Climate Risk Report

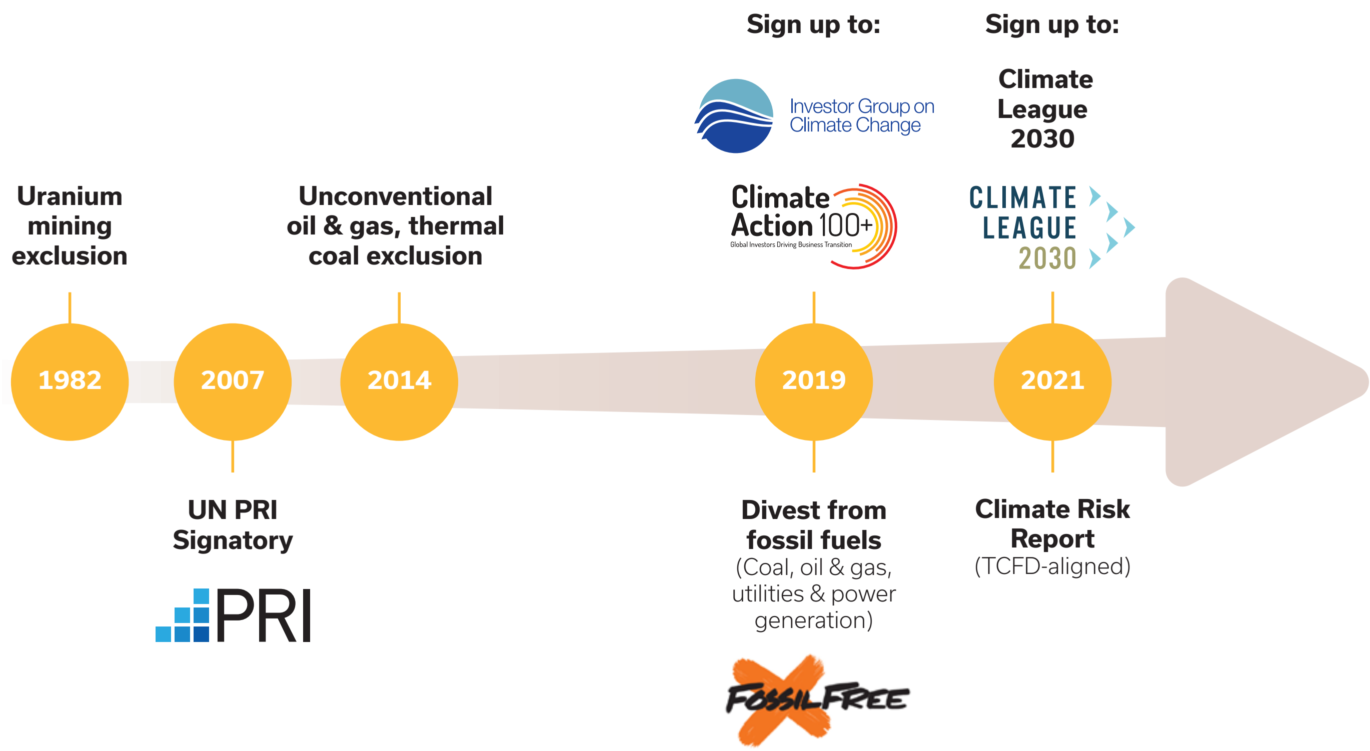
Task Force on Climate-related Financial Disclosures (TCFD) – aligned

27 April 2021

u ethical
investing with purpose

Contents

U Ethical's Climate Risk Roadmap



Governance

SUMMARY

- Alongside *ethical and environmental, social and governance* (ESG) considerations, U Ethical's values include commitments to portfolio alignment with a climate-safe and just transition. All of these considerations are fundamental to U Ethical's investment philosophy and the long-term risk and return of U Ethical's portfolios.
- The Investment Committee (IC) approves amendments to U Ethical's investment beliefs following the investment team's reviews and analyses - in consultation with U Ethical's Ethical Advisory Panel (EAP).
- The investment team has delegated responsibility to assess, monitor, evaluate and implement U Ethical's ethical investment policy, which includes fossil fuels exclusions along with climate risk considerations and analytics.
- The EAP advises on emerging and/or evolving market and research trends, including themes such as target setting, decarbonisation scenarios and reporting requirements, which the IC reviews and approves where there is a policy change on a quarterly basis.
- The Board has delegated to management the on-going development and implementation of the climate risk strategy.

Describe the board's oversight of climate-related risks and opportunities.

As an Ethical investor with a long-term outlook, U Ethical believes that climate risks are financially material and systemic in nature. Additionally, the alignment of U Ethical's investment portfolios with a low carbon transition and just transition will not only mitigate risk exposure, but ultimately contribute to investment portfolios' resilience and continued performance.

- U Ethical's IC provides oversight and delegates to the leadership team the management of climate-related risks and opportunities.
- The EAP advises on a diversity of ESG themes, including climate risk targets, decarbonisation scenarios and reporting trends.
- Both the EAP and the IC meet on a quarterly basis respectively to: advise on emerging ethical and ESG concerns and monitor the investment team's implementation of the ethical framework and fund performance.
- As part of regular investment performance reporting, the investment team reports to the IC on the investment Trusts' ESG profile, sustainable impacts alignment, key carbon foot-printing metrics (including historical data for Scope 1 and 2 emissions) and low carbon transition risk exposures. In accordance with established practice, such processes are reviewed by the Board annually, as part of U Ethical's governance and compliance plans.

Describe management's role in assessing and managing climate-related risks and opportunities.

Since 2014, both the IC and the EAP have endorsed U Ethical's divestment positions with the IC providing full oversight and responsibility of climate-related risks and opportunities.

The investment team, headed by the chief investment officer (CIO), have delegated responsibility to integrate climate risk considerations in daily investment decision-making, industry collaborations, proxy voting and active engagement with portfolio companies. In turn, U Ethical's ethical investment policy and related procedures, processes and external communication collateral are regularly reviewed to ensure alignment with risk-return targets and ethical considerations.

When considering new investments, the investment team accounts for climate change-related risk assumptions (e.g. carbon emissions metrics and low carbon transition risk exposure) in their assessments, alongside ESG profiles (i.e. ESG ratings and controversies data), UN Sustainable Development Goal (SDG) alignment and negative screening considerations.

The ethics and impact manager, who holds climate risk and reporting expertise, is part of the investment team, and is responsible for ensuring that policies, processes and procedures align with the ethical investment policy and are fit-for-purpose. As climate risk management and analysis is a complex and evolving field of research, the manager also ensures that the team is informed of both regulatory and research developments in a timely manner and, within the dynamics of a collaborative and agile team, that knowledge sharing is on-going.

The investment team meets daily and internal data, reports and market trend updates are also shared with the risk, marketing and distribution teams. Induction of new employees involves both team and 1-on-1 sessions with individual team members to provide an overview of U Ethical's investment processes, a deeper understanding of U Ethical's ethical investment policy, clients' values and expectations along with related reporting capabilities.

Strategy

SUMMARY

- Climate risk is material and systemic. Transition and physical risks are, to different degrees, already impacting several regions as well as asset values.
- As a certified B Corporation, U Ethical strives for integrity across its business operations, investment products, employee engagement and consideration of key stakeholders.

U Ethical's investment climate strategy focuses on:

— fossil fuels divestment
— carbon emissions exposure reduction; and
— preference for issuers transitioning to a just and low carbon world.

- We favour investments in companies that are better positioned in a just and low carbon transition by means of strong governance practices and management's commitments to innovative business models and resilient operations.
- On a quarterly basis, we run portfolio-level carbon footprint analyses and regularly map (for both new and existing issuers) the low carbon transition risk exposures, historical CO2-e emissions reduction trends and corporate management's climate risk resilience capabilities. This review focuses on opportunities in clean energy and clean technology related revenues and capital expenditure.
- Stewardship is carried out both via direct engagement with portfolio companies, proxy voting and collaboration with like-minded organisations.
- As part of industry initiative Climate League 2030, we have committed to engaging with the top largest carbon emissions contributors in our portfolio.

Describe the impact of climate related risks and opportunities on the organization's businesses, strategy, and financial planning

Despite being not yet fully priced, climate risk is an undiversifiable risk of a systemic nature with 'potentially irreversible consequences in terms of the damage it can cause'[1]. As such, U Ethical believes that most sectors, to different degrees, will be impacted by climate change with transition and physical risks varying by country, regional location and supply chain complexity. Physical risk exposure is already impacting the value of assets which are subject to extreme weather events, bushfires and/or rising sea levels and storm surges.

Risks are varied and can arise from:

- actual physical damage (whether chronic or acute) and economic impacts due to business damage and/or supply chain interruption;

[1] Commissioner Allison Herren Lee, Securities and Exchange Commission (SEC), November 2020 "Playing the Long Game: The Intersection of Climate Change Risk and Financial Regulation"

- the inability to suitably (i.e. timely and cost effectively) adapt both in financial and operational terms; and
- The supply and demand changes from material and/or product substitution, cost increases, changes in consumer preference and regulation (e.g. carbon pricing).

Leading global investors and several countries in both developed and emerging markets, are structurally transitioning their economies and setting ambitious decarbonisation targets. As part of our ethical investment policy, following the negative exclusion of companies involved in fossil fuels activities (coal, oil and gas – reserves, emissions, potential emissions – utilities and power generation), we analyse climate risk in terms of individual issuers' overall ESG profile, carbon emissions exposures and historical trends (Scope 1 and 2 emissions), solutions providers and low carbon transition score and management capabilities. With regards to the latter, we rely on a transition risk category (stranded asset – neutral – product – operational) and management score (0-10) and related quartiles to prioritise engagement activities.

We actively engage with investee companies to ensure they consider carbon emissions' reduction targets and encourage them to embrace decarbonisation plans in line with the Paris Agreement and industry best practice. We apply the above across all products.

In our proxy voting we also support environmental (E) and social (S) resolutions that address climate risk, call for transparency and disclosure of emissions targets, seek a higher aspiration for decarbonisation targets or climate transition plans. We disclose voting decisions on our website as part of our commitment to best-practice governance and transparency. As part of our active engagement, we also collaborate with industry initiatives[2] and peer investors to advocate for a broader shift of capital markets and support regulatory frameworks.

When considering potential new investments and reviewing our existing holdings, our fundamental valuation analyses account for:

— The climate risk intensity exposure of industry groups,
— The management capabilities of investee companies/holdings,
— Emissions reduction targets and, increasingly, commitments to decarbonisation plans.

We will continue to evolve our investment strategy as climate models, research and related data evolve. We also strive to align with best practice approaches as they emerge. In line with this, U Ethical aims to expand its capabilities to define net zero targets and be able to analyse and report on complete climate scenario analyses and where possible, on historical trends across Scope 1, 2 and 3 emissions.

ClimateAction100, Climate League 2030, Quit Nukes

Risk management

SUMMARY

- U Ethical's 2019 materiality study identified Climate Change Mitigation and Resilience as "highly material" to the business and its key stakeholders.
- U Ethical's fossil fuels divestment policy significantly lowers the carbon footprint metrics of our investment portfolios.
- In identifying investment risk for our listed equity holdings, we use carbon emissions, carbon intensity; for both listed and fixed income securities, we use a weighted average carbon intensity (WACI) metric.
- We manage risk exposures by investing in better ESG-rated companies, favouring issuers with strong to medium management capability, emissions reduction commitments and robust targets, low carbon investments and/or and decarbonisation plans.
- Since 2014, our investment risk assessment processes have aimed to de-risk our exposures to climate change risk when considering new types of investment opportunities or reviewing existing ones.
- We actively engage with many investee companies to ensure they consider carbon emissions' reduction targets and are committed to encouraging portfolio companies to embrace decarbonisation plans in line with the Paris Agreement and industry best practice.

Describe the organization's processes for identifying, assessing and managing climate-related risks.

Consideration of climate change risks is fundamental to our assessment and evaluation of risk-return drivers in investment decision-making. In 2019, an externally conducted materiality assessment identified climate change mitigation and resilience as one of U Ethical's top three highly material themes. Following divestment from Oil and Gas in 2014, and complete divestment from fossils fuels in 2019, the investable universe is therefore defined by our core ethical exclusions, minimum ESG requirements, ESG controversies screening and preference for companies that align with the UN-SDG goals[3].

Analysis of new issuers (and the review of existing ones) includes consideration of a low carbon transition management score, category and related quartile score, a review of the carbon footprint profile and opportunities in clean energy and clean-tech, energy efficiency, green buildings, alternative products and services. We leverage third party ESG data, industry level analyses, broker research and think tanks' sectoral mappings to both mitigate and pre-empt portfolio risk exposure while aiming to identify issuers with greatest resilience and capacity to embrace a transition pathway. All of the above also informs and helps prioritise U Ethical's engagement activities.

[3] These include UN-SDGs such as Climate Action (UNSDG 13), Affordable and Clean Energy (UNSDG 7), Partnerships for the Goals (UNSDG 17).

A preliminary climate scenario exercise carried out by U Ethical's third party ESG data provider, has indicated that our climate-related Value-at-Risk exposures (transition and physical risks) are concentrated in a few sectors: materials, transportation, telecommunication services, health care and equipment, pharmaceuticals, etc.

In our climate risk due diligence, we rely on regulatory frameworks, ASIC and APRA's evolving requirements and third party analyses and taxonomies such as:

- MSCI ESG Research's Climate Change Metrix methodology, Carbon Estimation methodology Low Carbon Transition Risk Assessment, Business Involvement Screening Research and we are also exploring MSCI-Carbon Delta's Climate Value-at-Risk Analytics.
- Climate Work's Decarbonisation Futures report.
- Climate Bonds Initiative (CBI)'s Taxonomy.

On an ad hoc basis, we will also reference:

- Science Based Targets (SBTi)'s Methods and
- 2 Degree Investing Initiative's PACTA tool.

The above process applies to U Ethical's equity portfolios for alignment with our position. As covered in the strategy section above, all ethical and ESG considerations, including climate risk, inform U Ethical's engagement activities with investee companies in order to improve issuers' carbon data transparency and disclosures and encourage consideration of climate scenario alignment of business models, operations and climate risks related to supply chains.

Targets and metrics

SUMMARY

- We measure carbon emissions, historical carbon emissions trends carbon emissions intensity/$M invested and weighted average carbon intensity (WACI).
- We also measure low carbon transition (LCT) management score and low carbon transition quartile scores.

Disclose the metrics used by the organization to assess climate related risks and opportunities in line with its strategy and risk management process.

As part of the ESG profile reviews of issuers, we assess the ESG risk exposures and related capabilities of companies to manage both social and environmental key issues material to their sub-Global Industry Classification Standard (GICS). Active engagement focuses on human rights and labour management concerns, business governance and behaviour, environmental stewardship, and climate change risk. For issuers where climate risk has not been identified as financially material, we seek disclosures and consideration of climate risk in accepted warming scenarios within the relevant industry and best-practice. In proxy voting we support resolutions that call for greater transparency and climate risk mitigation and adaptation strategies.

At present, we are reviewing the extent to which climate scenario analyses impact U Ethical's trusts. The preliminary analysis through MSCI-Carbon Delta's Climate Value-at-Risk[4] has indicated that our climate-related risk exposures (transition and physical risks) are concentrated in the following sectors: materials, transportation, telecommunication services, health care and equipment, pharmaceuticals, etc. We also review banks' loans to verify what share of loan books might be invested in fossil fuels and would therefore be in breach of our ethical framework.

[4] Climate CVaR accounts for climate transition risk and physical risk. It also gives a portfolio-level global warming potential value for Scope 1, Scope 2 and Scope 3 emissions.

Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.

U Ethical's fossil fuels divestment policy significantly lowers the carbon footprint performance of our investment trusts.

AETW**	Carbon Footprint				
	Carbon Emissions	Total Carbon Emissions*	Carbon Intensity	Weighted Average Carbon Intensity	Carbon Emissions Data Availability
AETW	57.3	57,343	137.0	105.2	100%
ASX300	137.4	137,379	319.1	208.7	99.2%
	tCO2e/$M Invested	t CO2e	t CO2e/$M Sales		Market Value

* Based on Portfolio investment of $1,000,000,000 and Benchmark 1 investment of $1,000,000,000

IET**

	Carbon Footprint				
	Carbon Emissions	Total Carbon Emissions*	Carbon Intensity	Weighted Average Carbon Intensity	Carbon Emissions Data Availability
IETW	17.8	17,811	57.3	51.6	100%
MSCI World ex Australia	75.8	75,806	168.9	136.3	99.9%
	tCO2e/$M Invested	t CO2e	t CO2e/$M Sales		Market Value

* Based on Portfolio investment of $1,000,000,000 and Benchmark 1 investment of $1,000,000,000

**Constituents as at 31st March 2021

For new and existing stocks, we carry out a CO2-e emissions trend analyses for Scope 1 and 2 (we hold historical data is since 2008). Considering U Ethical investment policy's fossil fuel divestments in 2014 and 2019, we will continue to review the portfolio-level carbon footprint performance moving forward.

Further to a data release by our data provider[5], we are now analysing Scope 3 GHG emissions exposures in line with the GHG Protocol methodology as both reported and estimated by our provider. We review all new and existing stocks by analysing the extent to which Scope 3 emissions (upstream and downstream) are broken by GHG category[6].

The Low Carbon Transition (LCT) factor that we use accounts for companies' carbon emissions intensity, share of avoided emissions and management resilience to business transformation.

[5] MSCI ESG Research released a carbon emissions Scope 3 methodology in August 2020

[6] https://ghgprotocol.org/scope-3-technical-calculation-guidance

U Ethical

Level 6, 130 Lonsdale Street,
Melbourne VIC 3000

Website www.uethical.com
Email info@uethical.com
Telephone 1800 996 888

u ethical