

# WaveStone ESG Report

## Quarter ending December 2021

### ESG Sector Spotlight – Australian Banks

#### Major Banks are supporting Australia's energy transition to a low carbon economy

We've just been through the AGM reporting season for three of the major banks and we've met with the Chairs of the banks and reviewed:

1. The fossil fuel exposures of the major banks
2. Current climate change policies and the differences between the bank's lending policies and the current Regulatory Oversight
3. How the banks are supporting Australia's transition to net zero by 2050
4. Hunter coal region and Port of Newcastle - an example of a region being supported by the banks as it transitions from dependence on fossil fuel exports to new industries

The Fossil Fuel exposure for the major banks are as follows:

A\$bn	ANZ			CBA			NAB			WBC		
	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021
Metallurgical Coal	0.7	0.8	0.6	0.1	0.1	0.0	0.8	0.6	0.4		0.2	0.3
Thermal Coal	0.8	0.5	0.5	1.5	1.4	0.9	0.9	0.8	0.6	1.2	1.3	1.1
<b>Total Coal</b>	<b>1.5</b>	<b>1.3</b>	<b>1.1</b>	<b>1.6</b>	<b>1.5</b>	<b>1.0</b>	<b>1.6</b>	<b>1.4</b>	<b>1.0</b>	<b>1.2</b>	<b>1.6</b>	<b>1.4</b>
Oil & Gas Direct	9.8	9.3	7.3	6.3	5.7	4.7	4.7	3.7	3.7	4.1	5.5	3.3
Oil & Gas Indirect	10.1	8.3	8.3	1.6	1.7	1.4	1.2	1.0	1.2		1.9	2.6
<b>Total Fossil Fuel Exposure</b>	<b>21.4</b>	<b>18.9</b>	<b>16.7</b>	<b>9.5</b>	<b>8.9</b>	<b>7.1</b>	<b>7.5</b>	<b>6.1</b>	<b>5.8</b>	<b>5.3</b>	<b>8.9</b>	<b>7.3</b>
% of Total Committed Exposures			2.50%			0.86%			0.93%			1.85%

Source: Annual reports, Climate reports on various bank websites.

#### Current fossil fuel lending policies

ANZ is Australia's largest institutional bank so it is not surprising that it has the largest absolute exposure to fossil fuels, which it has reduced by 22% over three years. The disclosure across the major banks is not unanimous and only includes the direct or balance sheet exposure to fossil fuel sectors. It may not include financing activities around arranging or underwriting capital market transactions such as bonds or derivatives which is an important component of institutional banking revenues as large corporates prefer to access cheaper debt or lengthier tenure from offshore markets that the Australian banks facilitate.

The banks have announced the following on fossil fuel lending policies:

- i. Thermal Coal - all four major banks have announced commitments to exit by 2030.
- ii. Metallurgical Coal - whilst 3 of the 4 majors excluding ANZ have announced increased due diligence and WBC and CBA have both announced the projects must be Paris aligned, none are planning to reduce exposure citing the importance to steel production.
- iii. Oil and Gas - only NAB has set an exposure limit of US\$2.4bn and it will reduce this from 2026. The other 3 majors have committed to projects being Paris aligned but no plan to reduce sector exposure.

#### Regulatory Oversight

In November 2021 APRA released its final prudential practice guide on climate change financial risks or CP229. As per APRA's release "The guide imposes no new regulatory requirements or obligations but will instead assist APRA-regulated entities to manage climate-related risks and opportunities within their existing risk management and governance practices".

In 2022, APRA intends to undertake a survey to help gauge the alignment between institution's management of climate change financial risks, the guidance set out in CPG 229, and the Financial Stability Board's Taskforce for Climate-related Financial Disclosures. In addition, APRA continues to advance its climate-related program of activities, including the Climate Vulnerability Assessment (CVA) that is underway with Australia's five largest banks. This has been delayed due to lack of granular data but is expected some time in 2022.

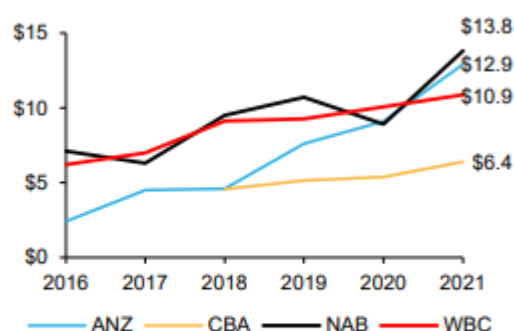
The major banks have joined over a dozen climate related bodies both here and globally and all report progress in line with frameworks and standards:

WBC	Taskforce on Climate related Financial Disclosures (TCFD); Climate Measurement Initiative
NAB	Member UN Environment Programme Finance Initiative (UNEP FI); TCFD
CBA	Global Reporting Initiative (GRI), TCFD
ANZ	UNEP FI; TCFD

### Sustainability Finance

While analysis remains opaque, the cost to decarbonise Australia is estimated to be between \$35bn-\$80bn to 2030 and \$130bn-\$165bn by 2050\*. The four major banks have announced sustainable finance targets totalling ~A\$215bn committed by 2030. Since 2015, a total of \$86bn has been deployed across sustainable projects, including renewable energy, low-carbon transport and green buildings.

**Australian Major Banks Sustainable finance (A\$bn)**



Note: ANZ & NAB disclose financing deployed per year while CBA and WBC disclose balances.  
Source: Company data, Macquarie Research, November 2021

The commitments by the major banks are as follows:

- ANZ: \$50bn sustainable financing - includes low carbon projects as well as affordable housing.
- CBA: \$70bn sustainable financing - includes low carbon funding of \$15bn as well as funding for broader social issues such as affordable housing.
- NAB: \$70bn environmental financing target. NAB also has a \$2bn affordable housing target.
- WBC: \$25bn climate change solutions fund.

In the past decade due to the large number of finance companies looking to support renewable energy projects, the banks have seen a flood of capital coming into the sector which has meant the risk return trade off (ROE<WACC) has not been as attractive. However, the returns are better now and the banks are looking to both use their balance sheets and act as arrangers to provide debt to new sustainable projects. In FY21 ANZ took part in >\$100m of sustainable finance, up 75% yoy, and CEO Shane Elliott believes this loan book could put on an additional \$500-\$700m growth over 5 years.

## Supporting the transition to Net Zero

The Chair of NAB, Phil Chronican said "to get to net zero, every business in every industry will have to evolve and every household will need to make changes". He cautioned that even if Australia was to source 100% of its power from renewables that that will only address a third of our carbon emissions. Citing Deloitte analysis that electrifying Australia's transport, heating and cooling systems could reduce our emissions by 80% by 2050 once electricity reaches 100% renewable supported by battery storage.

NAB has taken reported data from its corporate customers and made sector estimates for three sectors below for the attributable financed emissions of 8 key sectors within its lending portfolio and it is intending to disclose how they will align lending to its 1.5 degree Paris commitment in 2022:

SECTOR	% OF SECTOR EAD COVERED	ABSOLUTE EMISSIONS (TCO <sub>2</sub> -E)	EMISSIONS INTENSITY (TCO <sub>2</sub> -E/AU\$M EAD)
Power generation	22%	2,036,484	1,018
Heavy manufacturing	69%	185,727	267
Resources	22%	536,921	261
Transport	9%	101,347	135
Agriculture	100%	3,929,316	115
SMEs	100%	990,005	24
Residential mortgages	100%	3,072,195	8
Commercial real estate (office and retail)	19%	33,844	6

## Port of Newcastle - a long term commitment to energy transition

Port of Newcastle (PON) is co-owned 50% by The Infrastructure Fund (Macquarie Asset Management) and 50% by CMPort. The port handles approximately 4,400 ship movements, and 164 million tonnes of cargo annually handling a diversity of international trade, including coal, wheat and other grains, fertiliser, steel, cement, bulk liquids, containers, machinery and alumina. However, the bulk of the trade is thermal coal for export which will naturally reduce by 2050. As a result in November 2021, the PON with the backing of the NSW and Federal Governments announced a diversification of the port in two areas - a feasibility study into the PON Green Hydrogen hub and a release of tenders to expand the port's container berths and to take bulk liquids. In 2021 NAB arranged for PON a \$515m sustainability linked loan which aligns with the International Capital Market Association climate transition handbook and incentivises PON to keep greenhouse gas emissions below agreed levels and various social targets in return for a lower cost of funding. Transitioning the 9000 direct jobs and the up to 200,000 coal direct and indirect employment in the Hunter Valley region requires a long-term commitment by all parties to diversify this region's emission intensive economy.

## Conclusion

Whilst the exposure of the Australian major banks is low in context of the loan books to fossil fuels and the commitment to zero lending to thermal coal by 2030 by all banks allows an orderly transition. The question remains 'Are the major banks doing enough to support the transition of the economy and is 2050 too far away?' The oil & gas exposure is the most problematic as gas is acknowledged to be a transition fuel but the emissions remain large. We can't help but think this needs to happen a lot sooner.

## Carbon Emission and Intensity Tracker:

WaveStone Australian Share Fund (WASF)	Carbon Emissions Scope (tonnes CO2e)		
	Scope 1	Scope 2	Total
Portfolio – WASF	25,649	5,429	31,077
Benchmark - S&P ASX 300 Accumulation Index	36,603	11,182	47,784
Difference	-30%	-51%	-35%

Source: MSCI ESG (as at 31/12/2021)

WaveStone Australian Share Fund (WASF)	Carbon Intensity Scope (tonnes CO2e/sales)		
	Scope 1	Scope 2	Total
Portfolio - WASF	96.0	34.0	130.0
Benchmark - S&P ASX 300 Accumulation Index	98.3	54.5	152.7
Difference	-2%	-38%	-15%

Source: MSCI ESG (as at 31/12/2021)

## Engagement

### ESG-related Engagements during the Quarter

Company	ESG Category	Topics
ANZ	Environment Governance	Result and strategy. Growth areas such as sustainable finance. Management and Board succession planning.
APM	Governance	Feedback on listing process. Discussion on Governance given market feedback post IPO. Corporate strategy.
BHP	Governance	Provide feedback on unification vote with BHP and also Petroleum demerger.
CSL	Environment Governance	REM – Change in LTI to use EPS growth as a criterion. Lack of climate policy raised. Management succession planning.
CWY	Environment Social Governance	Meet new CEO. Raised Vision 40:40. Sought clarity on likely decarbonisation priorities.
EDV	Social Governance	Board objectives for the new entity. Social and Governance issues.
HPG	Governance	Board oversight and Governance
IAG	Social Governance	REM structured to reflect improvements for shareholders. Discussion around Risk framework and culture; given mispricing and product related issues.
IGO	Environment Social Governance	Governance of Tianqi JV, climate change and strategy.
LIC	Governance	Board objectives. Management succession planning.

MQG	Environment General	Post result meeting. Green Bank strategy. Sustainability of commodities earnings.
NAB	Environment Social Governance	AGM run-through. ESG policies on climate with focus on fossil fuel exposure
NEC	Social Governance	REM – appropriateness of targets and lack of disclosure. Capital allocation plans. Vision 40:40. Board composition and succession plans.
OSH	Governance	Discuss merger terms and update pre vote.
QAN	Social Governance	Management succession planning and Board structure. 40:40 Vision. Staff Retention
RIO	Environment Social Governance	Better understanding of culture post management and board changes. Priorities within the organisation. ESG catch up given upgraded capex, culture and portfolio strategy in response to climate change.
RMD	Environment Social Governance	Status of governance regarding regulatory reporting of insulation in CPAP machines post Philips recall. General trading conditions. Supply chain management issues.
STO	Environment Governance	Discussed merger with OSH and implications post COP26 meeting.
SVW	Governance	Understand further details regarding BLD governance. Board composition was also discussed.
SYD	Governance	Understand process of getting Scheme documentation to this point. Airports Act interpretation plus FIRB & ACCC. Timetable, next steps and risks of deal completion from here.
TCL	Governance	Better understand REM outcomes prior to FY21 AGM and REM structure for FY22 given WGT issue. Update on Board and management succession planning.
TPG	Governance	Governance structure given share sell-down by David Teoh. Corporate strategy. Integration progress.
WES	Social Governance	Remuneration (REM), Strategy; Management succession planning. REM - to understand any changes to framework. Supply chain and ethical sourcing.

# MSCI ESG Ratings

Summary

ESG Portfolio Snapshot  
WaveStone Australian Share Fund

MSCI ESG Rating  
AAA

Portfolio Scores

ESG Quality Score	Environmental (Weight - 20%)	Social (Weight - 44%)	Governance (Weight - 36%)	Portfolio Securities
9.5	4.8	4.9	6.9	46

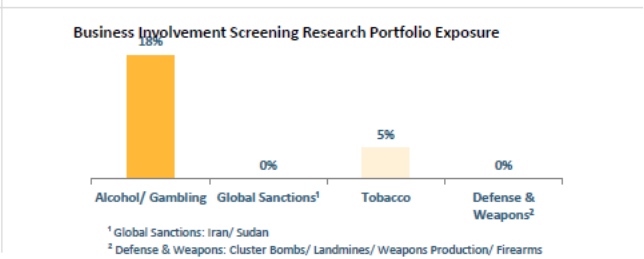
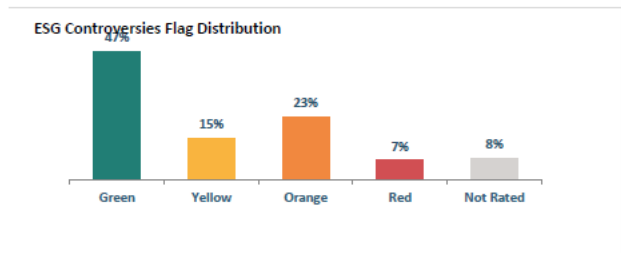
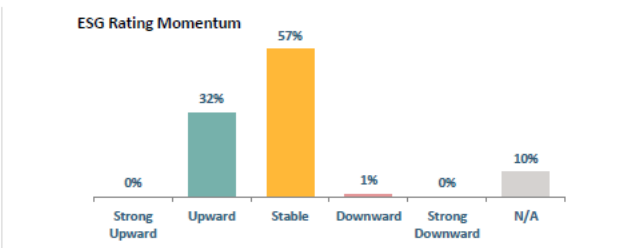
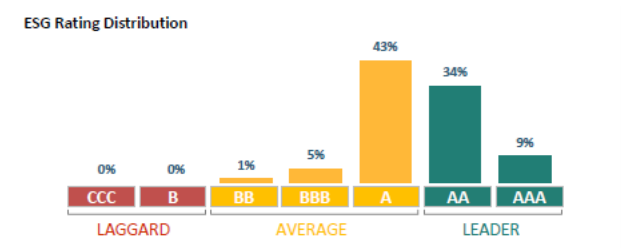
By # of securities

36	10
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By % of securities weight

92%	8%
MSCI Coverage	Not included in report analysis

**OVERALL ESG SUMMARY** Charts showing: By % of securities weight



**LARGEST 5 HOLDINGS IN THE PORTFOLIO**

ISSUER	PORTFOLIO WEIGHT	SECTOR	DOMICILE COUNTRY	ESG RATING	CONTROVERSIES OVERALL FLAG	BISR ACTIVITIES
CSL LIMITED	7.93%	Health Care	Australia	A	●	Animal Welfare
BHP GROUP LIMITED	7.10%	Materials	Australia	A	●	Nuclear Power
COMMONWEALTH BANK OF AUSTRALIA	5.74%	Financials	Australia	AA	●	No involvement
AUSTRALIA AND NEW ZEALAND BANKING GROUP LIMITED	5.59%	Financials	Australia	AA	●	No involvement
NATIONAL AUSTRALIA BANK LIMITED	5.53%	Financials	Australia	A	●	No involvement

## Memberships and initiatives

- Principles of Responsible Investment (PRI)
- Climate Action 100+
- 40:40 Vision

## Links to WaveStone Policies

- ESG Policy: **WaveStone ESG Policy**
- ESG Activity Report: **WaveStone ESG Activity Reports**
- Proxy Voting Policy: **WaveStone Proxy Voting Policy**
- Proxy Voting Records: **WaveStone Proxy Voting Records**
- Engagement Policy: **WaveStone Engagement Policy**
- **WaveStone PRI Transparency Report 2020**
- **WaveStone PRI Assessment Report 2020**

## Want more information?

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