corporate	Cash	Fixed income	Equities
Cash management trusts		✓		
Enhanced income trust		✓	✓	
Diversified income trust			✓	
Equities trusts				✓
Growth portfolio			✓	✓
U Ethical	✓			
Corporate	U Ethical's scope 1 and 2 emissions are minimal. However, it is exposed to the risks associated with scope 3 indirect emissions inherent in managing cash, fixed income and equity investment portfolios and in purchasing from service and product providers.			
Asset class / valuation risk	Climate change risks and opportunities vary by asset class. They are heightened for longer duration securities, such as equities and longer-term fixed income.	Cash, cash equivalents and term deposits are short duration assets. As 'fixed dollar' assets, their price is not currently affected by the risk of climate change.	The duration of fixed income securities varies from short to long-term. Climate change risks are more relevant for longer-duration fixed income securities, but to a lesser degree for short duration securities.	Climate change risks (particularly physical risks) and opportunities are heightened for equities given the longer-term investment time horizon.

	Corporate	Cash	Fixed income	Equities
Company / issuer risk		Climate change will increasingly pose a risk to the financial institutions that issue cash, cash equivalents and term deposits—generally authorised deposit-taking Institutions (ADIs) such as banks regulated by the Australian Prudential Regulation Authority. It is likely that the value of ADI assets (loans, securities and reserves) will be affected over time by the adverse effects of climate change.	Climate change will increasingly pose a risk to the companies that issue fixed income securities. As the level and consistency of disclosure by issuers improves, it will enhance the assessment of climate risk and therefore the accuracy of credit quality analysis and security pricing.	Climate change poses systemic risk to listed companies. Portfolio-level systematic risk is in part addressed through active stewardship, and in particular advocacy at both local and international level.
Management of climate risk				
• Exclusions	Companies and securities issued by companies involved in fossil fuel activities—coal mining, oil and gas production, power generation and equity ownership in any of the former—are excluded from U Ethical's investable universe where such activities are more than 5% of revenue or earnings.	All securities currently held by the trusts are issued by ADIs that comply with U Ethical's ethical investment policy and are therefore not excluded from the trusts' investable universe.	Securities issued by companies involved in fossil fuel activities—coal mining, oil and gas production, power generation and equity ownership in any of the former—are excluded from the trusts' investable universe where such activities are more than 5% of revenue or earnings.	Companies involved in fossil fuel activities—coal mining, oil and gas production, power generation and equity ownership in any of the former—are excluded from the trusts' investable universe where such activities are more than 5% of revenue or earnings.

	Corporate	Cash	Fixed income	Equities
• Company / issuer and portfolio analysis	U Ethical uses MSCI ESG Manager to monitor greenhouse gas emission trends, science-based targets, target coverage and progress on targets by companies and issuers. For equity portfolios, U Ethical specifically monitors climate value-at-risk, which covers physical risks, transition risks and technology opportunities. As climate change risk disclosures continue to improve, U Ethical's ability to manage those risks, both at the security and portfolio level, will also improve.	U Ethical uses MSCI ESG Manager to monitor greenhouse gas emission trends, science-based targets, target coverage and progress on targets by issuers.	U Ethical uses MSCI ESG Manager to monitor greenhouse gas emission trends, science-based targets, target coverage and progress on targets by issuers.	U Ethical uses MSCI ESG Manager to monitor greenhouse gas emission trends, science-based targets, target coverage and progress on targets by companies. For equity portfolios, U Ethical specifically monitors climate value-at-risk, which covers physical risks, transition risks and technology opportunities.
• Engagement and advocacy	U Ethical's engages with portfolio companies and issuers on climate risk issues. This engagement may be carried out directly or collaboratively with investment peers, industry bodies or civil society organisations, such as Climate Action100+, the UN Principles for Responsible Investment or the Responsible Investment Association of Australasia.	U Ethical's engagement with cash issuers on climate risk issues (such as fossil fuel financing) is limited to where there is an overlap with holdings in equity portfolios. This engagement may be carried out directly or collaboratively with investment peers, industry bodies or civil society organisations, such as the UN Principles for Responsible Investment or the Responsible Investment Association of Australasia.	U Ethical's engagement with fixed income issuers on climate risk issues (such as fossil fuel financing) is limited to where there is an overlap with holdings in equity portfolios. This engagement may be carried out directly or collaboratively with investment peers, industry bodies or civil society organisations, such as the UN Principles for Responsible Investment and the Responsible Investment Association of Australasia.	U Ethical's engages with companies on climate risk issues including greenhouse gas emission trends, science-based targets, target coverage and progress on targets. This engagement may be carried out directly or collaboratively with investment peers, industry bodies or civil society organisations, such as Climate Action100+, the UN Principles for Responsible Investment and the Responsible Investment Association of Australasia.

U Ethical's Climate Risk Roadmap



GOVERNANCE	
DISCLOSURE	**COMMENTARY**
SUMMARY	• Alongside *ethical* and *environmental, social and governance* (ESG) considerations, U Ethical's values include commitments to portfolio alignment with a climate-safe and just transition. All of these considerations are fundamental to U Ethical's investment philosophy and the long-term risk and return of U Ethical's equity portfolios. • The Investment Committee (IC) approves amendments to U Ethical's ethical investment policy. • The investment team has delegated responsibility to assess, monitor, evaluate and implement U Ethical's ethical investment policy, which includes fossil fuels exclusions along with climate risk considerations and analytics. • The Ethical Advisory Panel (EAP) advises on market and research trends, including themes such as target setting, decarbonisation scenarios and reporting requirements. The IC reviews and approves policy changes on a quarterly basis as required. • The Board has oversight of the development and implementation of the climate risk strategy.
Describe the board's oversight of climate-related risks and opportunities.	As an ethical investor with a long-term outlook, U Ethical believes that climate risks are financially material and systemic in nature. Additionally, the alignment of U Ethical's investment portfolios with a low carbon transition and climate just transition will not only mitigate risk exposure but ultimately contribute to investment portfolios' resilience and continued performance. • U Ethical's Board oversees the climate risk governance framework and delegates oversight of climate risks and opportunities as they relate to investment portfolios to the IC and management of climate-related risks and opportunities to the leadership team. • The EAP advises on a diversity of ESG themes, including climate risk targets, decarbonisation scenarios and reporting trends. • Both the EAP and the IC meet on a quarterly basis and advise on emerging ethical and ESG concerns and monitor the investment team's implementation of the ethical investment policy. • As part of regular investment performance reporting, the investment team reports to the IC on the equity trusts' ESG profile, sustainable impacts alignment, key carbon footprint metrics (including historical data for Scope 1 and 2 emissions) and low carbon transition risk exposures.

Describe management's role in assessing and managing climate-related risks and opportunities.	Both the IC and the EAP[1] have endorsed U Ethical's divestment positions with the IC providing oversight of climate-related risks and opportunities. The investment team, headed by the chief investment officer (CIO), has delegated responsibility to integrate climate risk considerations into daily investment decision-making, industry collaborations, proxy voting and active engagement with portfolio companies (and where relevant cash and fixed income issuers).
STRATEGY	
DISCLOSURE	**COMMENTARY**

SUMMARY	• Climate risk is material and systemic. Transition and physical risks are, to different degrees, already impacting several regions as well as asset values.
	• As a certified B Corporation, U Ethical strives for integrity across its business operations, investment products, team engagement and consideration of key stakeholders.
	• U Ethical's investment climate strategy focuses on:
	    o fossil fuels divestment
	    o carbon emissions exposure reduction; and
	    o preference for portfolio companies and issuers transitioning to a just and low carbon world.
	• We favour investments in companies that are better positioned in a just and low carbon transition by means of strong governance practices and management's commitments to innovative business models and resilient operations.
	• On a quarterly basis, we run portfolio-level carbon footprint analyses for equity trusts and regularly map (for both new and existing issuers) the low carbon transition risk exposures, historical CO2-e emissions reduction trends and corporate management's climate risk resilience capabilities. This review focuses on opportunities in clean energy and technology related revenues and capital expenditure.
	• Stewardship is carried out via direct engagement with portfolio companies (and where relevant cash and fixed income issuers), proxy voting and collaboration with like-minded organisations.
	• As part of industry initiative Climate League 2030, we have committed to engaging with the largest carbon emitters in our portfolio.

[1] The EAP was set up in 2019

Describe the impact of climate related risks and opportunities on the organisation's businesses, strategy, and financial planning	Climate risk is not fully priced, it is an undiversifiable risk of a systemic nature with *'potentially irreversible consequences in terms of the damage it can cause'*[2]. As such, U Ethical believes most sectors, to different degrees, will be impacted by climate change with transition and physical risks varying by region, country and supply chain complexity. Physical risk exposure is already impacting the value of assets which are subject to extreme weather events, bushfires and/or rising sea levels and storm surges. Risks are varied and can arise from: • Actual physical damage (whether chronic or acute) and economic impacts due to business damage and/or supply chain interruption, • The inability to suitably (i.e. timely and cost effectively) adapt both in financial and operational terms; and • The supply and demand changes from material and/or product substitution, cost increases, changes in consumer preference and regulation (e.g. carbon pricing). Leading global investors and several countries in both developed and emerging markets, are structurally transitioning their economies and setting ambitious decarbonisation targets. As part of our ethical investment policy, following the negative exclusion of companies involved in fossil fuels activities (coal mining, oil and gas production, power generation and equity ownership), we analyse climate risk in terms of individual issuers' overall ESG profile, carbon emissions exposures and historical trends (Scope 1 and 2 emissions), solutions providers and low carbon transition score and management capabilities. With regards to the latter, we rely on a transition risk category (stranded asset – neutral – product – operational) and management score (0-10) and related quartiles to prioritise engagement activities. We actively engage with portfolio companies (and where relevant cash and fixed income issuers) to ensure they consider carbon emissions' reduction targets and encourage them to embrace decarbonisation plans in line with the Paris Agreement and industry best practice. In our proxy voting, we also support environmental (E) and social (S) resolutions that address climate risk, call for transparency and disclosure of emissions targets, and seek a higher aspiration for decarbonisation targets or climate transition plans. We disclose voting decisions on our website as part of our commitment to best-practice governance and transparency. As part of our active stewardship, we also collaborate with industry initiatives[3] and peer investors to advocate for a broader shift of capital markets and support evolving regulatory frameworks.

[2] Commissioner Allison Herren Lee, Securities and Exchange Commission (SEC), November 2020 "Playing the Long Game: The Intersection of Climate Change Risk and Financial Regulation"
[3] ClimateAction100, Climate League 2030, QuitNukes

	When considering potential new investments and reviewing our existing holdings, our fundamental valuation analyses account for: • The climate risk intensity exposure of industry groups, • The management capabilities of portfolio companies/holdings, • Emissions reduction targets and, increasingly, commitments to decarbonisation plans. We will continue to evolve our investment strategy as climate models, research and related data evolve. We also strive to align with best practice approaches as they emerge. In line with this, U Ethical aims to expand its capabilities to define net zero targets and be able to analyse and report on complete climate scenario analyses and where possible, on historical trends across Scope 1, 2 and 3 emissions.
RISK MANAGEMENT	
DISCLOSURE	**COMMENTARY**
SUMMARY	• U Ethical's 2019 materiality study identified Climate Change Mitigation and Resilience as "highly material" to the business and its key stakeholders. • U Ethical's fossil fuels divestment policy significantly lowers the carbon footprint metrics of our investment portfolios. • In identifying investment risk for our listed equity holdings, we use carbon emissions, carbon intensity; for both listed and fixed income securities, we use a weighted average carbon intensity (WACI) metric. • We manage risk exposures by investing in better ESG-rated companies, favouring issuers with strong to medium management capability, emissions reduction commitments and robust targets, low carbon investments and/or decarbonisation plans. • The investment risk assessment process aims to de-risk our exposures to climate change risk when considering new types of investment opportunities or reviewing existing ones. • We actively engage with many portfolio companies (and where relevant cash and fixed income issuers) to ensure they consider carbon emissions' reduction targets and are committed to embracing decarbonisation plans in line with the Paris Agreement and industry best practice.

Describe the organisation's processes for identifying, assessing and managing climate-related risks.	Consideration of climate change risks is fundamental to our assessment and evaluation of risk-return drivers in investment decision-making. In 2019, an externally conducted materiality assessment identified climate change mitigation and resilience as one of U Ethical's top three highly material themes. Following divestment from unconventional oil and gas in 2014, and complete divestment from fossils fuels in 2019, the investable universe is defined by our core ethical exclusions, minimum ESG requirements, ESG controversies screening and preference for companies that align with the UN-SDGs[4]. Analysis of new equity holdings and issuers (and the review of existing ones) includes consideration of a low carbon transition management score, category and related quartile score, a review of the carbon footprint profile and opportunities in clean energy and clean-tech, energy efficiency, green buildings, and alternative products and services. We leverage third party ESG data, industry level analyses, broker research and think tanks' sectoral mappings to both mitigate and pre-empt portfolio risk exposure while aiming to identify issuers with greatest resilience and capacity to embrace a transition pathway. The above also informs and helps prioritise U Ethical's engagement activities. The engagement focus is on Australian equity holdings, although there is a large overlap with cash and fixed income issuers. A preliminary climate scenario exercise for equity holdings carried out by U Ethical's third party ESG data provider has indicated that our climate-related Value-at-Risk exposures (transition and physical risks) are concentrated in a few sectors: materials, transportation, telecommunication services, health care and equipment and pharmaceuticals. In our climate risk due diligence, we rely on regulatory frameworks, ASIC and APRA's evolving requirements and third-party analyses and taxonomies such as: • MSCI ESG Research's Climate Change Metrics methodology, Carbon Estimation methodology, Low Carbon Transition Risk Assessment, Business Involvement Screening Research (and we are also exploring MSCI-Carbon Delta's Climate Value-at-Risk Analytics). • Climate Work's Decarbonisation Futures report. • Climate Bonds Initiative (CBI)'s Taxonomy. On an *ad hoc* basis, we also reference: • Science Based Targets (SBTi)'s Methods and • 2 Degree Investing Initiative's PACTA tool.

[4] These include UN-SDGs such as Climate Action (UNSDG 13), Affordable and Clean Energy (UNSDG 7), Partnerships for the Goals (UNSDG 17).

	The above process applies to U Ethical's equity portfolios for alignment with our position. As covered in the strategy section above, all ethical and ESG considerations, including climate risk, inform U Ethical's engagement activities with portfolio companies to improve companies' and issuers' carbon data transparency and disclosures and encourage consideration of climate scenario alignment of business models, operations and climate risks related to supply chains.
TARGETS AND METRICS	
DISCLOSURE	**COMMENTARY**
SUMMARY	• We measure carbon emissions, historical carbon emissions trends, carbon emissions intensity/$M invested and weighted average carbon intensity (WACI) • We also measure low carbon transition (LCT) management score and low carbon transition quartile scores.
Disclose the metrics used by the organisation to assess climate related risks and opportunities in line with its strategy and risk management process.	As part of the ESG profile reviews of companies and issuers, we assess the ESG risk exposures and related capabilities to manage both social and environmental key issues material to their sub-Global Industry Classification Standard (GICS). Active engagement focuses on human rights and labour management concerns, business governance and behaviour, environmental stewardship, and climate change risk. For companies and issuers where climate risk has not been identified as financially material, we seek disclosures and consideration of climate risk in accepted warming scenarios within the relevant industry and best-practice. In proxy voting for equity holdings, we support resolutions that call for greater transparency and climate risk mitigation and adaptation strategies. At present, we are reviewing the extent to which climate scenario analyses impact U Ethical's trusts and portfolios. The preliminary analysis through MSCI-Carbon Delta's Climate Value-at-Risk[5] has indicated that our climate-related risk exposures in equity trusts (transition and physical risks) are concentrated in the following sectors: materials, transportation, telecommunication services, health care and equipment and pharmaceuticals. We also review banks' financed emissions to verify what share of loan books might be invested in fossil fuels and would therefore be in breach of our ethical framework.

[5] Climate CVaR accounts for climate transition risk and physical risk. It also gives a portfolio-level global warming potential value for Scope 1, Scope 2 and Scope 3 emissions.

Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.

U Ethical's fossil fuels divestment policy significantly lowers the carbon footprint performance of our investment trusts.

AETW**

	Carbon Footprint				
	Carbon Emissions	Total Carbon Emissions*	Carbon Intensity	Weighted Average Carbon Intensity	Carbon Emissions Data Availability
AETW	57.3	57,343	137.0	105.2	100.0%
ASX300	137.4	137,379	319.1	208.7	99.2%
	t CO2e / $M Invested	t CO2e	t CO2e / $M Sales		Market Value

*Based on Portfolio investment of $1,000,000,000 and Benchmark 1 investment of $1,000,000,000

IET**

	Carbon Footprint				
	Carbon Emissions	Total Carbon Emissions*	Carbon Intensity	Weighted Average Carbon Intensity	Carbon Emissions Data Availability
IETW	17.8	17,811	57.3	51.6	100.0%
MSCI World ex Australia	75.8	75,806	168.9	136.3	99.9%
	t CO2e / $M Invested	t CO2e	t CO2e / $M Sales		Market Value

*Based on Portfolio investment of $1,000,000,000 and Benchmark 1 investment of $1,000,000,000

	***Constituents as at 31st March 2021* For new and existing equity holdings, we carry out a CO2-e emissions trend analysis for Scope 1 and 2 (we hold historical data is since 2008). We continue to review the portfolio-level carbon footprint performance and trends. Further to a data release by our data provider[6], we are now analysing Scope 3 GHG emissions exposures in line with the GHG Protocol methodology as both reported and estimated by our provider. We review all new and existing equity holdings by analysing the extent to which Scope 3 emissions (upstream and downstream) are broken by GHG category[7]. The Low Carbon Transition (LCT) factor that we use accounts for companies' carbon emissions intensity, share of avoided emissions and management resilience to business transformation.

[6] MSCI ESG Research released a carbon emissions Scope 3 methodology in August 2020
[7] https://ghgprotocol.org/scope-3-technical-calculation-guidance