cær
responsible corporate analysis

Responsible Investment Agenda 2019

A Work Plan for Australian and New Zealand Investors

ABOUT CAER

CAER's mission is to broaden the reach of ethical and responsible investment. To achieve this we provide, structure and add value to ESG information on companies and investment portfolios.

CAER's business activities focus on the provision of expertly assessed ESG information. Our team of analysts have a deep knowledge of the responsible investment market, and are able to provide our clients with expert insights in addition to high quality, well-structured global ESG data.

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CAER – Responsible Corporate Analysis

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RESPONSIBLE INVESTMENT IN 2019

Nithya Iyer

As the availability, use and impact of environmental, social, and governance (ESG) research continues to grow so too does its impact on investment decision-making and the development of new models for risk analysis. Out of a turbulent year that has included a Royal Commission into banking, the legislation of a modern slavery act, and increased dialogue on the urgency of climate action emerges a greater alignment between the long-term goals of the responsible investment (RI) industry and the overall economy.

Building upon a rich dialogue within an increasingly sophisticated RI market, CAER presents our second Responsible Investment Agenda report highlighting our key ESG considerations for the year ahead. The report supports our mission to broaden the reach of responsible investment through the provision of high-quality ESG research by reflecting upon issues that we see as influential to ESG analysis and thinking.

While identifying 'trends' in ESG can be counterintuitive to creating and sustaining holistic thinking and decision-making by investors, this report aims to encourage clarity and criticality in the ESG approach of investors in 2019. It is also our hope that issues discussed in the report facilitate healthy debate among the broader investment community.

In addition to discussing five specific issues influencing the RI market this year, we have identified a number of broader changes taking place that investors should consider.

The proliferation of 'greenwash' across mainstream investment offerings?

In 2018, the Responsible Investment Association Australasia (RIAA) reported that 55.5% of total assets managed in Australia were covered by a Responsible Investment (RI) strategy. Representing $866 billion, the majority of this group (78.5%) was covered by a broad RI strategy, such as ESG integration, whilst the remainder used a core RI strategy, such as screening, sustainability-themed or impact investment.[1] These findings note that majority of investment offerings in Australia now constitute considerations of ESG risks.

However, alongside this increased consideration has come concerns of a rapid proliferation of 'greenwashing' - that is, the marketing of mainstream investment products as ethical, sustainable, or otherwise 'green' as part of a key sales strategy without applying or changing the product process and/or outcome. Regardless of whether the product meaningfully integrates ESG, investment houses have become well versed in the packaging and description of traditional investment products according to their perceived RI traits.

These strategies correlate with the demands of an incoming demographic of millennial investors. According to the Legg Mason Investment Survey of December 2018, millennials are more likely to invest in ESG products than their previous generational counterparts. The annual survey, which captures the perspectives of 17,000 investors across 17 markets, found millennial investors leading the call for ESG, ranking environmental impacts as the most important aspect of ESG for long-term investing.[2]

As noted by Anthony Serhan, former managing director of research strategy Asia-Pacific at Morningstar, *"There has been a lot of 'green washing' of investment options just to capture this demand and broadly, the industry has not done a good enough job educating investors on what is a meaningful way to invest."* [3]

There are signs that the RI industry is starting to consider this challenge through the tightening of RI benchmarking frameworks, such as the PRI setting minimum standards of ESG integration for signatories. Nevertheless, more work is required to ensure the integrity of mainstream ESG offerings. In cases such as the *2018 Climate Change, Superannuation and Millennials* report published by the Future Business Generation and EY, the push is coming from millennial investors within the RI industry regarding what meaningful action on climate change looks like in terms of specific investment actions. The authors of the report have noted that they will consider benchmarking superfunds against these actions in the future.[4]

As greenwashing appears to proliferate, investors are consequentially tasked with ensuring renewed rigor in ESG integration as well as increased transparency of RI strategies. This means interrogating the intended and actual impacts of ESG products and evaluating how fit-for-purpose RI strategies actually are in light of the real socio-political and environmental concerns we face. The increasing sophistication of RI investors in this area suggests that those who do not evaluate the effectiveness of their RI strategies against their impacts will be left behind among a new generation of investors and superannuation members.

Working with companies in an era of ESG regulation

The development of regulatory interventions regarding ESG risks indicates a distinctive shift in the mainstreaming of ESG while also ushering in a new framework for discussion between RI investors, investee companies and regulators. This shift highlights a number of important considerations for investors.

Who is responsible for driving change?

Whilst consumer groups and NGOs often carry the baton for raising awareness, there is an increasing need for RI investors to become active participants in advocating ESG-based policy measures, particularly when policy outcomes are uncertain. Where investors do not assume this mantle, and consumer groups fail to secure adequate audience, other actors rise to fill this gap and influence policy-makers.

The current debate in Australia regarding the tax on sugar-sweetened beverages provides an example of how other actors can influence public policy against ESG-aligned outcomes. Despite the endorsement of the World Health Organisation[5] and a coalition of 34 health and medical groups – such as the Obesity Policy Coalition, Cancer Council, Royal Children's Hospital and the Stroke Foundation – calling for a tax on sugary beverages, industry associations such as the Beverages Council and the Australian Food and Grocery Council continue to campaign against the measure.[6]

Some industry associations have explicitly disclosed intentions to disrupt ongoing policy discussions in this space, which raises the question, whose interests are represented in policy debates around long-term ESG issues? How can RI investors participate meaningfully in these conversations?

These issues challenge existing mechanisms of ESG integration - such as voting, engagement, and company research – to counter complex socio-political risks that are inherently values-based. They also indicate that an RI investor that is committed to stewardship cannot shirk away from advocacy on key issues, and must instead acknowledge the widening parameters of their accountability through considered action.

What issues should we act on?

RI investors grapple with a multitude of ESG issues each day. Whilst most issues present possibilities for further action – either through investment decision-making, voting, advocacy or company engagement – it can be difficult to identify which issues are the most urgent.

Recent ESG issues that have gained traction beyond the RI market, and eventually resulted in broader policy-based change, suggest that there are a number of confluent factors that result in an ESG issue having material long-term consequence. Some of the factors that CAER has noticed are listed below:

- Investors, civil society, NGOs, and special interest consumer groups share concerns regarding the issue and are able to provide reliable statistical and/or anecdotal evidence regarding the impacts of the risk.
- Controversies surrounding companies embroiled in the ESG risk are globally known and have cultivated strong opinions from consumer groups, including boycotts and ongoing campaigns to disrupt operations.
- Companies involved in the issue are not able to provide sufficient assurances through investor disclosure that the risk is being adequately managed.
- The issue has been addressed in comparable jurisdictions and through regulatory mechanisms that can be feasibly implemented in Australia (and possibly have been raised before in Australia).

The introduction of a Modern Slavery Bill (the Bill) into Australian parliament in November 2018 provides a key example of the kind of ESG risks that showed all of the above characteristics and eventually gained traction to effect policy-based change. Other ESG issues with such characteristics include climate change, plastic pollution and sugar.

While it is not exhaustive, the above list asks investors to consider the threshold factors that suggest an ESG-risk may become an economy-wide and globally acknowledged threat to civil society and the economy.

What information do we need?

It is clear that greater investor attention on ESG risks can build towards systemic policy changes, shaping the conversation between investors, regulators and investee companies. Whether the voice of RI investors on key issues can reach a critical mass remains the challenge.

Climate change represents an area where investors, alongside NGOs, civil society organisations and even companies, have been more active in their efforts to drive policy change and seek information that is consistent and relevant to decision making.

The Task Force on Climate-related Financial Disclosures (TCFD), established in December 2015, now has more than 500 signatories who have agreed to report against the voluntary disclosures it has put forward. While the recommendations made by the TCFD have been welcomed by the Australian government alongside an agreement in principle to related recommendations made by the Australian Securities and Investments Commission and the Australian Stock Exchange,[7] further law reform regarding the disclosure framework has not been indicated. Most RI investors agree that while the TCFD is a step in the right direction, much more needs to be done in providing a detailed framework or strategy for companies and investors to disclose climate risks.

In such an environment, it is imperative that investors specifically outline the information that they need to make informed investment-decisions, lest the dialogue be swayed by an influx of information that – whilst readily available – adds little to our understanding of the risk.

Actions towards an RI/ESG integrated investment industry

Considering both the concerns of 'greenwashing' and simultaneously the deepening accountability for ESG placed on companies by regulators and broader stakeholder groups, investor behaviour is – as always – pivotal towards the development of a cohesive and integrated RI industry. An enhanced maturity and quality of conversation between investors and companies is paramount to the next phase of RI development.

The PRI has indicated that signatories will soon be required to meet minimum requirements of responsible investment to remain compliant, thereby increasing accountability against the voluntary scheme.[8] Separately, the Future Business Generation has outlined its expectations of superannuation funds regarding climate change risk mitigation in its inaugural report. The report calls for funds to provide evidence of portfolio-wide risk assessment using forward looking climate scenarios across all asset classes and sectors, as well evidence of the active assessment of asset managers' climate risk management.[9]

In such an environment, CAER has identified the following actions as integral for RI investors in 2019.

- Ensuring rigour and clarity regarding the appropriateness of RI strategies relative to desired outcomes.
- Sense-checking whether RI products meaningfully deliver the impacts they are designed to. This includes testing the effectiveness and usefulness of ESG inputs, internal and external capacities and methodologies.
- Alignment between company engagement meetings and broader global and national regulatory developments. Particularly with regards to ensuring companies are aware of investors' expectations regarding adherence to policy, regulatory disclosures and cooperation.
- Identifying areas in which investors require a greater level of insight on an ESG issue than what is afforded through current regulatory disclosures and developing company engagement frameworks that allow for that insight to be obtained.

Revisiting measures of quality and performance within internal systems to ascertain overall RI impact.

The Impact on Investment

Overall, in 2019 investors can be more ambitious both in the quality of their internal approaches to RI and in stepping up to the role that they play in addressing economy-wide ESG risks. While regulatory demands are aligning to some areas of ESG, there are many areas in which Australian policy, and the activities of Australian companies, fall behind international policy, consumer demands and the expectations of a smarter and better informed electorate.

Simultaneously, a maturing ESG market and the 'greenwashing' of investment products asks investors to scrutinise the appropriateness of their ESG strategies relative to impacts, rather than to rely on the business as usual benchmarks. Like so many ESG risks, RI is also evolving, and investors must adapt to remain committed to the best outcomes for their stakeholders, the upholding of trust and long-term thinking.

THE RI AGENDA – A SUMMARY

CAER has identified the following specific areas as influential to the consideration of ESG and responsible investment practices for 2019.

Climate Scenario Analysis	Robust scenario analysis is required Companies are not yet reporting extensively on the climate risks they face Transparency and Disclosure are essential	Engage with companies on: • What is the scope of the climate risk analysis applied: does it cover all company operations globally? • Has the company considered that some (or all) of its business activities may not be relevant in a low carbon economy? • What impacts do changes to company operations have on human resource factors such as job growth and diversity?
Trust and Influence	Loss of trust in public and private institutions Increasing opacity around influence on policy Uncertainty for both corporations and investors	Engage with companies on: • Membership of lobby and special interest groups • Disclosures of such memberships • Potential misalignments between the company's stance on an issue versus the stance of a lobby group they belong to Investors should also consider their own stewardship practices, particularly when it comes to disclosing voting at company AGMs.
Automation and the Future of Work	Advances in materials, software and robotics leading to an explosion in the take-up of automation technologies An increase in the complexity of jobs and tasks that have the potential to be automated Challenges for companies in all sectors regarding a changing workforce	Engage with companies on: • Transparency around plans for workforce down-sizing • Commitments to re-training and re-deployment • The position of the company's representative industry body in terms of encouraging government investment in social security measures, and in debates around issues like changes to existing working hours and related workplace practices

Water Availability and Management	Climate change, population growth, unsustainable production and consumption patterns ↓ A shift away from regulatory risk towards environmental, social, reputational and financial risk ↓ Need for greater water stewardship	Engage with companies on: • Disclosure of water consumption • The processes (or lack of) in place to manage and mitigate water risk • Preparedness to adapt to a possible insufficient water supply Investors should make use of the tools available to help them incorporate water stewardship into their decision-making process.
Waste	Bans on overseas export of waste leads to the stockpiling of waste ↓ Uncertain regulatory environment, increasing pressure from consumers ↓ Opportunities to re-evaluate operations and develop innovative new solutions	Engage with companies on: • What is the company's approach to reducing hazardous waste? • How is the company managing its environmental impacts regarding use and disposal of products/services? • Is the company providing services that will help solve the waste problem, including waste collection and waste treatment? • Has the company prepared for the possibility of a change in regulation? • Is the company engaging with consumer demand?

MAKING SENSE OF CLIMATE SCENARIOS

Erin Levey

In June 2017, the Taskforce on Climate Related Financial Disclosures (TCFD) published a comprehensive set of recommendations for companies to assess and disclose climate risk analysis within their financial reports. The recommendations while voluntary are significant due to the initiative being industry led as well as informed by companies that report their financial data and the groups using that data for financial decision-making related to investment, lending and insurance.

A core component of the recommendations set out by the TCFD is climate scenario analysis aligned with the two-degree warming target set by the Paris Accord. This target received overwhelming support at COP21 with 195 member countries supporting a global action plan for putting the world on track to avoid dangerous climate change by limiting global warming to 2°C.

Across government, regulators, financial institutions and civil society, the need to manage climate risk in line with the Paris Accord has become a mainstream societal issue, as well as a financial one.

Investors are committed to a carbon-free future

Investors recognise that climate change is not only an environmental problem; it's a business one as well. The implications of decisions made by companies today are going to affect generations to come, and given the current focus on long-term climate analysis, navigating the intersection between climate-related financial disclosures and responsible investment is essential.

In December 2018 at COP24 in Katowice Poland, 420 investors with over US $32 trillion in assets under management signed a statement urging world governments to support the TCFD recommendations to:

- Commit to achieve the Paris Agreement
- Accelerate private sector investment into low carbon transition
- Commit to improve climate-related financial reporting as per the TCFD recommendations[10]

This statement has been developed by the Asia Investor Group on Climate Change, CDP, Ceres, Investor Group on Climate Change, Institutional Investors Group on Climate Change, Principles for Responsible Investment, and the UN Environment Finance Initiative.

In Australia, investors have demonstrated a commitment to developing a Sustainable Finance Roadmap that encourages long-term investment solutions to facilitate the shift to a sustainable economy.[11] It also recognises that leadership from the finance community is necessary, especially while there is a lag in the implementation of necessary regulatory and reporting steps by government, regulators and corporations.

While key components of progressing the TCFD guidance are taking place, there is still significant headway to be made.

Questions raised in early scenario analysis

The TCFD recommends that both transition and physical risks be considered in climate scenario analysis. Transition risks involve changes in law, policy, technology and markets and are related to the transition to a lower-carbon energy supply. Physical risks from climate change may be acute or chronic and include, for example, damages to fixed assets or supply chain disruptions caused by extreme weather events, and changes in water availability.[12]

Early results from companies that are reporting on TCFD recommendations are limited. Of the companies that do report, very few are yet fulfilling the full TCFD recommendations. They instead report either partially on their business operations or partially against the four key disclosure recommendations in the TCFD guidance: Governance; Risk Management; Strategy; Metrics and Targets.

Analysis carried out by Market Forces on ASX 100 listed companies identifies that as of December 2018, 57% of the top listed entities publicly recognise climate change as a material business risk while just three companies disclose in line with all of the TCFD recommendations.[13]

The focus of companies publishing climate risk and scenario analysis reports in these early pilots has thus far been largely on transition risks – how policy drivers will change and what the market will demand. This makes sense; finance is more readily focused on rates of change in the demand for activities. Physical risks however are more difficult to predict and long-term forecasting isn't an exact science.

Given the scope of risks that the TCFD expects companies to consider, it's unlikely that many businesses will have the skills internally to assess the range of risks, particularly if these businesses operate globally and across a diverse range of business activities. Climate risk scenario analysis could quickly become an affordability issue for smaller organization's that don't house that expertise internally.

The Investor Group on Climate Change (IGCC) report *Investing in Resilience* includes tools and frameworks for managing physical climate risk specific to Australia – particularly in relation to property, infrastructure and due diligence. This, combined with the work of the National Resilience taskforce, combining data on climate related disasters and vulnerable communities, give investors a set of comprehensive tools for structuring the analysis on long-term physical risks as well as capturing the additional societal impacts that climate-related disasters will have.

These social aspects of climate risk need to be identified in the outcomes that companies consider – there is likely to be significant backlash from communities if skills, resources and employment are not effectively accounted for as part of a transition to a low carbon economy. Responsible investors should be asking questions about the type of scenario analysis companies undertake, which external sources of information and third party providers they are working with, the underlying assumptions of the scenarios, and the ESG issues that have been taken into consideration in the process.

How good is reporting?

Climate scenario analysis is still in its pilot stage with companies beginning to provide analysis on their transition to a low carbon economy as well as the physical risks of climate change that are likely to impact on their business. In this respect, it is fair that the extent to which this analysis is readily available and reported on is limited. However, there are already established mechanisms for reporting that indicate the extent to which companies are prepared to report, and their willingness to do so without a mandated disclosure requirement in place.

CDP, the established reporting mechanism for Greenhouse Gas Protocol reporting, has been in place since 2002 and provides a globally recognised and standardised questionnaire for reporting on company Scope 1 – direct carbon emissions, and Scope 2 – indirect emissions data.

CDP has committed to aligning its questionnaire with the TCFD recommendations, making the mechanisms for reporting against targets easily accessible.[14,15] However, there is still limited uptake by companies to disclose emissions data and provide transparency on strategies for managing carbon and energy related risks.

The proportion of ASX listed companies reporting on climate related risks is still very low with less than 50% providing metrics such as Scope 1 and Scope 2 emissions data. According to CDP, in 2017 "more than 200 companies based or listed in Australia were invited to respond to CDP's environmental information requests. In response, 81 companies disclosed environmental data."[16]

In addition, when we look at the qualitative disclosures of companies in Australia, the proportion providing information on their strategy for managing energy and climate related risks is relatively low, particularly for Energy and Materials companies – two of the key sectors identified by the TCFD as facing major disruptions in the transition to a low-carbon economy. Looking at company disclosures on systems for managing energy and climate emissions, Australian companies are lagging when compared with global peers.

Disclosure is a key driver in understanding climate related risks. More emphasis needs to be placed on the importance of transparency and disclosure from companies.

The Impact on Investment

Investors need to understand the key changes that will take place and the timeframes within which sector activities will face technological and political disruption, which means having access to company information and external sources on climate scenario analysis. There are already good sources of information on scenario analysis provided in the TCFD technical note[17] and in the IPCC working group outputs[18] and, pleasingly, some great resources on Climate risk for Australia and New Zealand in the TCFD Knowledge Hub.

Additionally, investors can use engagement mechanisms to influence company transparency and disclosure on climate-risks – particularly in the sectors identified by the TCFD as facing major disruptions in the transition to a low-carbon economy: Agriculture, Energy, Materials and Transport.

Lastly, responsible investors should consider the external impacts that transition and physical impact scenarios have on societal factors, and ensure that job creation, social well-being and human rights continue to be prioritised. With that in mind, key questions that investors can discuss with companies when engaging on climate risk and scenario analysis are:

- What is the scope of the climate risk analysis applied: does it cover all company operations globally?
- Has the company considered that some (or all) of its business activities may not be relevant in a low carbon economy?
- What impacts do changes to company operations have on human resource factors such as job growth and diversity?

TRUST ISSUES: THE NEW FACE OF RISK

Julia Leske

The Banking Royal Commission has revealed serious concerns regarding the accountability and integrity of Australian financial services institutions. While the Commission has been the main face of waning public trust in the industry, it is representative of a greater loss of trust in all institutions occurring across the country. An increasing opacity around the influence special interest groups have on governmental systems and economic policy has also called into question the integrity of the bodies charged with ensuring an appropriate balance of power in society.

Investors are beginning to push back. Following on from unsuccessful behind the scenes company engagement, the Australasian Centre for Corporate Responsibility has lodged resolutions[19] calling on companies to cease financing of anti-climate lobbying, receiving widespread investor support. Outside such initiatives, regulatory responses to these concerns have been ad-hoc and non-systematic, creating uncertainty for both corporations and investors regarding the reliability of the systems within which they operate.

A closer look at indirect and undue influence on the political and economic system, alongside the statistics regarding risk and corruption in the Australian market, suggest that trust issues could be a significant influence on emerging ESG risk.

Measuring Trust

The increasingly opaque and complex nature of influence upon public policy has coincided with what appears to be an overall decrease in public trust in political systems as well as in institutions.

A study from the Australian National University entitled *Trends in Australian Political Opinion: Results from the Australian Election Study 1987 – 2016* found that public trust in the Australian government fell from 43% in 2007 to just 26% in 2016. The remaining 74% of people surveyed in 2016 believed that people in government only looked after themselves.[20]

In a different measurement, Australia's score on the Transparency International *Corruption Perceptions Index* dropped from 79/100 in 2016 to 77/100 in 2017 and 2018. The Index ranks 180 countries and territories by their perceived level of public sector corruption according to experts and business people.[21]

The Edelman Global Trust Index, measuring the responses of 33,000 respondents across 27 markets between October and November of 2018 also found that the general population of Australia showed distrust towards the government. It also identified that the 'Mass Population' in Australia were 13 points less trusting than the 'Informed Public', again reinforcing the notion that public perception of trustworthiness in Australian institutions was waning. Moreover, Australia was listed as one of the 14 markets in which the majority of the mass population did not believe that they would be better off in five years.[22]

Given that we are facing a loss of trust in both public and private institutions as well as the political and regulatory systems that govern them, identifying the evaluating the impact of influence presents a difficult task for investors.

Questioning Influence

Research conducted by the Grattan Institute in 2018 identified a range of groups influencing public policy at the expense of public interest.[23] It was found that Australia was vulnerable to 'policy capture' with well-resourced special-interest groups able to hijack discussions with parliamentarians due to the reliance of political parties on donations and a lack of checks and balances in place to determine how access to Parliament is facilitated.

Many States and Territories have acted to remedy concerns regarding the transparency of political donations through the implementation of 'disclosure thresholds'. Commonwealth regulation however remains problematic— only donations above $13,800 are required to be disclosed and disaggregated donations are allowed to occur (e.g. multiple donations under the threshold amount for disclosure are possible without disclosure of the donor). The result is that parties are able to receive more than $100 million from undisclosed sources, as they did in the two financial years over which the 2016 elections took place.[24] Calls for political donation reform and a federal anti-corruption agency have steadily increased with some form of legislation looking likely to pass in 2019[25].

Separately, public debate on climate change and obesity (sugar taxation) regulation, for example, has sparked renewed interest in how industry associations and special interest groups use political lobbying as a strategy to prioritise private profits over public welfare. During 2018, several news media outlets reported on the refusal of both major political parties to introduce a tax on sugar-sweetened beverages despite calls from major Australian health and medical groups (including the Australian Medical Association and the Australian Dental Association) and the endorsement of the World Health Organisation[26,27,28]. The blatant strategies of disrupting public policy processes self-reported by the Australian Beverages Council in its own annual report[29] were of particular concern.

The Guardian's research on the register of lobbying firms identified that majority of registered lobbyists had some government link, either through the employment of former public servants or other government representatives. These firms often specialised in representing particular industries to the two major political parties, with the pharmaceutical and energy, mining and resources industries named as key buyers of the lobbying services.[30]

In the day-to-day business of portfolio management, broad societal issues such as trust may not appear relevant to investment decisions on a company-by-company basis. However, given how pervasive and far-reaching the issues of trust and influence can be especially over longer time horizons, it is imperative that investors don't let them drop off their radar.

A Complex Web of Risk

In an environment of decreasing trust in the government and increasing concern regarding the integrity of governance systems, capital markets start to be increasingly vulnerable to ESG investment risks.

Some examples of long-term ESG issues that we have known about over many years, if not decades, that are now rapidly transforming into threats to investments include:

- The Climate Council's report *Weather Gone Wild* notes the increasing cost of extreme weather events and identifies a lack of governmental action as an obstruction to better management of these issues.[31] It also provides figures for the economic losses caused by the insurance cost of climate change impacts between January and December of 2018, including $80 million due to bushfires in New South Wales, $99 million due to flooding in Hobart and at least $871 million due to storms in east coast of New South Wales. It is reasonable to predict that the 2018/19 summer will only be more costly in light of recent droughts, fire, heatwaves, flooding and storm events across the continent.
- According to a report by The Australia Institute, the mismanagement of the $13 billion Murray Darling Basin Plan by the NSW Government resulted in the death of at least one million native fish and severe losses for local business. While drought and high temperatures were cited as factors, the improper management of water in the Menindee Lakes was identified as the main reason for the impact on the waterways.[32]
- The Banking Royal Commission has highlighted a series of regulatory failures, deceptive behaviours and conflicts of interest in Australia's banking and financial services industry. Consumers and shareholders have already begun filing lawsuits in response to the findings.[33] Although Commissioner Hayne's report criticises the improper activities of the Big Four banks, the recommendations were not as hard on the banking sector as expected by the public. The share price of banks surged after the recommendations were released, signifying their biggest day increase in value in history.[34]

Challenges thrown at societies and governments around the world are increasingly complex and are by no means easy to address. However, that we have reached crisis point sadly is no surprise to many experts in their respective fields. With climate change, globalisation and technological disruption continuing at pace, these challenges won't get easier, and investors are starting to recognise the increased importance of sound policy action, in addition to market responses.

The Impact on Investment

Investors must use their influence to support companies that aren't obstructing much-needed policy reforms, and empower them to speak out against peer companies that are blocking such actions. Trust is essential if our society is to work collectively to address the monumental environmental and social challenges we face over the next few decades.

Investors should consider the following questions when engaging with companies on issues of trust and influence:

- Have you conducted a review of your lobby group memberships?
- Do you publicly disclose your lobby group memberships?
- Are you aware of points of difference between your company and the lobby groups you are a member of?

Investors should also consider their stewardship practices and take more accountability for AGM voting decisions, particularly those where there is a clear ESG component in the motion being put forward.

WE ROBOT: AUTOMATION AND THE FUTURE OF WORK

Duncan Paterson

Advancements in the materials, software and robotic industries are driving an explosion in the take-up of automation technologies across the global workforce.

While mechanisation and the rise of machine-based working environments have traditionally had their primary impacts in the blue collar and manual labour sectors, the latest wave of automation is more pervasive – the rise of big data, machine learning and advanced algorithms means that all sectors of the economy will be impacted to some extent.

As is the case with all new technologies, the nature of the impacts will be mixed. Investors are preparing for opportunities in new growth sectors, but responsible investors will also need to be mindful of the potential negative repercussions for those elements of the workforce who find their jobs evaporating.

Is this the future?

They say that all journeys start with a single step – the relentless march of automation is well underway, however.

With a large wages bill, a high proportion of FIFO workers, and a comparatively high level of OH&S risks on site, Australia's mining sector has been an enthusiastic early adopter of automation technologies. Australian company Rio Tinto is a leader in the implementation of new technologies in their remote workplaces, with 400 people employed in a Perth office controlling operations at 16 mines, 4 port facilities and 1,700 kilometres of rail.[35]

When looking at the sorts of work that can be automated, it has long been axiomatic that while production-line style jobs are readily automated, tasks requiring more dexterity and judgment were less likely to be lost to automation. Recent work by an Australian industry body may put the lie to this belief, however.

In a collaboration with University of Technology in Sydney, the wool industry's research and development body Australian Wool Innovation (AWI) is incorporating automation into the Australian shearing sheds, with the aim of developing a fully automated wool-harvesting production line in 4 years.[36]

If a task as complex as shearing a sheep is in the sights of automation technologies, it becomes harder to imagine manual tasks that can't be undertaken by a robot. Even human-facing services are rolling out algorithm-driven product lines, such as the job interview AI being developed by Sydney-based startup Curious Thing.[37]

The Pros and Cons

Advocates of automation highlight the benefits that the technology will bring to the economy, environment and to society, including increased workplace productivity, lower operating costs, improved human safety and more leisure time.

It is likely that investors who are able to accurately predict the corporate winners from coming waves of automation will enjoy higher returns. Australian fund management firm Nanuk Asset Management have been early movers in this space, predicting that lowering cost of robot production will lead to rising affordability and a virtuous circle of demand and production.[38]

While it is generally agreed that there are large economic opportunities associated with an increase in the use of automation technologies, it is not as clear that the impacts on society will be as positive.

A recent McKinsey report has estimated that a rapid uptake of automation in the workplace will lead to the loss of up to 800 million jobs globally.[39] While they also predict that a large number of new roles will be created, there is a risk that unless considerable investment is made in training and upskilling, a 2-tiered employment market will be created, with benefits for high-paid and cognitive roles but a shrinking opportunity pool for physical or repetitive labour.

Responsible investors also need to be mindful that the impacts on employment will impact some sectors disproportionately, with the associated reputation issues that go with that.

A way forward

The majority of commentators acknowledge that the genie is well and truly out of the bottle when it comes to automation. The question now is how to make sure that the changes that will be taking place in global workplaces lead to the best possible outcomes for workers and society in general.

Education and re-training of workers constitutes one of the most important tools to assist in this process. Global civil society is already taking steps to develop frameworks and lobby for more investment in re-skilling – examples include the International Labour Organisation's Global Commission on the Future of Work[40] and in the UK the Fabian Society's Commission on Workers and Technology.[41]

At a corporate level, we have seen the mining industry investing directly in the re-training of workers for new automation-related roles, but beyond that, there has not been a lot of noise in terms of direct action.

While training will play a key role, we must also be prepared for some broader fundamental changes in the way society thinks about work and the role of the state in supporting people who are unable to make the transition to a future workplace. This will pose significant challenges in a political environment that has seen populist political messages around the globe demonising the unemployed.

In a future where there are less jobs to go around, one solution is to reduce the amount of hours that people work – resulting in a more even spread of opportunity across the society. Anthony Veal from the University of Technology in Sydney has recently suggested that a reduction in the working week from 40 to 15 hours would address the challenges posed by a future workplace dominated by automation, as well as dealing with issues plaguing Western society around stress and over-work.[42]

Another radical suggestion that is gaining currency at the moment is the adoption of a universal basic income, whereby the state supports all members of society with a living wage, allowing people to move away from paid work and focus on alternative activities.[43]

While all of the above measures will pose economic and practical challenges for society, it is likely that some form of each of them will be required if our society is to remain stable in the face of a rapid change in the labour market.

The Impact on Investment

While the obvious role for investors is to ensure that their portfolios maximise returns from these emerging new workplace paradigms, responsible investors need to be mindful of the long-terms societal risks associated with a poorly managed transition to automated workplaces.

Investors engaging with companies on this topic could consider asking questions such as:

- How transparent are companies being about their own plans for workforce downsizing?
- Has the company made a commitment to re-training and re-deployment of workers within their organisations?
- Is the company's representative industry body taking a progressive position in in terms of encouraging government investment in social security measures, and in debates around issues like changes to existing working hours and related workplace practices?

If these risks are management appropriately, then the future workplace will be one that is productive for employers and rewarding for employees. If not, there is a risk that future societies will be characterised by a significant disparity between high and low-income people, with the potential for conflict and disharmony that implies.

WATER AVAILABILITY AND MANAGEMENT

Emily Faithfull

The term 'water risk' — defined as 'the effect of water-related uncertainty on an organisation's objectives'[44] — has become increasingly ubiquitous in the ESG arena in 2018. Never before has the corporate world had such cause to concern itself with water management. Several key factors — namely, climate change, population growth and unsustainable production and consumption patterns — threaten this finite resource. It is imperative that we ensure the sustainable and equitable use of water, a task in which investors have a role to play.

The Shift from Regulatory Risk

While in past decades regulatory bodies have posed the most serious threat to a company's water use, today, companies face equal pressure from multiple stakeholders. The physical risks posed by water stress have the potential to be damaging to not only the planet, but to human rights and business operations across sectors. Aside from the obvious environmental damage posed by unsustainable production and consumption of water, an array of social, financial, and reputational risks exist concomitant to water risk.

Every business activity requires fresh water to some degree; however, some business sectors, such as the water-intensive operations of mining companies (which often take place in water-scarce regions) are more exposed to water risk than others. Consider the contentious planned operations of Adani's Carmichael mine in Queensland, which plans to draw 12.5 billion litres of water from the Suttor River each year – roughly equivalent to the water use of all local farmers combined.[45]

Having been granted unlimited groundwater access by the Queensland government for the next sixty years,[46] regulatory risk is certainly not Adani's most pressing water-related issue. The Indian mining giant has faced nationwide uproar, particularly from farmers and indigenous rights groups, who continue to highlight the human rights risks posed by such unsustainable water consumption. Alongside increased public awareness of water management issues,[47] Adani's operations have attracted a series of legal and environmental disputes, which have already led to a serious scale-down from the original plan for the mine.[48] Moreover, the company's reputation in Australia lies in tatters.

Water-intensive industries cannot continue their current operations indefinitely; companies must be prepared to adapt. Regulatory bodies no longer pose the most serious threat to companies' unsustainable water use; today, environmental, social, reputational, and financial realities serve to bring the overambitious down to earth.

Hidden Water Costs

While in some industries, such as mining, the source of water risk is evident; in other industries, one must look more closely at the supply chain in order to detect the real extent of water risk.

Supply chain operations contribute the most to a company's water footprint. These operations often take place in water-stressed regions, where a company has less direct control and water stewardship is more difficult to implement. The supply chain, therefore, constitutes the most important and often the most overlooked element of water management in many industries.[49] For companies with agricultural suppliers, such as those in the food, beverage, or textile industries, this is certainly the case.

PepsiCo, for example, is a food and beverage company that relies heavily on water consumption throughout its largely agricultural supply chain, withdrawing and consuming 92,000 megalitres per year.[50] Further, much of the company's production occurs in India, a water-scarce region. PepsiCo is now a global vanguard company in terms of acting and reporting on water stewardship; having invested significantly in water access solutions, it is on track to achieve its 2025 goal of improving water-use efficiency in its global supply chain by 15% (from 2015).[51]

Comprehensive disclosure of water consumption is an essential step towards water stewardship. To this end, investors should demand transparency from companies as 'hidden' water costs must first be uncovered before they can be addressed.

Considerations & Tools for Investors

With so many factors contributing to water risk, and so many hidden water costs, how should the conscientious investor proceed?

The CDP Global Water Report (2017) provides six key areas to track regarding a company's water management. These include: transparency surrounding water consumption; board-level governance and oversight of water consumption; measuring and monitoring water withdrawals, discharges, quality, and consumption; water risk assessment (across the supply chain); setting and achieving targets and goals to reduce water impact; and engaging with suppliers across the supply chain regarding water management.[52] Engaging with a company on these criteria will allow an investor to ensure the company is making genuine and critical efforts towards water stewardship.

A series of tools exist which allow investors to incorporate water stewardship into the decision-making process. These are summarised in the table below:

Table 1 Water Stewardship Tools for Investors

Tool	Creator	Function	Link
CDP Water Disclosure	Carbon Disclosure Project (CDP)	Provides critical water management data on disclosing companies.	https://www.cdp.net/en/water
Investor Water Toolkit	Ceres	Essentially a how-to-guide for investors to understand how to integrate water risk into their portfolio management.	https://www.ceres.org/resources/toolkits/investor-water-toolkit?toolkit=view
Aqua Gauge	Ceres	A downloadable, Excel-based tool and associated methodology that allows investors to evaluate, scorecard and compare a company's water management activities.	https://www.ceres.org/resources/tools/ceres-aqua-gauge-comprehensive-assessment-tool-evaluating-corporate-management
Aqueduct	World Resources Institute (WRI)	Provides interactive layered maps, which allow investors to assess water risk based on region of operation and sector, as well as by type of stress.	https://www.wri.org/our-work/project/aqueduct/
Water Risk Filter	World Wildlife Fund (WWF)	Provides interactive layered maps with a variety of risk layers (physical, regulatory, reputational, and specific environmental risks).	http://waterriskfilter.panda.org/

For more information about these tools see Appendix 1.

The Impact on Investment

The need to confront water risk is becoming increasingly urgent. By 2030, the UN predicts a 40% shortfall of the current global water supply.[53] Moving forward, investors should strive to support companies (across all sectors) that engage actively with water stewardship. Supply chains must be examined — not only in terms of the nature of activity undertaken, but the location in which it is conducted — in order to properly assess a company's water footprint.

Investors should consider the following questions when engaging with companies on water use and management:

- How is the company using water? Where does it fall in the value chain?
- Where is the company using water? How abundant is water there?
- What is the company doing to manage and mitigate water risks?
- Has the company prepared for the possibility of insufficient water supply for its operations?

The answers to these questions will be of great consequence in determining a company's environmental and financial sustainability into the future.

DON'T WASTE YOUR INVESTMENTS

Justine Muller

The amount of waste we produce is rising and it is having a significant impact on our eco-system. Discussions around possible waste management solutions are high on the agenda, especially in light of the recent bans on foreign imports of waste introduced by China and other Southeast Asian countries. Australia, which used to redirect the bulk of its waste to China (until January 2018), now faces increasing pressure to develop an adequate waste management system to deal with a rising stockpile of waste. CAER believes 2019 represents a turning point for waste management.

Socio-environmental impact of waste and emerging risks for companies

An increase in population commonly leads to an increase in waste. "It is therefore unsurprising that waste generated in Australia has increased significantly over the last decade: in 2006–07, 57 million tonnes of waste was generated; in 2014–15 this had increased to 64 million tonnes."[54]

Amongst all types of waste, plastic pollution is of utmost concern, largely due to its quantity, low value and non-degradable nature. Companies who contribute significantly to plastic pollution are exposed to serious material business risks including[55]:

- **Reputational risks** as they can be perceived as exacerbating the problem.
- **Transition risks** as the waste crisis deepens, fast-moving regulation toward a circular economy will require a rapid response and potential operational overhauls.
- **Physical risks** from the presence of plastic pollution impacting infrastructures, workforce productivity and supply chain leading to resource scarcity and impacts on other industries such as aquaculture (fish catch and vessel damages).
- **Liability risks** if the enterprise isn't able to face legal challenges from parties having experienced loss or damage due to plastic pollution. Insurance companies protect themselves from potential liabilities which could include plastic pollution.

Although the recycling of materials is increasing, "landfills and incinerators are widely used to manage the final phase of waste disposal"[56]. For this reason, reducing the amount of disposable waste produced alongside developing innovative technologies to reclaim and reuse waste are imperative to preserving our planet.

A shift in Australia's attitude toward waste and resources

One year on from the China ban, the recycling market is struggling to deal with the amount of waste generated and Australia is still thinking about its domestic processing capabilities[57] and the potential to create jobs in this sector. The main problem resides in the fact that multi-million-dollar facilities are not easily built without the insurance of an existing market.

To reduce waste to landfill and encourage recycling, a range of measures have been taken in Australia so far:

- The 2018 National Waste Policy provides a strategic national framework and principles for waste management and resource recovery in a circular economy to 2020[58]. The report mentions that information 'on where Australia's waste comes from and where it goes' needs improvement with such data being "critical to business investment" and influencing consumer behaviour'[59].
- In addition, the Product Stewardship Act 2011 provides a framework to effectively manage the environmental, health and safety impacts of products - in particular, those impacts associated with the disposal of products.
- A local initiative run by the NSW government entitled "Waste Less, Recycle More" is Australia's largest waste and recycling program funded through the waste levy[60], delivering value-for-money waste infrastructure for households and business. The introduction of the container deposit schemes is also a great illustration of the government's commitment.

It is likely that the trend towards plastic reduction will be legally reinforced in the coming years[61] influenced by the multiplication of advocacy groups tackling plastic pollution — like Greenpeace's campaign #banthebag[62] — and by consumer behavior. These changes will have a significant impact for all companies with plastic in their supply chain, as they will be more vulnerable to the financial risks with not being able adjust their operations to new regulations.

Companies like Coles and Woolworths are already facing increased pressure to minimise plastic packaging. According to Hermes and Impax, "firms such as Pepsi, Unilever, Nestle, and Coke, which have been found to be among the top sources of waste in countries with insufficient collection infrastructure, face significant and material reputational risk[63]".

A space of opportunities for companies in Australia

An upside to the dysfunction of Australia's recycling industry are the opportunities available to companies.

An Opportunity to Re-evaluate

The waste crisis provides an opportunity for some manufacturers to re-think their entire operations — from their products, and services to their client relationships — to create a more "environmentally friendly product" and reduce production costs. Forward looking businesses are already implementing product stewardship principles by minimising their products' environmental impact throughout all stages of its life cycle. Eliminating waste throughout the manufacturing process can be beneficial as a means of minimising disposal costs.

Qantas Airways has set a target of 30% reduction of waste to landfill by 2020. To achieve this the company has introduced recycling on international services and reduced plastic on every flight with the launch of plastic-free headsets and pyjamas. With millions of tonnes of passenger waste produced per year the company has become sensitised to consumer pressure and undoubtedly the cost of waste disposal[64].

An Opportunity to be Innovative

The problem of dealing with waste can be reframed as an opportunity to innovate, pushing companies to maximise its value. For instance, there is a latent market in Australia for waste-to-energy facilities[65]. Leader in the space, Macquarie's plants will be the first of its kind to turn waste into energy for commercial sale in Australia[66]. French utility company Suez has also reached an agreement to supply a waste-to-energy plant close to Perth[67].

Leading the way in reducing operating costs, driving emission reduction, aligning with customer advocacy and creating new business opportunities, Telstra has deployed several means to reduce its energy consumption and related CO2 emissions, like upgrading and redesigning their old network sites. The company has also introduced an electronics reuse and recycling strategy (FY2017-19) to apply product stewardship and circular economy principles to E-waste generated in their supply chain and offers Telstra customers the opportunity to recycle their E-waste.[68]

The Impact on Investment

The goal of transforming the waste sector into a regenerative system where resource usage, emissions, and waste are reduced cannot be achieved without increased investment. Minimising waste generation requires innovation in product design, production processes, resource recovery, remanufacturing, recycling, and final treatment – much of which requires new or adjusted facilities.

When engaging with companies on waste, investors should consider the following:

- What is the company's approach to reducing hazardous waste?
- How is the company managing its environmental impacts regarding use and disposal of products/services?
- Is the company providing services that will help solve the waste problem, including waste collection and waste treatment?
- Has the company prepared for the possibility of a change in regulation?
- Is the company engaging with consumer demand?

APPENDIX - WATER RISK TOOLS FOR INVESTORS

Incorporating notions of water risk and water stewardship into your portfolio is more important than ever. However, a lack of information, or method of navigating available information, can make this a tricky task. Here are a few tools to help the conscientious investor integrate water sustainability into the decision-making process.

CDP Water Disclosure

CDP pushes companies to disclose comprehensive details and targets regarding their water management, fostering accountability and transparency within water stewardship. For investors, CDP provides critical environmental data on disclosing companies, in order to integrate sustainability within the investment process.

https://www.cdp.net/en/water

The Ceres Investor Water Toolkit

Essentially a how-to-guide for investors to understand how to integrate water risk into their portfolio management. Includes an array of useful information and frameworks for assessing water risk, establishing priorities, and engaging with companies, as well as providing comprehensive case studies to help the investor develop a water-sustainable portfolio.

https://www.ceres.org/resources/toolkits/investor-water-toolkit?toolkit=view

Ceres' Aqua Gauge

For investors, Aqua Gauge includes a downloadable, Excel-based tool and associated methodology that allows investors to evaluate, scorecard and compare a company's water management activities against informed criteria of leading practice, based on a company's publicly available information.

https://www.ceres.org/resources/tools/ceres-aqua-gauge-comprehensive-assessment-tool-evaluating-corporate-management

The World Resources Institute's 'Aqueduct' Tool

Provides interactive layered maps which allow investors to assess water risk based on region of operation and sector, as well as by type of stress (physical risk to quantity, physical risk to quality, regulatory and reputational risk). Aqueduct also provides projected water stress data (change in seasonal variability, water supply and demand) with climate scenarios by outlook (optimistic, business as usual, or pessimistic). An engaging and easy-to-use tool, particularly for assessing regions and sectors.

https://www.wri.org/our-work/project/aqueduct/

The World Wildlife Fund's Water Risk Filter

Provides interactive world maps with a comprehensive set of risk layers (physical, regulatory, reputational, and a series of specific environmental risks). Also provides an assessment tool allowing investors to assess a company's water risk based on both the relevant river basin (though only a select number of river basins' data is available), and the nature of operations. Risks can then be analysed visually, and the user can be directed to a customized set of risk responses. Also developing a value tool, which will allow investors to calculate the financial implications of water risk.

http://waterriskfilter.panda.org/

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