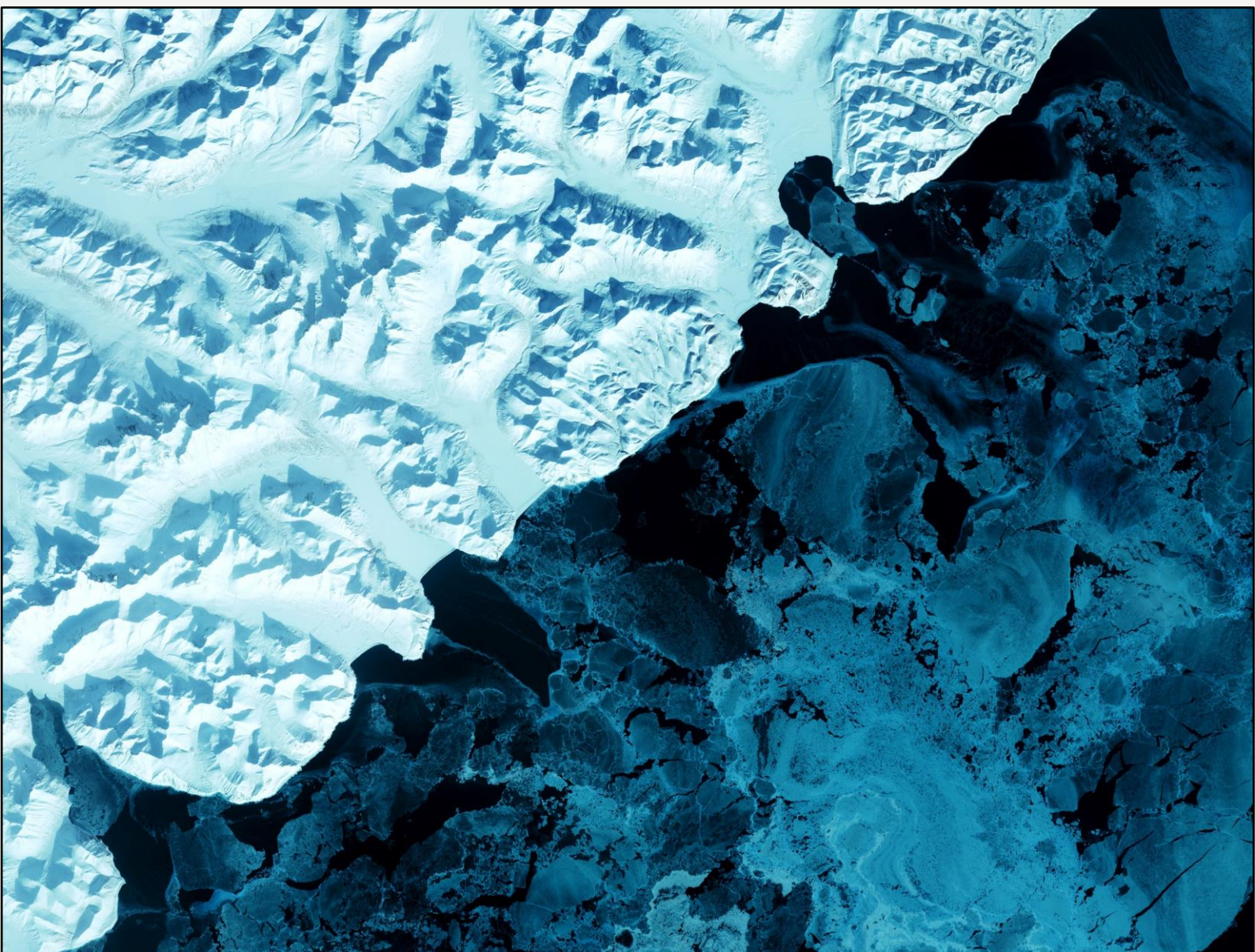


TCFD Report

Task Force on Climate-related Financial Disclosures
Report for the year ended 30 June 2021



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Our response to climate change

This report on our climate action follows the guidance of the Task Force on Climate related Financial Disclosures (TCFD). We cover strategy, governance, risk management and the metrics and targets we use to measure and manage our climate performance.

THE 2021 CLIMATE CONTEXT

As direct experience of the impacts of global warming grows, many are responding to the growing climate threat, but overall we see a continuing failure to act with the urgency needed to address climate change. Notable 2021 signposts included:

- [Climate Action 100+¹ research](#) told us critical Australian and global companies are not transitioning their businesses quickly enough. While some companies are setting longer term targets to reduce emissions to net zero by 2050, too many are not planning and acting today to get there.
- The International Energy Agency (IEA) published their [pathway to net zero emissions by 2050](#), and made it clear there is no investment in new oil and gas projects on that path. Alarming Carbon Tracker research showed that major global and Australian oil and gas companies (including Origin Energy, Santos, BHP and Woodside) are all planning capital expenditure which is not aligned with a pathway to net zero by 2050.
- The latest [report from the IPCC](#) (Intergovernmental Panel on Climate Change) told us that the timeframe for limiting global warming to a global average of 1.5°C is narrower than previously estimated. Every temperature increase matters, as does every tonne of greenhouse gas that is emitted. They called out that halting global warming requires strong, rapid, and sustained reductions in emissions that begin now.
- A growing number of countries set targets to reduce emissions to net zero by 2050 – and together those countries [account for over 70% of Australia's trade](#). The European Union (EU) foreshadowed [carbon tariffs](#) to be imposed on emissions intensive exports from countries without appropriate carbon pricing mechanisms.
- Australia carried on without the national climate policies needed to support a fast, fair and efficient transition to net zero by 2050. The [OECD reported](#) that Australia's emissions need to reduce faster to achieve the transition, and that carbon pricing will help incentivise the take up of low emissions technologies.

This is the context for our TCFD report this year: A growing climate change threat; stirrings of stronger responses to that threat; but too many stubbornly refusing to take the action needed. As we have done for 35 years, we apply our Ethical Charter to allocate capital, engage and advocate for an ethical climate response across business, government and society. And this year, as warming and the urgency for action has continued to grow, so has our climate ambition and action, including:

- A new [net zero by 2040](#) target for our investments
- Raising our [climate expectations](#) and greenwash-scrutiny for critical companies under our ethical investment criteria
- Growing focus on important and harder-to-transition industries like [building materials](#)
- [Advocacy](#) for comprehensive Commonwealth climate legislation for a fair and efficient economic transition to reduce climate risk and unlock climate opportunity.

¹ Climate Action 100+ is a global program of engagement by investors with the world's largest producers of GHG emissions, to work with these companies to align their businesses with the transition to net zero by 2050.

OUR STRATEGIC RESPONSE TO CLIMATE AND NET ZERO 2040 TARGET

Australian Ethical is pursuing an aggressive growth strategy to build a bigger, more impactful business. We aim to leverage the business tailwinds for responsible investment for our own growth and importantly also to help maintain and grow sustainable investment standards and impact across the investment sector. In a climate context, our growth will allow us to scale up our contribution to the rapid economic transformation needed to accelerate the reduction of greenhouse gas emissions. With this in mind, we have set a 2040 net zero target for our company and other private sector investments, bringing forward the 2050 target we set in 2015.

Why 2040?

The world is not currently on track for the critical global goal of net zero by 2050 – not because it cannot, but because key actors lack ambition. At the same time, damaging impacts of climate change are arriving sooner than predicted by many climate models. Ambitious transformational decarbonisation pathways exist that are able to repower energy with renewables and batteries, to restore land in a manner that draws down carbon and boosts sustainable agriculture, to decarbonise the built environment with reduced embedded energy in materials, and to directly capture carbon to abate sectors that are harder to transform. These pathways become more commercially viable as bold investors demonstrate leadership, driving technologies down the cost curve. However, these pathways are resisted by some commercial and political actors, including some nation states that lack the vision to drive positive transformation and turn disruption into opportunity. Australian Ethical wishes to demonstrate conviction for what is possible and commitment to what is necessary by driving its portfolio to net zero by 2040.

Our ambitious 2040 target and opportunity is achievable. For global emissions to reach net zero by 2050, the world will need diverse successful zero emissions businesses operating across the economy by 2040. Those zero emissions businesses which are leading in the management of climate risk and opportunity are the businesses we want to invest in, so that by 2040 we can offer our clients high performing, zero emissions portfolios. Setting a net zero 2040 target helps drive increased Australian Ethical capacity and innovation to make this a reality. While IPCC and IEA analysis makes clear the scale of action needed for global net zero by 2050, current transition paths can still be accelerated through a range of factors including stronger climate policy, more rapid scaling and improvement of clean technologies, and increased corporate ambition and green consumer demand.

What about public sector investment?

Our net zero target is for our investment in the private sector, not for our investment in government bonds and other public sector investments. Governments have a huge role to play in setting policies and allocating capital to drive the transition to net zero. However, we recognise that whereas a company can take action to decarbonise ahead of others, individual countries may have less flexibility to do this when they have responsibilities and activities across the entire economy and society. Some developing economies may be slower to transition, and responsible investors will have a role to continue to contribute capital to support this transition.

There will also be countries which irresponsibly delay climate action even though they have the capacity to act. We will continue to advocate for stronger climate policy from those climate laggards.

Other targets

We are currently reviewing nearer term climate targets, which we plan to have verified under the Science Based Targets initiative (SBTi).

2021 CARBON FOOTPRINT OF OUR 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. This year we report three carbon footprint measures for our share investments.

Carbon measure:	"Carbon intensity"	"Carbon emissions"	"Carbon exposure"
Description:	Investor share of company carbon emissions / Investor share of company revenue	Investor share of company carbon emissions / Amount invested	Average of carbon intensity of companies invested in (weighted by % of investment portfolio)
Climate significance:	Measures carbon relative to value of products and services	Measures carbon relative to \$ invested	Measures portfolio exposure to carbon intensive companies
AE share investments:	48	23	87
Benchmark²:	208	86	135
	t CO2e per \$m revenue	t CO2e per \$m invested	t CO2e per \$m revenue
AE % below Benchmark	77%	73%	36%

For the last six years we have tracked and reported our share investment footprint using the "carbon intensity" measure, which measures our share of companies' carbon emissions relative to the value of the products and services they produce. The carbon intensity measure is a guide to the carbon efficiency of the positive products and services which we invest in.

The carbon intensity of our share investments remains about one quarter of the share market benchmark, 77% lower than the market. Over the 18 months³ since our last footprint reporting, the carbon intensity of our share investments and the benchmark have reduced slightly (by about 2% and 1% respectively), with the historical trends shown in the following graph. The other two carbon footprint measures for our share investments are also well below benchmark, though not to the same extent. The differences are due to the different calculation methods, and we discuss later how some of the higher carbon companies we invest in effect the different carbon footprint measures.

Why is our carbon footprint low?

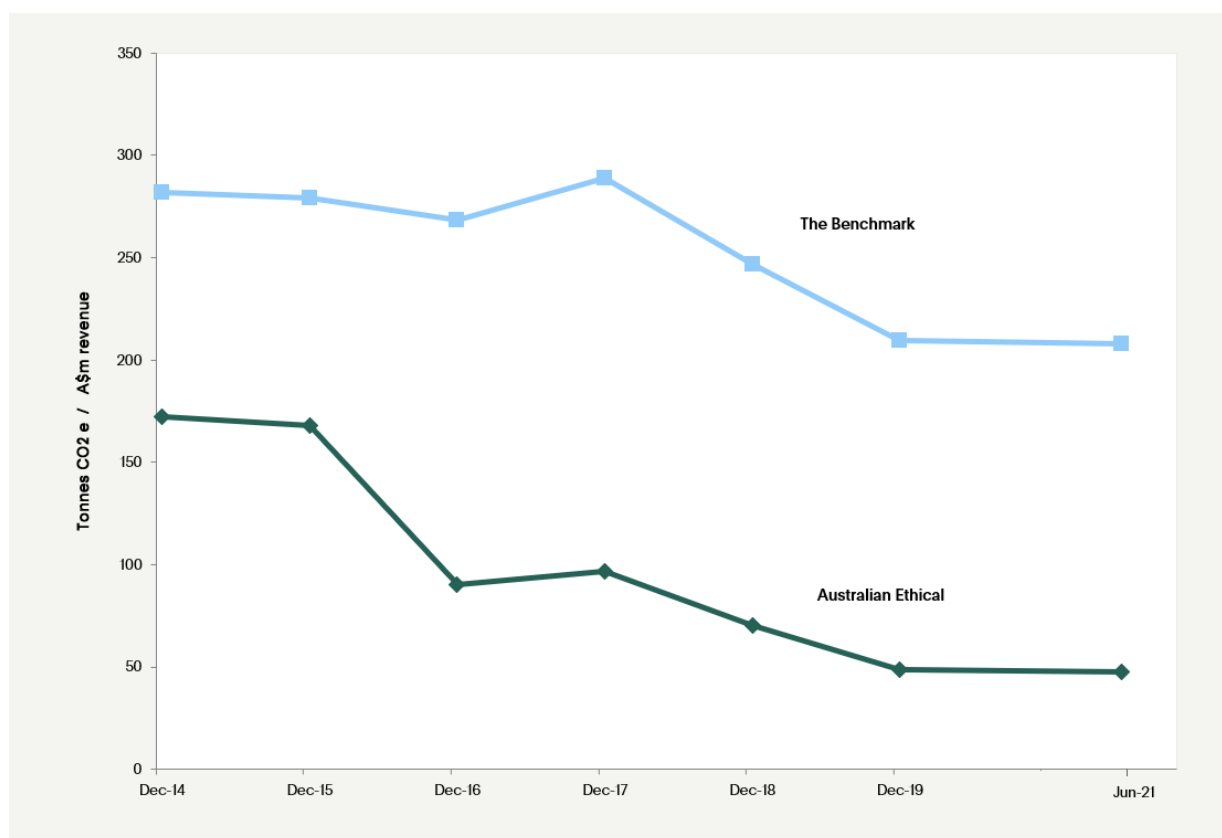
A range of factors contribute to our lower carbon footprint. We have lower investment in high emissions industry sectors such as mining and traditional energy, and higher investment in lower emission sectors such as information technology (IT) and communications.

We do also have higher investment in the high emissions 'Utilities' sector. But because our utilities investments include lower carbon renewables companies like Contact Energy, our overall investment in this sector lowers our footprint compared to the benchmark.

² 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).

³ The period is 18 months because we will now report these carbon metrics as at the end of the financial year, rather than at the end of the calendar year.

Carbon intensity of our share investments



This chart shows the carbon intensity of our share investments, as at the end of each calendar year 2014 to 2019, and for this year at 30 June 2021. The 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 carbon intensity is calculated from direct and some indirect emissions (Scope 1 & 2 emissions) of the companies relative to their revenue.

Fossil fuel reserves

Carbon footprinting doesn't capture all important climate risks. Fossil fuel reserves aren't included 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.

Fossil fuel reserves per A\$1,000,000 invested		
	Our share investments	Share market benchmark
Thermal coal reserves	Zero	1,320 tonnes
Gas reserves	Zero	950 barrels of oil equiv.
Oil reserves	Zero	520 barrels of oil equiv.
Potential emissions from fossil fuel reserves	Zero	2,960 tonnes CO2 equiv.
From thermal coal, oil sands, shale oil and shale gas	Zero	2,550 tonnes CO2 equiv.

Who are the most carbon intensive companies in our portfolios?

Even for low carbon portfolios like ours, analysing our investment carbon footprint is important to check the ethical rationale for our investment in any higher emissions companies. The table below lists our ten most carbon intensive companies and why we still invest in them under our Ethical Charter, even though they are involved in energy intensive activities such as managing waste and operating data centres.

Company	Country	Company Carbon Intensity*	Positive under our Ethical Charter
Pilbara Minerals Limited	Australia	2,798	Lithium for lithium-ion batteries for electric vehicles and storage.
Covanta Holding Corp	USA	1,761	Waste treatment, recycling and disposal, including energy generation from waste incineration
Nextdc Limited	Australia	1,187	IT servers and data centre infrastructure. They are energy hungry but overall help efficient use of resources.
Ausnet Services Ltd.	Australia	989	Electricity network infrastructure needed for the transition to 100% renewables. They are emissions intensive because of the energy lost (as heat) when electricity passes through the networks.
Spark Infrastructure Group	Australia	973	
Veolia Environment Sa	France	771	Water and waste management and treatment
Orocobre Limited	Australia	599	Lithium for lithium-ion batteries for electric vehicles and storage
Digital Realty Trust, Inc.	USA	583	Data centres
Contact Energy Limited	New Zealand	516	Renewable electricity (hydro and geothermal)
Boral Limited	USA	442	Building materials including lower carbon concrete

* t CO2e / A\$M revenue.

Three of these companies alone contribute to 50% of the “carbon exposure” measure of our portfolio footprint because of their carbon intensity and our high level of investment in them. Despite this they have an important role to play in the net zero transition and our portfolio:

- Pilbara Minerals’ lithium is needed for electric vehicles and energy storage for a renewable powered electricity grid.
- Spark Infrastructure’s electricity networks enable increased electrification of our lives and businesses, increasingly using renewables.
- Contact Energy contributes to that essential renewable energy supply with their hydro and geothermal generation.

Impact data by option

This year we have calculated and communicated [climate-related metrics for individual Australian Ethical superannuation investment options](#). This includes carbon intensity and renewables mix, as well as how revenue earned by companies in the different options and funds contribute to the Sustainable Development Goals (SDGs).

Carbon footprinting methods and limitations

Company carbon data often includes estimates and errors, and so footprint and reserve calculations need to be used with caution. There are also different measurement methodologies, and different carbon metrics which can be used to assess carbon footprint, each with different strengths and weaknesses. There is more information in the Supplementary Information at the end of this report, and also [here](#).

Assurance

KPMG have provided limited assurance over key sustainability disclosures in our TCFD reporting, including this year's carbon footprinting of our share investments. KPMG's assurance opinion is available [here](#).

OUR RENEWABLES INVESTMENT FOR A ZERO EMISSIONS WORLD

We monitor our investment in renewable power generation and our contribution to the massive global shift to renewables required to limit warming to 1.5°C. Our analysis this year showed that our share investment in renewable power generation (including solar, wind and hydro) is proportionately about 13 times that of the share market benchmark⁴⁵.

We also look at how quickly companies are growing their renewables capacity. This is particularly important where renewable energy generators still have some fossil fuel exposure. For example, Contact Energy generates about 80% of its electricity from hydro and geothermal renewables, and has been investing in new geothermal to fill gaps when low rainfall reduces hydro-power generation. Contact's new 150MW Tauhara geothermal power station is expected to be complete and operational in 2023. Contact's geothermal plants already supply 8% of New Zealand's electricity and that will increase to 10% once Tauhara is built. Contact considers Tauhara to be New Zealand's best low-carbon renewable electricity opportunity: "It will operate 24/7, is not reliant on the wind blowing or the sun shining to generate power. Geothermal will play a crucial role in New Zealand's transition away from fossil fuels."

In previous years we have reported on renewables growth planned by companies in our portfolio, compared to future emissions reduction scenarios like the International Energy Agency (IEA) Sustainable Development Scenario and Beyond Two Degrees Scenario. While this sort of analysis can be important, it has limitations because of the many factors which affect company decisions about when and where to invest in new power generation. Government climate policy is critical, with renewables investment in Australia constrained by continuing government failure to implement an effective carbon pricing mechanism to reduce the uncertainty companies face when making longer term investment decisions. Expected renewable energy demand in relevant markets is also important and influenced by things like increasing energy efficiency, industry shifts and grid capacity. There are also limitations to this sort of scenario analysis because of gaps in the underlying data and tools we have used – for example, they do not capture the new Tauhara geothermal project discussed above.

For these reasons we are developing a new approach to track our investment in new renewables capacity and other climate solutions. We are reviewing indicators and targets to help us continue to focus on how we can grow our contribution to the massive shifts of capital needed for the net zero transformation.

THE RESILIENCE OF OUR REAL ESTATE AND INFRASTRUCTURE INVESTMENT

Real estate and infrastructure are exposed to many physical impacts of different levels of global warming. Insurance may provide some short-term protection, but insurance costs will continue to increase. In some cases risks will be so extreme that insurance will become unaffordable, or simply not available at any price.

Last year we reported on how our external managers were responding to these growing climate-related risks. We discussed the challenges property investors face in assessing and managing physical climate risk in their portfolios, including the diversity and uncertainty of climate impacts. Investors also need to translate different climate impacts into financial impacts, for individual assets and for investment portfolios. This is important for investors to understand their investment risk and to encourage action to increase the resilience of new and existing buildings. It can also encourage more urgent action to reduce emissions and limit dangerous climate change, because scenarios aligned with net zero by 2050 and earlier pose less physical threat to property than higher warming scenarios.

This year our property and infrastructure managers Investa, Dexu and Morrison & Co have undertaken work to tackle the task of assessing asset and portfolio climate impacts under different warming scenarios. In some cases this included consideration of scenarios with expected temperature rise of over 7°C by the end of the century. While it is uncomfortable to contemplate these higher warming outcomes, we see this work as crucial. Firstly it can guide prudent decisions about capital expenditure to build and protect assets and people. More importantly it will build greater understanding of the great economic threat we face if we continue to respond too slowly to climate change.

⁴ 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).

⁵ We used analytic tools from the European 2° *Investing Initiative* ('2ii') for this review of our renewable power generation investment. There is more information in the [Supplementary Information](#) at the end of this report.

THE MANY IMPACTS OF CLIMATE CHANGE FOR OUR BUSINESS

The latest IPCC report tells us global temperatures will likely exceed 1.5°C in the next two decades and rise well above that across the century without immediate and stronger action to 2030. The biggest direct impact of this global warming on Australian Ethical's business is its effect on our investment portfolios. The prospects and value of the businesses we invest in are exposed to risks and opportunities flowing from the many effects of climate change.

Changes in temperature and rainfall are already affecting the productivity and viability of different types of agriculture. Physical impacts like 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.

Government climate policy action and inaction can radically alter the prospects of companies' products and technologies. A price on carbon and higher clean air standards will favour renewables over fossil fuels. Tougher emissions restrictions on new vehicles will help hybrid and electric over conventional vehicles.

Consumer climate action also affects business values when consumption choices favour businesses helping to reduce greenhouse gas emissions, and shun big contributors to global warming.

We've summarised the timing of key climate impacts in the following table. Although some more severe consequences of climate change may arise only in the longer term, the regulatory and consumer action taken in the short term can accelerate both positive and negative impacts on the value of investments.

Beyond more immediate impacts on more climate exposed industries like energy and agriculture, climate change has flow-on effects across the economy. With strong, well planned climate action, the growing availability of cheap and decentralised clean energy will invigorate many existing industries and enable new ones. But if we are slow to act we face not only economic disruption but also great social disruption, from growing inequality and movement of people from places hardest hit by the physical and economic effects of climate change.

Timing of climate impacts	
Short term 0-3 years	<ul style="list-style-type: none"> Nearer term physical impacts of temperature increase such as more extreme weather, fires, drought and flooding; and flow-on effects on climate sensitive sectors such as agriculture. Changes in customer demand due to evolving expectations for climate action by business. Changing government energy and climate policies and regulation such as tougher emissions standards and carbon pricing.
Medium term 3-10 years	In addition: <ul style="list-style-type: none"> Progressive physical impacts of temperature increase such as increases in sea level, and consequential technological, supply chain and other business and social disruption, including impacts on human health and well-being. Growing pressure on threatened species. Disruption of global trade from international disagreements about climate action and inaction. And from changing patterns of production and demand and growth.
Long term 10-100+ years	In addition: <ul style="list-style-type: none"> Social, political and economic disorder from climate harm suffered by people (including their displacement) and from increased inequality because different groups and countries suffer more harm than others. Disrupting effect of potential and actual conflict between countries.

HOW WE RESPOND TO CLIMATE-CHANGE AND PURSUE NET ZERO

Our [Ethical Charter](#) applies to all our investment strategies and products. It requires us to assess short, medium and long term impacts on people, animals and the environment. This guides us to invest in a way which minimises dangerous climate change. We aim to drive change in three main ways:

1. our investment choices
2. our advocacy and engagement on climate action and policy, and
3. reducing and offsetting our own operational emissions

Key features of our approach related to climate risk and opportunity are:

Investment screening

Investors can help limit global warming if they only choose companies with strategies aligned with limiting warming to below 1.5°C. By shifting capital from fossil fuels to renewables, investors help to bring down the price of renewable energy, they encourage investment in more flexible electricity grids and energy storage, and they contribute constructively to a sensible public discussion about energy policy. These investors, particularly universal investors like super funds, are also acting in the financial interests of their customers, because we believe that sustainable, risk-adjusted returns will be better in a low-warming world than a high-warming one.

In our day-to-day investing, 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 don't invest in companies assessed to be obstructing the objectives of the Paris climate 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 criteria also take account of the ever-growing climate change threat and our increased climate expectations for companies in climate-critical sectors. For example:

ENERGY

We seek out investment in clean energy solutions like energy efficiency, renewable energy and energy storage. Current investment include wind, solar, hydro and geothermal energy, battery storage, LED lighting, insulation, and clean energy technology start-ups (through the Artesian Clean Energy Seed Fund). We don't invest in oil, gas or coal companies, but we will invest in a transition company like Contact Energy which in the last financial year generated 81% of its electricity from hydro and geothermal renewables. As mentioned earlier, Contact is investing to grow its geothermal capacity to reduce the need to fall back on gas when low rainfall reduces hydro-power generation.

We won't automatically approve renewables companies under our Ethical Charter; we also consider whether they are operating their businesses responsibly. This year we divested from Siemens Gamesa Renewable Energy over human rights concerns. The company's wind turbines supply energy for the extraction of natural resources by Morocco in the occupied territory of Western Sahara.

FINANCIAL SERVICES

We expect large banks to align their institutional lending activities with the objectives of the Paris Climate Agreement. We consider both their restrictions on fossil fuel lending and action to support climate solutions like renewable energy, energy storage, green buildings and low-emissions transport.

FOOD SECTOR

We restrict investment in current systems of commercial animal agriculture including meat, dairy, eggs and seafood. We focus on investment in lower emissions plant-based protein and nutrition. The World Resources Institute assesses that "beef requires 20 times more land and emits 20 times more greenhouse gas emissions per gram of edible protein than common plant proteins, such as beans".

Through the Morrison & Co Growth Infrastructure Fund, we invest in Sundrop Farms which grows truss tomatoes in arid conditions in South Australia, meeting part of its irrigation needs with sea water which is

desalinated with power from a concentrated solar power tower system. This year we excluded food company Guzman y Gomez, because its menu relies heavily on ingredients which don't meet our climate, health and animal welfare criteria for sustainable food.

TRANSPORT SECTOR

We restrict investment in conventional cars and trucks and in air travel because of their high emissions intensity compared to rail, ships and buses and other forms of public transport. While we'll invest in low emissions transport like rail, in some cases we exclude companies for their business focus on fossil fuel freight, including Australian Rail Track Corporation (ARTC), Aurizon and Pacific National. This year we also excluded ARB Corporation which produces and sells accessories for high footprint 4WDs without helping the transition to lower footprint vehicles.

REAL ESTATE SECTOR

We will not invest in general purpose residential, office, retail or commercial property portfolios where they demonstrate below average environmental sustainability, with energy efficiency being a key factor. This year both Lifestyle Communities and National Storage REIT failed to meet our environmental sustainability criteria for their homes and self-storage facilities.

MINING SECTOR

Minerals will only be assessed as positive under our Ethical Charter if the continued extraction and use of the mineral is aligned with the transition to a world which limits warming to 1.5°C; or if it plays a significant role in an efficient net zero transition for society and the economy. Our current mining investments include lithium and potash.

ACROSS SECTORS

Companies in any sector may be excluded for obstructing the Paris agreement objectives where they are assessed to be obstructing informed climate policy debate; they specialise in servicing the fossil fuel sector; or they show general disregard for energy efficiency in their operations where they are involved in production of emissions intensive products and services.

Influencing companies

We engage with companies to influence better management of the climate impacts of the way the company's products and services are produced, supplied, consumed and disposed of. We encourage better measurement and reporting of direct and indirect greenhouse gas emissions; short- and long-term emissions reduction targets; and analysis of the resilience of the company's business strategy to different climate scenarios. We aim to reduce companies' contribution to global warming as well as reducing climate-related harm to their business prospects. Through engagement we also build our own understanding of climate-related risk.

We exercise our influence through private engagement, voting at company meetings, public praise or criticism, shareholder resolutions and divestment. Often this occurs when we are gathering and reviewing company data to assess companies against our climate and other ethical criteria. We communicated with many companies on climate related issues this year, including in real estate, mining, construction materials and financial services. We encouraged companies to show stronger climate ambition, and to demonstrate the action they are taking today to set strategies and allocate capital which puts them on a path to net zero by 2050. When we are assessing climate action, we examine whether the company is addressing its most significant direct and indirect emissions, and whether it is setting evidence-based targets aligned with the Paris Climate Agreement.

One focus this year was the building materials sector, a huge contributor to global carbon emissions, but also essential for our homes, buildings and infrastructure. As emissions reduction technologies are being developed for this sector, we are looking for opportunities to invest selectively in companies taking action to put their high carbon products on a path to net zero. This year we engaged with eight building product

companies and two infrastructure companies about their progress and the barriers and opportunities for the sector to transition in line with the Paris Agreement.

This year we co-filed for the third successive year a shareholder resolution calling on QBE to align its underwriting and investment of oil and gas assets with keeping the climate goals of the Paris Agreement. At QBE's AGM, the company's Chair claimed QBE will be working with oil and gas customers to confirm they are on the transition path. We voiced our concerns that QBE's oil and gas customers are planning capital expenditure that is not aligned with the Paris Agreement.

The most effective climate response requires strong action by all of government, business and citizens. We therefore scrutinise lobbying or other action by companies which undermines sensible public climate policy. Sadly, many companies and their industry associations have encouraged climate disinformation and made political donations which have helped to derail constructive climate debate and policy. We support shareholder resolutions calling for greater transparency about corporate climate change positions. We continue to focus on areas where a company is a member of an industry association which lobbies for policy which contradicts the member company's own stated position.

Further details of our company climate engagement and advocacy are included in our annual sustainability and engagement reporting.

Investment industry influence

By sharing experience of investment climate opportunities and challenges, we can learn from other investors and encourage broader investor support for strong climate action. We are active participants in the climate focussed work of the Investor Group on Climate Change (IGCC) and Climate Action 100+. We chair the IGCC Transparency and Thought Leadership working group, which helps investors develop and share climate reporting good practice. We are a lead and support investor for several Climate Action 100+ engagements, and also contribute to their research work on transition paths and challenges in the energy sector, including for gas and hydrogen. In early 2021 Climate Action 100+ published their benchmarking report on the climate performance of over 100 of the world's largest emitters. We spoke in the media to help publicise the report findings, and call for more urgent action by these systemically important companies.

We also participate in the work of FAIRR, a global network of investors focussed on sustainable food and representing \$50 trillion in assets under management. Through FAIRR and Climate Action 100+ we have been engaging with the two major supermarkets about how they will address the emissions and deforestation in their supply chain (from their food and other products), and their role in helping consumers make more sustainable food choices, including more plant-based protein over animal protein.

Public climate voice and policy advocacy

Investment decisions affect cost of capital, but often the most powerful impact of ethical and responsible investing is the public praise and disapproval associated with decisions to invest in sustainable businesses and to divest from or criticise unsustainable ones. The balanced voice of long-term investors is needed alongside voices of business and civil society (which are often more narrowly focussed). It can inform and influence government and business directly, and it can inform and influence citizens and consumers who hold government and business to account.

Through policy submissions, consultation with government and our public voice we aim to encourage more effective climate policy, including better energy policy, carbon pricing and corporate climate disclosure. Australian Ethical communicates continuously with a variety of audiences about climate, including calls for climate action in mainstream and social media, as well as more technical perspectives in finance industry media and public policy submissions to government. Our message is consistent though tailored. For non-specialists we develop clear and engaging content with a call to action, including in our website blog.

We strongly supported the private members Climate Change Bill introduced into parliament by Zali Steggal in November 2020. We made a submission to the parliamentary inquiry considering the Bill, and spoke in support in the media. The Climate Change Bill would provide a much needed national, long-term framework for climate change mitigation and adaptation.

As governments around the world responded to COVID-19 with unprecedented amounts of public expenditure, we called for the Australian government to design economic stimulus which promotes both public and private sector action to address climate change and support resilient and sustainable infrastructure and technologies. In the media and at industry roundtables and webinars we've called for:

a 2050 net zero emissions target and a comprehensive carbon pricing scheme to drive innovation and investment to meet the Paris climate objectives

support for WWF's Renewable Recovery plan, including for an Australian green hydrogen and steel industry powered by Australian renewables

recognition that the gas growth spruiked by the gas sector and government will exacerbate not mitigate climate change

Further details of our government policy submissions and engagement are included in our annual sustainability and engagement reporting.

Investment portfolio management

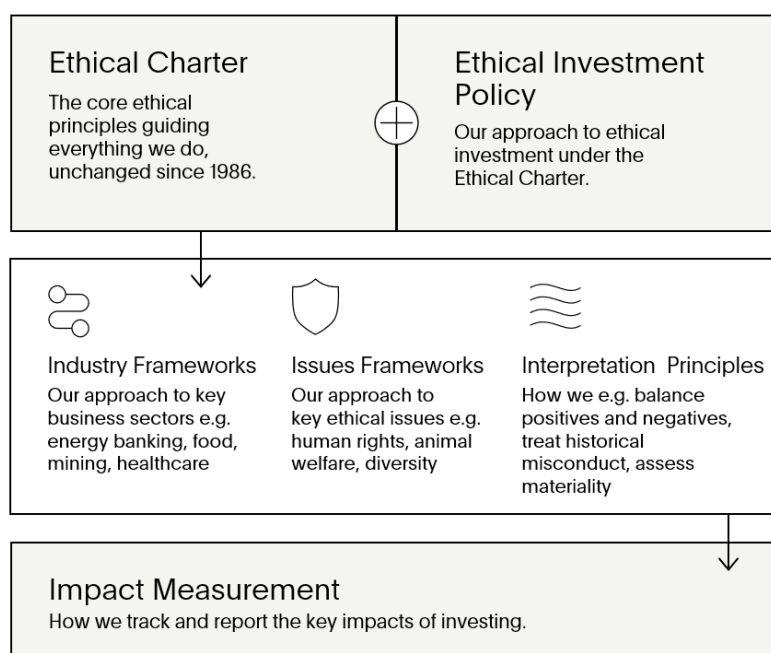
Our ethical screening process outlined above eliminates many high carbon risk companies from our investment universe and portfolios. Our ethical research of the climate impacts of companies and industry sectors and their products and services can also assist us in identifying climate-related financial risks and opportunities and feed into our buy, sell and portfolio management decisions for those companies which are part of our investment universe. For example, company prospects and valuations in the energy sector may be affected by our assessment of the future regulatory environment for the sector.

GOVERNING CLIMATE-RELATED DECISION MAKING

Our approach to ethical investment is governed by our Ethical Charter. The Charter principles are applied using our ethical frameworks, policies and measurement systems. These require detailed assessment of the impacts of climate change on people, animals and the environment, which in turn affects the way we invest including through negative and positive screening, engagement and advocacy, and climate performance measurement and reporting.

Our Chief Investment Officer and Head of Ethics Research 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 for emissions intensive sectors. The Board of directors has oversight of our ethical frameworks, with quarterly reporting to the Board of changes to frameworks and critical ethical issues.

Our ethics research team applies our Ethical Charter on a day-to-day basis in our investment screening and ethical stewardship. The team monitors existing and emerging ethical risks (including climate-related risks) using diverse company, industry, government, responsible investment, scientific, civil society and news sources.



CLIMATE RISK MANAGEMENT

We identify, assess and manage material climate-related investment risks through our ethical investment process. For example, 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 1.5°C. These companies are 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 global warming threatens to disrupt trade and financial markets and carries significant risk of loss to all investment portfolios.

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.

The ethics research team assesses whether these developments require review of our existing ethical assessments of companies and industry sectors, including our company engagement priorities. As an example of this process, our periodic ethical review of a carbon intensive sector like the energy sector takes into account changes in renewable energy and energy efficiency and storage technologies and their social and environmental impacts; changes in levels of atmospheric carbon; changes in scientific understanding of the pace, extent and impacts of global warming; changes in energy infrastructure such as the grid; and changes in energy market supply and demand. Consequential changes to our ethical framework for the energy sector and engagement objectives are prepared by the ethics research team and reviewed and approved by the Chief Investment Officer and Head of Ethics Research. These changes may include additional investment exclusions or inclusions (e.g. a change in our screening of biofuels), or a change in our engagement and advocacy objectives and priorities for companies in the sector. The changes to our energy sector framework may then have flow on effects to other frameworks (e.g. to the way we assess the alignment of banks' lending with the Paris Agreement under our banking framework).

MEASUREMENT, TRANSPARENCY, ACCOUNTABILITY

We measure and report annually on our climate performance, including the [emissions intensity of our share investments](#) (portfolio carbon footprinting), our [operational carbon footprint](#) and the extent of our [investment in renewables](#). This helps us test the effectiveness of the application of our Ethical Charter to manage climate risk and opportunity, as well as our progress towards our net zero emissions target for our investments.

The current focus of our ethical screening and engagement is the need to reduce emissions to limit dangerous climate change (mitigation of climate change), and the above measurement metrics reflect this mitigation focus. Of course it is also crucial that companies have business models, strategies and assets which are adaptable and resilient to the physical impacts of current and future climate change, and we have reported some information in the last two years on [approaches to resilience by our real estate and infrastructure managers](#). We continue to look for opportunities to analyse and report on physical risk and resilience in other ways, including at a portfolio level.

We do not currently report the impact of different emissions and temperature increase scenarios on the value of our investment portfolios. Our ethical investment approach recognises the power which investors have to help positively shape the future, including to help limit climate change which we expect to be positive for our portfolios. By shifting capital from fossil fuels to renewables, investors help to bring down the price of renewable energy and encourage investment in more flexible electricity grids and energy storage. They are also acting in the financial interests of their clients because we believe that risk-adjusted returns will be better in a low-warming world than a high-warming one.

We have trialled some external tools to "stress test" our portfolios under different transition scenarios. The insight these provide has been limited by their restricted coverage of the companies and sectors we invest in. We are investigating options for more comprehensive stress testing and reporting of testing results.

OUR OPERATIONAL EMISSIONS

In order to work towards becoming a net zero business we need to look at our operational footprint. 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 our direct operational emissions and offsetting what's left.

Last year we worked with consultants Pangolin Associates to review and expand the scope of our operational footprint measurement and offsetting from previous years which focussed on the emissions from our electricity use and business travel. In 2020 the expansion included emissions from food and drink, furniture and IT equipment, external IT support, staff commuting to and from work, and traditional (non-digital) advertising. Although many companies do not include advertising in their operational footprint, we consider advertising an integral part of growing our business for the benefit of all stakeholders. In our 2020 Sustainability Report we were unable to include digital marketing in scope as we did not identify a reasonable basis for estimating those emissions, but we did commit to monitoring calculation developments. We're excited to report that this year we worked with Net Zero Media (NZM), a pioneering emissions measurement and analytics technology provider that uses proprietary technology to measure emissions from marketing and advertising activity, to bring digital marketing into scope. In addition to applying a reasonable calculation methodology to our digital marketing, NZM was also able to more accurately calculate our traditional marketing activity using their "micro measurement methodology". The previous input/output method spend based formula used in FY20 can overstate actual emissions and as a result of the more granular methodology being used this year we have seen a decrease in the emissions from our FY21 traditional marketing activity. There are also a number of other emissions categories where the emissions calculations methodologies have become more accurate resulting in lower emissions in FY21, such as base building electricity and postage.

As a result, despite the increase in scope as well as an increase in employee count, our FY21 operational emissions reduced by more than 20% from the previous year to 350 tonnes CO₂-equivalent. There's a detailed breakdown with all additional inclusions in the Supplementary Information at the end of this report.

REDUCING EMISSIONS

We limit our operational emissions in a number of ways. We purchase renewable electricity for our directly metered office power. We consider climate performance in our selection of significant suppliers of products and services. We continue to explore further action we can be taking, and the expansion of our emissions measurement will contribute to our understanding of where we can have the greatest impact. The disruption caused by the current pandemic has also highlighted opportunities to limit business and commuting travel emissions through increased use of online meeting technologies and more flexible work practices. At the same time we will need to consider management of additional employee home emissions from increased work at home.

OFFSETTING EMISSIONS

We continue to offset our reported operational emissions. Carbon offsetting plays an important role for companies on the journey to net zero by 2050, 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 continued to offset our operational footprint through carbon credits from the West Arnhem Land Fire Abatement (WALFA) project, run by an Aboriginal-owned, not-for-profit carbon farming business. The WALFA project supports Traditional Owners in utilising customary fire knowledge to accomplish largescale fire management on country. Our Foundation provides funding to the Mimal Land Management Aboriginal Corporation (Mimal) women's program via the Karrkad Kanjdji Trust, and Australian Ethical are proud to further support Mimal's work through the procurement of their carbon abatement services. Ranger programs and the income they generate from offsetting programs have wide reaching benefits, not just for the climate but for all communities and people involved, as well as preserving species, land and culture.

In FY21 our marketing business partner JC Decaux helped offset our projects with them using credits from the Redd Forests Grouped Project: Protection of Tasmanian Native Forest, Australia. These generate carbon credits through avoided deforestation in the Midlands region of Tasmania over a 25-year period⁶ By avoiding deforestation, the project also helps protect nine endangered and 22 vulnerable species close by the areas.⁷ While there are merits to avoided deforestation method carbon credits, there have been some concerns raised about the robustness of the methodology and the permanence of the credits (See the recent report released by The Australia Institute, *Questionable integrity: Non-additionality in the Emissions Reduction Fund's Avoided Deforestation Method*). This scrutiny of different sources of carbon offsets is important to provide security that the promised carbon benefits will be realised; that they will be lasting; that non-carbon benefits and harms are considered; and that payment is being made for new (additional) carbon removal. This is crucial to drive capital to the most effective carbon removal activities. For this reason, we went back and asked JC Decaux some questions around their approach to choosing carbon credits to offset business activity. By starting conversations like these, we and our business partners can better understand the complexities surrounding different carbon credit options.

BREAKDOWN OF OUR OPERATIONAL CARBON FOOTPRINT

Our operational footprint in FY21 and FY20 were much larger than previous years because of the additional inclusions discussed above. The detailed breakdown is on the following page. Big contributors to our footprint include significant emissions from our advertising (discussed above) and external IT assistance (who support the work of our internal IT staff).

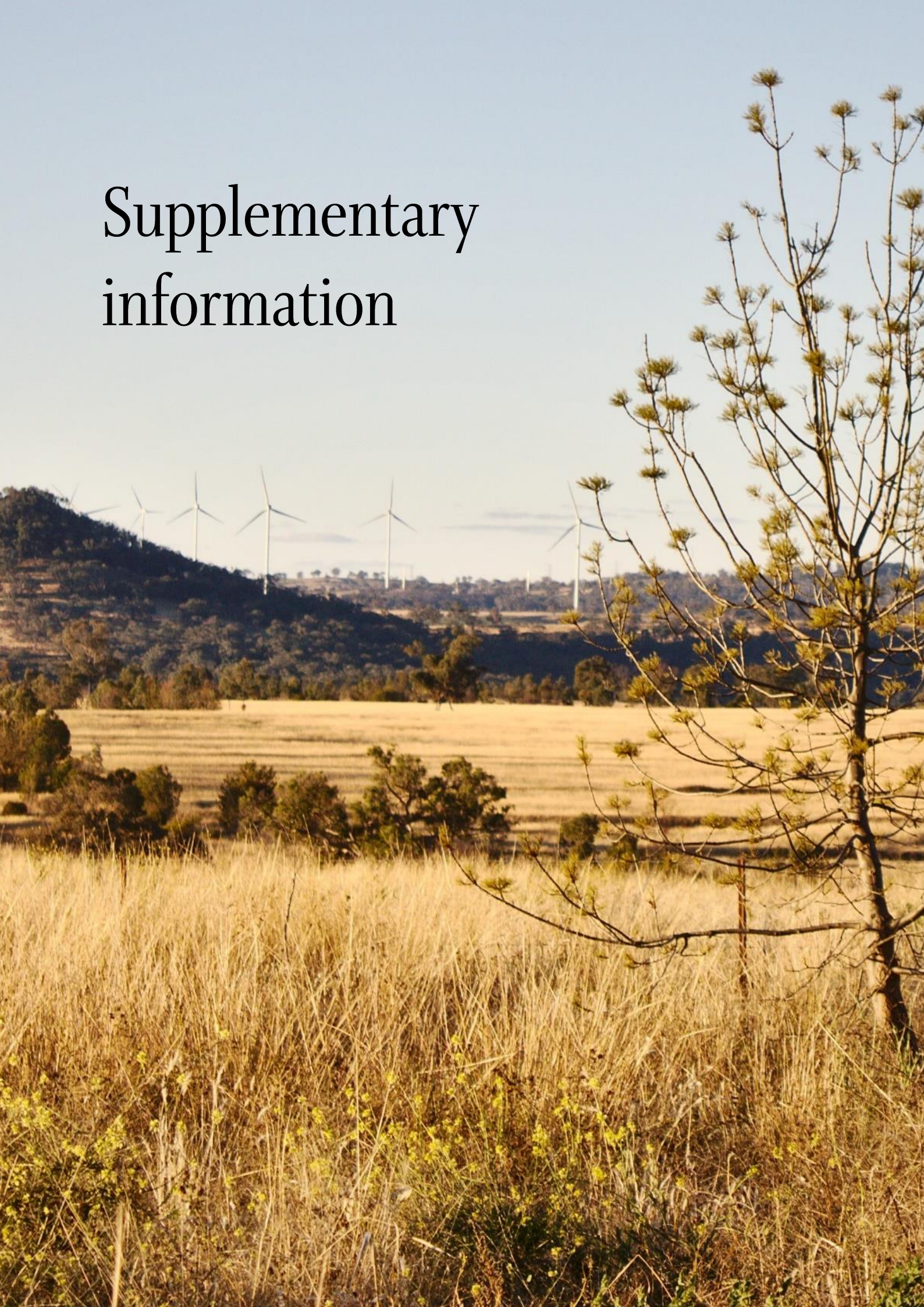
Category	FY17	FY18	FY19	FY20	FY21
Scope 1 & 2 emissions (tonnes of CO ₂ emissions pa)	41.5*	50.1*	50.2*	0	0
Operational Scope 3 (tonnes of CO ₂ emissions pa)	36.6*	36.5*	54.7*	449.5	349.8
Full scope emissions per full time equivalent employee	0.84*	0.86*	0.77*	6.9	4.4
Full scope emissions intensity (total per \$A million revenue)	2.8*	2.4*	2.6*	9.0	5.9
Full scope emissions per \$A billion funds under management	36*	31*	31*	111	57.6
Offsetting of reported operational emissions	100%	100%	100%	100%	100%

Figures prior to FY20 are not directly comparable with FY20 and after because in FY20 we expanded the categories of emissions reported (and we have expanded these categories again in FY21). Previous years' emissions were limited to directly metered electricity and business travel. We also incorrectly reported our purchase of renewable electricity under Scope 2 emissions, whereas in FY20 and after our Scope 2 (and Scope 1) emissions are correctly reported as zero.

⁶ Redd Forests Project Design Document s3.amazonaws.com/CCBA/Projects/Reducing_Carbon_Emissions_by_Protecting_a_Native_Forest_in_Tasmania/REDD_Forests_CCB_PDD_FINAL_071609.pdf

⁷ Tasmanian Native Forest Protection Fact Sheet <https://try.sendle.com/hubfs/content/files/PDF/Tasmanian%20Native%20Forest%20Protection%20Fact%20Sheet.pdf>

Supplementary information



OPERATIONAL CARBON FOOTPRINT BREAKDOWN					
Activity Sector	Activity/Service	Activity Data	Units	Emissions (tCO ₂ -e/yr)	Percentage
Utilities	Electricity	58,414.0	kWh	0.0	0.0%
	Base Building Electricity	43,725.9	kWh	26.2	7.5%
	Telecommunications	56,969.4	\$	9.0	2.6%
	Water	0.2	ML	0.5	0.1%
Equipment	IT Equipment	18,394.7	\$	3.3	0.9%
	Paper	66.7	kg	0.2	0.04%
	Carbon Neutral Paper	49.9	kg	0.0	0.0%
	Merchandising	12,174.0	\$	7.4	2.1%
	Staff Clothing	2,499.0	\$	0.3	0.1%
	Office Furniture	9,131.6	\$	2.1	0.6%
Employees	Employee Commute	231,626.8	passenger.km	17.9	5.1%
	Working From Home	39,506.9	h	8.4	2.4%
Flights	Business Flights	95,267.7	passenger.km	16.2	4.6%
Transport Fuels-SCOPE 3	Privately owned/controlled	414.0	L	1.0	0.3%
Third Party Services	Cleaning Services	22,079.3	\$	3.1	0.9%
	Hire Car	430.6	\$	1.0	0.3%
	Postage	10,976.5	\$	4.0	1.1%
	Couriers	814.4	\$	0.3	0.1%
	Printing & Stationery	27,860.2	\$	20.2	5.8%
	Domestic Hotel Accom.	138.0	occupancy.nights	6.7	1.9%
	Traditional Advertising	418,460.0	\$	45.4	13.0%
	Digital Advertising	2,414,046.0	\$	46.9	13.4%
	Taxis & Ridesharing	22,136.1	\$	1.9	0.5%
	IT Support	559,231.6	\$	92.6	26.5%
	Software	129,037.8	\$	21.4	6.1%
Food & Beverage	Tea & Coffee	6,237.2	\$	2.6	0.7%
	Bakery	487.8	\$	0.2	0.1%
	Dairy	494.8	\$	0.3	0.1%
	Other Foods	9,370.6	\$	8.0	2.3%
	Drinks (Beer)	505.2	\$	0.1	0.04%
	Drinks (Wine & Spirits)	3,705.9	\$	0.6	0.2%
	Drinks (Soft drinks)	130.9	\$	0.03	0.01%
Waste	Waste-landfill	1.7	t	2.2	0.6%
	Recycling	0.4	t	0.0	0.0%
Gross Total				349.8	100.0%
Activity values presented in this table may be a derived number expressed as the quantity unit for use with the NGA factors workbook or NGER (Measurement) Determination (whichever is relevant) as converted from raw data supplied.					

METHODS & LIMITATIONS OF PORTFOLIO CARBON FOOTPRINTING AND OTHER MEASUREMENT OF INVESTMENT IMPACT

General

Impact measurement is an emerging practice for investments. Being able to measure the environmental and social impacts of one company is difficult enough; when you extend to a portfolio of hundreds of companies the difficulties multiply. Complications include:

- Most products and services and activities have many positive and negative effects which vary depending on the situation, so working out what's most material and how to balance good and bad is challenging. Food production, for example, is obviously essential for human well-being, but has varied effects on people, animals and environment. Many foods can be healthy or unhealthy, sustainable or unsustainable, depending on the way they are produced and consumed.
- The impact of investment is different to the impact of companies invested in. Investment choices make a difference, but quantifying their impact is difficult. We can't claim direct credit for the good deeds of the companies we invest in; or that we can stop the harm caused by irresponsible companies simply by selling their shares. The impact is often more indirect. Demand for shares in more sustainable companies makes it cheaper for them to raise new capital for growth. There's also the public 'signalling' effect on the reputation of a company when an ethical investor decides to buy or sell shares of the company. These effects can be significant as responsible investing action and voices grow, as we have seen with the fossil fuel divestment movement.
- Company carbon and other impact data often includes estimates or is incomplete, and may include errors. Companies make different decisions about what they do and don't include when measuring and reporting their operational footprints or the revenue they earn from different products and services. Information may be inaccurate or incomplete, and data providers may use their own estimates. There are different methodologies and frameworks for classifying and taking account of positive and negative impacts of a company's operations, products and services.

Caution should be exercised when considering impact data because of its limitations, and because past performance is not a reliable indicator of future performance. It is important to consider financial characteristics of investments when assessing potential investments to pursue your financial and other objectives.

Carbon footprint metrics

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

There are also different portfolio measurement methodologies, and different carbon metrics which can be used to assess carbon footprint, each with different strengths and weaknesses. As described earlier, this year we have reported three carbon footprint measures for our share investments, "Carbon intensity", "Carbon emissions" and "Carbon exposure". The TCFD reporting recommendations compare these and other footprint metrics [here](#).

What's not included

Current carbon footprinting methods don't generally take into account emissions produced or emissions saved from the use of a company's products. One reason is difficulties in fairly allocating the emissions or emissions savings between the many companies involved in production and use of the products. For example, how should the emissions from the burning of coal be allocated between the coal miner, the coal fired electricity generator and the businesses using that electricity?

The same double counting issues apply to products that result in emissions reductions ('avoided emissions'), for example solar panels which over their life can reduce emissions by displacing other sources of electricity production like fossil fuels. These emissions savings are much more relevant to our ethically screened investment

portfolios. It's important to calculate and allocate these savings, to help us better understand what emissions savings our investments are supporting.

We explored these issues and potential solutions in our [Emissions Crediting Project](#) several years ago. We are now seeing the development of new carbon datasets and tools which can be applied at a portfolio level to investment portfolios to calculate Scope 3 emissions and emissions savings. We plan to trial these as they evolve.

Carbon footprinting data and tool providers

We assess our share investment carbon intensity based on the carbon intensity of the companies we invest in. The carbon intensity is calculated from direct and some indirect emissions (Scope 1 and 2 emissions) of the companies relative to their revenue. The carbon intensity for 2014 to 2017 was assessed by S&P Trucost. For the last three years we used tools and data provided by MSCI ESG Research LLC. Although we have used different data providers, we consider the comparison with previous years to be meaningful because there is general alignment between the methodologies and data sources used by MSCI ESG Research and S&P Trucost. However, there are differences in data, estimates and company coverage which affect direct comparability. More information on carbon footprinting methodology and metrics is available [here](#).

We also used the MSCI ESG Research tools and data for our reporting on fossil fuel reserves and carbon intensity of individual companies.

MSCI ESG Research LLC

We used the MSCI ESG Research tools and data for our calculations this year on 19 July 2021, against shareholdings at 30 June 2021. The analysis and comparison to benchmark is based on listed shares in those companies for which we have relevant carbon data available from MSCI, being 84% of our share investments by value and 99% of benchmark shares by value. MSCI ESG Research is not responsible for the way we have used their data and tools or for the carbon-related information we have reported.⁸

Paris Agreement Capital Transition Assessment (PACTA) developed by 2° Investing Initiative

The Paris Agreement Capital Transition Assessment (PACTA) is a free online tool developed by 2° Investing Initiative (2DII) allowing investors to upload their investment portfolios (platform.transitionmonitor.com/). For the renewable energy information in this report we uploaded portfolios on 19 July 2021. The comparison to benchmark is based on listed shares in those companies for which 2DII make the relevant carbon data available, being 88% of our share investments by value and 90% of benchmark shares by value. 2DII is not responsible for the impact information or the way we have used their data and tools. 2DII have no liability for any errors or omissions in connection with our reporting or our use of their data and tool.

Choice of benchmark for comparisons

For comparison we have selected indices which we consider to be an appropriate investment benchmark for listed shares which Australian Ethical invests in. We use a blended benchmark of S&P ASX 200 Index (for Australian & New Zealand share holdings) and MSCI World ex Australia Index (for international fund share holdings). The benchmark indices reflect the composition of relevant share markets, without selection of companies based on ethical, sustainability or ESG factors. The industry mix and other characteristics of Australian Ethical's portfolios are different.

Currency considerations

Some of the data we use is provided in US\$ terms, and some of this data has been converted to US\$ using exchange rates selected by the data provider. Where we have needed to convert to A\$ for reporting of this year's information we have used an average exchange rate as published by the Australian Taxation Office for the 2021 financial year.

⁸ MSCI ESG Research (1) retains copyright in all its data; (2) does not warrant or guarantee the originality, accuracy and/or completeness of their data; (3) makes no express or implied warranties of any kind, and disclaims all warranties of merchantability and fitness for a particular purpose; (4) has no liability for any errors or omissions in connection with their data or for our reporting and use of their data; and (5) without limiting any of the foregoing, has no liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages.

“Those zero emissions businesses which are leading in the management of climate risk and opportunity are the businesses we want to invest in, so that by 2040 we can offer our clients high performing, zero emissions portfolios.”