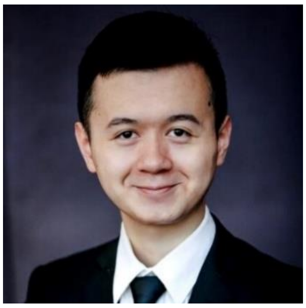
Guest Speaker Spotlight: ANU Investment Office

Mary Fallon
Director

Saksham Malhotra
Investment Analyst - ESG



Justin Chan
Investment Analyst - Portfolios

The SMF welcomed three members of the ANU Investment Office – Mary Fallon, Saksham Malhotra and Justin Chan – as guest speakers on 1st March 2021. They shared how the Socially Responsible Investment (SRI) Policy is implemented across the University's portfolio.

Mary is the Director of the ANU Investment Office and sits on the SMF Investment Advisory Committee. Saksham works as the Office's ESG Investment Analyst, and Justin works as the Portfolio Investment Analyst. The ANU Investment Office manages two portfolios. The primary portfolio is the Long-Term Investment Pool, a multi-manager, multi-asset class and multi-currency portfolio of approximately $1.3 billion. The Office also manages the University's General Cash Float.

Some of the key insights shared with the SMF are summarised below, as well as the Q&A session that followed.

Implementation of SRI Practices

Socially Responsible Investing

The financial services industry is seeing a significant shift towards the adoption of SRI practices. The Investment Office is an industry leader in this trend and strictly implements the University's SRI policy across the entire portfolio. Various environmental, social and governance (ESG) considerations, carbon intensity targets and other constraints are incorporated into the Investment Management Agreement, or Memorandum of Offer. The Investment Office closely monitors compliance of its investment managers with the Policy on a monthly basis, both through its own internal analysis and with the assistance of the external custodian.

Environmental, Social, Governance Scores

There is a low correlation between ESG scores from different providers such as MSCI, ISS or Sustainalytics due to a lack of standardisation driven by providers applying different methodologies. These providers combine publicly available data to form ESG scores, and may create their own estimates using proprietary models where data is unavailable. Given the lack of standardisation, the Investment Office would like the external investment managers to undertake their own independent analysis rather than relying on ESG scores.

The Investment Office also conducts extensive due diligence on its external investment managers both prior to their engagement and on a quarterly basis post-engagement. They assess how ESG is integrated into their investment processes and the extent to which a manager goes above and beyond their peers in developing their approach to SRI. They want managers to demonstrate dedication to SRI practices, which also helps to combat the aforementioned data biases in ESG scores. The industry as a whole is seeing a trend towards favouring managers who develop integrated SRI processes and demonstrate a sincere concern for ESG issues.

Carbon Intensity

Carbon intensity can be measured at three levels:

- Scope 1: Carbon emissions released as a direct result of a company's activities.
- Scope 2: Carbon emissions released from indirect consumption of energy inputs like electricity.
- Scope 3: Indirect emissions released as a consequence of a company's activities, but from sources not owned or controlled by the company.

Scope 1 and 2 are measurable as they have auditable trails and are reported in Australia under the National Greenhouse and Energy Reporting (NGER) Scheme. Scope 3, a form of indirect emission, is not as widely reported and its measurement is more difficult.

The Investment Office measures weighted average carbon intensity using the formula recommended by the Task Force on Climate-Related Financial Disclosures, expressed in the tons of scope 1 and 2 carbon dioxide (CO_2) emitted per million dollars in revenue. This method is used due to its simplicity and ability to be translated across asset classes. The resultant carbon intensity metric informs the overall carbon exposure the Investment Office holds with respect to a particular investment or manager, and across the entire portfolio.

Other Metrics

In addition to ESG and carbon intensity scores, the Investment Office also utilises other metrics such as the Bloomberg Gender Equality Index and Carbon Offset to inform views on various investments or managers.

- Bloomberg Gender Equality Index: An annual, non-financial benchmark that lists leaders in the gender equality space.
- Carbon Offset: An in-house metric that assesses the amount of carbon emissions avoided by using renewable energy sources. This metric was developed to investigate the availability of carbon offset offered by renewable energy assets within the infrastructure portfolio. The main challenges in calculating this metric are the lack of a standardised approach and data unavailability.

Portfolio Screening

For negative screening, the Office uses Bloomberg's ESG screening tool. The Investment Office, in collaboration with an ANU SRI Working Group, has developed a new methodology to further enhance the negative and positive screening process for future implementation of the SRI policy. The new methodology to identify positive and negative screening topics is as follows:

1. Identify emerging best practices through desktop research and external experts.
2. Results reviewed by the Working Group to shortlist areas of interest.
3. Leverage existing ANU research on shortlisted topics.
4. Seek advice from University subject matter experts on relevant topics.
5. Conduct quantitative back testing.
6. Produce a final recommendation.

Q&A

1. **How does the Investment Office distinguish between fund managers who incorporate ESG practices to meet minimum contractual or social expectations versus those who actively work to incorporate SRI values into their investment philosophies?**

The Investment Office performs an extensive due diligence process prior to hiring a manager and throughout the engagement. They examine investment philosophies, evaluate internally developed ESG models, consider whether the managers have dedicated SRI analysts and investigate how they produce consistent performance in line with SRI requirements. Strong portfolio performance and construction is not sufficient if their underlying mindset does not accord with the University's SRI policy requirements.

2. Does the ANU Investment Office have different benchmarks for Australian and international investments, given Australia is a more carbon intensive stock exchange?

Carbon intensity is measured relative to the benchmark index against which the portfolio is managed, as approved by the University's Finance Committee. The benchmarks are the MSCI World ex Australia for international equities, and the S&P/ASX 200 for Australian equities.

3. Does the Office evaluate the investment managers themselves against ESG criteria, or only their portfolios, i.e. the companies they invest in? For example, is the gender or racial mix of their own management team considered in the due diligence process?

Yes. The Investment Office assesses its managers with regard to ESG issues such as gender and racial diversity both during initial due diligence and on a biannual basis. We look for trends in the managers' behaviours and decisions, as well as try to identify inconsistencies in their investment and hiring decisions.

4. How does the Investment Office monitor breaches of SRI policies, and how is a breach handled?

First, we conduct ESG checks on a monthly basis. Our custodian performs random compliance checks each month as well. Every quarter, we host consultations with our investment managers to assess their alignment with our SRI requirements. Since those requirements are written into the management contract, a breach in the SRI policy equates to a contractual breach. This necessitates the manager divesting as necessary to ensure they remain in compliance with their contract and hence the University's policy.

5. To what extent do you engage in shareholder stewardship? Or is that a role for your investment managers? If so, how does that process work?

We are dedicated to being active owners. We monitor and report on all proxy votes related to the University, and ensure our managers are voting in line with our requirements. The University holds the right to veto a manager's decision if it goes against its policies. Another part of our due diligence process is to assess how managers engage with companies on our behalf, and what impact their actions have had on the companies they hold.

6. Is it more important for a company to have a good track record in ESG or to be actively trying to be better despite having a questionable track record? Is questionable past behaviour an indicator that more social harm will occur in the future?

When analysing investment managers, it comes down to two questions: "Are they generating returns?" and "How are they generating returns?" The factor paramount to assessing a suitable manager is whether they are generating returns in a fiduciary responsible manner. The second factor is about how ESG principles are woven into the investment philosophy and the decision-making process. As for whether questionable past behaviour is an indicator of future social harm, this is tough to tell. However, one can say that culture often changes slowly and begins at the top. To be forward looking, one should analyse the gender and racial composition of the executives, analyse their decisions and outlook, and assess whether they are ready for a change in culture.

Prepared by Petal Minyue Wang (Relationship Officer)