

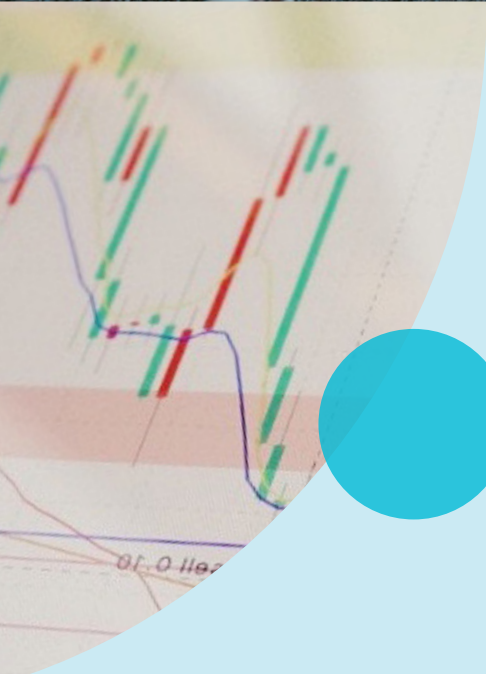


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Australian Ethical is publicly listed with \$3.13 billion in funds under management across superannuation and managed funds.

### AXA INVESTMENT MANAGERS



AXA Investment Managers is an active, long-term investor. From equities, fixed income and real assets to alternatives and multi-asset, we marry innovation and risk management in a bid to deliver long-term value for clients. We are responsible investors; we believe that responsible investment not only delivers sustainable, long-term value for clients, it also makes a positive impact on society. This is why we incorporate environmental, social and governance considerations into our investment decisions. We are committed to making investing easier – we want to help investors cut through the noise and empower them to make the right investment choices. We are bringing to bear the power of big data and technology not only to improve our investment offering but to enhance the ways in which we engage with our clients. We manage \$1,185 billion\* on behalf of our clients, with 766 investment professionals in 19 investment centres around the world.

\* as at 31 December 2018



BT is Westpac Group's wealth brand and is one of Australia's leading wealth management organisations. We have been a signatory to the Principles for Responsible Investment since 2007.

BT provides wealth management services to Australians across superannuation, insurance and investments. We focus on how we can help our customers and, in doing so, make a sustainable difference through our industry to achieve better environmental, social and economic outcomes.

BT believes that sustainable investment is intrinsic to the provision of long-term value for our customers and are pleased to continue our sponsorship of RIAA's annual benchmark report.

### TEACHERS MUTUAL BANK LTD

### TEACHERS MUTUAL BANK LIMITED

Teachers Mutual is a values based bank where profit has a purpose. Doing business ethically and sustainably has driven our model of mutual banking for 50 years. Our mission is for the Bank to operate in an ethical and sustainable manner.

Teachers Mutual Bank Limited comprises four brands: the original Teachers Mutual Bank, UniBank, Firefighters Mutual Bank, and Health Professionals Bank. With over 200,000 members and more than \$7.5 billion in assets, we are one of Australia's largest mutual banks.

The Bank's \$1 billion Debt Issuance Programme (DIP) for wholesale investors is a Certified Ethical Investment by RIAA. All new retail mortgage and deposit products sold by the Bank are Certified Responsible Investment products.

## RESEARCH PARTNER

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KPMG has a one of the largest and most respected dedicated sustainability teams in Australia which works with clients to identify, understand, manage and report sustainability risks and opportunities for businesses and investors.

A clear focus on ESG, or pre-financial issues, identifies risks and opportunities that have significant implications for corporate value creation and the investment decision. Companies are under increasing pressure to manage these aspects to protect and create corporate value, and to communicate their impact. We work with organisations to help them manage all emerging risks and opportunities (both financial and pre-financial) in an integrated way to enhance all aspects of risk management, reporting and communication.

## SURVEY RESPONDENTS

We are extremely grateful to the 68 institutions that responded to the survey. They are listed in Appendix 4.

## RESEARCH SUPPORT



# ABOUT THIS REPORT

This is the 18th annual *Responsible Investment Benchmark Report Australia* prepared by the Responsible Investment Association Australasia (RIAA). The report details industry data on the size, growth, depth and performance of the Australian responsible investment (RI) market over the 12 months to 31 December 2018 and compares these results with the broader Australian financial market.

Through this report, RIAA aims to support the ongoing growth of the responsible investment market consistent with our objective of broadening the uptake of RI while increasing the positive impact of investments on society and our environment. By providing clear and transparent data on the development of the market and the implementation of RI strategies, RIAA aims to support more investors undertaking a responsible approach to investment. Furthermore, by identifying the key drivers of increased RI assets under management (AUM) and the barriers to uptake, RIAA works to increase the adoption and quality of RI strategies.

RIAA commissioned KPMG to help undertake the data collection and analysis for this 2019 report. KPMG developed a survey for investment managers across Australia, compiled the data derived from this primary research, undertook secondary research on publicly available data, undertook the environmental, social and corporate governance (ESG) integration assessment based on RIAA's framework, and assisted in the analysis of the data to deliver the size, performance and growth of the responsible investment market.

MarketMeter provided data analysis and database services. MarketMeter is contracted to RIAA to provide in-house research insights and management of its research programme.

The project was led by Rebecca Thompson with support from Nicholas Coles, James Erickson, Samantha Bayes, Mark Spicer and Simon O'Connor. The report was edited by Melanie Scaife and designed by Loupe Studio.

## ABOUT THE RESPONSIBLE INVESTMENT ASSOCIATION AUSTRALASIA

RIAA champions responsible investing and a sustainable financial system in Australia and New Zealand, and is dedicated to ensuring capital is aligned with achieving a healthy society, environment and economy.

With over 240 members managing more than \$9 trillion in assets globally, RIAA is the largest and most active network of people and organisations engaged in responsible, ethical and impact investing across Australia and New Zealand. Our membership includes super funds, fund managers, banks, consultants, researchers, brokers, impact investors, property managers, trusts, foundations, faith-based groups, financial advisers and individuals.

RIAA achieves its mission through:

- providing a strong voice for responsible investors in the region, including influencing policy and regulation to support long-term responsible investment and sustainable capital markets;
- delivering tools for investors and consumers to better understand and navigate towards responsible investment products and advice, including running the world's first and longest-running fund Certification Program, and the online consumer tool Responsible Returns;
- supporting continuous improvement in responsible investment practice among members and the broader industry through education, benchmarking and promotion of best practice and innovation;
- acting as a hub for our members, the broader industry and stakeholders to build capacity, knowledge and collective impact; and
- being a trusted source of information about responsible investment.

# EXECUTIVE SUMMARY

## BACKGROUND

To gauge the size, breadth, depth and performance of responsible investment in Australia, RIAA reviewed the practices of 183 investment managers, with 68 of those assessed directly via survey, and supplementary desktop analysis undertaken across the research universe. The commitment to and interest in this area of finance is evident from the number of investment managers that engaged with this research project. This year, a record number took part in the survey, allowing RIAA to draw more insights from the data than ever before.

This year, for the first time, RIAA canvassed superannuation funds to the extent that they directly manage investments. This acknowledges the growing trend for superannuation funds to bring investment management in-house.

To date, RIAA has classified responsible investment assets under management (AUM) as either 'Core' or 'Broad' to distinguish between those funds that are undertaking a screening, sustainability-themed or impact investment approach (traditionally more aligned with ethical investment) and those that are committed to investing under a

strategy that integrates environmental, social and corporate governance (ESG) factors. As responsible investing is becoming more mainstream, RIAA expects to move away from these classifications and instead focus on best practice across the spectrum of RI strategies. For continuity purposes, the data is presented as Core and Broad in Appendix 1C.

This report details industry data on the size, growth, composition and performance of the Australian RI market over the twelve months to 31 December 2018 and compares these results with the broader Australian financial market.

## KEY FINDINGS

**1 The responsible investment market continues to grow** with associated AUM up 13% over the course of 2018 to \$980 billion. This represents 44% of total professionally managed AUM (TAUM), which now sits at \$2.24 trillion according to the Australian Bureau of Statistics (ABS). Using ABS data to determine the market size for the first time this year has resulted in responsible investment reducing proportionally whilst growing in absolute terms year on year. ABS data will be used going forward, as it better reflects the broader dataset we are drawing upon for this research.

**2 The dominant responsible investment strategy is ESG integration**, which represents 45% of AUM when taking both primary and secondary strategies into account. When nominated as the primary strategy, ESG integration is usually paired with corporate engagement and shareholder action as a secondary strategy.

FIGURE 1: Responsible investment AUM as a proportion of TAUM

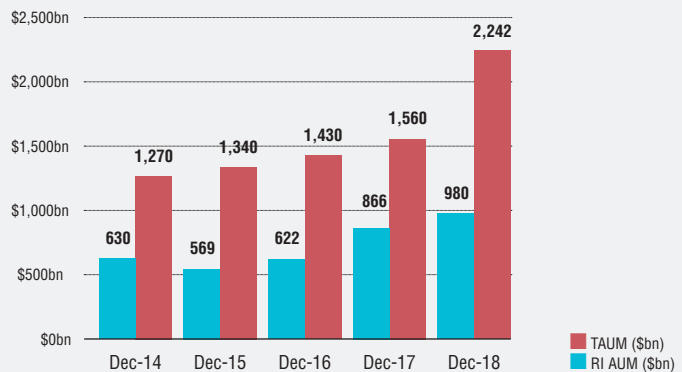
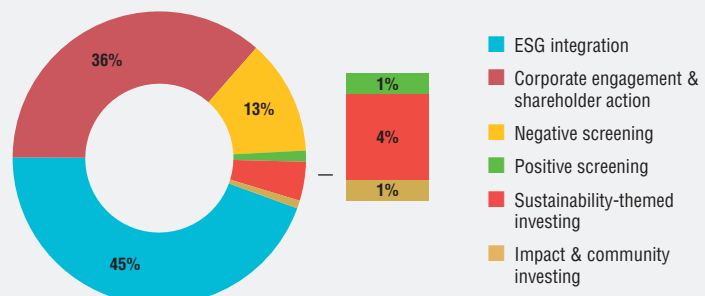
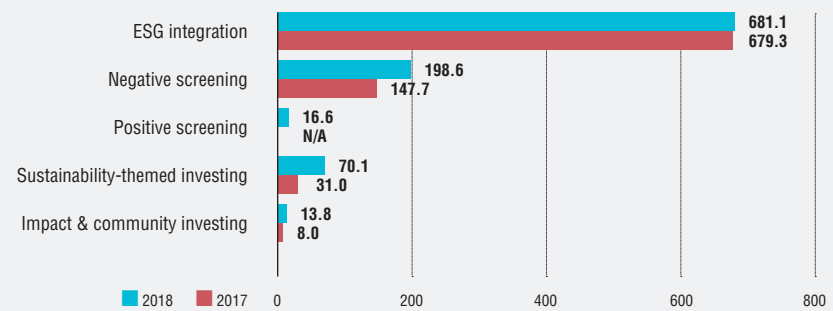


FIGURE 2: Composition of Australian RI market by primary & secondary strategy



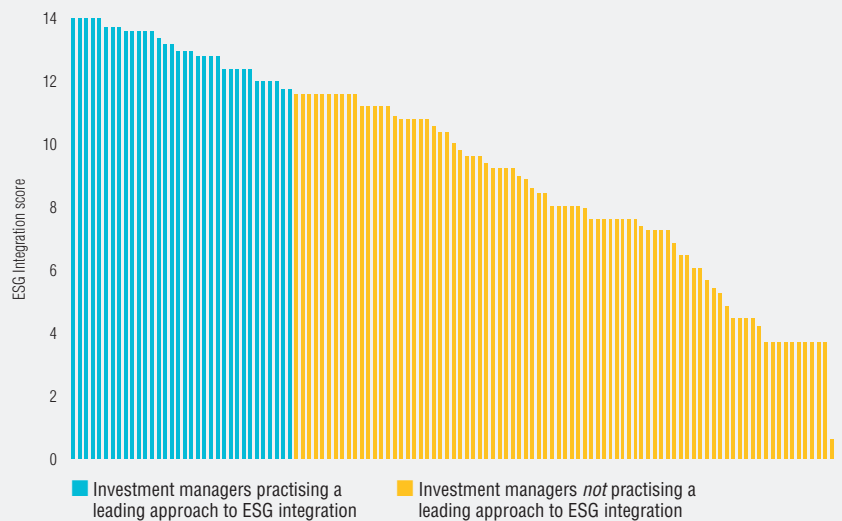
**3 Progression along the responsible investment spectrum is evident.** While there is little growth in the AUM of ESG integration, there is progression along the RI strategy spectrum, with strong growth in screening strategies (both positive and negative) and sustainability-themed investments as well as in impact and community investing.

**FIGURE 3: AUM employed in primary strategies (\$bn)**



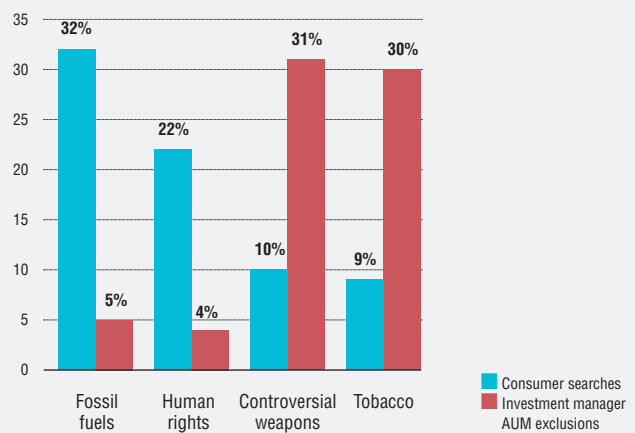
**4 There's a growing number of investment managers applying leading practice ESG integration, but the overall number remains small.** Of the 120 investment managers assessed, 34 (28%) are applying a leading approach to ESG integration (score >80%). The number of leading ESG integration practitioners has risen from 24 last year, with several employing other responsible investment strategies as their primary strategy.

**FIGURE 4: ESG integration scores of the 120 investment managers assessed**



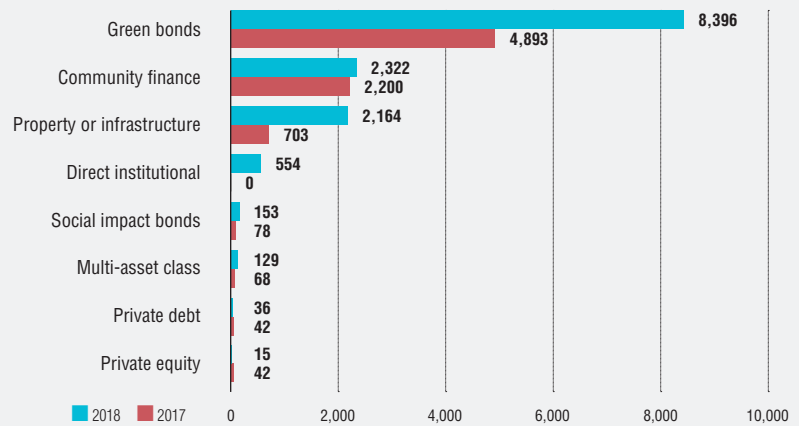
**5 Negative screening is gaining traction** as a strategy, but the exclusions applied by investment managers are not always aligned with what's important to consumers. Controversial weapons and tobacco are the most prevalent exclusionary screens among Australian institutional investors, while consumers using RIAA's Responsible Returns online tool are searching mainly for funds that screen out fossil fuels and human rights violations.

**FIGURE 5: Negative screening: consumer vs investment manager exclusions**



**6 Impact investment growth has accelerated** over the course of 2018 driven by \$2.8 billion of domestic green bond issuance. As a component of impact investment, green bonds now account for \$8.4 billion of the data set.

**FIGURE 6: Impact investing and community investing breakdown (\$m)**



**7 Responsible investment funds outperformed mainstream funds** over most time frames and asset classes. Australian RI share funds outperformed mainstream Australian share fund benchmarks for all periods except the three-year term.

International RI share funds outperformed the Morningstar average mainstream international share fund over every time horizon, as did responsibly managed multi-sector funds against the mainstream multi-sector growth fund average.

**FIGURE 7: Performance of responsible investment and mainstream funds**

Australian share funds	1 Year	3 Years	5 Years	10 Years
Average responsible investment fund (between 17 and 34 funds sampled depending on time period)	-1.24%	5.70%	6.43%	12.39%
Morningstar: Australia Fund Equity Large Blend	-5.49%	4.87%	4.42%	7.95%
S&P/ASX 300 Total Return	-3.06%	6.65%	5.60%	8.91%

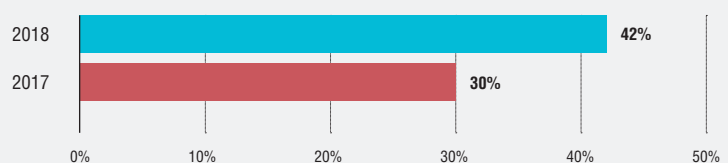
International share funds	1 Year	3 Years	5 Years	10 Years
Average responsible investment fund (between 7 and 38 funds sampled depending on time period)	-0.03%	11.18%	9.48%	9.50%
Morningstar: Equity World Large Blend	-0.68%	6.37%	8.42%	8.97%
MSCI World Ex Australia NR AUD	1.52%	7.49%	9.81%	9.57%

Multi-sector growth funds	1 Year	3 Years	5 Years	10 Years
Average responsible investment fund (7 funds)	-1.13%	4.75%	5.65%	7.66%
Australia Fund Multisector Growth	-2.26%	4.39%	4.92%	7.02%

■ Outperformed by the average RI fund ■ Underperformed by the average RI fund

**8 Retail fund inflows to responsibly managed investment products are evident**, with 42% of surveyed AUM managed on behalf of retail clients in 2018, up from 30% in 2017. This growth story is supported by the 14 new retail investor products certified by RIAA during the course of the year representing \$1.3 billion of retail AUM and bringing the total number of RIAA certified Australian retail products to 88.

**FIGURE 8: Percentage of responsible investment AUM managed on behalf of retail clients**





# ABOUT RESPONSIBLE INVESTMENT

All businesses, and therefore all investments, have an impact on people and the planet, both positive and negative. Responsible investing seeks to minimise the negative effects generated by business and promote positive impacts, ultimately delivering a healthier economy, society and environment and underpinning a stronger investment outcome.

Responsible investing, also known as ethical investing or sustainable investing, is a holistic approach to investing, where environmental, social and corporate governance (ESG) and ethical issues are considered alongside financial performance when making an investment.

Responsible investing considers a broad range of risks and value drivers as part of the investment decision-making process, beyond and in addition to reported financial risk. It is a systematic approach that takes ESG and ethical issues into account throughout the process of researching, analysing, selecting and monitoring investments. It acknowledges that these factors can be critical in understanding the full value of an investment.

## INTERNATIONAL RESPONSIBLE INVESTING CONTEXT

It has been scientifically established that human activities involving the production of carbon dioxide have caused Earth to warm by about 1 degree Celsius above pre-industrial revolution levels. At this rate and with cumulative effects, it is anticipated that Earth will have heated up by 1.5 degrees Celsius as early as 2030. This situation is widely regarded as a tipping point where climate and weather extremes become irreversible, sea levels rise and some ecosystems are permanently lost.

The Intergovernmental Panel on Climate Change published a special report on the 1.5 degrees scenario, which makes clear that unless we rapidly increase our transition towards a more sustainable and low-carbon society, we are within decades

of catastrophic climate change.<sup>1</sup> Large-scale investment is needed in order to direct funding towards sustainable actions.

Globally, momentum is building to better align finance with the world's sustainable development needs. Countries and regions around the world are setting out Sustainable Finance Roadmaps that provide pathways and policy signals and set frameworks to enable the finance sector to contribute more systematically to the transition to a more resilient and sustainable economy, consistent with these global goals.

In March 2018, the European Commission presented its ten-point action plan to enable sustainable growth. Soon after, it put forward three legislative proposals to facilitate and incentivise green and climate-friendly investments.

The Global Sustainable Investment Alliance (GSIA) recently released its biennial *Global Sustainable Investment Review 2018*, showing that global responsible investment assets reached US\$30.7 trillion at the start of 2018, a 34% increase from 2016.<sup>2</sup>

## AUSTRALIAN RESPONSIBLE INVESTING CONTEXT

In Australia, there is greater scrutiny of the role of investment managers in not only delivering attractive long-term financial outcomes for their clients but also their influence and impact on societal and environmental outcomes.

Australian regulators and industry bodies have supported ESG integration and reporting. In a speech delivered in March 2019, Guy Debelle, Deputy Governor of the Reserve Bank of Australia, indicated the first-order economic effects of climate change. Geoff Summerhayes, Executive Board Member of the Australian Prudential Regulation Authority (APRA), identified the need for investors to assess risks and declared "some climate risks are distinctly 'financial' in nature. Many of these risks are

foreseeable, material and actionable now."<sup>3</sup> The Australian Securities and Investments Commission has also publicly acknowledged the distinctly financial threat of climate change and the need for financial institutions to take action to mitigate these risks.

The shift in views of the fiduciary duty of funds, shareholder activism and members demanding more alignment of their investments with their values has stirred increased media attention and fuelled the impetus for funds to seriously consider how they invest in terms of environmental and social factors. Directors have an increasing obligation as part of their fiduciary duty to consider ESG issues in their management of beneficiaries' funds due to changing investor demand and awareness, with global policy settings moving ahead in some jurisdictions to require fiduciaries to consider ESG and climate risks.<sup>4</sup>

In March 2019, a ground-breaking initiative launched: the Australian Sustainable Finance Initiative (ASFI). Its goal is to redefine the financial system to better support economic, social and environmental outcomes. It will develop a set of recommendations to enable the finance sector to contribute more systematically to the transition to a more resilient and sustainable economy, consistent with the United Nations (UN) Sustainable Development Goals and the Paris Agreement on Climate Change.

<sup>1</sup> Intergovernmental Panel on Climate Change, *Global Warming of 1.5° Celsius*, 2018. [https://report.ipcc.ch/sr15/pdf/sr15\\_spm\\_final.pdf](https://report.ipcc.ch/sr15/pdf/sr15_spm_final.pdf)

<sup>2</sup> Global Sustainable Investment Alliance, *Global Sustainable Investment Review 2018*, 2018. [http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR\\_Review2018.3.28.pdf](http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf)

<sup>3</sup> Geoff Summerhayes, 2017. <https://www.apra.gov.au/media-centre/speeches/australias-new-horizon-climate-change-challenges-and-prudential-risk>

<sup>4</sup> UNEP FI & PRI, *Fiduciary duty in the 21st Century*, 2015. <https://www.unpri.org/fiduciary-duty/fiduciary-duty-in-the-21st-century/244.article>

## RESPONSIBLE INVESTMENT STRATEGIES

There are many different ways to engage in responsible investment, as outlined in RIAA's responsible investment spectrum (Figure 9), and investors often use a combination of strategies.

As responsible investment becomes an increasingly sophisticated component of the financial sector, it is guiding the investment approach of a broad range of products and services, from large investment managers that integrate ESG factors into their decision-making to 'deep green' ethical investment funds that apply exclusionary screening criteria over investments, and impact investments that intentionally seek to deliver positive social and environmental outcomes. It includes superannuation funds that apply multiple RI strategies across all asset classes, to the banks taking an ethical and socially minded approach to lending.

Given the volume and variety of responsible investment, superannuation and banking products available in Australia, individual investors are best positioned to determine the products and services most closely aligned to their values and beliefs. Across this responsible investment spectrum, there is a high level of variability in the degree in which these factors are weighted, analysed and incorporated into investment decision-making. Yet to claim to be a responsible investor, it's critical that investment managers can articulate and evidence their own approach and demonstrate a systematic and effective implementation of responsible investment strategy. This underpins much of RIAA's work to define leading practice standards across responsible investment approaches, such as is detailed on ESG integration in this report.

To enable comparison of Australia's responsible investment market with those of other regions, this report has been prepared in line with the seven strategies for responsible investment as detailed by the GSIA and applied in the *Global Sustainable Investment Review 2018*,<sup>5</sup> which maps the growth and size of the global responsible investment market. These strategies are:

- 1 ESG integration
- 2 Corporate engagement and shareholder action
- 3 Negative/exclusionary screening
- 4 Norms-based screening
- 5 Positive/best-in-class screening
- 6 Sustainability-themed investing
- 7 Impact investing and community investing

<sup>5</sup> Global Sustainable Investment Alliance, *Global Sustainable Investment Review 2018*, 2018. [http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR\\_Review2018.3.28.pdf](http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf)

FIGURE 9: RIAA's responsible investment spectrum

CORPORATE ENGAGEMENT & SHAREHOLDER ACTION	TRADITIONAL INVESTMENT	RESPONSIBLE & ETHICAL INVESTMENT							PHILANTHROPY
		ESG INTEGRATION	CORPORATE ENGAGEMENT/SHAREHOLDER ACTION	NEGATIVE SCREENING	SCREENING	POSITIVE/ BEST IN CLASS SCREENING	SUSTAINABILITY-THEMED INVESTMENT	IMPACT INVESTING (& COMMUNITY INVESTING)	
FOCUS	Limited or no regard for ESG factors	Consideration of ESG factors as part of investment decision	Using shareholder power to influence corporate behaviour	Industry sectors or companies excluded/divested to avoid risk and better align with values	Screening out investments that do not meet minimum standards & including investments that meet defined ESG criteria	Investments that target companies or industries with better ESG performance	Investments that specifically target sustainability themes eg: clean energy; green property	Investments that target positive social & environmental impact and provide either a market or below market rate.	Grants that target positive social & environmental impact with no financial return
IMPACT INTENTION	Agnostic	Avoids harm			Benefits stakeholders				
		Contributes to solutions							
FEATURES	Delivers competitive financial returns								
	Manages ESG risks								
							Pursues ESG opportunities		
							Intentionality: delivery of impact is central to underlying asset/investment		
							Impact of investment is measured & reported		

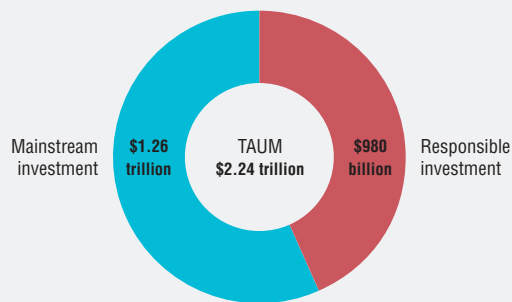
# RESPONSIBLE INVESTMENT STRATEGIES – THE AUSTRALIAN EXPERIENCE

In Australia, the size of the professionally managed investment market (TAUM) as at 31 December 2018 was \$2.24 trillion, according to the Australian Bureau of Statistics (ABS). Figure 10 shows responsible investment strategies were applied across \$980 billion of this universe, representing 44% of TAUM. In this year's report we have moved to using ABS data to determine the market size (TAUM) as it better reflects the broader dataset we are now drawing upon for this research, noting that it has resulted in a decrease in the proportion of responsible investment assets, despite growth in absolute terms.

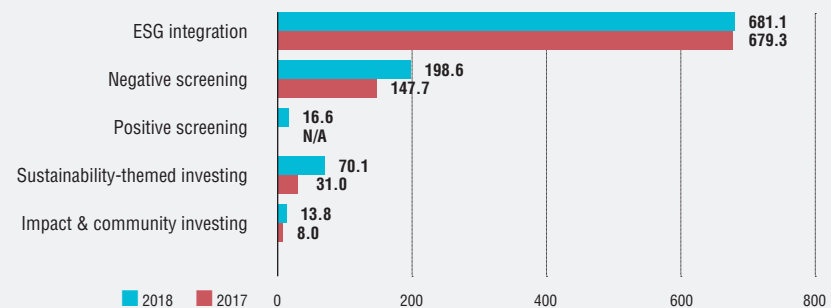
This \$980 billion of responsibly managed AUM represents 13% growth on the \$866 billion recorded at 31 December 2017. While ESG integration still accounts for the majority of RI AUM, there was little growth in the AUM managed by this strategy. However, the number of managers being included has grown from 24 last year to 34 this year (note that only investment managers exhibiting leading practice in ESG integration are included and that some employ other primary RI strategies). Progression along the RI spectrum was a feature of this year's data analysis, with strong growth in screening (both positive and negative) and sustainability-themed investments as well as in impact and community investing, shown in Figure 11.

The dominant primary responsible investment strategy employed in Australia is ESG integration, which is usually accompanied by corporate engagement and shareholder action as a secondary strategy. Results from the survey were skewed towards ESG integration and corporate engagement as only primary and secondary strategies were sought, and these two strategies are often the starting point from which to apply additional RI strategies. Figure 12 shows the composition of the Australian responsible investment market when both primary and secondary strategies are taken into account.

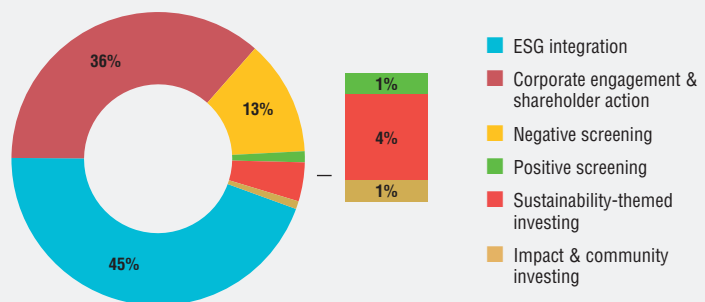
**FIGURE 10: Size and composition of Australian professionally managed investment market (2018)**



**FIGURE 11: AUM employed in primary strategies (\$bn)**

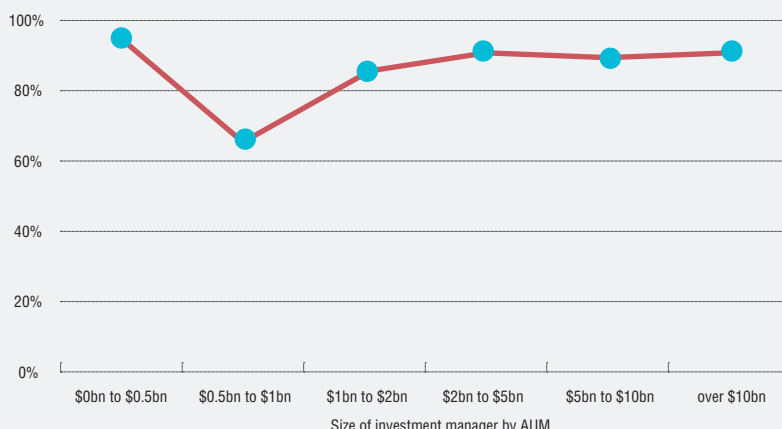


**FIGURE 12: Composition of Australian RI market by primary and secondary strategies (2018)**



To give a wider perspective of and deeper sample for the take up of responsible investment in the region, the depth and breadth of the application of RI strategies was examined spanning both sides of the Tasman, in Australia and New Zealand. Figure 13 shows the majority of investment managers haven't just dipped their foot in the RI water, but have immersed themselves by applying the strategies to more than 80% of their AUM. The data demonstrates that scale is a factor in whether an organisation applies responsible investment strategies to its entire AUM, with smaller, boutique investment managers (<\$0.5 billion) likely to have a single, focused RI fund as their core business and larger investment managers with more dedicated resources able to implement RI strategies across all portfolios.

**FIGURE 13: Degree to which Australasian investment managers engaged in responsible investment apply RI strategies to their AUM**



## 1 ESG INTEGRATION

**ESG integration** involves the systematic and explicit inclusion of environmental, social and governance factors into the investment decision-making process.

### AT A GLANCE

- ESG integration is the most popular RI strategy employed by survey respondents.
- Globally, according to the GSIA, the strategy runs a close second to negative screening and accounts for US\$17.5 trillion AUM.
- In Australia, this strategy represents 45% of AUM when taking both primary and secondary strategies into account. It is predominantly the primary strategy, and is often paired with corporate engagement and shareholder action as the secondary strategy.

- 69% of AUM is managed with ESG integration as a primary strategy, representing \$681.1 billion.
- Of the 120 Australian and international investment managers assessed, 34 (28%) are applying a leading approach to ESG integration. This is up from 24 last year, showing a deepening of practices in ESG integration in Australia.

**ESG integration** continues to dominate in the United States, Canada, Australia and New Zealand in asset-weighted terms. ESG integration is the second largest RI strategy globally (US\$17.5 trillion AUM) after negative/exclusionary screening (US\$19.8 trillion AUM) and has experienced the greatest growth in dollar terms over the past two years.<sup>6</sup> It is interesting to note that ESG integration is the fastest growing RI strategy in Europe, however the strategy is only applied to 19% of the total RI AUM.<sup>7</sup> In contrast, ESG integration in Australia is the most common RI strategy employed with 69% of responsibly managed AUM using this as a primary strategy in 2018.

In the past two years, integrating ESG considerations in the investment strategy has been the subject of much discussion, not only among investors, but also at a policy level. Sometimes this strategy is considered as a general proxy for the RI industry as a whole, which can potentially increase information asymmetry for investors as it oversimplifies an industry that has grown in maturity, sophistication and diversity of approaches over the last decade.<sup>8</sup>

ESG integration can range from a simple, tick-box approach to a well-defined integration strategy systematically embedded in the investment process and valuation practices. Defining and measuring ESG integration practices is challenging due to limited disclosure and a broad variation in depth of integration.

For the purposes of this report – to define the size of the responsible investment market in Australia – RIAA includes only those assets managed by investment managers that are practising a leading approach to ESG integration, rather than all assets managed by organisations that have self-declared they are implementing responsible investment.

For the fifth year in a row, RIAA undertook a desktop review of the following:

- all Australian investment managers that are signatories to the UN-backed Principles for Responsible Investment (PRI) (93 in total, up from 87 investment managers the previous year);

- other investment managers on RIAA's database known to practise ESG integration;
- a selection of international investment managers with strong local presence and ESG credentials.

These 120 self-declared responsible investors were rated against a framework of leading practice to ESG integration. Only those that scored more than 80% have been included in this report. This approach was taken so that only those demonstrating leading practice would be included in determining the size of the Australian responsible investment market.

Refer to Appendix 3 for more information on the ESG scorecard used to analyse whether ESG integration is approached systematically by investment managers.

<sup>6</sup> Global Sustainable Investment Alliance, *Global Sustainable Investment Review 2018*, 2018. [http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR\\_Review2018.3.28.pdf](http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf)

<sup>7</sup> Eurosif, *European SRI Study 2018*, 2018. <http://www.eurosif.org/wp-content/uploads/2018/11/European-SRI-2018-Study.pdf>

<sup>8</sup> Eurosif, *European SRI Study 2018*, 2018. <http://www.eurosif.org/wp-content/uploads/2018/11/European-SRI-2018-Study.pdf>

The results of RIAA's desktop research are summarised in Figure 14, which shows that of the 120 investment managers assessed, 34 (28%) are applying a leading approach to ESG integration in their responsible investment approach. These leading practitioners comprise:

- 22 Australian investment managers
- 12 international investment managers with a significant presence in Australia

The low percentage of inclusion (28%) suggests that many investment managers are yet to provide evidence of a detailed and systematic approach to their commitment to RI. It also highlights the need for the work being conducted internationally (through the European Commission for example) and by ASFI, which both look to ensure better informed financial decision-making by enhancing disclosures and transparency in financial markets.

Indeed, the bar is lifting elsewhere for investment managers to demonstrate the effectiveness of their RI commitments, and be able to evidence their ESG integration practices. In February 2019, the PRI announced to its signatories that it would require them to report on climate change risks from 2020. The PRI's increased disclosure requirements suggest it will focus more intently on the quality of RI practices to manage investment risks. The PRI is also implementing the minimum requirements for existing and future asset owner and investment manager signatories. Failure to meet these requirements by 2020 will result in delisting.

As mentioned, there are 34 investment managers that clearly demonstrate leading practices of ESG integration in their investment process via their policies, their clearly defined approaches to stewardship, their active ownership (including corporate engagement and voting) and their meaningful disclosures. Investment managers in this group comprised some of the largest in Australia through to some of the smaller boutique managers, across asset classes from equities, to property and infrastructure. Figure 15 lists these leading investment managers and outlines the ESG scores achieved together with the AUM represented.

FIGURE 14: ESG integration scores of the 120 investment managers assessed

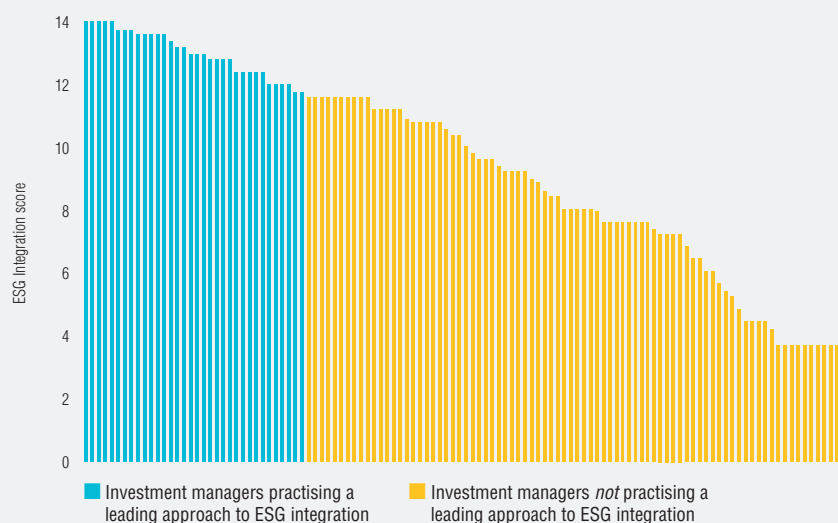
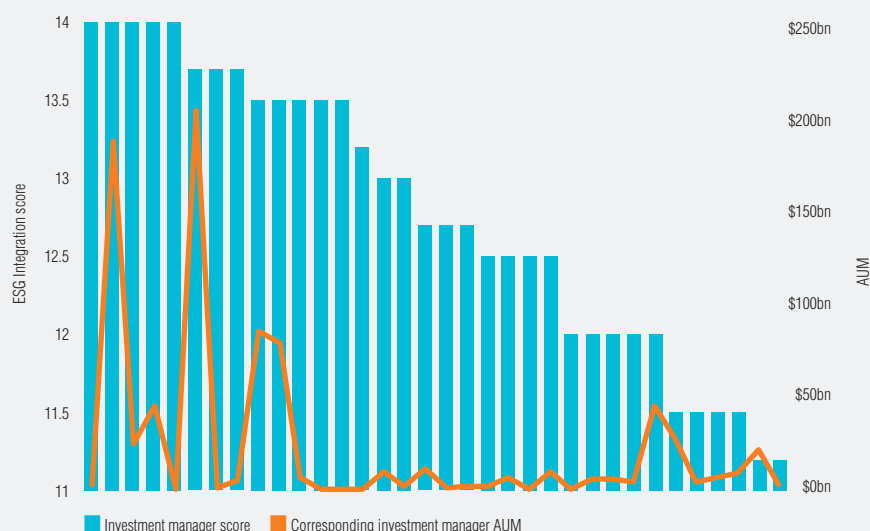


FIGURE 15: Leading investment managers and their ESG integration scores



**Australian investment managers**

- AMP Capital Investors
- Ausbil Investment Management
- Australian Ethical Investment
- CFSGAM
- Dexus
- IFM Investors
- Investa Property Group
- JCP Investment Partners
- Lendlease Investment Management
- Magellan Financial Group
- Maple-Brown Abbott

- Mercer Australia
- New Forests
- Pendal
- Perpetual Investments
- QIC
- RARE Infrastructure
- Resolution Capital
- Solaris Investment Management
- Stewart Investors
- Stafford Capital Partners
- U Ethical Funds Management
- WaveStone Capital

**International investment managers**

- Aberdeen Standard Investments
- AllianceBernstein
- Amundi Asset Management
- AXA Investment Managers
- BlackRock
- BNP Paribas Asset Management
- Franklin Templeton
- Nikko Asset Management
- Robeco
- Russell Investments
- TIAA-CREF

## 2 CORPORATE ENGAGEMENT & SHAREHOLDER ACTION

**Corporate engagement and shareholder action** refers to the employment of shareholder power to influence corporate behaviour. This may be conducted through direct corporate engagement such as communications with senior management or boards, filing or co-filing shareholder proposals, and proxy voting in alignment with comprehensive ESG guidelines.

**Corporate engagement and shareholder action** is the second most popular responsible investment strategy in Australia. It is generally employed as a secondary strategy in conjunction with ESG integration and is considered a critical component of good stewardship and active ownership.

This RI strategy is the third largest globally (US\$9.8 trillion AUM) after negative/exclusionary screening (US\$19.8 trillion AUM) and ESG Integration (US\$17.5 trillion AUM).<sup>9</sup>

Active ownership refers to the manner in which investors use their formal rights (proxy voting and filing shareholder resolutions) and their position as an investor to influence the activity or behaviour of companies or other entities. The use of this strategy gives a clear indication of the investors' willingness to engage with the companies they invest in and positively contribute to the sustainability of their business model.

Voting and corporate engagement are critical components of good stewardship and are fundamental to most investment managers' processes. At high level, these activities can be regarded as 'business as usual' given active investment managers of sufficient size would generally meet with company management teams post-profit results to better understand the details and would also meet with board members pre-AGM to examine upcoming resolutions. Likewise, voting at AGMs is standard procedure for the majority of professional investors. Consequently, it would appear relatively easy for an investment manager to tick this particular box, however, to deliver well on this strategy requires a systematic process that guides the ESG component of corporate engagement and voting.

Institutional investors should have a clear policy on voting and report periodically on their stewardship and voting activities. The

### AT A GLANCE

- Corporate engagement and shareholder action represents the second most popular RI strategy (36% of AUM).
- It is mostly employed as a secondary strategy with ESG integration as the primary strategy.
- No AUM is being managed with corporate engagement and shareholder action as a primary strategy in Australia.
- 84% of AUM is being managed with corporate engagement and shareholder action as a secondary strategy in Australia.
- 23% (28 out of the 120 scored) of the Australian and international investment managers had public evidence of activity in areas of active ownership and stewardship.

desktop research conducted found that 23% (28 out of the 120 scored) of the Australian and international investment managers had public evidence of activity in areas of active ownership and stewardship such as proxy voting and corporate engagements. Breaking down these 28 investment managers into domestic and international shows that Australian investment managers have some work to do with regard to transparency with only:

- 17% of the Australian investment managers demonstrating leading practice, versus
- 65% of the international investment managers demonstrating leading practice.

Clearly international investment managers are stronger at demonstrating their active ownership practices than Australian managers. This can be seen in the very detailed engagement and voting reports that are published by European managers in particular, with only some Australian managers disclosing these activities. Specifically, the recent introduction in Australia of stewardship codes - ACSI's Australia Asset Owner Stewardship Code and the FSC's Principles of Internal Governance and Asset Stewardship - will continue to grow the importance and use of corporate engagement as an RI strategy.

Many countries have now introduced regulations and codes requiring institutional investors to take account of ESG issues in their investment decision-making. These changes – in investment practice and in public policy – demonstrate there are positive duties on investors to integrate ESG issues. The work of the European Commission, following the recommendations of the High-Level Expert Group, has clarified investors' duties, which is leading to the ongoing growth of this RI strategy across most countries. In Australia, the Financial

Services Council's 'Standard No. 13: Voting Policy, Voting Record and Disclosure' sets out the minimum standards on voting disclosure and ESG risk reporting.<sup>10</sup> ASFI will also be looking to embed sustainability considerations into financial markets through fiduciary duties.

The link between this RI strategy and fiduciary duty is substantial as it revolves around the relationship between stewards of assets – shareholders – and their accountability to beneficiaries. Recent evidence suggests that investors have proven they have the power to bring about changes in company behaviour when they engage with them on ESG issues. A recent Australian example involves a number of Australia's biggest superannuation funds engaging through the Climate Action 100+. After engagement by this collaborative investor initiative, Glencore committed to not grow coal production capacity beyond current levels and prioritise future capital expenditure and investments in commodities essential to the energy and mobility transition. The company started to align its business and investments with the goals of the Paris Agreement.<sup>11</sup>

There are limits to investor pressure; policymakers have a key role to play as well, and need to work together with investors. As such, ASFI will also be focusing on policy levers to mobilise capital towards more sustainable challenges and opportunities.

While it has been established that the strategy of corporate engagement and shareholder action is the foundation of good stewardship, there are some additional reasons that institutional investors readily embrace this activity. In the case of passive index funds, they need to advocate because there is no capacity for them to sell their shares if they are unhappy with management performance. When it comes to active investment managers, they have been losing market share to the passive funds and are under increasing pressure to demonstrate engagement to justify relatively higher fees. And then there are the activist hedge funds that make a business out of taking positions and taking on company management. With these dynamics, corporate engagement and shareholder action as a strategy is likely to continue to gain ground globally.

<sup>9</sup> Global Sustainable Investment Alliance, *Global Sustainable Investment Review 2018*, 2018. [http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR\\_Review2018.3.28.pdf](http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf)

<sup>10</sup> Financial Services Council, 'Standard No. 13: Voting Policy, Voting Record and Disclosure', 2019. <https://www.fsc.org.au/resources/standards>

<sup>11</sup> *Financial Review*, 'AustralianSuper targets dirty dozen in Climate Action 100+ push', 2019. <https://www.afr.com/personal-finance/superannuation-and-smsfs/australiansuper-takes-leading-role-in-climate-action-100-push-on-australian-companies-20190221-h1bjkl>

### 3 NEGATIVE/EXCLUSIONARY SCREENING

**Negative/exclusionary** screening is the systematic exclusion from a fund or portfolio of certain sectors, companies or practices based on specific ESG criteria, such as what goods and services a company produces, or how inadequate a company or country response is to emergent risks such as climate change impacts. This approach is also referred to as values-based or ethical screening.

#### AT A GLANCE

- Negative/exclusionary screening represents 13% of AUM when taking both primary and secondary strategies into account.
- It ranks third in popularity with Australian investment managers; this contrasts with the global situation where it is the most popular RI strategy.<sup>12</sup>
- Almost half the growth in Australian RI was due to the adoption of negative screening as a primary strategy, which now represents \$199 billion AUM, up 34% on last year.

- The most popular institutional exclusions weighted by AUM are for controversial weapons (31%) and tobacco (30%).
- The next most commonly excluded activities are gambling and fossil fuels.
- The screens employed by investment managers are slightly at odds with those most regularly sought by consumers using RIAA's Responsible Returns online tool.
- During 2018, consumers were most keen for funds to screen out fossil fuels (32%) followed by avoiding investments that violate human rights (22%).

Controversial weapons and tobacco are the most prevalent **exclusionary screens** among Australian institutional investors, both by the number of funds applying the screens (see Figure 16) and by the AUM of the funds employing the screen (see Figure 17). Figure 16 also shows an overall increase in the number of issues screened, with junk food and Genetically Modified Organisms (GMOs) coming into the mix this year and exclusions for animal welfare, predatory lending and environmental/ climate change issues becoming increasingly popular. The rise in the frequency of screening for environmental and climate change issues is likely driven by a heightened focus on climate risks in portfolios associated with activity of the

Task Force on Climate-related Financial Disclosures (TCFD) and APRA in the last few years.

For domestic equities funds, controversial weapons and tobacco exclusions are relatively easy to apply as listed controversial weapons manufacturers and tobacco producers are not a feature of the ASX200. From an international equity fund perspective, however, these exclusions are highly relevant.

In the case of tobacco exclusions, while there are no ASX-listed companies that produce tobacco, further down the supply chain there are some large cap listed Australian companies involved in the packaging and distribution of tobacco.

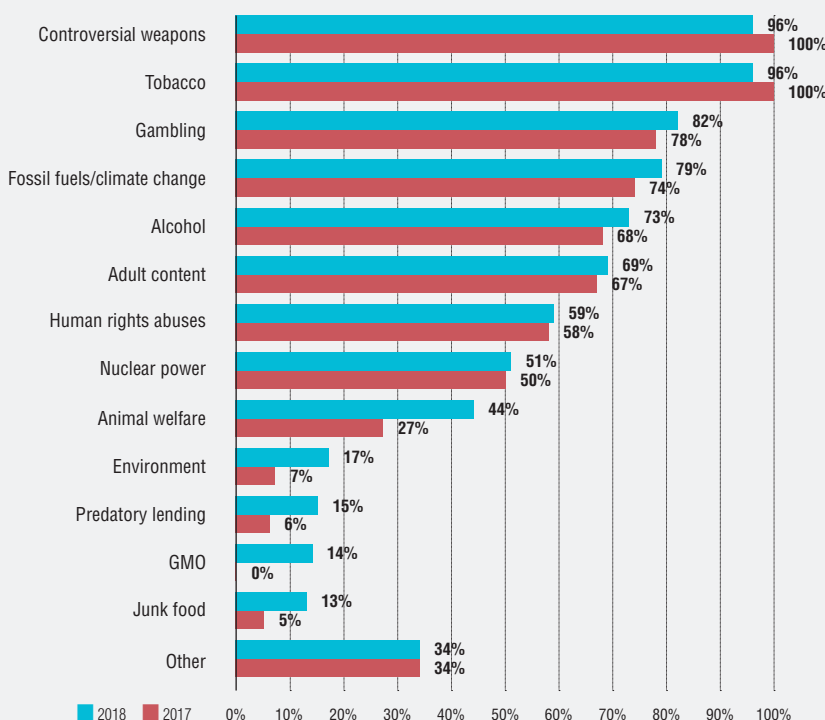
It's here that definitions and materiality thresholds come into play. Tobacco and its negative health impact is a black-and-white case, however, when it comes to investment screening, there are shades of grey.

The relevance of investment in weapons manufacturing and distribution came into sharp focus in New Zealand in the wake of the mass shootings in Christchurch. NZ Super Fund acted swiftly in the wake of this human tragedy to exclude companies involved in the manufacture of civilian automatic and semi-automatic firearms, magazines or parts prohibited under New Zealand law. The move reflected the passing of the Arms (Prohibited Firearms, Magazines and Parts) Amendment Bill in Parliament on 10 April 2019. As a consequence, the fund has divested NZ\$19 million of international equity investments in American Outdoor Brands Corporation, Daicel Corporation, NOF Corp, OLIN Corp, Richemont, Sturm, Ruger & Company and Vista Outdoor Inc.

In New Zealand, the Arms Amendment Bill does not prohibit investment in weapons, however, some funds may interpret their mandates in relation to New Zealand laws as reason to divest. The situation is more clear-cut when it comes to investment in companies that produce cluster munitions, an activity that is criminalised in New Zealand since it enacted laws after becoming a party to the international treaty, Convention on Cluster Munitions. Many New Zealand based managers refer to the NZ Super Fund exclusions list in the determination of their own responsible investing strategies.

While it is without doubt that controversial weapons and tobacco are harmful to society, and that it stands to reason that many institutional responsible investors

FIGURE 16: Frequency of issues being screened (by number of survey respondents)



<sup>12</sup> Global Sustainable Investment Alliance, *Global Sustainable Investment Review 2018*, 2018. [http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR\\_Review2018.3.28.pdf](http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf)

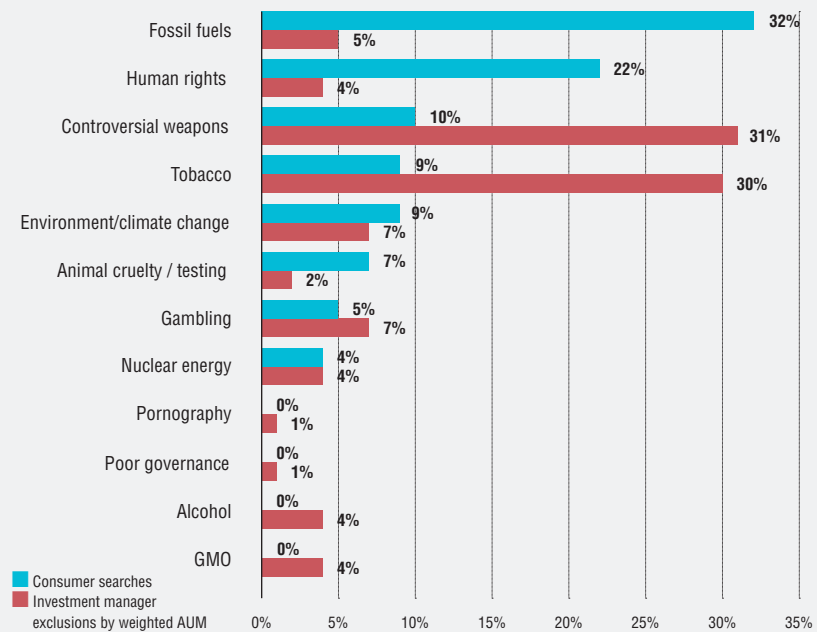
screen associated companies out of their portfolios, these are not the industries that are top of mind for consumers who want to align their investments with their values. RIAA's Responsible Returns online tool ([www.responsiblereturns.com.au](http://www.responsiblereturns.com.au)) helps consumers find, compare and choose responsible and ethical superannuation, banking and investment products that best match their interests. The online tool attracts more than 800 unique visitors per month and in 2018, more users searched for funds that screened out fossil fuels, with the next most popular search being for funds that screened out human rights violations. The divergence between what consumers want and what institutions offer could possibly be explained by consumers assuming that investment funds would already screen out controversial weapons and tobacco under a 'business as usual' situation. Whatever the case, Figure 17, based on a total of 2,218 searches completed over 2018, highlights the variation between the exclusions investment managers apply and the exclusions consumers may want.

It is unsurprising to see fossil fuels rank highly with consumers when it comes to their place in investment portfolios; climate change was a pivotal issue shaping the 2019 federal election. Additionally, there have been various exposés of human rights abuses/labour violations within the supply chains of some high-profile Australian companies, potentially influencing the number of consumers screening out poor corporate behaviour in this space.

The Australian Government has just taken steps to help screen out poor corporate behaviour with the *Commonwealth Modern Slavery Act 2018* entering into force on 1 January 2019. The Act requires reporting entities (Australian-based with over \$100 million p.a. in consolidated revenue) to identify and address their modern slavery risks and maintain responsible and transparent supply chains. The introduction

of the Act may help close the gap between what consumers look for in their investments and what the responsible investment industry in 2019 offers.

FIGURE 17: Negative screening: consumer vs investment manager exclusions



## 4 NORMS-BASED SCREENING

**Norms-based screening** involves the screening of investments that do not meet minimum standards of business practice. Standards applied are based on international norms and conventions such as those defined by the UN. In practice, norms-based screening may involve the exclusion of assets that contravene the UN Convention on Cluster Munitions and the Paris Agreement, as well as those that uphold the UN Global Compact and the UN Convention Against Corruption.

### AT A GLANCE

- Norms-based screening was not nominated by any respondent as a primary strategy, although two funds nominated this strategy as a secondary strategy (AUM represented is \$320 million).
- The lack of penetration of norms-based screening in Australia contrasts with its popularity in Europe.

**Norms-based screening** was not nominated by any respondent as a primary strategy, although two funds nominated this strategy as a secondary strategy (AUM represented is \$320 million).

Norms-based screening is not a feature of the Australian RI landscape, however, it is a popular strategy in Europe according to the *Global Sustainable Investment Review*,<sup>13</sup> with 77% of global usage occurring in the region. That said, the strategy has lost significant ground in Europe over the last two years with ESG integration becoming increasingly popular. Globally, despite modest growth in Canada, and more rapid growth in Japan in norms-based screening AUM, the global total of these assets fell from 2016 to 2018.

<sup>13</sup> Global Sustainable Investment Alliance, *Global Sustainable Investment Review 2018*, 2018. [http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR\\_Review2018.3.28.pdf](http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf)



## 5 POSITIVE/BEST-IN-CLASS SCREENING

**Positive screening** is the inclusion in a fund or portfolio of certain sectors, companies or practices based on specific ESG criteria such as the goods and services a company produces, or how well a company or country is responding to emergent opportunities such as the rollout of low and zero carbon energy assets.

It may also be referred to as best-in-class screening, which involves investment in sectors, companies or projects selected from a defined universe for positive ESG performance relative to industry peers.

### AT A GLANCE

- In Australia, positive screening accounts for 1% of AUM when taking both primary and secondary strategies into account.
- This proportion is slightly below the ~3% the strategy represents globally according to the *Global Sustainable Investment Review*.

- As a primary strategy in Australia, it has grown to \$16.6 billion from a standing start.
- Renewable energy is the favourite inclusion selected by consumers according to RIAA's Responsible Returns online tool users, accounting for 31% of searches.
- More sustainable companies is the second most popular inclusion (23% of searches).

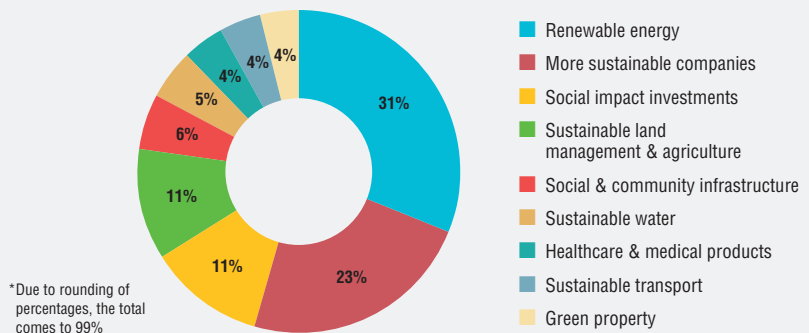
**Positive screens** were employed by a relatively small proportion of the institutions assessed. As discussed earlier, this strategy could be under-represented given the survey skew towards ESG integration and corporate engagement strategies. In addition, positive screening is closely associated with sustainability-themed investing (discussed next), so the true take-up of this strategy could be masked by classification ambiguity.

Notwithstanding, there were a handful of institutions surveyed that nominated positive screening as a primary strategy for some of their funds, namely AMP Capital, Ausbil, CareSuper, IFM Investors and Pandal. The AUM represented by this primary strategy in Australia is \$16.6 billion.

Using Pandal's sustainable funds as a case study, its positive screen identifies companies for active consideration given its focus on the production of sustainable goods and services. Examples of positively screened companies include those that derive greater than 20% of their revenue from sustainable technologies, products and services.

This type of approach is consistent with what consumers seem to want with RIAA's Responsible Returns online tool, highlighting the popularity of renewable energy and more sustainable companies as seen in Figure 18.

**FIGURE 18: Positive screening – consumer searches using the Responsible Returns online tool (2018)**



## 6 SUSTAINABILITY-THEMED INVESTING

**Sustainability-themed investing** relates to investment in themes or assets specifically related to improving social or environmental sustainability. This commonly involves funds that invest in clean energy, green technology, sustainable agriculture and forestry, green

property or water technology. This category also includes multi-strategy portfolios that may contain a variety of asset classes or a combination of these themes.

### AT A GLANCE

- Sustainability-themed investing represents 4% of AUM when taking both primary and secondary strategies into account.

- As a primary strategy, its use has more than doubled since last year to now represent \$70.1 billion.
- It largely relates to green property and sustainable equity funds.
- Most popular themed investments by AUM were climate change (25%), energy efficiency (24%), building sector (16%), water management (12%), renewable energy and waste management (9% each).

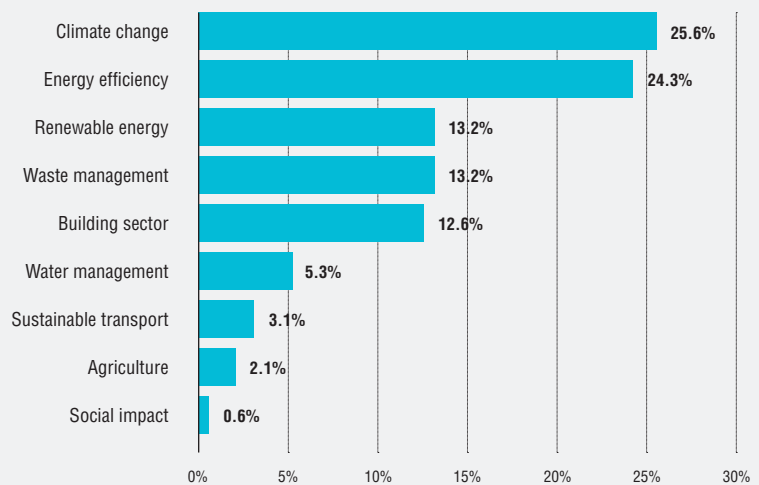
Investment managers employing **sustainability-themed investing** as a strategy are predominantly associated with green property, with examples being Investa Property Group, LendLease and GPT. For inclusion in this category, the property fund needs to demonstrate the highest credentials from verified sources such as Green Star or Global Real Estate Sustainability Benchmark (GRESB) rating. Agricultural investment managers are also a feature of this strategy with New Forests included for its commitments to and systems for positive environmental outcomes.

Climate change is the investment theme that tops the table with 26% of AUM committed to the issue, however, Figure 19 demonstrates the weighting towards green property in this strategy, with property-related sustainability themes including energy efficiency, waste management, building sector and water management a feature.

While the asset class associated with this strategy is typically property, and related investment managers are usually targeting wholesale institutions, there is potential for some double counting of AUM to the extent that assets are owned jointly by wholesale funds and the listed entity. That said, the materiality of these possible overlaps is unlikely to skew the findings of this segment of the report.

In the case of equities funds, some call themselves 'sustainability themed', whereas others use the term 'positively screened'. There are similarities in approach, and where possible RIAA has categorised these consistently in this research. Equally, RIAA notes that there is a global emergence of funds that refer to themselves as impact funds that may have traditionally been seen as sustainability-themed funds. Consistent with the growth in impact investments, RIAA is also observing a growth in sustainability-themed and positively screened investment products that are targeting positive impacts beyond merely financial returns.

FIGURE 19: Sustainability-themed investments by theme (AUM) (2018)



There has been 28% growth in AUM of sustainability-themed equity funds since last year, with Nanuk Asset Management, Stewart Investors and AXA Investment Managers/Rosenberg Equities leading the way. Nanuk invests globally in companies involved in clean energy, energy efficiency, industrial efficiency, waste management, pollution control, food and agriculture, advanced and sustainable materials, water and healthcare technology. Stewart Investors focuses on investments targeting sustainable development challenges such as population pressure, land and water scarcity and degradation, resource constraints, income inequality, ethnic and gender inequalities, and extreme levels of poverty. AXA Investment Managers/Rosenberg Equities identifies and tracks a range of company-relevant impact metrics across 1) products and services, 2) research and development, 3) operations, 4) corporate social responsibility (CSR) initiatives and 5) negative externalities.

## 7 IMPACT INVESTING & COMMUNITY INVESTING

**Impact investing** pertains to targeted investments aimed at addressing social or environmental issues while also creating positive financial returns for investors. This is closely associated with **community investing** where capital is specifically directed to traditionally underserved individuals or communities, as well as financing that is provided to businesses with a clear social or environmental purpose.

### AT A GLANCE

- Impact and community investing represents 1% of AUM when taking both primary and secondary strategies into account.
- The category grew 72% to \$13.8 billion from \$8 billion in 2017.
- Green bond issuance was the primary growth driver with A\$2.8 billion issued domestically in 2018.
- Green bonds account for 61% of AUM in this strategy.
- The first-time capture of institutional/super fund impact investing has bolstered the total by \$0.5 billion.

finance grew only marginally from 2017 to \$2.3 billion. Figures 20 and 21 respectively show the composition of and growth in Australian impact and community investing.

There is some potential for double counting of AUM in this strategy with 1) institutional impact investment allocations and 2) the likelihood that some investment managers surveyed have invested in green bonds. Direct institutional impact investments and green bonds should therefore only be considered for illustrative purposes in this report with their take-up evidence that impact investment is moving into the mainstream.

Impact investing products are issued by a diverse and growing list of providers including dedicated impact investment intermediaries, community financiers and large banks. Some of the banks participating in this category are active through community finance or impact products, largely with a focus on microfinance, social impact or affordable housing. These banks include Teachers Mutual, Bank of Australia, Bendigo & Adelaide Bank's Community Sector Banking, Westpac and National Australia Bank.

Some ongoing growth of existing impact investment products also occurred in 2018. Non-banking institution issuers or intermediaries of impact investments include Foresters, Social Ventures Australia, Social Enterprise Finance Australia, Impact Investment Group, The Nature Conservancy, FlexiGroup, Monash University and the Victorian Government.

Some of the types of environmental and social impacts being delivered by investment products in the data set include tons of CO<sub>2</sub>-e avoided or abated; vulnerable families assisted; employment pathways or jobs created; students supported; clients receiving health and well-being services; and megalitres of water delivered to wetlands, creeks and ecosystems.

While there are a diverse range of investment approaches and impact strategies across impact investment, it should be noted that the impact created by these investments varies markedly. For example, social impact bonds typically create deep impact for a small number of individuals. In other cases, such as with green bonds, the impact may be direct but not necessarily 'additional'. This is because, particularly in the case of refinancing, the green building or renewable energy assets have already received a different form of finance that would still yield the same environmental benefits. In these instances, 'additionality' is not present, as the investment is not delivering additional impacts to what would have taken place in the absence of the investment.

**Impact investing and community investing** increased by 72% in 2018 to \$13.8 billion, showing that investors have a growing appetite for products that deliver measurable social or environmental impacts alongside financial returns.

Growth was driven largely by domestic green bond issuance of \$2.8 billion, with this asset type now accounting for \$8.4 billion

of the data set. However, other types of impact investment products such as social impact bonds and property or infrastructure (including renewable energy funds) have also grown rapidly from nearly \$800 million to \$2.3 billion over the period. Institutional/superannuation fund impact investment was captured by survey for the first time in this project and accounted for approximately \$0.5 billion, while the value of community

FIGURE 20: Impact and community investments by type (by dollar weighting)

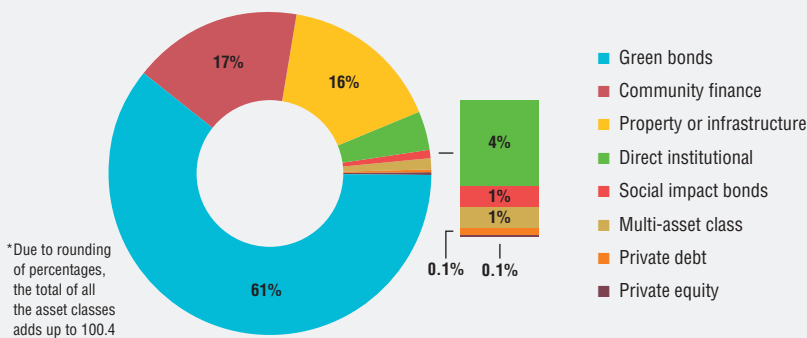
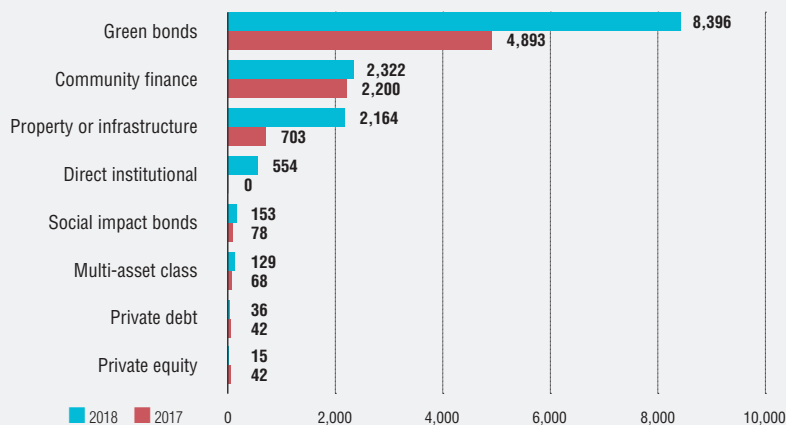


FIGURE 21: Impact investing and community investing growth breakdown (\$m)



# MEASUREMENT AND PERFORMANCE

Figure 22 shows a comparison of the performance of the principal categories of responsible investment funds against the performance of mainstream funds over one-, three-, five- and ten-year time horizons. The average performance in each time horizon has been determined using the asset-weighted returns (net of fees) as reported by each responsible investment fund within its category. Using a comparable methodology, Morningstar calculated the mainstream performance indices and fund comparison data. Key findings are summarised below:

- The responsible investment Australian share funds surveyed outperformed mainstream Australian share fund benchmarks for all periods except the three-year term.
- Responsibly invested international share funds outperformed the Morningstar average mainstream international share fund over each time horizon, however, when compared with the MSCI World ex Australia index, the RI funds only outperformed over three years.
- Multi-sector funds that were responsibly managed outperformed mainstream multi-sector growth fund average over the one-, three-, five- and ten-year periods.

**FIGURE 22: Performance of responsible investment and mainstream funds**

<b>Australian share funds</b>	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>10 Years</b>
Average responsible investment fund (between 17 and 34 funds sampled depending on time period)	-1.24%	5.70%	6.43%	12.39%
Morningstar: Australia Fund Equity Large Blend	-5.49%	4.87%	4.42%	7.95%
S&P/ASX 300 Total Return	-3.06%	6.65%	5.60%	8.91%

<b>International share funds</b>	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>10 Years</b>
Average responsible investment fund (between 7 and 38 funds sampled depending on time period)	-0.03%	11.18%	9.48%	9.50%
Morningstar: Equity World Large Blend	-0.68%	6.37%	8.42%	8.97%
MSCI World Ex Australia NR AUD	1.52%	7.49%	9.81%	9.57%

<b>Multi-sector growth funds</b>	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>10 Years</b>
Average responsible investment fund (7 funds)	-1.13%	4.75%	5.65%	7.66%
Australia Fund Multisector Growth	-2.26%	4.39%	4.92%	7.02%

■ Outperformed by the average RI fund ■ Underperformed by the average RI fund

# MARKET DRIVERS AND FUTURE TRENDS

In order to gain insight into the factors behind the increased use of responsible investment strategies, RIAA asked survey respondents to identify and rank the key drivers of adopting responsible investment strategies and the key factors that have deterred growth.

## KEY GROWTH FACTORS

Fifty percent of survey respondents attributed growth in responsible investment to the belief that factoring ESG considerations into investment decisions will have a positive impact on portfolio performance. This alone explains the continued growth in AUM and in increasing uptake of RI investment strategies by 'mainstream' investors. ESG performance is also aligned with increasing institutional demand as asset owners continue to recognise that their members expect RI strategies to be applied to their funds and that this approach will not harm performance.<sup>14</sup>

Figure 23 shows that good stewardship is at the forefront, with alignment to mission and fiduciary duty ranking highly with survey respondents, while retail investor demand also featured prominently. It is noted that even though demand from institutional and retail investors is identified on both sides of the results (both as a driver and deterrent), it appears survey respondents see demand as a net driver of growth.

It is worthwhile noting that this year, regulatory positions asserting that climate risk is a current rather than future risk were selected by survey respondents as reason enough to employ responsible investment strategies.

<sup>14</sup> Responsible Investment Association Australasia, *From Values to Riches, Charting consumer attitudes and demand for responsible investing in Australia, 2017*. <https://responsibleinvestment.org/wp-content/uploads/2017/11/From-values-to-riches-Charting-consumer-attitudes-and-demand-for-responsible-investing-in-Australia-2017.pdf>

## RETAIL FUND FLOWS

The investment managers surveyed in 2018 indicated that 42% of their responsibly managed AUM was on behalf of retail clients, up from 30% in 2017 (see Figure 24). This demonstrates the retail investor demand referred to by survey respondents above and is illustrated by the 800 unique visits per month to RIAA's Responsible Returns online tool.

Some of the investment products those searches might have uncovered are the 14 new retail funds that RIAA certified during the course of 2018, bringing the total number of certified Australian retail funds to 88. Together these new funds represent \$1.3 billion in AUM and provide further evidence of retail funds flow into responsible investment products. Figure 25 on the following page lists these funds.

FIGURE 23: Key drivers of market growth by those surveyed

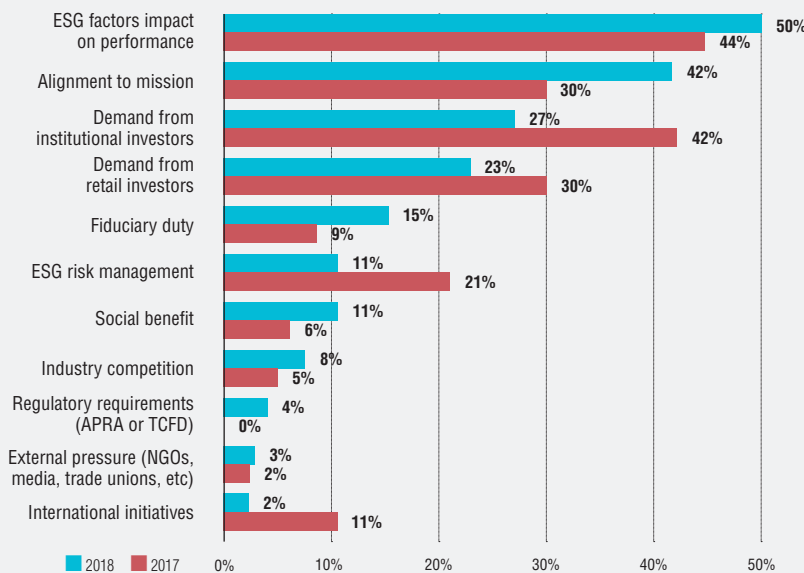
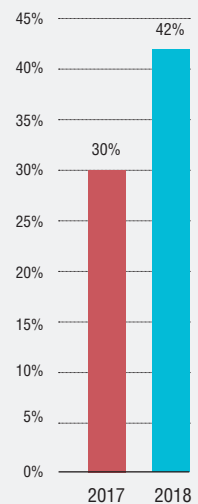


FIGURE 24: Percentage of RI AUM managed on behalf of retail clients



**FIGURE 25: Australian retail products RIAA Certified during 2018**

**Alphinity Investment Management**

Alphinity Sustainable Share Fund

**BetaShares**

BetaShares Australian Sustainability Leaders ETF (ASX:FAIR)

**BNP Paribas Asset Management**

BNP Paribas Environmental Equity Trust

**Colonial First State**

Affirmative Global Bond Fund

**Legg Mason Asset Management Australia**

Legg Mason Martin Currie Ethical Values With Income Fund

Legg Mason Martin Currie Ethical Income Fund

**Mercer Australia**

Mercer Socially Responsible Global Shares Fund (Hedged)

Mercer Socially Responsible Global Shares Fund (Unhedged)

Mercer Socially Responsible Australian Shares Fund

**Nanuk Asset Management**

Nanuk Asset World Fund

**Pendal**

Pendal Sustainable Future Australian Share Portfolio (SMA)

**Perpetual Investments**

Perpetual Ethical SRI Credit Fund

**Terra Capital**

Terra Capital Ethical Emerging Companies Fund

**VanEck Australia**

VanEck Vectors MSCI International Sustainable Equity ETF

**GROWTH DETERRENTS**

The largest factor deterring additional growth in responsible investment related to performance concerns, with almost half the survey respondents identifying this as an issue (see Figure 26). This perceived problem was not borne out in the performance data collected this year and in recent years, with funds employing responsible investment strategies largely outperforming mainstream funds. Nevertheless, by definition, screening and themed investments make for concentrated portfolios so it stands to reason that there is an element of fear of missing out (FOMO) when considering narrowing the investible universe.

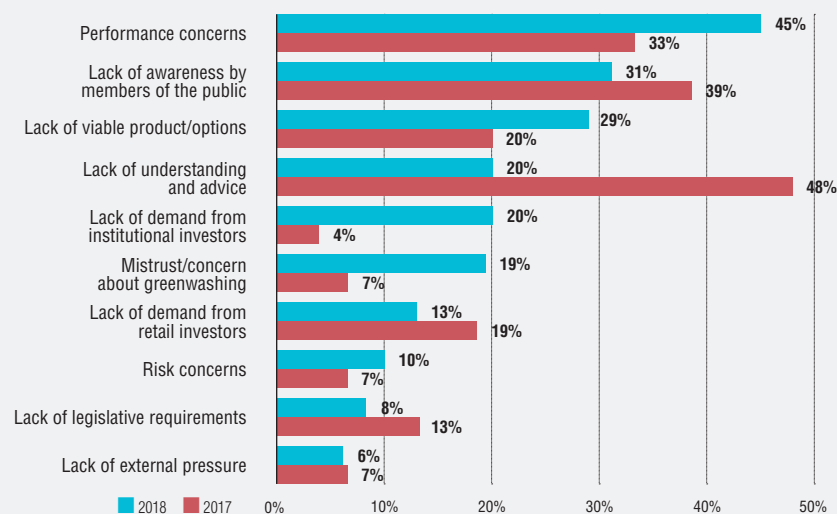
A lack of understanding and advice was identified as the most important factor in last year's survey, and while still important, with 20% of survey respondents noting it as a deterrent, it has been overtaken by the belief that lack of public awareness as well as a lack of viable products are bigger issues.

**DATA AVAILABILITY & RELIABILITY**

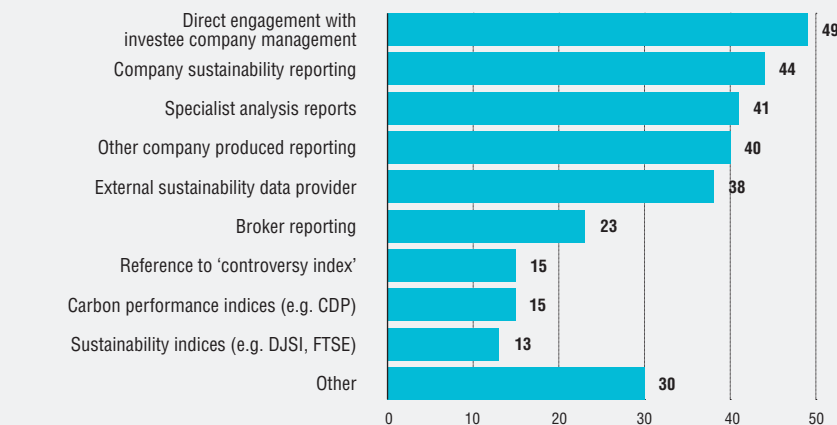
Related to investment managers' take-up of responsible investment strategies is the availability and reliability of ESG data. Figure 27 below shows the key sources of information on which investment managers rely to make investment decisions. It is clear that the investee company itself is central to this flow of information, with third-party specialist reports and indices featuring to lesser extents.

With legislation such as *the Commonwealth Modern Slavery Act 2018* now in force, requiring the larger Australian reporting entities to identify their modern slavery risks and maintain responsible and transparent supply chains, and the PRI now requiring mandatory

**FIGURE 26: Key deterrents to RI market growth by survey respondents**



**FIGURE 27: Key sources of information used to make ESG-related investment decisions**



TCFD reporting of its signatories, RIAA expects the availability and reliability of ESG data to improve and the barriers to the further take-up of responsible investing to recede.

# APPENDICES

## APPENDIX 1A: ABBREVIATIONS

<b>APRA</b>	Australian Prudential Regulation Authority
<b>ASFI</b>	Australian Sustainable Finance Initiative
<b>AUM</b>	Assets under management
<b>ESG</b>	Environmental, social and governance
<b>GSIA</b>	Global Sustainable Investment Alliance
<b>IGCC</b>	Investor Group on Climate Change
<b>PRI</b>	UN-backed Principles for Responsible Investment
<b>RI</b>	Responsible Investment
<b>RIAA</b>	Responsible Investment Association Australasia
<b>SRI</b>	Socially responsible investing
<b>TAUM</b>	Total assets under management
<b>TCFD</b>	Task Force on Climate-related Financial Disclosures
<b>UN</b>	United Nations

## APPENDIX 1B: DEFINITIONS

**Responsible investment** is an approach to investment that explicitly acknowledges the relevance to the investor of ESG factors, and of the long-term health and stability of the market as a whole. It recognises that the generation of long-term sustainable returns is dependent on stable and well governed social, environmental and economic systems. Responsible investment can be differentiated from conventional approaches to investment in two ways. The first is that timeframes are important; the goal is the creation of sustainable, long-term investment returns not just short-term returns. The second is that responsible investment requires that investors pay attention to the wider contextual factors, including the stability and health of economic and environmental systems and the evolving values and expectations of the societies of which they are part.<sup>15</sup>

**Broad responsible investment** applies ESG integration and corporate engagement and shareholder action as the key responsible investment strategies.

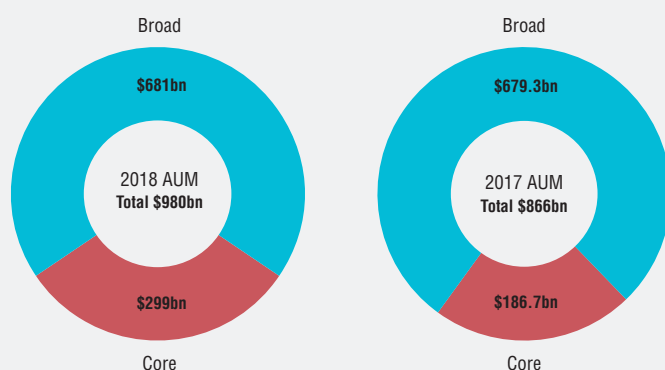
**Core responsible investment** applies at least one of the following responsible investment strategies:

- screening of investments – negative, positive or norms-based screening;
- sustainability-themed investing;
- impact or community investing.

## APPENDIX 1C: PRESENTATION OF DATA AS CORE & BROAD FOR CONSISTENCY

Historically, RIAA has classified responsible investment AUM as either 'Core' or 'Broad' to distinguish between those funds that are undertaking a screening, sustainability-themed or impact investment approach (Core) and those that are committed to investing under a strategy that integrates ESG factors (Broad). As responsible investing is becoming more mainstream, RIAA is moving away from these classifications and instead focusing on best practice across the spectrum of RI strategies. For continuity purposes, Figure 28 shows the split between Core and Broad responsible investment in 2018 and 2017.

FIGURE 28: Core & Broad responsible investment in 2018 v 2017



<sup>15</sup> UNEP FI & PRI, *Fiduciary duty in the 21st Century*, 2015. <https://www.unpri.org/fiduciary-duty/fiduciary-duty-in-the-21st-century/244.article>

## APPENDIX 2: METHODOLOGY

### REPORTING BOUNDARY

This report covers the 2018 calendar year and, where possible, data disclosed has been recorded as of 31 December 2018. Data from some investment managers was not available on a calendar year basis and in these cases, data was taken from the closest available reporting date. All financial figures are presented in Australian dollars.

The financial sector is a globalised industry. Responsible investment funds may be held in one country, managed in another and sold in a third, meaning that a level of estimation is applied in order to demarcate the boundary of the Australian market. This year, for the first time, ABS data was used to calculate the TAUM figure, as it was felt the ABS's underlying definitions were better aligned with the uses and applications of the overall data set moving forward. Previously TAUM data was provided by Morningstar. Applying the ABS TAUM figure to the 2017 data changes the proportion of RI AUM from 56% to 40% for the period up to 31 December 2017. This report is intended to inform readers of the range of responsible investment products that are available in Australia. As such, it includes assets managed within the Australian region, as well as assets managed outside the region where these are on behalf of Australian clients.

This research is primarily targeted at investment managers, rather than asset owners, with a focus on capturing the underlying managers of the capital being deployed responsibly in this market. Asset owners assisted RIAA in the data collection process by pushing the survey to their investment managers. Data was captured from asset owners to the extent that they directly managed investments in-house.

### DATA COLLECTION

Data used to compile this report was generously provided and collected from the following sources:

- directly supplied by investment managers and asset owners;
- Morningstar provided data for the average performance of mainstream managed fund categories. Morningstar also provided a secondary source of AUM data for some of the funds listed;
- RIAA's and MarketMeter's databases; and
- desktop research of publicly available information regarding assets under management, performance data and investment strategies from sources including company websites, annual reports and PRI Responsible Investment Transparency Reports.

A total of 337 investment managers were targeted as respondents to this survey; 68 financial institutions responded by providing information directly whilst 183 were assessed through desktop analysis. In total, this research managed to gather a comprehensive summary of the full responsible investment market in Australia. Responses that identify the key drivers of RI and detractors were only taken from survey respondents. No data has been extrapolated from its original source.

### DATA ANALYSIS & REPORTING

The RIAA online survey aimed to capture data from funds where the investment decision is made internally/directly at the asset level and where the funds are managed on behalf of Australian and New Zealand beneficial owners.

As many investment managers apply several investment strategies, the data collection survey required respondents to identify a single primary responsible investment strategy. The survey also requested that respondents nominate any secondary strategies, identify any overlap of approaches and assist in categorising funds. This approach was used in order to create an accurate depiction of the responsible investment environment in Australia.

Where investment managers have applied multiple responsible investment approaches (eg: a fund may apply ESG integration as well as strategies such as negative or positive screening), we have categorised the fund according to the primary responsible investment strategy being pursued. The primary strategy is identified by the organisation in their survey response, however RIAA performs a review of all survey responses to ensure that strategies are categorised consistently across the cohort of responses and that investor responses are categorised consistently year on year.

Fund overlaps between survey respondents have been removed, where identified, from the reported figures. RIAA is continuously working to improve its data collection process to enhance the quality of reported figures and to ensure that all products in the Australian market are identified.

It is important to note that all information in this survey is 'self-reported' by survey respondents and only limited analysis is performed over statements made. There is no assurance of statements.

### DATA COMPLETENESS

Many of the products in the Australian responsible investment market are not bound by any public reporting, disclosure requirements or independent review (assurance). This report includes both retail and wholesale investment products, and increasingly, superannuation fund mandates, individually managed accounts and separately managed accounts. Some investment custodians are reluctant to supply information for reasons of privacy or commercial confidentiality. Data pertaining to funds held outside of managed responsible investment portfolios was not accessible. For this reason, as well as matters identified in the reporting boundary section above, this report provides a conservative depiction of the responsible investment environment in Australia.

## APPENDIX 3: ESG SCORECARD

For the fifth year in a row, RIAA undertook a desktop review of investment managers that are self-declared responsible investors – either via their commitment to the PRI or other public commitments – and rated each of these against a framework of leading practice to ESG integration.

This framework is based on global definitions and existing assessment frameworks for ESG integration practices and was used in last year's report. It acknowledges that although it is difficult to prescribe a single best-practice process for the integration of ESG factors into investment decision-making, several leading practices and constituent parts of leading practice can be identified.

RIAA's framework assesses and scores:

- publicly stated commitments to responsible investment;
- responsible investment policy;
- commitments to the transparency of processes and approach;
- systematic processes for ESG integration as well as evidence demonstrating how this process is applied as part of traditional financial analysis;
- evidence of activity in other areas of active ownership and stewardship including voting and engagement;
- membership of a collaborative investor initiative; and
- coverage of total AUM by responsible investment or ESG practices.



These pillars are weighted to ensure balance between evidence of systematic investment processes versus policies and public commitments.

Using this framework, RIAA then assessed Australian and a selection of international investment managers who have an active presence in Australia based on their publicly available information including websites, PRI responsible investment transparency reports and all other available material. All investment managers were scored using these criteria. This year investment managers were given the opportunity to score themselves via completion of an online survey. These results were then cross-referenced against the ESG score awarded and harmonised if required.

See below table for detailed scoring methodology:

Only those investment managers that scored more than 80% are included in this report. RIAA took this approach so that only those demonstrating leading practice would be included in determining the size of the Australian responsible investment market. This methodology was fairly applied to investment managers across all asset classes and sizes.

Core pillars and weighting	Question description	Scoring methodology
<b>1. Commitment to RI</b> Available score: 1 Weight: 7%	Does the organisation have a publicly stated commitment to RI (such as a description as to what it means to the organisation) on their website?  Website or other	1 = yes, statement on website 0 = no, not evident (Just stating you are a member to PRI is not sufficient)
<b>2. RI policy</b> Available score: 2 Weight: 14%	Does the organisation have an RI policy? Is the RI policy disclosed publicly?  Website, PRI Transparency Report, or other	2 = yes & publicly disclosed 1 = yes, not public 0 = no, not evident
<b>3. Commitment to transparency</b> Available score: 2 Weight: 14%	Does the organisation report its approach to RI and ESG integration process clearly on its website? (e.g. disclose PRI Transparency Report on website or other)  Website, PRI Transparency Report	1 = Discloses process and approach on website 2 = Discloses in greater detail, such as including link to PRI Report
<b>4. Systematic process for ESG</b> Available score: 3 Weight: 21%	Is evidence of systematic process of integrating ESG into traditional financial analysis described? (NB: use of case studies can inform this question.)  PRI Transparency Report	3 = rated on self-declared level of systematic integration based on multiple measures in PRI report, where 3 = thorough process, and 1 = process evident but little description of integration
<b>5. Evidence of activity in other areas of active ownership &amp; stewardship</b> Available score: 3 Weight: 21%	How does the organisation demonstrate stewardship & active ownership, such as proxy voting, corporate engagements, or other?  Website, PRI Report, scan of website membership lists (e.g. RIAA, IGCC, ACSI, ESG RA)	1 = for voting (should be easily accessible on website) 1 = for engagement 1 = if systematic processes and reporting on voting and engagement
<b>6. Member of collaborative initiative</b> Available score: 2 Weight: 14%	Is the organisation a member of a collaborative initiative, e.g. PRI, local SIF, Investor Groups, other groups?  Website, PRI Report, scan of website membership lists (e.g. RIAA, IGCC, ACSI, ESG RA)	1 = member of one group 2 = member of more than one group
<b>7. Coverage of total AUM by RI or ESG processes</b> Available score: 1 Weight: 7%	What proportion of all AUM is being managed with some form of ESG integration or other RI strategy? (NB: aim for this is to be clear what is and isn't managed under RI.)	1 = 100% 0.5 = 50% 0.1 = 10%

**APPENDIX 4: SURVEY RESPONDENTS**

Acadian Asset Management	ESSSuper	Northern Trust Asset Management
Affirmative Investment Management	Ethical Investment Advisers	Nuveen
AllianceBernstein	Ethical Partners Funds Management	Pendal Group
Alphinity Investment Management	First State Investments	Pengana Capital
Altius Asset Management	First State Super	Perennial Investment Management
AMP Capital Investors	Franklin Templeton	Perpetual Investments
Ausbil Investment Management	Future Fund	Platypus Asset Management
Australian Catholic Superannuation	Future Super	Realindex Investments
Australian Ethical Investment	Generation Investment Management	Solaris Investment Management
AustralianSuper	HESTA	State Street Global Advisors
AXA Investment Managers	IFM Investors	State Super
BlackRock	Infradebt	Stewart Investors
BNP Paribas Asset Management	Investa Property Group	Teachers Mutual Bank
BT Financial Group	Kilter Rural	The GPT Group
Campbell Global	Legg Mason Asset Management Australia	U Ethical Funds Management
CareSuper	Local Government Super	UniSuper
Catholic Super	Maple-Brown Abbott	Uniting Financial Services
Cbus	Melior Investment Management	VanEck Australia
Christian Super	Mercer Australia	Vanguard Investments Australia
CFSGAM	Morphic Asset Management	VicSuper
Dimensional Fund Advisors	Nanuk Asset Management	WaveStone Capital
Eight Investment Partners	NGS Super	Yarra Capital Management
Ellerston Capital	Nikko Asset Management	

**APPENDIX 5: OTHER ORGANISATIONS USED IN DATA (DESKTOP RESEARCH)**

AAG Investment Management	Australian Chamber Orchestra	Celeste Funds Management
Aberdeen Standard Investments	Australian Eagle Asset Management	CHAMP Private Equity
Adamantem Capital	Avenir Capital	Charter Hall Group
agCap	Avoca Investment Management	Commonwealth Bank
AGNITIO Real Estate Investments	Bank Australia	Community Sector Banking
AJ Financial Planning	Bell Asset Management	Continuity Capital Partners
Allan Gray Australia	Bendigo and Adelaide Bank	Crescent Wealth
Allegro Funds	Bennelong Funds Management	Dexus
Amundi Asset Management	Bentham Asset Management	DNR Capital
ANZ	BetaShares	Drapac Capital Partners
Ardea Investment Management	Blue Sky Alternative Investments	ECP Asset Management
Artesian Capital Management	Brandon Capital Partners	EG Funds Management
Auscap Asset Management	Carthona Capital	Ethical Property Australia

FlexiGroup	Mirvac Group	Sigma Funds Management
Foresters Community Finance	Monash University	Social Outcomes
Fortius Funds Management	National Australia Bank	Social Ventures Australia
Greencape Capital	New Forests	Spheria Asset Management
Growth Farms Australia	New South Wales Treasury Corporation	Stafford Capital Partners
Gunn Agri Partners	NovaPort Capital	Sustainable Insight Capital Management
Hepburn Wind	Odyssey Private Equity	Swell Asset Management
Hyperion Asset Management	Pacific Equity Partners	Talaria Capital
Impact Investment Fund	Pacific Road Capital	Taurus Funds Management
Impact Investment Group	Palisade Investment Partners	Terra Capital
Indigenous Business Australia	Pepper Group	TIAA-CREF
Infrastructure Capital Group	Perpetual Private	Treasury Corporation of Victoria
Integrity Investment Management *	Phoenix Portfolios	Ubique Asset Management
Intrinsic Investment Management	PIMCO	UBS Asset Management
Investors Mutual	Plato Investment Management	Vantage Infrastructure
ISPT Super Property	PM Capital	Vicinity Centres
JCP Investment Partners *	QBE	Wealthcheck Funds Management
Karara Capital	QIC	Westpac
Kinetic Investment Partners	Queensland Treasury Corporation	Whitehelm Capital
L1 Capital	Questus	Wisdom Funds
Laguna Bay Pastoral Company	RARE Infrastructure	
Lendlease	RedPoint Investment Management	
Lennox Capital Partners	Renaissance Asset Management	
Lighthouse Infrastructure	Resolution Capital	
Macquarie Asset Management	Robeco	
Macquarie University	Russell Investments	
Magellan Financial Group	Sacred Heart Mission	
Merlon Capital Partners	SEFA	

\* Ceasing operations

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