



Climate Report

Task Force on Climate Financial Disclosures (TCFD)

Climate change: the risks and opportunities

For more than 35 years, Australian Ethical has been investing to protect⁷ our planet. During these three decades, the scientists with the Intergovernmental Panel on Climate Change (IPCC) have been issuing major reports about the state of the climate, gradually expressing more certainty about what is happening and why and the action needed to limit global warming.

The climate crisis is not just a threat to future generations; we are already feeling the consequences today. If we continue the current global trajectory, the crisis will only worsen, deepening the impact of irreversible changes to our world.

The climate threat is also bringing climate investment opportunity in reducing emissions and helping

communities adapt to the changes already underway and locked in by historical emissions.

In the following pages we report on the carbon emissions associated with our investments and our operations (carbon footprint) and how, through our investments and stewardship, we are working towards the emissions reduction needed to achieve a 1.5°C temperature limit - consistent with the most ambitious aims of the Paris Agreement.

This report has been prepared with reference to the recommendations of the [Task Force on Climate-Related Financial Disclosures \(TCFD\)](#).



Governance

all of our investments are made considering our Ethical Charter, which is embedded in our Constitution and overseen by our Board.

The [Charter's 23 principles](#) are applied using our more detailed Ethical Criteria, reflected in our ethical frameworks, policies and measurement systems. These ensure we prioritise action to help avoid dangerous climate change and its serious impacts on the planet, people, and animals.

Read more about our ethical investment approach at australianethical.com.au/why-ae/ethics.

Responsibilities

Our Chief Investment Officer and Head of Impact & Ethics are responsible for implementation of our Ethical Charter across our investment activities. They approve new and updated ethical frameworks, which include our climate-related ethical screening criteria.

The Board, via the Investment Committee, receives reports quarterly on changes to frameworks and critical ethical issues. Climate change related topics are regular agenda items and the Board includes [members](#) with climate change expertise.

Our in-house team applies our Ethical Criteria on a day-to-day basis in our investment processes. The team includes members with expertise in climate change.

Our ethics research team monitors existing and emerging climate-related risks. Using diverse information sources the team monitors developments in scientific understanding of the rate and impacts of global warming; in domestic and international climate policy and regulation; and in technological innovation in climate mitigation and adaptation.

Risk management

climate change is the top factor we consider when applying our Ethical Charter to companies because of its wide-ranging implications for people, animals and the planet. We restrict⁺ investments in companies assessed to be obstructing the objectives of the Paris Agreement to limit global warming to well below 2°C and to pursue a

limit of 1.5°C. The way this test is applied depends on the company and its sector.

Our investment screening and company engagement guides us to sectors and companies which are aligning their businesses with the transition needed to limit global warming to 1.5oC. These companies can be better positioned to manage many climate-related risks, such as the risk of introduction or increase in carbon pricing.

However, the effects of climate change will be felt across the economy and society. Higher warming threatens to disrupt trade and financial markets with implications for all investment portfolios.

At the portfolio level, our:

- Strategic asset allocation approach (which guides our long-term investment positioning) is informed by scenario analysis that includes social and environmental factors, including climate change. Within our six core scenarios, we include both a negative scenario (high climate change) and a positive scenario (optimal energy transition).
- Active asset allocation process considers the resilience of our portfolio in the short term (up to 1 year) to shocks like extreme weather events. This shows strong resilience for individual extreme events and is informing our thinking about portfolio positioning as extreme events increase in frequency and number with escalating climate change.

Our asset allocation forum meets quarterly to monitor signposts (like renewable energy investment and climate ambition) and review probabilities for each scenario, as well as considering whether new scenarios should be added.

Strategy

our investment approach leads us to portfolios that are already far less emissions intensive than relevant benchmarks. However, climate change presents systemic risks to the continuing good health of the planet and society on which all investment returns depend. That's why we believe accelerating the transition to net zero carbon is an urgent priority and critical to the financial best interests of those that invest with us.

⁺ Our investment restrictions include some thresholds. Thresholds may be in the form of an amount of revenue that a business derives from a particular activity, but there are other tolerance thresholds we can use depending on the nature of the investment. We apply a range of qualitative and quantitative analysis to the way we apply thresholds. For example, we may make an investment where we assess that the positive aspects of the investment outweigh its negative aspects. For information on how we make these assessments for a range of investment sectors and issues such as fossil fuels, nuclear power, gambling, tobacco, human rights, and many others, please read our Ethical Criteria.

Risks

As a diversified investor, the securities we invest in are exposed to a broad range of climate risks, for example:

- Changes in temperature and rainfall are already affecting the productivity and viability of different types of agriculture.
- Sea level rise and extreme weather are changing where and how buildings and infrastructure can be safely built, with flow on effects to building and operating costs.
- Increased flood and fire risk affects insurance costs, and whether property is insurable at all.

Increased variability of returns across all asset classes can be expected to arise from climatic change that is unavoidable due to historical emissions, regardless of how effective emission reduction efforts are going forward.

Our growth strategy recognises that our strong early position on climate change is core to our brand and reputation with customers and employees and critical to our competitive positioning. Under our strategic pillar 'advocates for a better world' climate change is a priority topic.

Given this, we consider our business is relatively well positioned compared to peers under both low and high temperature scenarios. But we also expect high-temperature scenarios to bring lower economic output and higher variability of returns, undermining trust in investment markets and overall demand for investment management.

Conversely, rapid action to address climate change would contribute further to already rapid growth in climate investment opportunities.

In all scenarios, imperfect information on climate attributes creates challenges to investment management as well as opportunities for outperformance.

In addition to these opportunities and risks to investment performance, we face risks from increased regulatory expectations around climate and opportunities for climate focused investment products.

Metrics & targets

we pursue net zero outcomes for our investments and the world (our climate ambition) aligned with the emissions reduction needed to limit temperature rise to 1.5°C – consistent with the most ambitious aims of the Paris Agreement.

We use a range of measures to check the effectiveness of our ethical investment approach in managing climate risk and pursuing our climate ambition.

Emissions intensity of investments

We report carbon footprint and fossil fuel reserves relative to Benchmark¹ for our listed share investments below.

We report on our listed share investments because these comprise a large proportion of our total funds under management (~70%), and because data is less readily available across our other investments.

We believe this measurement remains a useful demonstration that our Ethical Investing approach – which is applied across all investments – results in our portfolio maintaining an emissions intensity well below the relevant Benchmark.

Investment in clean energy

Investment in renewable power generation and other clean energy solutions is critical to support the massive global shift to renewables required to limit warming to 1.5°C. Our analysis this year showed that our listed share investment in renewables and energy solutions is proportionately 4.6 times that of a comparable share market benchmark.¹

Climate-related engagement, voting and advocacy

In FY23, our stewardship action in pursuit of our climate ambition included:

- Engagement and advocacy to help stop finance for expansion of the fossil fuel sector; to help stop and reverse land clearing and deforestation for animal agriculture; and to help increase the development and use of low carbon building materials supporting the net zero transition of the real estate sector.

- Seeking to leverage the collective power of aligned investors by leading and participating in collaborative engagements with high emissions companies, including through the global initiative Climate Action 100+.
- Work to encourage better government climate policy, including through active participation in the Investor Group on Climate Change.

Further detail on progress from our engagement and advocacy efforts is available in our [Stewardship Report](#) and in our [Proxy Voting report](#).

Foundation giving targeting emissions reduction

Our foundation targets initiatives that directly and practically address climate change, with key focus areas for funding including stopping sources of carbon and supporting carbon sinks. Read more about our approach and outcomes in our [Foundation report](#).

¹ Comparison based on shareholdings at 30 June 2023 and analysis tools provided by external sources which cover 92% of the listed companies we hold shares in by value. The comparison benchmark is a blended benchmark of the S&P ASX 200 Index (for Australian and New Zealand share holdings) and MSCI World ex Australia Index (for international fund share holdings). There is more information about the calculations and metric limitations on page 6.



2023 Carbon footprint of our listed share investments

The carbon footprint of our investments is one way to check the effectiveness of our ethical investment approach to manage climate risk and to support the transition to a net zero-emissions economy and society. We report three carbon footprint measures for our share investments.

Measure	Carbon intensity of earnings	Carbon emissions share	Carbon exposure (WACI)
Description	Investor share of company carbon emissions / Investor share of company revenue	Investor share of company carbon emissions / Amount invested	Average carbon intensity of companies invested in (weighted by % of investment portfolio) also known as WACI (weighted average carbon intensity)
Significance	Measures carbon relative to value of products and services	Measures carbon relative to \$ invested	Measures portfolio exposure to carbon intensive companies
Metric	tCO ₂ e per \$m revenue	tCO ₂ e per \$m invested	tCO ₂ e per \$m revenue
Scope 1 & 2 emissions			
AE listed share investments	34	22	34
Benchmark²	147	78	102
AE % below Benchmark	77%	72%	67%
Total emissions (Scope 1, 2 & 3)			
AE listed share investments	252	164	285
Benchmark²	1,277	674	1,175
AE % below Benchmark	80%	76%	76%

The table includes three carbon metrics for our listed share investments. The carbon intensity of those investments

remains about one quarter of the share market Benchmark, 77% lower than the market considering scope 1 and 2 emissions only. Scope 1 and 2 emissions arise directly in the business operations of investee companies (from things like car and truck fleets, and furnaces and boilers) and from their purchase of fossil fuel-based electricity.

This year we have also included the same metrics extended to include additional 'upstream' and 'downstream' emissions sources (scope 3 emissions) of our investee companies. Upstream these may include emissions of the companies' suppliers and from transport of business inputs. Downstream scope 3 may include emissions from customers' use of purchased products and services including transport of goods to the end consumer, fossil fuel energy used to power an item purchased, and from ultimate disposal at end of a product's life. While scope 3 emissions involve more uncertainty than scope 1 & 2 emissions, they are also significant in scale and importance to the climate challenge.

Our portfolio has even lower relative emissions (as much as 80% below Benchmark) when scope 3 emissions are included. This is a result of our strong restrictions on investment in fossil fuel companies, whose scope 3 emissions include the burning of these fossil fuels (coal, petrol, gas) by their customers.

Fossil fuel reserves

Carbon footprinting doesn't capture all important climate risks. Fossil fuel reserves aren't included in emissions totals while they remain in the ground, but they will frustrate all efforts to limit global warming if they are extracted and burned. To supplement our carbon footprint comparison, the following table shows how our zero investment in fossil fuel reserves compares to the share market benchmark.

Potential emissions from fossil fuel reserves per A\$1,000,000 invested

Our share investments	Share market benchmark
Thermal coal reserves	
Zero	2,558
Gas reserves	
Zero	376
Oil reserves	
Zero	224
Oil sands, shale oil and shale gas	
Zero	140

² Comparison based on shareholdings at 30 June 2023 and analysis tools provided by external sources which cover 92% of the listed companies we hold shares in by value. The comparison benchmark is a blended benchmark of the S&P ASX 200 Index (for Australian and New Zealand share holdings) and MSCI World ex Australia Index (for international fund share holdings). There is more information about the calculations and metric limitations on page 6.

Who are the most carbon intensive companies in our portfolios?

Even for low carbon portfolios like ours, its important to check the ethical rationale for our investment in any higher emissions companies. The table below lists our most carbon intensive companies and why we still invest in them under our Ethical Charter.

Company	Country	Company Carbon Intensity*	Positive under our Ethical Charter
Boral Limited	Australia	534	Building materials including lower carbon concrete
Veolia Environnement SA	France	494	Water and waste management and treatment
Cleanaway Waste Management Limited	Australia	416	Recycling and waste management
Contact Energy Limited	New Zealand	358	Renewable electricity (hydro and geothermal)
Canadian Pacific Kansas City Ltd	Canada	354	Lower emissions transport (rail)
Digital Realty Trust, Inc.	USA	316	IT servers and data centre infrastructure. They are energy hungry but overall help efficient use of resources.
Owens Corning	USA	308	Building materials including insulation
Canadian National Railway Co	Canada	276	Lower emissions transport (rail)
Redeia Corporacion, S.A.	Spain	234	Electricity transmission infrastructure
Equinix, Inc.	USA	227	Data centres

* tCO₂e (Scopes 1&2) / A\$M revenue.

Our clean energy investment

Our carbon footprint metrics capture the emissions of renewable energy companies from their production of electricity from sources like wind, solar, hydro and geothermal. But the metrics don't capture the emissions lowering effects of these companies when they create new renewable energy capacity which displaces higher emissions fossil fuel energy. That's one of the reasons we measure our listed share investment in renewable power generation and other clean energy solutions, which this year is proportionately 4.1 times that of a comparable share market Benchmark.³ This includes investment in renewable energy generation from wind, solar, geothermal, biomass, small scale hydro (25 MW or less) and wave tidal energy. Also included are biofuels, waste-to-energy, renewables equipment (e.g. solar inverters and wind turbines), transmission of renewable energy, and batteries and other energy storage supporting renewable energy.

Investing in climate transition minerals

Our ethical assessment of investments in the mining sector balances three factors: the value that the mined mineral has to the well-being of society; the harms of the mining process and mineral for people, planet and animals; and the scarcity and recyclability of the mineral.

Considering these factors, we restrict* investment in most mining companies, including those mining fossil fuels and uranium.

During the year we updated our ethical framework for the mining sector to define criteria for investable "transition minerals". The criteria address:

- the balance between positive and negative uses of the mineral, and
- the projected growth in demand for the mineral over the period to 2030 to help transition the economy to net zero emissions.

Lithium, copper and nickel satisfy our transition minerals criteria, recognising that the production of these minerals need to grow significantly for decarbonisation of high emissions sectors like energy and transport.

Individual mining companies are ethically assessed based on the proportion of their revenue earned from transition minerals and other minerals. In addition we examine whether the mining company is responsibly managing its impacts on people, planet and animals in their mining and processing operations.

³ Comparison based on shareholdings at 30 June 2023 and analysis tools provided by external sources which cover 92% of the listed companies we hold shares in by value. The comparison benchmark is a blended benchmark of the S&P ASX 200 Index (for Australian and New Zealand share holdings) and MSCI World ex Australia Index (for international fund share holdings). There is more information about the calculations and metric limitations on page 6.



Our operational emissions

While we can influence the biggest emissions reductions through our investment screening, engagement and advocacy, it's also important that we pay attention to reducing the emissions that arise in our own operations (like in our offices and employee travel), and offsetting what's left.

The following table shows our operational emissions for FY23 and the prior two years.

Category	FY21	FY22	FY23
Scope 1 & 2 emissions (tCO ₂ e pa)	0	0	0
Operational Scope 3 (tCO ₂ e pa)	349.8	569.6	683.4
Full scope emissions per full time equivalent employee	4.4	5.5	6.2*
Full scope emissions intensity per \$A million revenue	5.9	8.0	8.0
Full scope emissions per \$A billion funds under management	57.6	86.6	88.0
Offsetting of reported operational emissions	100%	100%	100%

There's a more detailed breakdown of the year's footprint in our databook [here](#).

Reducing our operational emissions

Our scope 1 emissions are zero because we don't directly generate emissions – we don't own vehicles or operate gas appliances, for example. Our scope 2 emissions are zero because we purchase renewable electricity for our directly metered office power. On scope 3 emissions, we consider climate performance in our selection of significant suppliers and continue to explore further action we can take. The disruption caused by the Covid pandemic highlighted opportunities to limit business travel emissions through increased use of online meeting technologies, although our flight emissions increased significantly following the lifting of travel restrictions.

Offsetting operational emissions

We continue to offset our reported operational emissions. Carbon offsetting plays an important role for companies on the journey to net zero, provided they recognise the imperative to minimise emissions as much as possible before offsetting what remains. When offsetting our operational emissions, we look for opportunities for carbon abatement which also deliver additional benefits to people, planet and animals.

This year we offset our operational footprint with three different types of carbon credits. We purchased ACCU carbon credits from the Thiaki Rainforest Restoration project, which restores previously cleared pasture to rainforest in the Wet Tropics region of northeast Queensland. As well as carbon sequestration benefits, the project

reduces sediment run off which ultimately flows into the Great Barrier Reef, and also restores potential habitat for several native species. We also purchased "Verra - REDD+ VCU" credits from the Rimba Raya Biodiversity Reserve, which protects critical rainforest and habitat from deforestation as well as supporting local employment, education and healthcare. "Verra - VCU" credits purchased come from Indian wind projects contributing renewable energy to regional electricity grids in the Indian states of Andhra Pradesh, Madhya Pradesh, Rajasthan and Telangana.

Many important concerns have been raised about the effectiveness of carbon reduction and sequestration under different carbon credit certification schemes and methodologies. We intend to grow our capacity to analyse and access credible carbon credits both for our future offsetting needs and for potential investment by our funds.

Climate metrics calculation and limitations

Company carbon and other climate related data often includes estimates and errors, and so footprint, reserve and clean energy calculations need to be used with caution. There are also different measurement methodologies and metrics which can be used to assess climate performance. There is more information on page 6.

Assurance

KPMG have provided limited assurance over key metrics in sustainability disclosures, including some carbon metrics. KPMG's assurance opinion is available [here](#).

* Calculated using FY23 activity data, FY22 conversion factors and the average of FTE employees at year beginning and end, including contractors paid via monthly payroll.



Sustainability information calculation and limitations

The investment carbon footprint and other climate and sustainable solutions metrics in this report are presented for Australian Ethical's aggregate listed share investments at 30 June 2023 and for which we have relevant sustainability data. This should not be considered representative of individual funds or options which will have their own mix of share and other investments. Sustainability information will change with changes to investments, the sustainability performance of companies, and the companies for which we have sustainability data.

The comparison share market benchmark is a blended benchmark of the S&P ASX 200 Index (for Australian and New Zealand share holdings) and MSCI World ex Australia Index (for international fund share holdings). The comparison share market indices are based on the composition of the relevant share markets, without selection of companies based on ethical, sustainability or ESG factors. The industry mix and other characteristics of companies comprising the Australian Ethical investment portfolio and the indices are different.

We have used carbon and sustainable impact revenue data and analysis tools provided by global research firm MSCI ESG Research LLC. This data covers 92% of Australian Ethical's listed share investments by value. We present the sustainability information and the benchmark comparison only for investment in listed shares in those companies which have been analysed by MSCI ESG Research for their carbon intensity and sustainable impact revenue. MSCI ESG Research is not responsible for the way we have used their data and tools to calculate the amounts in this report.

The sustainability information is limited to the specific sustainability metrics reported. Sustainability characteristics of an investment may or may not be relevant to individuals' investment decisions. The sustainability metrics relate to the impacts of companies which Australian Ethical invests in, and they are not a measure of the impact of acquiring an investment in those companies or in an Australian Ethical fund. Investment decisions should take into account the financial, risk, fee and other characteristics of potential investments.

The information in this report is general information only and does not take account of your individual investment objectives, financial situation or needs. Before acting on it, consider its appropriateness to your circumstances and read the Financial Services Guide (FSG), the Product Disclosure Statement (PDS) and Target Market Determination (TMD) for the relevant product available on our website for information on the benefits and risks of our Funds. You should consider seeking advice from an authorised financial adviser before making an investment decision.

Past performance is not a reliable indicator of future performance.

Carbon footprinting and sustainability measurement limitations

Investment carbon footprint metrics need to be used with caution. Company carbon data is historical, it often includes estimates or is incomplete, and it may include errors and be out of date. Companies make different decisions about what they do and don't include when measuring and reporting their operational footprints. Data providers use estimates for some companies.

There are also different carbon metrics which can be used to assess carbon footprint, each with different strengths and weaknesses. We report three carbon footprint measures for our share investments, "Carbon intensity of earnings", "Carbon emissions share" and "Carbon exposure". The TCFD reporting recommendations compare these and other footprint metrics [here](#).

Similar limitations apply to measurement of other types of impact of companies, such as their sale of sustainable products and services. Company reporting of the revenue they earn from different products and services may be inaccurate or incomplete, and MSCI may make estimates in breaking down and categorising company revenue. There are different methodologies and frameworks for classifying sustainable products and services and for taking account of negative impacts of a company's operations.

MSCI ESG Research LLC

We have used data and tools provided by MSCI ESG Research when calculating the sustainability information in this report about carbon intensity, share of carbon emissions, carbon exposure, sustainable impact revenue, fossil fuel reserves and investment in renewables and energy solutions. We accessed the MSCI tools and data for our calculations on 20 October 2023.

More information on MSCI carbon footprinting methodology and metrics is available here: [msci.com/documents/10199/2043ba37-c8e1-4773-8672-fae43e9e3fd0](https://www.msci.com/documents/10199/2043ba37-c8e1-4773-8672-fae43e9e3fd0)

and

[msci.com/www/blog-posts/scope-3-carbon-emissions-seeing/02092372761](https://www.msci.com/www/blog-posts/scope-3-carbon-emissions-seeing/02092372761)

The Sustainable Impact Solutions table in the 2023 Sustainability Report shows links between MSCI's categories of sustainable impact solutions and selected Sustainable Development Goals (SDGs). We have determined these links based on our own assessment of how MSCI's criteria for their Sustainable Impact Solutions relate to SDGs. There is more information about MSCI's categories here: [msci.com/documents/1296102/1636401/ESG_ImpactMetrics-2016.pdf/0902a64f-af8d-4296-beaad105b7d74dc3](https://www.msci.com/documents/1296102/1636401/ESG_ImpactMetrics-2016.pdf/0902a64f-af8d-4296-beaad105b7d74dc3)

and

[msci.com/documents/1296102/16472518/ESG_ImpactMetrics-cfs-en.pdf/7a03ddab-46fd-cef7-5211-c07ab992d17b](https://www.msci.com/documents/1296102/16472518/ESG_ImpactMetrics-cfs-en.pdf/7a03ddab-46fd-cef7-5211-c07ab992d17b)

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Currency conversion for sustainability Information

Some of the sustainability data we use is provided to us in US\$ terms, and some of this data has been converted to US\$ using exchange rates selected by the data provider. Where we report sustainability information in A\$ terms, we have used an average exchange rate as published by the Australian Taxation Office for the 2023 Financial year.

Investing ethically and sustainably means that the investment universe will generally be more limited than non-ethical, non-sustainable portfolios in similar asset classes. This means that the Portfolio may not have exposure to specific assets which over or underperform over the investment cycle. This means that the returns and volatility of the Portfolio may be higher or lower than non-ethical, non-sustainable portfolios over all investment time frames.

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