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AUSTRALASIAN FIXED INCOME: GLOBAL REACH, LOCAL EXPERTISE



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Each issue provides all the information market participants need to keep up to date with the deals and trends making headlines in the markets, in-depth issuer and investor insights, and deal and league tables.

KangaNews magazine is published six times a year and KangaNews also publishes regular supplements and yearbooks. In addition, subscribers have access to email updates on breaking deals and news from the KangaNews Alert service, as well as priority invitations to KangaNews events and full access to the www.kanganews.com website.

KangaNews is independent – it is not owned or part owned by a larger media or financial-services business. Its mission and commitment is to helping the flow of information in the fixed-income sector, and to bringing information about the sector to a wider audience.

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TAKING IMPACT INVESTMENT TO THE TIPPING POINT

Rosemary Addis, chair of the **Australian Advisory Board on Impact Investing**, talks about the growing momentum for impact investing and why now is the time for the private sector to show leadership in encouraging more targeted capital and thereby realise benefits for people and the planet.

“We are convinced financial and social returns go hand in hand.”¹ Coming from PGGM, a major Dutch-based pension fund with over US\$220 billion in assets under management, this statement heralds quite revolutionary shifts.

The drivers differ depending on your starting point. Some have seen systemic issues like climate, labour-market conditions and the integrity of the financial system affect long-term investment performance. Others want to see greater values alignment between how capital is used and positive effects for people and the planet. Still others see terrific opportunities to bring products and services to under-served markets.

Wherever you start, the shifts underway are leading us towards the same place: an evolution in how capital is managed and directed. Even for those already applying environmental, social and governance factors to avoid harm, the focus is shifting to more integrated approaches and how capital can contribute to more positive benefits for people and the planet, and even contribute to new solutions.²

SHIFTING FOCUS

There is real interest in the opportunities and challenges of meeting the United Nations Sustainable Development Goals (SDGs). Nearly two-thirds of respondents to the latest Global Impact Investment Network (GIIN) survey indicated they were already tracking investments to the SDGs or planned to do so.³

At the same time, changing citizen expectations and growing demand for services is putting the spotlight on resource constraints, and the efficacy and quality of government service provision. All over the world, the focus is shifting from inputs and outputs to measurable outcomes. New technologies and a different outlook from a generation seeking to integrate its values with how it makes and invests its money is fuelling socially motivated entrepreneurship and purpose-driven business.

Larger corporates are also employing more integrated approaches to sustainability and new-value creation, including those embracing Michael Porter's shared value approach⁴ and Mohamad Yunus's social business movement.⁵

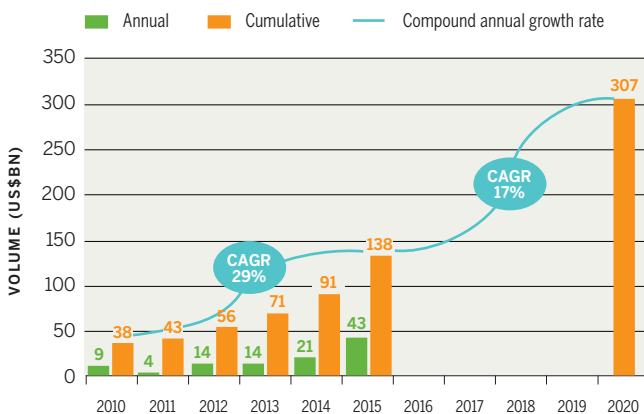
The confluence of these shifts is literally moving markets – catalysing new investment opportunities, encouraging entrepreneurship and innovation and challenging binary choices between public and private, for profit and not for profit.⁶

Impact investing is a field of practice and market development that sits within this broader context. Designed to deliver measurable, positive benefit for society and financial return, it is growing fast. Recent market sizing indicates 29 per cent compound annual growth from 2010-15 and US\$138 billion under management by the end of 2015⁷ (see chart on this page).

THE POWER OF CAPITAL

Capital can be a powerful enabler of impact-driven activity. It is already being used to finance initiatives in a wide range of areas including the arts, aged care, community development, education, employment, health, environmental management, sustainable agriculture, renewable energy, justice, social housing and international development.

GLOBAL IMPACT INVESTING: MARKET SIZE AND FORECAST



SOURCE: GLOBAL STEERING GROUP ON IMPACT INVESTMENT 2016 & 2017

On the ground, this looks like health insurance and basic health services available for the first time to more than 110 million people across Asia and Africa through investee companies of Australian-based Leapfrog Investments, that has delivered average annual revenue growth of more than 43 per cent.⁸

It looks like quality sustainable jobs in regions facing economic change and decline, and new facilities and services that meet the needs of a community through organisations like Bridges Fund Management and Pacific Community Ventures.⁹

It looks like 580 million children vaccinated against preventable disease today because approximately US\$5.7 billion has been raised in double-A rated immunisation bonds through the International Finance Facility for Immunisation.¹⁰ These bonds are repayable as government and aid commitments to vaccination programmes come through.

CALL TO ACTION

Now is the time to capitalise on the gathering momentum and take impact investment to a tipping point. In Chicago in July 2017, 550 people from 43 countries came together for the Global Steering Group for Impact Investment (GSG) Summit. Their focus was clear: harnessing the momentum of impact investment for better lives across the world and for a sustainable planet.¹¹

The potential for growth is material and the GSG has set aspirational targets to exceed US\$300 billion in investments actively targeting solutions by 2020.¹² Estimates for Australia's domestic market in the same time frame have been put at A\$32 billion.¹³

Australia has been at the forefront of global developments since 2013, when then UK prime minister, David Cameron, launched the Social Impact Investment Taskforce as president of the G8. This was the predecessor to the GSG. The collective effort has grown from the G7 countries, Australia and the EU to 17 GSG member countries at the global table. More than 11 others are shaping efforts for their countries. The effects have reached across political systems and cultures to high-, medium- and low-income countries with a growing sense of urgency.

Coordinated and sustained effort is needed to drive a dynamic ecosystem at scale. This includes governments and policy makers taking up their critical role in seeing the potential of impact investment realised. Just like in other markets, governments have substantial capacity to signal interest and stimulate activity with catalytic capital and to create incentives for new investment. When it comes to impact investing, they can also encourage outcomes-focused innovation.

There are some great examples of leadership from governments and policy makers around the world, including in Australia and New Zealand. The New South Wales government in particular has taken leadership. There is more to do for governments to embrace their roles as market builders to catalyse the ecosystem, as market stewards setting the guideposts, and as market participants to mobilise and direct capital in priority areas of policy and demand – and to reap the benefits.¹⁴



FAST FACTS: BIO

Rosemary Addis is a global leader on shared value, social innovation and investment. She is recognised for her contributions to innovation, strategy and policy, including as one of the 2015 Westpac/AFR 100 Women of Influence.

Rosemary is executive director of Impact Strategist.

she represents Australia on the executive board of the Global Steering Group for Impact Investment and she established and chairs the Australian Advisory Board on Impact Investing. She is widely published and advises leaders across sectors globally.

www.impactstrategist.com

But this is not linear geometry. The answer is not to wait until there are perfect conditions or the policy settings are all in place or until one thing has been seen through to the end before others are trialled or implemented.¹⁵ In tandem with continuing advocacy for active engagement from governments, there is ample room for leadership and action.

The SDGs provide a clear to-do list. Initiatives such as the Responsible Investment Association of Australasia Impact Investment Forum and the GIIN provide opportunities to engage and collaborate. There are frameworks available such as the Impact Management Project¹⁶ that represent an emerging consensus for planning for, managing and measuring impact, including in portfolio design.¹⁷

Targeted capital sends powerful signals to the market. When the target is impact, it can mobilise capital to benefit communities and the economy.

The more impact is part of the equation, the more benefits will flow to governments and taxpayers through greater public value from improved outcomes, and the greater the multiplier effect for public funding and the capacity to target limited public resources. And the more benefits that flow to social and environmental sectors from greater access to a wider range of funding and finance options, and to philanthropy from the potential to achieve more impact from the strategic use of grants and investment capital.

The market also benefits from better understanding of how systemic risks can affect investment performance, greater insight into areas where risk is mispriced and from new opportunities.

The shifts are positive. Realising the benefits that can flow from impact investment is still a strategic challenge. The game will be worth the candle, to coin an Australian phrase. The proactive leadership and action taken today will reap benefits for people and the planet well into the future. •

Footnotes can be found on www.kanganews.com/news/7500-aab-article

BUILDING THE IMPACT INVESTING MARKET IN AUSTRALIA – THE GAME CHANGER

Sally McCutchan, CEO at **Impact Investing Australia** (IIA), explains how the United Nations (UN) Sustainable Development Goals (SDGs) will be a key driver in accelerating the adoption of impact investing. IIA has incubated a critical piece of market infrastructure for Australia, an impact-investing wholesaler which is seeking funding from the government and the major banks.

If you are reading this article, you are probably already open to the idea that the impact our investments make matters. Whether you come from government, the community or the private sector you understand that the decisions we make in respect of funding and capital deployment have impact – positive, negative or neutral – on the future of society, the environment and the planet.

Conventional finance theory based on risk-and-return analysis has been largely disconnected from associated investment impact. Often this has played out in money being made through traditional investment or commercial practices in one sphere with government spending and philanthropic donations directed to addressing societal issues in another.

Globally, this paradigm is now being seriously challenged. Thus raising the question: what if we could make a financial

return and create a positive societal impact with the same investment? Enter impact investing.

A key driver in accelerating the adoption of impact investing at both global and domestic level is the achievement of the SDGs. In September 2015, 193 UN member states, including Australia, signed up to deliver the SDGs. These goals are designed to guide efforts towards ending extreme poverty, promoting prosperity and wellbeing, protecting the environment, addressing climate change, and encouraging good governance, peace and security for all by 2030.

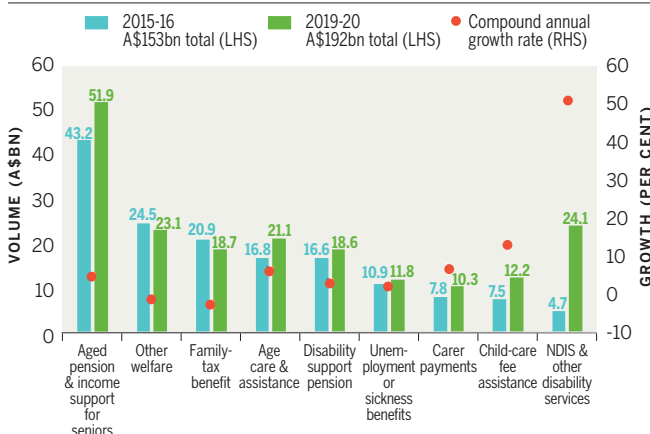
The SDGs are not just targeted at developing nations but are equally applicable to developed countries like Australia. With Australia's national voluntary reporting around the SDGs taking place in July 2018, the process has already begun as to what actions will be put in place and how these will be funded. Funding is unquestionably a critical issue. There is an estimated US\$2.5 trillion annual funding gap in developing nations alone on delivering on the SDG targets. This funding challenge quite clearly cannot be met by governments alone.

In Australia, like many developed nations, we are already facing budgetary pressures. Social security and welfare alone represent 35 per cent of the government budget or an estimated A\$159 billion (US\$126.3 billion) in 2016/17. This is forecast to grow, well ahead of GDP, at a compound annual growth rate of around 8 per cent to 2020. Drivers include an ageing population and the introduction of the National Disability Insurance Scheme.

Despite a growing philanthropic sector, now at A\$12.5 billion, a bigger solution is required to resolve the funding gap. We need social innovation and more private-sector funds directed towards addressing societal issues. Impact investing, while not the silver bullet, has an important role to play in our domestic context.

In accepting the need for impact investing, the logical question is: how do we build and grow the market? The G8 Social

ESTIMATED AUSTRALIAN GOVERNMENT EXPENDITURE ON SOCIAL SECURITY AND WELFARE



SOURCE: AUSTRALIAN GOVERNMENT, BUDGET STRATEGY AND OUTLOOK: BUDGET PAPER NO. 1: 2016-17

Impact Investment Taskforce, now the Global Steering Group on Impact Investing (GSG), concluded that key pieces of market infrastructure that ground and accelerate development of impact investment will be required in all countries. First among these is a wholesale institution to support and grow intermediaries and act as market champion.¹

After extensive market consultation, the Australian Advisory Board on Impact Investing (AAB) – a national advisory board of the GSG – supported this key piece of infrastructure for Australia. In its report, *Delivering on Impact, 2014*, the AAB identified a cornerstone social-impact fund as the key breakthrough action to deliver demonstrable impact, meaningful practice, and attract greater numbers of informed entrants into the field.²

What was also clear from the AAB's consultation, and remains an issue today, is that the impact-investing market in Australia lacks scale. The trajectory of other markets, like the UK, shows scale will come from the support of existing and new intermediaries and the proving up of new and innovative business and financing models. A wholesaler is seen as the central catalyst that drives these outcomes.

Three wholesale investors – the UK's Big Society Capital, the EU's Social Impact Accelerator and Portugal's Portugal Inovação Social – are already in operation. McKinsey & Company described the entry of Big Society Capital into the UK market in 2012 as representing a decisive shift in market development.³ In Japan, late last year a bill was passed to use unclaimed bank accounts to fund a wholesaler. Other countries, like Israel, Canada and Brazil, are exploring the creation of a wholesaler to build scale.

Since early 2015, the AAB through its implementation arm, Impact Investing Australia, has been working to establish an impact investing wholesaler in Australia. Concept design was completed over a 12-month period through a series of workshops leveraging the extensive skills of a cross-sector group of senior leaders.

IMPACT CAPITAL AUSTRALIA

The Australian wholesaler, Impact Capital Australia (ICA) is progressing with capital raising. The vision for ICA is straightforward: a new organisation that has the capital, mission and mandate to drive the Australian market towards impact at scale. ICA is designed to be independent, collaborative, proactive, agile and transparent. It has two key roles: investor and market champion.

ICA's investment mandate has three central elements: clear impact, financial viability and contribution to market development. Its predominantly wholesale focus will provide finance and capital on terms that encourage existing market participants to grow their reach and impact as well as encourage new participants to enter the market. To be effective, ICA will also need capacity to be proactive in filling market gaps potentially through direct investment or origination. This will enable deals that would otherwise not happen and send a market signal through preparedness for participation that unlocks the potential for innovation and transformative approaches to societal issues.



FAST FACTS: BIO

Sally McCutchan has worked with Impact Investing Australia as executive director since 2015 and became CEO in April 2017.

She has extensive experience in finance, funds management and strategy, and has spent many years working in Asia-Pacific markets.

Sally is a non-executive director of Indigenous Business Australia Asset

Management, and two National Australia Bank securitisation companies.

She is also a member of the GSG Working Group on Wholesalers, the AHURI inquiry panel into social-impact investment for housing and homelessness outcomes, the QBE Social-Impact classification committee, and is an external member of the Finance, Risk and Audit Committee for Oxfam Australia.

www.impactinvestingaustralia.com

Beyond its investments, ICA would be a market champion, addressing barriers to growth, and actively developing and openly sharing expertise, knowledge and tools. It would build meaningful engagement with communities, sector experts and with regulators and governments.

ICA would need sufficient capital, A\$300 million, to enable its mandate and to operate self-sufficiently. Early collaboration is critical and this is evidenced in the design of a funding partnership between the government (50 per cent), the major financial institutions (40 per cent), and community-sector organisations, foundations and other values-aligned investors (10 per cent). Modelling anticipates ICA will have a self-sustaining cash-flow profile within seven years.

Wholesalers are designed to be catalytic and this has been evidenced in other markets like the UK, where Big Society Capital has helped unlock £1 billion (US\$1.4 billion) of capital since commencing operations in 2012.

By taking the proactive step of funding ICA, government, the major financial institutions and other investors will enable many aspects of impact-investing market development. ICA will create a multiplier effect on capital, talent and practice, drive scale and diversity through intermediary support, convene and promote multidisciplinary collaboration, mobilise more flexible capital to social innovation, and promote greater efficacy of capital and spending through targeted measurement. The stakes are high for the social and economic impact on our communities. The time for positive action has arrived and Impact Capital Australia is a critical first step. •

Footnotes can be found on www.kanganews.com/news/7501-footnotes-impact-investing-australia-article

SHIFTING RESPONSIBLE INVESTMENT LANDSCAPE

Simon O'Connor, chief executive officer at **Responsible Investment Association Australasia** (RIAA), talks about the growing body of evidence pointing to better financial outcomes for companies with strong environmental, social and governance (ESG) policies. At the same time, responsible investors are increasingly moving capital toward more sustainable assets and shifting their focus to responsible-investment outcomes.

Now reaching half of all institutional investment in Australia, according to RIAA data, responsible investing has grown to represent a significant pool of capital in the Australian financial system. As such, responsible investing offers compelling opportunities for those savvy enough to appeal to this pool.

Often poorly understood, the responsible-investment commitments being made by some of Australia's largest institutional investors effectively mean these investors have committed to considering ESG or ethical issues as a part of their everyday investment process.

This reflects a widening acknowledgement that a whole lot more drives investment return and asset valuation than just traditional financial metrics. In practice, it results in many more

investors seeking out ESG data and disclosures from issuers across the market, and many more conversations and direct engagements on issues that only a few years ago would not have been considered relevant in a purely financial analysis of investment options.

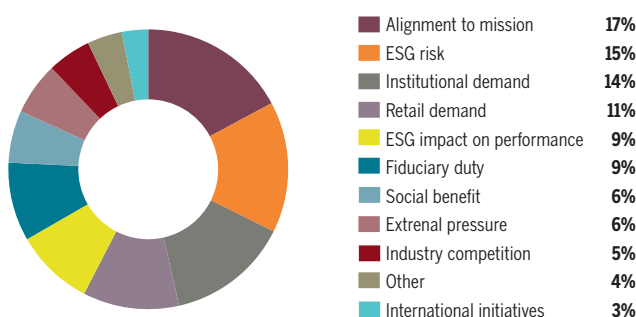
There are different approaches to responsible investing that are often conflated and confused:

- Ethical investing brings a values-based lens to investing, and leads to exclusions of industries. For example, where climate change is an issue of interest, this could exclude fossil-fuel companies from a portfolio.
- ESG investing focuses on ESG risks and how they might influence valuations. Investors considering ESG issues such as climate change would potentially engage a company to improve how it manages or is exposed to risk factors relating to climate change.
- Impact investing looks to generate financial returns alongside measurable social or environmental outcomes. This could include investment into renewable-energy assets where the positive environmental impact of the asset can be measured.

As the market matures and becomes more sophisticated, we are seeing more and more investors incorporate elements of all these approaches across a single portfolio.

KEY DRIVERS OF MARKET GROWTH

(RIAA BENCHMARK REPORT AUSTRALIA 2017)



SOURCE: RESPONSIBLE INVESTMENT ASSOCIATION OF AUSTRALASIA BENCHMARK 2017

FROM ESG TO IMPACT INVESTING: WHAT'S CHANGED?

As this yearbook highlights, responsible investing has entered the mainstream, becoming a license to operate in financial markets in Australia.

Increasingly, institutional investors are being tested on the *bona fides* of their approach to ESG to ensure they have adequately accounted for critical issues that are playing out in financial markets.

But a shift has occurred in 2017, whereby responsible investors have changed from aiming purely to avoid the downside risks posed by ESG issues and are increasingly moving capital towards more sustainable assets and enterprises.

With growing consumer interest in what activities their investments are supporting, and how their retirement savings are being invested, institutional investors are being pushed to move from just a focus on responsible-investment process to responsible-investment outcomes. They are looking at questions like how their responsible-investment strategies have driven better environmental and social impacts.

This has run concurrent with a maturing of responsible investment, whereby the focus is moving beyond listed equities to other asset classes: venture capital, private equity, property and, very rapidly, into fixed income. It is this latter asset class that opens up some of the biggest opportunities to achieve positive impact through responsible investment.

This last year has seen a rapid ramp up of issuances of sustainability-themed debt, from banks, universities, state treasuries and corporations. Sustainability bonds, green bonds, climate bonds, gender-equality bonds and social bonds have flowed at a rate that had surpassed the previous year by the mid-way point of the year according to KangaNews data. Yet the appetite of responsible investors is not yet satiated.

For savvy, quality issuers, there remains a significant and aligned pool of capital willing to be directed towards assets and enterprises that deliver more sustainable outcomes.

ESG DRIVING THE SHIFT

A body of evidence has continued to grow over recent years that underpins this shift towards consideration of ESG as a mainstream component of leading investment practices. In short, ESG matters, and multiple studies clearly demonstrate the many ways ESG influences valuations.

As such, we are now at a point where ESG data is becoming sufficiently robust to play a role in investment decision making. There are detailed analyses and meta analyses that support the uptake of ESG, indicating there is not only no need to give up returns to invest responsibly but that ESG integration can enhance risk-adjusted returns.

For example, a study from Harvard Business School published in the *Journal of Applied Corporate Finance* in 2016 – titled *ESG Integration in Investment Management: Myths and Realities* – gives some good insights into how strong ESG integration is delivering improved investment outcomes. The study found that companies with a robust management of ESG also had lower risk, lower cost of capital, improved operating efficiencies and greater abilities to break into new markets.¹ Another article in the same journal in 2016 concludes that ESG provides “unequivocally positive contribution to risk-adjusted returns”.²

More recently, research from Bank of America Merrill Lynch concludes that ESG factors would have helped avoid more than 90 per cent of recent bankruptcies, and further supports the case for ESG as the most important signal on avoiding future risk.³



FAST FACTS: BIO

Simon O'Connor is the CEO of RIAA, the peak industry body for responsible, ethical and impact investors across Australia and New Zealand.

RIAA represents 200 members managing more than A\$1 trillion of assets globally. RIAA's goal is to see a greater quantity of capital flowing into sustainable assets and enterprises, working with members to increase the uptake and deepen the impact of responsible investment.

www.responsibleinvestment.org

Simon operates at the intersection of economics, finance and sustainability. To this position he brings extensive international experience as an economic adviser, investment analyst and environmental consultant. He has worked in all of the finance, corporate and not-for-profit sectors.

He is a firm believer that capital can be one of the strongest levers to shift to a more sustainable, equitable and prosperous world.

This growing evidence base, helping to contribute to the overwhelming shift towards responsible investment, shows no signs of slowing down. A global survey by BNP Paribas recently concluded there will continue to be a huge shift to responsible investment. The authors write: “It is widely accepted that incorporating ESG can be beneficial to returns, but what we will see now is firms really putting investment weight behind this.”⁴

In addition to the strong performance analysis, an RIAA survey conducted as part of our annual *Responsible Investment Benchmark Report* highlights a number of other drivers of growth, most of which come down to rising demand from clients – whether institutional, or retail (see chart on facing page).

For credit issuers, these are all important signals to stay on top of. The growing cohort of responsible investors will be looking to understand how companies are managing ESG risks and tapping ESG opportunities in alignment with their own goals. ESG is being built much more deeply into due-diligence and credit-risk processes, and investors will continue to ask the tough questions on ESG issues and how they are being managed.

This convergence of rising demand from investors, together with the evidence showing ESG integration delivers stronger outcomes, underscores the enormous potential of responsible investment. For financial markets, this is only the beginning of capital starting to realise its potential to help create a more sustainable and prosperous society. •

Footnotes can be found on www.kanganews.com/news/7499-footnotes-riaa-article

A NEW AGE OF FINANCE?

For **Sean Kidney**, chief executive of the **Climate Bonds Initiative**, the global shift of our time is to a climate-resilient future. He says we are entering a new age of finance, where financial markets must align with the move towards zero emissions, work to develop new global growth and employment models, and contribute to the United Nations Sustainable Development Goals (SDGs).

In the second decade of this century, it is increasingly cogent to posit that we are in a critical moment in history, characterised by three striking features of today's economic and financial configuration. These are the investment challenges in the infrastructure realm, the threats emerging from climate change and other environmental risks, and the need for finance to reconnect with the real economy.

In practice, demographic and economic growth are driving demand for new infrastructure, particularly in emerging and developing nations in Asia and Africa. This implies that significant investment flows will have to be directed towards the building and rebuilding of our world's infrastructure over the coming decades.

It also means financing has to shift to cover the systemic transformation towards a low-carbon economy, primarily supporting investments in clean energy, low-carbon transportation, energy-efficient buildings and smart green cities and megacities.

Simultaneously, investors are becoming aware of the adverse effects of extreme climate change on assets and portfolios.

The recognition of the risks posed by increasing probability of catastrophic natural disasters and by choices in government policy and technologies in response to climate change are key motives behind the mobilisation of sustainable finance. These risks can no longer be ignored, downplayed or passively managed.

The G20 *Green Finance Synthesis Report* of 2016¹ outlines the opportunities. The FSB Task Force on Climate Change Disclosure (TFCD)² conclusions have put paid to any lingering notions that institutional investors can 'sit this one out'.

THE ROLE OF GREEN FINANCE

We are entering a new age of finance, where markets must align with the move towards zero emissions, work to develop new global growth and employment models and contribute towards the SDGs. These are the biggest challenges of our time.

As the financial sector starts seeking opportunities to take part in the clean-economy transition and hedge the risks, green finance and green-bond markets present the tools to meet this fast-growing demand.

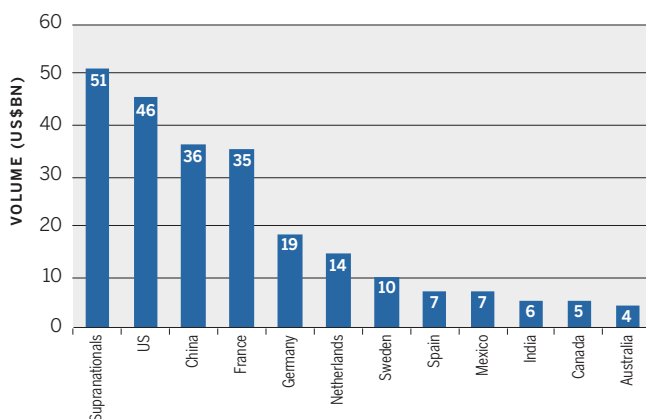
Green bonds facilitate the reallocation of capital flows towards sustainable infrastructure while delivering comparable risk-adjusted returns. Green bonds ultimately allow finance to reconnect with hard assets in the economy. The market for green bonds is growing fast and, with 2017 issuances already exceeding the 2016 total, it is well set to achieve the target³ of US\$1 trillion global climate leaders⁴ are calling for by 2020.

There is more capital available today than ever before. With interest rates at low historical values in the largest economies and as much as US\$13.4 trillion in bonds with negative yields, this is the perfect time to invest in the world's transition to a climate-resilient future.

AUSTRALIA'S GREEN-BOND MARKET

In Australia to date there have been 15 labelled green bonds amounting to A\$5.5 billion (US\$4.4 billion) from 12 issuers (see chart on this page). Despite having a relatively small

TOP 12 COUNTRIES OF ORIGIN FOR GREEN BONDS FROM MARKET INCEPTION TO END OF Q3 2017, INCLUDING SUPRANATIONALS



SOURCE: CLIMATE BONDS INITIATIVE 17 OCTOBER 2017

market, Australia has a diverse range of green bonds, including 13 certified climate bonds from the nation's big-four banks, two state governments, a listed property company, a leading tertiary institution and two green asset-backed securities.

Australia has become a global best-practice example of market development, driven by leadership from the banks and their support for robust standards and disclosure, the involvement of subsovereigns and the government-backed Clean Energy Finance Corporation, as well as demand from local asset managers and superannuation funds.

BUT THE WORLD IS MOVING FASTER

Despite this favourable start, Australia risks being left behind in what is clearly becoming a green-finance race. A quick scan of the region sees Singapore repositioning, with a particular focus on capturing new green-bond listings⁵ on the Singapore Exchange.

In Hong Kong the new chief executive has committed to issuing a sovereign green bond⁶ in the next financial year and building green-finance initiatives. In mid-October, Fiji announced a sovereign green bond. Malaysia is seeking to extend its dominance as a global centre of Islamic finance to that of green Islamic finance. The Industrial and Commercial Bank of China, the largest bank and largest public company in the world, has just issued a climate bonds certified⁷ green bond and signalled a new green-finance push.

Further afield, the EU High Level Expert Group on Sustainable Finance⁸ process is gathering pace and institutional support. London, Paris, Luxembourg, Frankfurt and Shanghai are all actively working at business, corporate and climate levels to position themselves as the green-finance hubs of the future. Casablanca has adopted a similar posture in relation to northern Africa while a group of European and Chinese financial centres have recently committed⁹ to cooperative action on building green- and sustainable-finance networks.

Meanwhile, the UK government has just launched its Clean Growth Strategy. To quote from the Department of Business, Energy and Industrial Strategy website: "This strategy sets out our proposals for decarbonising all sectors of the UK economy through the 2020s. It explains how the whole country can benefit from low-carbon opportunities, while meeting national and international commitments to tackle climate change."

This simple statement broadly reflects mainstream¹⁰ global views: new growth will come from increasing green investment and the shift to a green economy.

WHERE NEXT?

Australia is uniquely placed as the world's 13th-largest economy, a G20 member with a stable financial sector and world-ranked banks. Australian superannuation funds have a global presence with expertise in infrastructure, debt-financing facilities and alternative assets.

The national savings pool is fast-growing due to mandatory retirement contributions and now ranks as the third-largest



FAST FACTS: BIO

Sean Kidney is the co-founder and CEO of the Climate Bonds Initiative (CBI), an international nongovernment organisation working to mobilise debt capital markets for climate solutions.

CBI administers a global green-bond standards and certification scheme and supports market-development programmes in Latin America, Africa, China and Asia, working with governments, cities and

investment banks on growing green finance.

CBI provides strategic advice on green bonds, climate-finance policy, green investment markets and project aggregation to a range of international organisations, governments, regulators and financial institutions.

Sean is a member of the EU High Level Expert Group on Sustainable Finance and is a director of the Network for Sustainable Financial Markets.

www.climatebonds.net

in the world, according to the latest OECD *Pension Funds in Figures* report.

Despite the political vacuum on climate policy, the big-four banks can take due credit. Over the last three years they have led the domestic-market's green bonds towards global best-practice while making benchmark-size transactions.

Now it is time for local asset managers and superannuation funds to make their voices heard and call on corporate Australia to start substantive green issuance. Signalling internationally that Australian investors have appetite for more quality green product would be another positive.

Continued growth in green finance would help build local capacity and solidify best practice as the market develops. A bigger presence would also see Australia well placed to make the most of the forthcoming Asia region funds passport and the corporate collective investment vehicles regime¹¹. In addition, a strong domestic green-finance sector may in time become a greater source of green capital flow to Australia's Asian neighbours as they develop their emission-reduction plans and seek international investment to help meet their intertwined national-development, clean-energy, infrastructure and climate goals.

The biggest global shift of our time – the move from high- to low-carbon economies – is happening. Capital will inevitably have to shift with it. Australia has dipped its toe in the water. A doubling and then tripling of green investment in the next 12 and 24 months would show that domestic investors have decided it is time to paddle a little harder to catch the coming waves. •

Footnotes can be found on www.kanganews.com/news/7502-footnotes-climate-bonds-initiative-article

DEBT CAPITAL MARKET DEVELOPMENT AND TRENDS IN **THE SRI SPACE**



*K*angaNews speaks to a range of representatives from Australia's big four banks about the role of capital markets in financing global sustainability initiatives, developments in the fixed-income socially responsible investment (SRI) space, the challenges to growth of the impact bond market, and what tops their wish list of things to happen to promote further market growth.

PARTICIPANTS

■ **Michael Chen** Head of Sustainability WESTPAC INSTITUTIONAL BANK ■ **Mark Goddard** Head of DCM and Syndicate WESTPAC INSTITUTIONAL BANK ■ **David Jenkins** Director, Sustainable Capital Markets NATIONAL AUSTRALIA BANK ■ **Simon Ling** General Manager and Global Head of Debt Markets COMMONWEALTH BANK OF AUSTRALIA ■ **Kylie Macfarlane** General Manager, Corporate Responsibility COMMONWEALTH BANK OF AUSTRALIA ■ **Katharine Tapley** Head of Sustainable Finance ANZ ■ **Paul White** Co-Head of Capital Markets ANZ ■ **Eva Zileli** Head of Funding NATIONAL AUSTRALIA BANK

MODERATOR

■ **Samantha Swiss** Chief Executive KANGANEWS

Swiss Can capital markets step up and play a direct role in the development of the SRI market globally, for example by funding projects that help meet the United Nations (UN)'s Sustainable Development Goals (SDGs)? Is this role one of the reasons

Australia's banks have made such a strong commitment to sustainable finance?

■ **TAPLEY** We have been a signatory to the UN Global Compact for the SDGs since 2010 – and our chief executive, Shayne Elliott, signed the CEO statement of support for the SDGs at the beginning of 2016. This was an initiative of the



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We know education outcomes have a profound effect on personal success, economic growth, improved health and social engagement. That's why we made a 25-year commitment to investing in education through Start Smart.

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For more information, visit commbank.com.au/StartSmart





“If we can get to a point where an issuer can achieve a more attractive cost of funds, albeit a small one, this will lead to more development of the sector.”

PAUL WHITE ANZ

UN Global Compact Network of Australia to spur further action on the SDGs here, and saw us map our corporate sustainability targets to the SDGs by the end of 2016.

These are definitely among the drivers behind our commitment to sustainable finance. Now that the SDGs are emerging as a potential financing platform, much like the Paris Agreement, we are actively engaging in conversation in this regard. For example, we participated in SDG financing forums during UN General Assembly week in New York in September this year.

Second, resulting from a conversation with PIMCO – one of our key fixed-income investors – we have recently mapped our project-finance book to the SDGs. This shows we have a few billion dollars-worth of assets that match to climate action, clean water, liveable communities, affordable energy, and so on.

■ **ZILELI** I think the role of capital markets in developing the SRI market was really evident with National Australia Bank (NAB)’s social bond. This was the first time I’ve been able to bring together a social issue that I recently started to drive internally with another thing I’m passionate about, which is funding and capital markets. What other opportunity has there been for these two topics to come together? For me, capital markets have a leadership role to play.

■ **JENKINS** I agree. The capital markets are a means to mobilise capital in scale. Sean Kidney from the Climate Bonds Initiative (CBI) has been singing from the hilltops about this for a long while but it has taken some time to gain traction in Australia. We are a bit behind the evolution of the market offshore. The flip

side is we are picking up at great pace with some good ideas and very innovative transactions coming out of Australia.

■ **GODDARD** There is an opportunity for capital markets to play a direct role in the development of SRI, and it is a leadership role the capital markets can play. Look at how the green-bond market developed offshore – green bonds were being issued before we saw any of the large policy changes come through at a governmental level.

Ultimately, however, the capital-markets piece is driven by supply and demand. If there is demand, supply will follow. We can’t create and force SRI product in a vacuum. Having said this, we are seeing growing demand for SRI products. This reflects that investors are being pushed by their clients and shareholders to invest in SRI product.

Westpac Institutional Bank (WIB)’s strategy, from a capital-markets perspective, is that when we see a need and demand growing we want to address it by providing the products that will be a catalyst to that need.

■ **CHEN** One way to look at this is in terms of supply and demand, another is to look at it in terms of risk and return. If you look at certain renewables, for example, with technology costs rapidly coming down renewables are already winning the war for investor dollars for new-build assets without any need for subsidies.

It’s the same when you look at social-benefit bonds (SBBs). With SBBs, the capital markets have found a way to structure deals that offer investors good returns for the risks they are taking on but that are also delivering positive social outcomes. Governments only pay according to the social impact generated. It’s a real win-win-win.

■ **MACFARLANE** I agree that the capital markets have a real opportunity to participate in the development of the SRI market both here and abroad. For Commonwealth Bank of Australia (CommBank), awareness of the SDGs is still building. However, there is no doubt the work we and others are doing supports and reflects the SDGs’ areas of focus. This said, I’m sure Simon Ling and his team also think this is very interesting and important, and it demonstrates a level of purpose to their roles even if it may not be core to the role.

■ **LING** There’s no doubt that people are inspired by this and there is a lot of innovation around the area. What a lot of us have done is taken something that started way out on the edge, and as a community we’ve brought green and social-impact financing towards the centre.



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ANZ - Best Domestic Bank over 20 years*
Australian Dollar Bond House & NZ Bond House of the Year**
Most Innovative Deal – ANZ Green Bond A\$600 million***

anz.com/institutional

* 2016 FinanceAsia Platinum awards

** 2016 KangaNews Awards

*** FinanceAsia 2015 Australia & NZ Achievement Awards

Australia and New Zealand Banking Group Limited (ANZ) ABN 11 005 357 522.





“If the inflow of dollars into the responsible-investment space continues, there’s no reason this market won’t continue to grow. The SDGs are helping with this – it’s becoming a default language in the bigger end of the investor universe globally.”

DAVID JENKINS NATIONAL AUSTRALIA BANK

■ **MACFARLANE** Our institutional bank has played an important role in demonstrating to clients and future customers that the bank is doing innovative things to support the sustainability agenda of the organisation. To have a sustainable organisation we need both sustainable profits and purpose.

STRATEGIC PURPOSE

Swiss Do you see the development of the SRI market as a strategic goal for your team, and how does it fit with other priorities?

■ **GODDARD** If you look at market responses on a supply-and-demand only basis, you might view the response as tactical rather than strategic. However, if you look at the strategy of the bank and the clear agenda the Westpac Banking Corporation (Westpac) group has in terms of overall sustainability you will see how delivering SRI product fits into a broader strategy.

Westpac has set clear goals to ensure its own sustainability and to maximise the sustainable contribution the bank makes to local and global economies. Capital markets have a role to play in all this, but the capital markets are not informing the group’s strategy – it is much bigger and broader.

Having said this, the fact that we have a head of sustainability in WIB shows we are doing a lot in this space across our institutional-banking platform. It’s not limited to what we are doing in capital markets – there is an SRI overlay on everything we do.

■ **TAPLEY** Our sustainable-finance business has been built to leverage off the success we have had in project financing

renewable energy and to put strategic priority on building capability to capture the opportunities arising out of the transition to a lower-carbon economy beyond just project financing. The fact is our customers are talking about this transition and wanting expertise and financing solutions – we are seeing this right across our franchise, both in our home markets of Australia and New Zealand and also through Asia and Europe.

Green and sustainability bonds specifically are emerging as one of the key financing tools, hence the strategic focus we are putting on this within sustainable finance and jointly with our capital-markets team.

■ **WHITE** From our side this asset class has become more relevant for our issuer clients and, even more so, our investor clients – not only domestically but globally. So it is an important development for the markets globally to continue to be more relevant in this sector, and we are expecting more growth going forward.

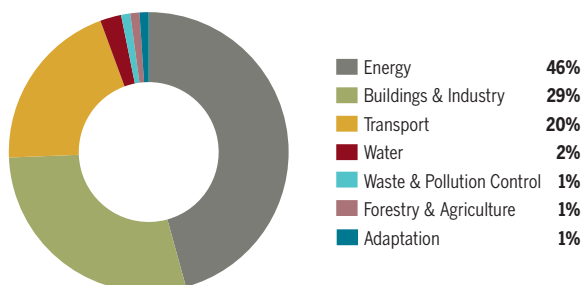
One of the key strategies for ANZ is around the capital flows across the Asia-Pacific region as a whole. If you look at what has happened around sustainable finance in the last 18 months, particularly in China, this has clearly been the big driver of growth.

Of course we see the Australian market as important but we have also been actively involved in the development of the New Zealand market. We joint-led the first green Kauri bond from International Finance Corporation (IFC) earlier this year and we also worked with Contact Energy when it converted its entire MTN programme into a green one. In Asia, too, we have done a number of transactions for the likes of Castle Peak Power in Hong Kong and Rural Electrification Corporation in India.

■ **LING** It’s one of our long-term priorities to develop these markets towards their potential, which we believe is much bigger than now. For example, green issuance in Australia has already gone from A\$300 million (US\$238.3 million) in 2013 to A\$1.7 billion issued this year to the end of September. It’s still early days in Australia and we are not generating significant revenue from it, but we see it as a part of the capital market that will expand considerably over time.

We are involved in the SRI space because our clients are, and our business is client-led. The demand side of the equation is increasingly green and our issuing clients and investors are increasingly interested in social impact. It also makes sense

AUSTRALIAN GREEN BONDS’ USE OF PROCEEDS, MARKET INCEPTION TO END Q3 2017



SOURCE: CLIMATE BONDS INITIATIVE 17 OCTOBER 2017

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DEAL HIGHLIGHTS: WESTPAC INSTITUTIONAL BANK

Although Westpac Institutional Bank has worked on big transactions in the socially responsible investment (SRI) arena, the deal the team is most proud of is the social-benefit bond (SBB) for The Benevolent Society of New South Wales (BenSoc).

■ SWISS What deals are you most proud of bringing to market?

GODDARD Of course I'm very proud of Westpac Banking Corporation's own green-bond deal. Also, World Bank's green-bond deal in the Australian market. The deal helped develop the green-bond space – as the first deal of its kind in the domestic market, the World Bank trade provided a benchmark for green product. Prior to this all green product had been issued offshore.

Bringing the World Bank deal allowed investors to see how the World Bank green bond was positioned relative to the existing World Bank Kangaroo curve in Australia as well as relative to World Bank's green bonds issued offshore.

But I'm probably most proud about what our structured-finance team and other colleagues did to bring the SBB to market for BenSoc.

This is the hardest type of transaction to bring due to the education required for investors. It's not as vanilla a product as a green bond, and this makes the process more challenging. However, the reason it also resonates is that it has a much more direct social impact. Seeing a capital-markets instrument have a direct positive impact on foster care is a great outcome.

CHEN I agree – especially if you look at what BenSoc has achieved over the past four years. Since its inception, the programme has an 89 per cent preservation rate for families referred to it. This makes the programme among the strongest-performing intensive family-preservation services in the world. By meeting the performance KPIs, it also generates financial returns for investors – 7 per cent for capital-protected class investors and 15 per cent for capital-exposed class investors.

for us to be involved in developing this market due to our experience and capability, and not just in Australia.

One of the things I enjoy most about social impact as well as green markets is that the cross-discipline aspect brings people with different skills and backgrounds together across the bank. Whether it's securitisation, bonds or loan syndication, you need a variety of skills to execute these deals.

CommBank is well positioned to innovate in this space due to the depth of our product expertise and the resources and capabilities across the bank including in customer advocacy,

sustainability and community engagement. Another reason it's part of our strategy and a priority is that working on these deals is inspiring. Our people put their hands up to work on a social-impact bond, for example, even if it's on top of their day job or takes more effort, because they feel more connected to the bigger picture and can see directly how they're giving something to society in a way that is relevant to their roles and skills.

■ **MACFARLANE** Sustainability is core to what an organisation does, as opposed to something that is overlaid on an organisation's day-to-day activities. If you can apply a commercial impetus and industrial scale to sustainability, and embed it in your policies and processes, it becomes part of who you are as a company and what you do every day.

When working on deals, our teams work together to think collectively about how green or social-impact investing aligns with the organisation's overall vision, our corporate-responsibility strategy, and how it might provide us with a point of differentiation or commercial capability longer term.

The other part of this is how we measure and report on the work we're doing through social-impact investing. Our annual corporate-responsibility report shows the work we are doing above and beyond the numbers, and institutional investors see nonfinancial metrics as an essential measure of the overall health of an organisation.

■ **ZILELI** This is absolutely a strategic area for NAB's team – it's a fundamental part of the strategic approach. In treasury we want to embrace the shared-value concept, which is part of core business for NAB. Shared value is a competitive business strategy to create business value while also creating societal value, and one way our teams do this is by using capital markets to address pressing social issues.

To show that it is really part of NAB's values and direction, in September 2015 we announced a commitment to undertake lending and financing of at least A\$18 billion to support the transition to a lower-carbon economy by September 2022. In two years we are very well on track with this target – which is a reflection of NAB's commitment to this strategy.

Another example is gender equality. This is one of the social issues facing society, hence our leadership and creation of the social bond around gender equality – to show NAB supports this issue.

■ **JENKINS** Our chief executive has made comments around our support of the SDGs, we are a member of the UN Global Compact, and we are looking at ways to collaborate and drive progress towards the adoption of the SDGs through our existing businesses, and also with our clients – both investors and borrowers. We see sustainable capital markets as a great way to mobilise this, and do it with scale.

For us it's about how we can develop products that deliver both a financial and a social return. The wealth of money that is seeking opportunities to deliver a positive social or environmental impact, as well as a financial return, is overwhelming and it's continuing to grow.



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DEAL HIGHLIGHTS: COMMONWEALTH BANK OF AUSTRALIA

For Commonwealth Bank of Australia, its role in developing the social-benefit bond (SBB) market is a highlight. The bank is also proud of being an arranger on the first green bond, globally, done by a university in the US private placement (USPP) market.

■ SWISS What deals are you most proud of bringing to market?

LING If I have to pick one, it would be the SBB we helped structure for The Benevolent Society of New South Wales. While the deal was relatively small financially at A\$10 million (US\$7.9 million), it is a unique product and the first in this particular suite – and I am most proud of the tangible and very real difference it has made.

As a banker, I'm not used to thinking about or dealing with

foster care or at-risk children. It was extremely 'real' to sit at a table with police, the Department of Community Services and foster carers, to talk about a confronting issue and come up with a solution that has really made a difference. It has helped more than 400 families in just a few years.

If I could pick a second deal, it would have to be the Monash University USPP transaction as it was the first university globally to do a green USPP, and also highlights our international expertise.

'Throughout the organisation at NAB we all understand we have a social purpose in the community and this aligns perfectly with the bank's vision to become Australia's most respected bank. Our purpose is to 'back the bold' to move Australia forward.

MARKET DEVELOPMENT

Swiss What has been your bank's role in developing the domestic capital market for green and other impact bonds?

■ **LING** We're looking at all the various areas and how we can bring innovation. We were there for the first securitisation green bond, the FlexiGroup deal. We printed the first university deal in the US private placement (USPP) market. We issued the biggest Australian dollar green bond out of all the big-four banks. We executed the SBB for The Benevolent Society of New South Wales. And we were a lead manager on the Investa Commercial Property Fund deal which was the second green bond from an Australian REIT.

■ **TAPLEY** ANZ Banking Group has issued and then taken that experience to act as an intermediary in the Australian, New Zealand and Asian markets for a range of issuer types. We

are regularly host investor and issuer roundtables to exchange ideas, and also participate in global forums on driving financial innovation through these markets.

So education is a big part of what we're doing to develop the market. This includes education around the process of issuing these types of bonds, and dispelling myths about how hard it is. A lot of this comes down to connecting treasury teams with sustainability teams. Where we get the most traction and the most interest is where sustainability teams are core to strategy or very closely aligned to treasury teams.

There are different levels of knowledge and awareness of how the market works in the corporate world. I think there's general acceptance that you get access to a broader range of investors with a green bond. But we are still dealing with concern around the lack of a pricing benefit, and there is scepticism about it being 'just marketing' or greenwashing.

■ **WHITE** I agree that most issuers have tended to approach the concept of sustainable finance with a degree of scepticism. But this quickly changes once they have stood back and had investor engagement. We have had a number of discussions with issuers and investors in the last few months and the message is getting through that this is becoming more and more relevant for fund managers globally, so I think the market will continue to develop. It has been a slow start, but as with other asset classes once it gets momentum it will only increase.

■ **ZILELI** NAB was the first of the Australian majors to issue a green bond, in December 2014. When working on this bond, we were very conscious of not creating a superficial, gimmick climate bond. We took our time about it – it was important for our first issue to be gold-plated and set a standard.

We followed this deal with our euro climate bond earlier in 2017. It was an interesting transaction because we were marketing to European investors as opposed to domestic accounts. This involved a whole new dimension of scrutiny. The calls David Jenkins and I did with investors offshore were very, very rigorous. It was at that point that I felt great relief that the team had insisted on a framework that was robust, top of its game on a global-standard basis, compliant with the Climate Bond Standards and the Green Bond Principles, and we had addressed all the issues European investors wanted us to in the framework.

Although we had already done one climate bond, the rigour around building on the framework we had developed made the euro deal quite satisfying. Especially as we received a very positive reception from investors.

Taking these learnings on board, we then started working on the social-bond framework, which we built to the standard European investors were looking for. The gender-equality bond NAB issued this year was the first of its kind globally.

■ **JENKINS** Our team has worked on the three transactions for NAB's balance sheet, and we've brought 11 public deals in total across a range of different markets from AMTN and EMTN to USPP. We were a joint arranger on the first Kauri green bond for IFC, we arranged the first euro benchmark climate bond

for NAB, and we also worked on our first US dollar green bond, for TD Bank, during 2017. NAB was also an arranger on the first green securitisation in Australia, as well as the first sustainability bond.

Since I started with the bank, in late 2010, I have been immersed in this sector. We began talking to investors as early as 2011 about how we saw the market developing and getting their thoughts on whether SRI, initially green bonds, made sense for them and their investor bases. You can see we had to commit resources to this sector way before any deals were issued in the domestic market. It's only now we are seeing the recognition come through – for example, the CBI team has given NAB a green-bond pioneer award.

■ **GODDARD** We've had the same experience. The first deals that came in this space took a number of years of development before they even hit the screens. So we were doing a lot of work around trying to bring deals to this market before any deals actually materialised. In both the green and social spaces WIB brought the first bonds. WIB was a lead manager on both the World Bank Kangaroo bond, which was the first green bond in the domestic Australian dollar market, and the first SBB for The Benevolent Society.

The World Bank deal we brought to market in April 2014 was about two years in the making. While the end result was a vanilla green bond that could be seen as an ordinary supranational, sovereign and agency (SSA) issue, we spent considerable time working with the issuer to ensure the investors that were offered the bonds were really taking environmental, social and governance (ESG) issues seriously. World Bank didn't allow us to allocate to some investors because the issuer was clear from the outset that it wanted the inaugural trade in this market to reward investors with SRI-specific mandates and funds.

As the first benchmark deal, the transaction allowed discussions to take place for further issuance. So you could argue that this deal was the cornerstone for setting up all the transactions that followed.

As part of this process, we also spent a lot of time listening to investors. This allowed Westpac Banking Corporation, when structuring its own green bond, to ensure that it was perfectly formed to meet investor requirements.

Swiss Having spoken to both issuers and investors in the domestic market, what is the potential for the SRI market to grow? Will it develop into a viable asset class in its own right, or are we more likely to see intermittent deals? What is driving it and why now?

■ **TAPLEY** The Paris Agreement has a lot to do with this. When it was signed, the conversation quickly turned to how all this will get financed. And now the potential for the SDGs to be used as a financing platform is gaining traction.

I think the appetite of and pressure from investors is also a major factor. But it's also about what makes economic

DEAL HIGHLIGHTS: **NATIONAL AUSTRALIA BANK**

The National Australia Bank (NAB) duo choose their own bank's climate bond – the first to be done by a bank in Australia – and award-winning gender-equality bond as deals worthy of particular mention.

■ **SWISS** What deals are you most proud of bringing to market?

it could be done and how it would work from an issuer's perspective.

JENKINS For me it was what we did first – finally getting NAB's climate bond into the market. It took a long time – we started working on it in 2011 and it took until the end of 2014, working through a host of challenges both internally and externally.

After all this work, to see the market accept our framework and issuance was very pleasing. The other Australian banks have all followed our approach in the sense of getting their bonds certified by CBI. We have also been able to take the learnings and work with other clients to issue green bonds.

This was a great collaborative effort. We drew on people from areas as diverse as social innovation, sustainability, governance and risk, the clean-energy and infrastructure team, operations, legal, and sales.

Then we also had to partner with investors to bring them along on the journey, as well as working with the Climate Bonds Initiative (CBI) team as they developed their original standards and used us as a pilot. We were the proof point in the sense of whether

ZILELI I would have to say the deal I am most proud of is the social, gender-equality bond. For NAB, one of the major banks, to go out there and issue a bond that supports gender equality was a very bold statement to make.

The framework and the actual bond itself were both very innovative, but for me what made this bond special is the leadership NAB has taken on a social issue that resonates across the globe.

sense. The technology to upgrade buildings or switch power sources to renewable energy is becoming a lot cheaper, which is contracting return periods. There are actually economic benefits to making these investments.

On top of this there's a realisation that the world needs to transition to a low-carbon economy urgently. People are now taking a longer-term view around asset ownership and asset management.

■ **WHITE** I still think you're going to see one-off deals rather than huge growth in the asset class. But that's just the nature of the market. If you look at the overall market in Australia it's very much rates- and high-grade-heavy. So you are unlikely to see continuous issuance in this space from financial institutions

DEAL HIGHLIGHTS: ANZ

In choosing which deal it's most proud of bringing to market, the ANZ team says the transaction from Investa Office Fund was a significant milestone.

■ **SWISS** What deals are you most proud of bringing to market?

TAPLEY Our own transaction is worth mentioning. We are also very proud of bringing the first corporate, Investa Office Fund (IOF), to the green-bond market in Australia in 2017 – this was a significant milestone. The IOF deal was closely followed by its sister fund's deal, and together they created a lot of momentum and a general realisation that the green-bond market is real and available to tap into when the timing is right.

Investa Property Group is one of the most highly rated property companies in

Australia for sustainability. The company prides itself on its sustainability credentials and culture, as well as the very high-quality nature of the buildings in its overall portfolio.

It was also the first corporate in Australia to put in place science-based environmental sustainability targets, which it did at the beginning of this year.

Issuing a green bond was about aligning its funding needs with the strategy around sustainability. The green bond was a relatively straightforward and obvious thing for IOF to do due to the nature of its portfolio.

the long term. As you can see, we are committed to backing this market.

■ **GODDARD** Demand continues to grow because shareholders, policy holders and other stakeholders are ensuring that institutional investors have a focus on SRI when making investment decisions. Institutional investors have responded in different ways including innovation from the likes of QBE Insurance Group (QBE) with its premiums-for-good programmes. With more of this going on, demand will grow and supply will feed into this demand where possible.

On green bonds, offshore issuers will come to this market when the arbitrage works for them. This will always provide a strong base for the market.

■ **CHEN** What's exciting about the green space is because there's increasing consensus on what constitutes green, investors can allocate capital to this asset class confident of the 'greenness' of the bond.

■ **GODDARD** They start from the fact that green bonds are really vanilla. The majority are use-of-proceeds bonds. Because of this, it's very easy for mainstream investors to put green bonds into their portfolios, to value them and look at them alongside other instruments.

■ **ZILELI** This is not a one-off sector for NAB. We have issued three SRI bonds, compared with our peers that have each issued one. It is our expectation that these bonds will form a regular part of our issuance. I say expectation because you need to have the underlying assets to support these transactions. But certainly from my perspective as a funder, I would hope this forms a regular part of our issuance.

I definitely think this market has the potential to grow. We are starting to see a groundswell of movement and support for investing in socially responsible assets. It started in the equity space and now it has shifted into the fixed-income space. We need to see more people demanding their funds be put into socially responsible assets in order for the market to grow.

■ **JENKINS** If you look at the growth of the green-bond market over the years, it shows the potential. If you look at the development of the sector in Australia you can see the year-on-year growth. There were three deals in 2015, five in 2016 and, in 2017 to the end of September there had been 10 – noting that these numbers include Australian issuers going offshore. We expect next year to be the same, if not more. Most existing issuers say they are looking to be repeat issuers, and there are also new issuers coming to the table.

given their lending books. On the corporate side, issuance tends to be one deal a year from most large corporates rather than a whole host of deals from any one issuer.

I still think the market will grow but we will see less frequent deals than in offshore markets, due to the nature of the Australian domestic market.

■ **CHEN** This will absolutely develop into a viable asset class. To put our money where our mouth is, we recently announced a new target to facilitate up to A\$3 billion in climate-change solutions through activities such as green-bond issuance and arrangement. This is in addition to a target of A\$25 billion in lending exposure to climate-change solutions by 2030, which is putting our balance sheet at risk to support green solutions over



"If you can apply a commercial impetus and industrial scale to sustainability, and embed it in your policies and processes, it becomes part of who you are as a company and what you do every day."

KYLIE MACFARLANE COMMONWEALTH BANK OF AUSTRALIA

These bonds are now part of the discussion we have with issuers. If the continuing inflow of dollars into the responsible-investment space continues, there's no reason this market won't continue to grow. The SDGs are helping with this – it's becoming a default language in the bigger end of the investor universe globally. This may take time to filter down to Australia, but is growing based on our discussions across to the government sector. The banks are all embracing the SDGs, corporate Australia is too, and so are companies in New Zealand.

■ **LING** The green-bond market has already grown substantially. The interesting thing about green bonds is that offshore you can achieve a pricing advantage from issuing these products. If you're issuing into the euro and Asian green markets you get a price differential in a positive way and you could argue that these markets are well on the way to coming of age.

■ **MACFARLANE** There is also global imperative. There are a lot of resources globally focusing on a solution to transition, and the green-bond market is part of this.

Swiss What about the potential of growth for the SBB market?

■ **LING** Social impact is trickier – unfortunately it's still very much a niche market at the moment, with only A\$52 million issued so far in Australia. Nobody could say the market has kicked on to the point where it is really up and running with scale.

There were problems on both the supply and demand sides when we first started working on SBBs. Now the demand side of the equation is pretty good and the challenge is the supply side, as there is a lack of social projects you can scale and measure. There are a few organisations that can handle scalable projects so I think we can get there over time, though. However, relatively quickly to get to the hundreds of millions we would like to see, a social-housing bond-aggregation model would be a good step.

The holy grail for social-impact finance that we all seek is scale, and the key to scale is continued growth on the demand side. If we have a steady stream of investors knocking on our door asking us what's coming next, it will really drive the market to think harder and more laterally to come up with transactions. It would also help if we could find a more standard way to structure and document social-impact bonds as they are still too complex to scale.



■ **GODDARD** It doesn't matter how big the SBB market becomes. When you're working on a social transaction different measurements and processes are involved. There's no easy index, it's not vanilla. What is vital is that we keep seeing growth and that social issues are being addressed successfully via the product. In this context, it is good to see more state governments committing to these types of projects.

■ **CHEN** I agree that the SBB market doesn't need to be as big as the green-bond market. They are quite separate and we are proud of them for different reasons. For the SBB market, all the solutions need to be bespoke for the community or service being provided. As a result of this you will never see the scale that you do in green, but you will see a really strong social impact.

■ **JENKINS** It has been encouraging to see the South Australian, Queensland and Victorian governments following New South Wales (NSW)'s lead to test and learn with this financing mechanism so they can improve the transparency and impact of each dollar spent by government.

We were visited by an international guest who was involved in the first social-impact bond in the UK. He suggested that, even though the UK social-impact bond market was more advanced, it was still too early to tell where the market will lead. We hope to learn from the experiences across Australia to create more consistency in approach and structure of SBBs and therefore create efficiencies within the process.

We have completed two SBB transactions, with the NSW and Queensland governments, and we're working with the

“With SBBs, the capital markets have found a way to structure deals that offer investors good returns for the risks they are taking on but that are also delivering positive social outcomes. It's a real win-win-win.”

MICHAEL CHEN WESTPAC INSTITUTIONAL BANK



MEASURING **IMPACT**

It is all well and good to issue or invest in a green or social bond. But investors want to measure the impact of their investments and borrowers want to ensure they are reporting in a way that ties in with the developing trends in impact measurement.

■ **SWISS** One of the biggest challenges for this sector is how to define and measure impact. What are your views here?

JENKINS Impact is the first question we are asked – what impact reporting are you doing and how are you doing it. If you look at the green-bond market as the precursor to where we are now, it has taken a while for the market to land on a common metric.

It was led by the work the supranational, sovereign and agency issuers did a couple of years ago around developing a harmonised framework for impact reporting.

The Climate Bonds Initiative (CBI) has been very good at articulating these measures into benchmarks that allow them to give technical rigour around their standards. This gives us comfort because when we talk to investors we can say low-carbon transport in Sydney or Melbourne is aiding the journey to a two-degree climate-change world by 2050 and here's the proof – it's around reducing the emissions footprint over time via modal shift and transitioning to a lower carbon-generation mix.

When it comes to social bonds there's an understanding that

it's far less evolved because there is such a range of investments or projects – there's not a single, uniform metric. Over time, as each issuer brings another deal to market impact-measurement standards will evolve and look at precedents elsewhere.

CHEN There are so many different ways of measuring impact. The challenge is to find a common approach that everyone signs up to. 'Green' is easier to articulate. Westpac Banking Corporation is the only Australian bank to publish an impact report on our green bond one year on. For example, we show the amount of CO₂ emissions that has been avoided from the projects we have funded.

WHITE From an investor perspective there is an underlying mandate to see the impact. This requirement is less prevalent among the issuer base. As the market develops and it is measurable, this will grow.

TAPLEY Under the most recent version of the criteria released by the CBI standards, the suggestion for impact reporting is very strong. And investors are definitely looking for impact. They are saying 'I understand the use of proceeds, but what is the impact?'

ANZ Banking Group (ANZ) will be publishing an impact report on its green bond with our Corporate Sustainability Report. This is in response to investor requests to do so.

We have been thinking about impact measurement a lot because investors are telling us they want the ability to show what impact their allocations are having. To do this, issuers need to show what we they are doing with their bond proceeds.

It is somewhat uncharted territory and therefore challenging. For example, if I take ANZ as an issuer, we can look – as we have already – to our project-finance for single-asset loans to hospitals, schools, light rail, desalination plants and so on, all of which can be easily mapped to the United Nations Sustainable Development Goals (SDGs) as the measure of impact. How we then apply this measure across our lending for general corporate purposes, across our corporate-lending book, becomes more challenging and subjective.

■ **SWISS** So you are looking at the SDGs as a way to measure impact?

TAPLEY Yes, we are now starting to look at our Institutional lending book

through the SDG lens. For me, this is the really exciting part – using the SDGs to show the impact we have through our basic reason for being, which is facilitating the flow of money.

CHEN We will be launching our new group sustainability strategy in November. Everything we do in this strategy will be mapped against the SDGs. We will be measuring and reporting on how we address the SDGs.

MACFARLANE I think there's an opportunity for the SDGs to play a role in impact measurement, although understanding of the SDGs is still building. How we then embed them is the important piece.

At Commonwealth Bank of Australia we have mapped our corporate-responsibility strategy and our corporate-responsibility report to the SDGs. While we haven't gone to the level of sitting down with Simon Ling and saying 'now let's map your book to the SDGs' there is certainly an opportunity to do this down the line.

JENKINS The SDGs are giving a framework for impact measurement. We have teams internally that are working very actively on putting a framework in place, reporting our progress as a broader business against the SDGs. Corporate Australia is doing this too. We can take these learnings into the green-bond and social-bond arena.



“WE ARE NOW STARTING TO LOOK AT OUR INSTITUTIONAL LENDING BOOK THROUGH THE SDGS LENS. FOR ME, THIS IS THE REALLY EXCITING PART – USING THE SDGS TO SHOW THE IMPACT WE HAVE THROUGH OUR BASIC REASON FOR BEING, WHICH IS FACILITATING THE FLOW OF MONEY.”

KATHARINE TAPLEY ANZ

Victorian government on a third. With this experience, we are finding ways to do them faster and smarter each time.

CORPORATE POTENTIAL

Swiss The most consistent Australian deal flow so far has come from the banks. SSAs and two semi-government issuers have also issued SRI bonds. There has been limited activity from the corporate sector. Do you think this is the issuance pattern we're likely to see going forward, and do you anticipate more green-bond issuance from the corporate sector?

■ **CHEN** The obvious place for green bonds at the moment is around green buildings and renewables. We are also seeing more activity in the low-carbon transport sector. As green-bond standards develop we will see other sectors starting to come onstream. For example, land use.

■ **GODDARD** One of the things I hope is that people are patient with this market and don't compare it too much with offshore developments. You have to put it into perspective, especially when you talk about the corporate piece. The domestic market in Australia has only had a real corporate bond segment in the last five years, though of course there were sporadic deals before this. To expect the corporate green-bond market to develop rapidly in Australia is unrealistic. What we have seen is a number of offshore SSA issuers and the banks come into this market doing green bonds because they have set up use-of-proceeds programmes alongside their broader funding strategies.

We have seen some corporate issuance and we expect to see more corporates looking at the market – among our customers, for example, a number of our clients are either investigating or preparing for green-bond issuance.

In terms of sectors, property is an obvious one to mention. Because there are National Australian Built Environment Rating System ratings for buildings, it's easier for investors to get their heads around how green a bond that comes from this sector actually is. Also, the property space is the most well-supplied of all sectors in the Australian corporate bond market. So it's natural to see green-bond issuance from this sector.

I wouldn't limit growth to one sector, though. This market will develop across a range of sectors.



■ **JENKINS** The corporate sector is the most challenging. In terms of scale and volume, critical mass will continue to come from the banks, the SSAs and semi-governments – due to the size of their funding tasks and the fact that SRI bonds aligns with their reasons for being.

Green bonds are well understood in the corporate space – issuers can see that if they are investing in green infrastructure, renewable energy, and green buildings there is an easily understood impact measurement. In the short and medium term, these are the types of sectors where we will see growth.

Then you build on this to see which issuers are making a positive social impact – they can overlay green and social. If you apply this lens to the corporate sector there's a much bigger universe. We think, going forward, there will be more corporates looking at sustainability – which aligns the green and social elements together.

■ **LING** Banks tend to be leaders in financing because that is what we do, and we have big balance sheets that we continue to fund so we're always on the edge of innovation in funding.

Corporates are funding more for corporate-financing reasons, they're less frequent borrowers in the capital markets. I believe we will see more and more corporate SRI issuance, though, to follow demand from investors and consumers. It's great for the brand and you can actually get a pricing advantage and diversification from printing a green bond. So it makes sense for large corporates.

■ **WHITE** I think we will see more corporate issuance. There's certainly room for more deals from the property sector as well

“An important thing about social-impact investing is that we are sourcing finance from somewhere other than charities. We're mobilising capital markets to invest in social causes and we're creating a new class of investment.”

SIMON LING COMMONWEALTH BANK OF AUSTRALIA



as other Australian corporate issuers that have a sustainable strategy. But I also think we will see more from offshore corporates and financials.

BUYSIDE OBSERVATIONS

Swiss What are the main developments on the buy side in Australia? Are more bespoke SRI funds being set up or is SRI being incorporated as part of the overall process?

■ **LING** You've got everything from the big end of town to specific funds. The government has also been instrumental in driving market development through the Clean Energy Finance Corporation.

At the next level there are high-net-worth individuals, and undoubtedly SRI is going to become a more mainstream product for these clients. Meanwhile, retail investors are potentially more difficult due to different rules relating to listing and related documentation.

■ **MACFARLANE** Trustee boards of superannuation funds are already thinking about their sustainability remit as they consider the investments they make. Managed funds have had sustainable options for years, although take up hasn't always been up to expectation. I think a lot of this is due to the return profile. Millennials are also going to continue demanding more purpose-driven investments and we're already seeing this reflected in some product offerings.

■ **LING** Another important thing about social-impact investing is that we are sourcing finance from somewhere other than charities. We're mobilising capital markets to invest in social causes and we're creating a new class of investment.

This has a win-win property to it as social-impact investing is investing in something that is not correlated to the economy – and investors love uncorrelated risk.

■ **GODDARD** There's a mix of bespoke funds and overlays. Overall we are seeing more investors putting a focus on SRI investments. We are seeing the activity of some fund managers changing as end investors are becoming more interested in directing where their funds are allocated. Fund managers want to make sure they are involved in the SRI sector and they don't want to be left behind – especially as there is insufficient supply.

■ **CHEN** SRI-specific funds or investments are one part of the market, but importantly investors are also integrating ESG

into their mainstream strategies. We are seeing more of this in addition to specific SRI products or screens. We are also doing this in the lending space – we are assessing how companies perform in ESG as part of our normal credit-assessment process.

A good example of this in our wealth arm, BT Financial Group (BTFG). It has SRI-type funds, but in addition to this it actively considers ESG factors in its investment analysis and decision-making process.

■ **JENKINS** Traditionally, SRI has been a focus of the equity market. It's only in recent years this has translated into fixed-income offerings. Various retail investment offerings are now being developed. For example, we are seeing the first green exchange-traded funds and the first responsible-investment unitised trust vehicles are being created. NAB is also working on a low-carbon fund which is being marketed to institutional investors.

Regarding whether there are specific funds being set up or fund managers using ESG as an overlay, it's a mix. There are only around 20 dedicated green-bond funds globally – that's less than US\$2 billion, or less than a percentage point of the green-bond universe. So it's tiny.

■ **ZILELI** Domestically, the supply hasn't been there – so if an investor set up a dedicated SRI fixed-income fund, there hasn't been enough supply to choose from. We need to see more supply, then perhaps we will see more dedicated SRI funds.

■ **JENKINS** The vast majority of the big end of town applies ESG screening to the investment process. Our recent experience in Europe was that, across the board, investors apply an ESG screen before they will look at a company or issuer. If this makes sense, and the green or social bond stacks up, it then goes to the portfolio-management team which makes a credit and relative-value decision.

■ **ZILELI** We have found that in certain jurisdictions in Europe there are dedicated SRI teams that look at your framework, your processes, and the third-party verifications before it's passed on to the portfolio manager. In other jurisdictions it's the portfolio managers who are doing the work. But certainly in continental Europe there are dedicated SRI teams.

LOOKING TO THE FUTURE

Swiss What are the main challenges to SRI market development?



"We are starting to see a groundswell of support for investing in socially responsible assets. We need to see more people demanding that their funds be put into socially responsible assets in order for the market to grow."

EVA ZILELI NATIONAL AUSTRALIA BANK

“People need to be patient and to recognise that markets need to build benchmarks to allow relativities to develop. This is what will make the market itself more sustainable going forward – rather than simply trying to rush out deals.”

MARK GODDARD WESTPAC INSTITUTIONAL BANK



■ **WHITE** The main challenge is on the supply side rather than the buy side. Among investors there is a lot of momentum and it doesn't feel like it will stop any time soon. If anything, it will grow further. For us the challenge is how we can increase supply across all sectors.

Pricing and cost are also challenges. Longer term there needs to be a price differential of some sort for this market to really develop. We are still in the very initial stages of this and there are times, particularly in the secondary market, that we see sustainable bonds trading better than vanilla bonds. Whether this can be translated into a benefit for new-issue pricing remains to be seen.

If we can get to a point where an issuer can achieve a more attractive cost of funds, albeit a small one, this will lead to more development of the sector. We are starting to see some of this in Europe, and in the domestic market Queensland Treasury Corporation's green bond is trading through the issuer's curve. So there are some signs but more will be positive for the market.

■ **TAPLEY** For me, the challenge is continuing the education. We are slowly starting to break down concern over pricing and showing that there are no pricing disadvantages. Now the challenge is around educating issuers that a green or social bond is not 'just marketing'.

■ **GODDARD** Green bonds are easier to structure and issue, social bonds are much more of a challenge. This is the area in which we can have a bigger social impact, but they are hard to do and their lead times are long.

Generally, with more regulation and increased costs, banks have to remain focused on continuing to grow their overall businesses but also deliver these products – which don't make any money. This is the balance we are looking to attain and maintain.

■ **LING** In the social-impact bond market, scalability is the issue. In the green-bond market, I'd say the challenge is making sure the measurement of 'green' is robust.

Swiss What kinds of things are at the top of your wish lists with regard to developments to take place to ensure we maintain and even increase momentum for investing with impact?

■ **LING** We need demand. If we continue to see investors wanting these products and this type of innovation, we will

continue to see outstanding transactions and success stories. The growth of the market and everything else will follow.

■ **MACFARLANE** I agree – there's a real opportunity to grow this market particularly on the social-impact side. We just need to see demand industrialised and scaled first.

■ **TAPLEY** I would like to see more of the large Australian-based institutional investors starting to implement ESG mandates. For example, following what QBE is doing.

■ **WHITE** I would like to see one of the blue-chip corporates issuing a green bond.

■ **ZILELI** I want to see the basics of supply and demand addressed. I'd like to see more supply from across the spectrum of issuers to keep the momentum going.

On the demand side, I would like to see more of the community demanding that their funds be put to work in a socially responsible way and addressing the transition to a low-carbon economy as well as other societal issues.

■ **JENKINS** A broader allocation to fixed income from investors is what I'd wish for. Unless investors allocate more to fixed income, issuers won't come into this sector. I'd also like to see continued growth of issuance from the corporate sector and others so there's a good breadth of issuance.

Harmonisation around how to judge a green or social bond is also important. Agreeing on a standardised approach would help the development of the market. Finally, I'd love to see the SDGs become part of everyone's discussion when they talk about investments.

■ **CHEN** I would also like to see more consensus around global standards on social and environmental impact. This will allow us to expand the sectors that can be considered for green- or social-bond issuance.

■ **GODDARD** I would like to ask for patience. Too many times people have looked at the Australian bond market and written it off because of its size relative to other markets around the world, particularly compared with the US. Now, though, the Australian bond market has developed and become the third-largest funding pool for many international borrowers. People who called it early suggested the market wouldn't develop.

The same can be said for the potential of the SRI bond market. People need to be patient and to recognise that markets go through steps of building benchmarks to allow relativities to develop. This is what will make the market itself more sustainable going forward – rather than simply trying to rush out deals. •

Australasian corporates take the lead on ESG

A growing segment of corporate Australasia is stepping up to the plate on sustainability, taking the lead among peers and in many cases government. The issues are complex, especially when it comes to transition management, but the wins are starting to stack up – including in the capital-markets arena.

BY LAURENCE DAVISON

It would be fairly easy to be cynical about sustainability and corporate Australasia. Australia has one of the world's most prominent mining sectors – it ranks fourth for global coal production behind only China, the US and India – while its federal politics seems to be at least decade or two behind the global consensus on climate change.

New Zealand's reputation is greener and it is a leading developed-world nation when it comes to renewable-energy generation. But its agricultural sector, among others, makes it a surprisingly large carbon producer on a per-capita basis – ranking higher than the UK, for instance.

On the other hand, Australasian companies feature increasingly prominently in global sustainability rankings. Australian banks and real-estate firms were standouts in the 2017 iteration of the Dow Jones Sustainability World Index (see chart on facing page), while Australasia contributed nearly 20 per cent of the constituents of the 2017 Dow Jones Sustainability Asia-Pacific Index (see chart on facing page).

The momentum of sustainability within corporate Australasia appears to be growing as companies adopt, enhance and refine their own commitments and attempt to promote good sustainability practices in their supply chains and client bases.

This is not just a publicity effort. Sustainability, especially in the environmental realm, can have negative consequences and where necessary Australasian corporates have stood up to

political and public opposition to the wider impact of their commitments.

Deploying genuine environmental, social and governance (ESG) principles at corporate level is complex, too. Commitments in this area create potential conflicts, internally and with stakeholders. Indeed, in some cases the individual components of ESG can even be in apparent conflict with each other. Some leading corporates are also trying to inculcate sustainability principles in their supply chains (see box on p30).

Perhaps the greatest degree of nuance comes in the context of environmental transition. Not all ESG-committed companies are inherently 'green' at face value. Two examples are AGL Energy – which, as of 2017, remains one of Australia's most significant coal-fired energy generators – and Sydney Airport.

The point for companies like these is to acknowledge the required transition to a low-carbon future and understand how they should contribute to this process. Tomorrow's world will still need air travel and reliable energy supply. The issue for major corporates in sectors like these is how they manage their own transition, support that of the wider economy and manage all their stakeholders' needs in the process.

Finance and capital markets is one aspect of the holistic approach to sustainability. Australia's equity market has woken up to ESG considerations and corporates say this component of their investor relations grows with every passing year.



"We approach sustainability very much from the perspective of transition. It's not possible to turn coal off overnight. What we can do is lead the transition – particularly if we find the policy-setting backdrop isn't as strong."

BLÁTHNAID BYRNE AGL ENERGY

The debt arena is coming up the curve rapidly, too – as demonstrated by innovative transactions and structures on both sides of the Tasman Sea. In Australia, Investa Property Group (Investa) brought the first-ever nonfinancial corporate green bonds to the market in March 2017. In New Zealand, Contact Energy (Contact) achieved a clutch of national and world records when it had a whole debt programme certified as green by the Climate Bonds Initiative in August 2017.

SUSTAINABILITY CULTURE

While sustainability may be growing in prominence across the boardrooms of Australia and New Zealand, many leading companies say they have factored it into their strategic thinking for many years. Investa and Contact, for instance, say their capital-markets initiatives were the product of long-term alignment between corporate culture and ESG principles.

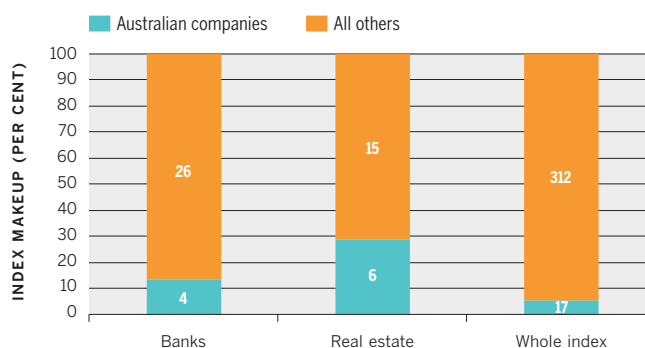
Louise Tong, Contact's Wellington-based head of capital markets and tax, says: "Contact has been focused on sustainability – building out our renewable generation and reducing carbon emissions as well as sustainability more broadly – for years. I also became aware of a groundswell of interest in sustainable finance coming from the financial-markets community. It got to the point where it seemed apparent to me that these two trends were crossing over."

Corporates also insist their sustainability goals are not siloed or sidelined but woven into the fabric of their businesses. Nina James, general manager, corporate sustainability at Investa in Sydney, tells *KangaNews* the company has a decade-plus track record of ESG leadership. It started with a fundamental business case for sustainability and moved quickly into capturing data to fine tune energy-efficiency savings in its property portfolio.

Investa's sustainability team is small – two people, with two more in the environment and safety team, cover corporate sustainability strategy, asset-level environmental initiatives and safety across the platform. But James says this simply reflects the integral nature of ESG thinking across the company's operations. "This business does sustainability every day, all day – it's in the bloodstream," she comments.

Sydney Airport also sees its sustainability goals as a natural component of its strategic direction as opposed to an external bolt on. Penny Barker, the airport's head of sustainability, tells *KangaNews* its fundamental purpose is "to foster the growth of aviation for the benefit of Sydney, New South Wales [NSW] and

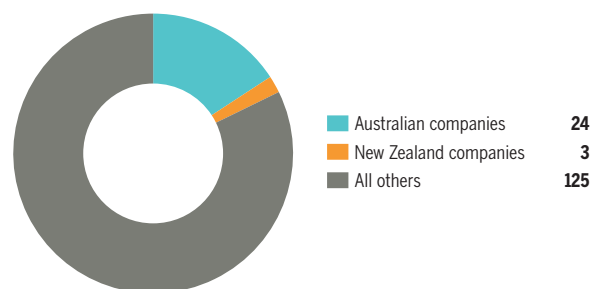
AUSTRALIAN COMPONENT OF DOW JONES SUSTAINABILITY WORLD INDEX



Note: Data labels refer to outright number of companies

SOURCE: DOW JONES SUSTAINABILITY INDICES, KANGANEWS 17 OCTOBER 2017

AUSTRALASIAN COMPONENT OF DOW JONES SUSTAINABILITY ASIA-PACIFIC INDEX (NUMBER OF COMPANIES)



SOURCE: DOW JONES SUSTAINABILITY INDICES, KANGANEWS 17 OCTOBER 2017

Australia". But this goal is consistent with an integrated ESG approach, she adds – and in fact the two complement each other.

"To deliver on our vision for the long term, we recognise that we need to balance social and environmental needs with our corporate objectives. To do this we know sustainability must be at the heart of everything we do," Barker comments.

In practice, this means a commitment to safety and security as a top priority, as well as playing a part in climate-change mitigation, investing in the communities in which the airport operates and maintaining its position as an "employer of choice".

AGL's commitment to sustainability became a major media and political talking point in Australia in 2017, as the company stuck by its carbon-transition principles in the face of intense

"We expect all our assets will get to a baseline level of 4.5-star NABERS, and we need to have a pathway for how this can be achieved. It's absolutely something that gets assessed during due diligence, and it's not just about how a property rates now."

PETER MENEGAZZO INVESTA GROUP



Take one and pass it on: encouraging good citizenship

For some Australian companies, sustainability principles go well beyond their own office space. The idea of encouraging peers and suppliers to get on board with environmental, social and governance (ESG) standards is catching on.

Sydney Airport is among those companies seeking to encourage good conduct in its sphere of influence. Its head of sustainability, Penny Barker, reveals: "We have a supplier code of conduct in place and we ask our suppliers to align with minimum expectations on ESG matters. These expectations align with the standards we set ourselves. We know our business partners have corporate-citizen commitments too and we look to partner with them to drive mutually beneficial outcomes."

AGL Energy (AGL) has a similar code of conduct in place, covering factors as diverse as environmental standards, safety and employee policies on diversity, labour conditions and LGBTI considerations. "It makes sure we're selective about who we do business with, because we want to ensure we're aligned on these core values," says AGL's group treasurer, Bláthnaid Byrne.

The company applies a similar code of conduct in its funding chain, too. The motivation was no different – AGL's banks are

suppliers in the finance realm and the company wants to be aligned with lenders that share its core values.

"We have to be realistic, because as the borrower we can't just say no to everyone," Byrne acknowledges. "But we want to be able to ask lenders where they stand on issues that matter to us and to plot how they all stack up against our policies. It also starts the conversation with those banks that are not where we would like them to be."

In fact, Byrne credits the banking community for – in general – making "significant changes and commitments" in recent years. "They've clearly demonstrated leadership and the commitment they're making from a time and energy perspective in sustainability reporting," she says.

Peter Menegazzo, executive director and chief investment officer at Investa Property Group (Investa), says the company is seeing a lot of movement on ESG engagement among its client base, especially

at the big end of town. "I think corporate conscience has grown over the last 10-15 years," he tells *KangaNews*. "Bigger tenants tend to be better resourced in this space while some smaller tenants don't really get the benefits as yet. There are obviously environmental benefits, but the way we sell ESG to our clients is as much on the financial benefits. There's a lot of money to be saved by just doing the right things up front."

This illustrates another trend among Australasian companies: trying to encourage good corporate behaviour, including in the capital-markets realm, by discussion and engagement with clients and peers.

For instance, Louise Tong, head of capital markets and tax at Contact Energy (Contact), says a number of other companies have shown interest in the green debt programme Contact signed in August 2017.

"I have had other borrowers coming to me since we announced the programme asking for more information

about the 'how' and the 'why'," Tong says. "We are the first New Zealand company to have certified green debt, so awareness and understanding of what's involved is pretty limited. But people are curious to learn more."

Investa has been an active promoter of its green-bond experiences with its peer group according to Nina James, the company's general manager, corporate sustainability. The company has shared its insights into the relative ease of the process, advocating adoption of the asset class even to competitors.

Peer-group leadership goes further even than this, though. "I think our group takes very seriously that we are a leader and that there are opportunities for us to have a bigger impact than just our own operations," James tells *KangaNews*. "When we were setting our carbon-neutral target we challenged the business and the executive to take on the idea that this is what leadership looks like, and that it means going beyond your own home patch."



"We have a supplier code of conduct in place and we ask our suppliers to align with minimum expectations on ESG matters. These expectations align with the standards we set ourselves."

PENNY BARKER SYDNEY AIRPORT

pressure from the federal government and certain sections of the media to extend the life of the Liddell coal-fired power station in NSW beyond its scheduled closure date of 2022.

The company sees sustainability as a logical component of its overall direction. Richard Clifton-Smith, senior manager, sustainability strategy at AGL in Sydney, tells *KangaNews*: "We're

committed to helping shape a sustainable energy future for Australia. Our approach to sustainability is being aware of the responsibilities we have to all our stakeholders, and the impact our decisions and actions might have on them."

One aspect of this work is forward looking – understanding changes in the community and environment and determining

“We have started exploring the issuance of green bonds, particularly given their ability to encourage further sustainable investment, demonstrate our commitment to sustainability both internally and externally, and deliver positive capital-management outcomes.”

MICHAEL MOMDJIAN SYDNEY AIRPORT



the appropriate corporate response. For instance, Clifton-Smith reveals, AGL has conducted scenario analysis on the consequences of a carbon-constrained future and has reported on the consequences of changing trends in social and economic inclusion.

TRANSITION POSITIONING

For a company like AGL, the absolutely critical consideration is the role it should take in a transition it believes to be necessary and inevitable. This provides a clear example of the potentially conflicting nature of specific ESG considerations. Clifton-Smith describes the “energy trilemma” – a phrase coined by Australia’s chief scientist, Alan Finkel – that has been behind much of the political brouhaha around energy policy in 2017.

The trilemma is that Australians require reliable and affordable energy while at the same time transitioning as rapidly as possible to a low-carbon economy with low-emissions energy generation at its heart. This matrix is at the centre of AGL’s social and environmental considerations.

“It’s a societal issue that we can all see being played out in the newspapers and in political debates. We’ve been very transparent on this and we don’t shy away from the fact that it is a challenge,” Clifton-Smith tells *Kangaroo News*. “The point is that we can’t address one aspect in isolation – we have to consider these issues holistically. We have 3.6 million customers, so energy affordability is important. But energy affordability is linked to energy supply, so we’re working with our stakeholders towards bringing a new, reliable and lower-carbon generation mix into the system.”

As the owner and operator of thermal power stations with large and longstanding social footprints, Clifton-Smith says AGL recognises it is important both to the communities in which it operates and to its shareholders that the company identifies, consults on and appropriately times its options for rehabilitation of these sites. Cost is just one aspect, though increasingly boards are recognising that ESG goals and economic performance are not mutually exclusive (see box on p32).

“We approach sustainability very much from the perspective of transition,” adds Bláthnaid Byrne, AGL’s Sydney-based group treasurer. “It’s not possible to turn off coal overnight. What we can do is lead the transition – particularly if we find the policy-setting backdrop isn’t as strong.”

In Byrne’s view, sustainability commitment is if anything even more critical for companies operating in less inherently ‘green’ sectors. She explains: “If you’re looking at what creates the greatest impact – using the environment as an example, but it could easily be community or any other ESG consideration – it’s great for, say, a hydro-power company to make these commitments but it doesn’t have much influence because they’re already there. The companies that can actually have the biggest influence and impact are those that are really pushing the transition.”

Investa’s view on commercial-property ownership, renovation and development paints a similar picture. Here, the transition aspect is largely encapsulated in the acquisition of poorly rated building stock and renovation to higher standards. In most cases, improving an existing building produces a better – if lower-profile – outcome than demolishing it and constructing a new one, however many National Australian Built Environment Rating System (NABERS) stars the new build might receive.

“The most sustainable building is an existing building that you can improve – certainly compared with having all the materials from a demolished building going to landfill,” explains Peter Menegazzo, executive director and chief investment officer at Investa in Sydney. “Of course a lot of this material will be recycled, but even so it leaves a far greater footprint than investing time, effort and dollars to enhance the status of an existing building.”

How this works in practice is that Investa does not rule out the acquisition even of zero- and one-star NABERS properties. What it will not do is take ownership of such a building and leave it at the existing level.

“We expect all our assets will get to a baseline level of 4.5-star NABERS, and we need to have a pathway for how this can be achieved,” Menegazzo adds. “It’s absolutely something that gets assessed during due diligence, and it’s not just about how a property rates now. It’s about what we do to get it to a better rating, how quickly this will happen and how much it will cost.”

“Part of our business’s 10-year track record in sustainability is verification of actual results and data. Where possible we favour third-party verification of our performance.”

NINA JAMES INVESTA GROUP



Board buy-in and corporate performance

Australasian companies with strong sustainability commitments universally report solid board backing for their initiatives. Sustainability's increasing ability to go hand-in-hand with positive economic outcomes is only helping.

"You can have all the great ideas you want, but nothing will happen if you don't have supportive senior management and corporate culture," says Bláthnaid Byrne, group treasurer at AGL Energy (AGL). "By the same token, existing culture benefits from and needs champions to push ideas."

Byrne compares the way individuals within large organisations represent sustainability to innovation in corporate culture, in the sense that innovative people need a supportive culture to thrive while, on the flip side, companies benefit from fostering innovative individuals within their ranks.

Contact Energy (Contact) provides an illustration of how this can work in practice. Louise Tong, the company's head of capital markets and tax, was prepared to champion the development of a certified green borrowing programme

but required institutional support to make it a reality.

"I floated the idea with our CFO and found him to be very supportive, on the basis that the initiative is perfectly aligned with Contact's purpose and direction. I then flagged the idea with the board, giving it the chance to add any insights or concerns while we were still in the early stages. The board members were also very supportive," Tong reveals.

This was a positive development but hardly a surprise given Contact's track record in capital markets. The company was, for instance, the first to issuer under New Zealand's same-class exemption rules that facilitate retail debt offerings. Tong tells *KangaNews*: "I think it's fair to say we have never been afraid to innovate with our funding – and indeed we have done so on a number of occasions. A green borrowing programme aligns

well with our corporate culture and values, I think – and should help kick-start this aspect of capital markets in New Zealand."

The point is that companies are not necessarily making financial sacrifices to develop and deploy environmental, social and governance (ESG) principles across their operations. For one thing, the better established a sustainability framework is within a business, the more it becomes simply part of day-to-day corporate life. Sustainability also provides competitive advantages.

"We're very much driven by a business-case approach to sustainability," says Nina James, general manager, corporate sustainability at Investa Property Group. "As you work away at it over 10 years or more, it becomes business as usual. This has allowed us, in the last three years, to focus much more on

the next big steps and the major advantages we can go for."

In many ways, having a robust sustainability framework is plain good business sense. "Absolutely it's an economic decision as well," Byrne tells *KangaNews*. "It is not in the best interests of shareholders to invest in something we believe, within the next decade, is not going to stack up against new technology that's coming to the market."

Identifying the true value to the business of nonfinancial risks and opportunities can make it easier to embed sustainability at the heart of the corporate decision-making process. "Although we are talking about ESG issues, there's a framework here by which we can discuss these kinds of issues at higher levels including senior management and the board," says Richard Clifton-Smith, senior manager, sustainability strategy at AGL.



"Although we are talking about environmental, social and governance issues, there's a framework here by which we can discuss at higher levels including senior management and the board."

RICHARD CLIFTON-SMITH AGL ENERGY

DEBT SPECIFICS

The emergence of the green bond has given Australasian corporates a way of flagging their ESG commitments to debt investors. To date, issuers say the charge on sustainability engagement from investors has come from the equity side – though debt-investor interest is picking up.

Menegazzo describes "a growing snowball" in the equity-investment realm, with ever-more investors pushing for information and reporting. He points to the Global ESG Benchmark for Real Assets (GRESB) as a key yardstick, with more than 800 real-estate funds globally now assessed under

GRESB criteria. "Equity investors are saying, 'this is the benchmark, you need to be part of it'. At survey time we get inundated with emails wanting to make sure we're participating," Menegazzo reveals.

Given this backdrop, as Australia's only domestic true-corporate issuer of green bonds to date Menegazzo says Investa found it relatively easy to meet the product's standards once it was confident about demand.

"Where's the downside?" he asks. "We looked at the reporting standards and what we needed to achieve to issue green bonds, and to be honest they were all things we've been

doing for years. It was a really easy conversation. We want to continue to evolve as an organisation, and we saw this as a logical progression for us.”

A company does not need to have been a green-bond issuer to have noticed growing interest in ESG in the fixed-income space. “While debt investors ultimately remain focused on credit quality, tenor and price, interest in green bonds and sustainable investment has rapidly increased,” reveals Sydney Airport’s treasurer, Michael Momdjian. “Even in the absence of green-bond issuance, our sustainability goals and ambitions resonate well with our more traditional debt investors.”

Byrne adds: “We’re very cognisant of the changing environment from an investor perspective, debt or equity, and we want to engage as much as we possibly can and be transparent with these investors – whether it’s through our sustainability reporting or via access to senior management. We recognise that the world is changing from a funding perspective as well, and we need to be mindful of this.”

The green-bond option could be open to Sydney Airport, and Momdjian argues that the claim it is difficult, or perhaps even impossible, for airports to satisfy green-bond criteria is a misnomer. He says the diverse nature of airport operations provides significant opportunities to invest in projects that meet green-bond criteria.

For example, Mexico City Airport issued US\$6 billion of green bonds to finance in part the design, construction and development of a carbon-neutral and 100 per cent renewable-energy New International Airport of Mexico City. The bonds also received a top E1 score from S&P Global Ratings using its new green-evaluation tool.

“We have commenced processes to rate and measure the sustainability of our assets through the use of green-star ratings and we have already invested in a number of green-eligible projects including electric buses, solar panels and low-carbon buildings,” Momdjian tells *KangaNews*.

He adds: “We have started exploring the issuance of green bonds, particularly given their ability to encourage further sustainable investment, demonstrate our commitment to sustainability both internally and externally, and deliver positive capital management outcomes such as investor diversification.”

Byrne acknowledges that an AGL green bond would “potentially still face a lot of cynicism” at this point. But the company is watching the market carefully. “It couldn’t just be a case of ticking off the criteria – I would not be comfortable

doing this. It has to be an authentic use of funds we can stand behind,” she concludes.

PRICING VIEW

Contact and Investa both challenge the conventional wisdom that green bonds do not deliver a pricing benefit to issuers. However, both stop short of definitively claiming a pricing advantage in primary prints.

Tong says the idea that green bonds would not give an improved pricing outcome used to be something she was “quite cynical” about. She explains: “Going back a year or more, whenever anyone talked to us about green issuance I tended to feel that if investors were really trying to drive change through this asset class they should be willing to pay a premium to make funding of low-carbon assets more attractive.”

Things may have changed. “More recently, we have started to see differential pricing emerging in the secondary market,” Tong adds. “I think we will see widening in the primary space between the opposite ends of the market – between certified green bonds and, say, a coal or tobacco company. In fact, I suspect this will happen quite rapidly, and certainly quicker than I would have thought possible a year or two ago. There is certainly a groundswell of focus on this issue from investors.”

It is of course impossible to compare the pricing of a bond transaction an issuer completed with what it would have achieved in a different deal it chose not to pursue. But Menegazzo says a straightforward supply-demand perspective on Investa’s green-bond deals suggests the company benefited from the format.

“I actually question the idea that green bonds don’t offer a pricing benefit,” he says. “Our experience, once we got in contact with investors around bringing a product to market, was of a very strong response sufficient to give momentum going into both transactions. I firmly believe we got some pricing benefit, particularly at the back-end through knowing we had good support going into the deals.”

At the very least, Menegazzo agrees that engaging with funds seeking sustainable assets should give issuers a degree of additional confidence around execution risk that could be significantly more useful should funding-market conditions become less conducive in future.

“Doing green-bond deals certainly opened our eyes to one thing in particular – that the capital wanting to look at green debt-finance products is growing quite substantially. It just doesn’t have the products to invest into,” he reveals. •

“I think we will see widening in the primary space between the opposite ends of the market – between certified green bonds and, say, a coal or tobacco company. In fact, I suspect this will happen quite rapidly.”

LOUISE TONG CONTACT ENERGY



MAJOR-BANK SUSTAINABILITY FOCUS:

NAB

PURPOSE: *Back the bold
who move Australia forward*

For **National Australia Bank** (NAB), understanding the value of sustainability and implementing the measures needed to support it at the institutional level starts with a perspective on the world outside the bank. NAB's focus is on shared value – the concept that corporate performance can and should go hand-in-hand with positive sustainability outcomes.

If NAB's sustainability commitment has a single guiding principle, it is that to remain successful in a changing world the bank itself must change. In this way, it is not simply trying to be a good corporate citizen – it believes its future growth and indeed relevance will be compromised if it does not act in a way that promotes sustainability.

Sasha Courville, head of social innovation at NAB in Melbourne, says this conclusion becomes ever-more apparent given the nature of challenges to society in the modern world. She explains: "There are changing expectations on all the key institutions in society – on business, government and civil society. This is all playing out in the context of a world that is volatile, uncertain, complex and ambiguous. The pace of change is quite phenomenal and will only accelerate."

In this context, NAB is responding to clear expectations of businesses to take a leadership position in the economy and in society more broadly. The bank recognises that businesses are successful in the long term when they operate in a healthy environment and a healthy society. These things do not exist, and cannot be created or defended, in a vacuum. "It's in a business's interests to ensure it is playing an appropriate role in contributing to a healthy, prosperous society and to the environment in which it's situated," Courville adds.

How an institution like NAB plays its part is changing, too. Historically, social and environmental engagement was done via philanthropy. Companies generated profits, took a small or large proportion of these and gave it back to society. More recently, the concept of corporate social responsibility emerged. This concept asked how businesses could use their vast footprints, supply chains, workforces, and consumption of resources and energy to improve social and environmental outcomes.

Corporate social responsibility is still relevant at NAB, as the bank seeks to ensure it is doing the right thing and leading by example in society. For instance, Steve Lambert, NAB's Sydney-

based executive general manager, corporate finance, points out that in 2010 NAB was the first bank in Australia to become carbon neutral, and the first company of any stripe to have an Elevate Reconciliation Action Plan. This is a business plan documenting what an organisation commits to do to contribute to reconciliation in Australia through practical actions that build respectful relationships and create opportunities for Aboriginal and Torres Strait Islander peoples.

But this is not the end of the story at NAB. It is the bank's deployment of the concept of shared value that it believes is its key differentiator. This is a recognition of sustainability as a genuine catalyst for corporate, as well as social and environmental, success. "We are backing the bold to move Australia forward," says Courville. "What we are asking is how we can advance Australia and how we support our customers, our communities and our society to move forward."

Achieving goals through shared value requires NAB to recognise there are big societal issues – like climate change, inequality and affordable housing – and no single government agency, civil-society organisation, philanthropic trust or business, no matter how big, can address these issues alone. The bank's role is in working with others to help "connect the dots", Courville explains.

SHARED VALUE EXPLAINED

The concept of shared value was first defined in an article published in the *Harvard Business Review* as recently as 2011, written by Mark Kramer and professor Michael Porter.

The authors describe shared value as: "Policies and practices that enhance the competitiveness of companies while improving social and environmental conditions in the regions where they operate...to qualify as shared value, there must be an identifiable economic benefit to the company as well as measurable impact on a social or environmental issue."

PLACES FOR PEOPLE FINDS A HOME IN AUSTRALIA

Places for People printed Australia's first-ever social-housing bond in August 2017. The social aspect of the deal demonstrates the growing demand for sustainable debt in the Australian market, and the increased relevance of Australia for global corporate borrowers.

Places for People is a UK-based, not-for-profit company that owns or manages more than 180,000 homes. The company says its "placemaking approach" involves considering the infrastructure and services supporting the houses it builds.

Its visit to the Australian debt market netted A\$150 million (US\$119.2 million) of five-year, fixed-rate bonds with 86 per cent participation from local investors. National Australia

Bank (NAB) was arranger and sole bookrunner on the transaction.

The issuer credits NAB for bringing the value of bond issuance in Australia to its attention. "We have been working with NAB for many years in both the sterling and US private-placement markets and it was NAB's recommendation to try the Australian market. It was a great call," says Matt Cooper,

tax and treasury director at Places for People in Preston. He adds: "NAB handled the process fantastically and explained the slight nuances between the UK and Australian markets. Investors were engaged and interested in our credit, and our expectations for pricing and size were exceeded."

The evolution of an Australian environmental, social and governance (ESG)-informed

debt market provided a boost to Places for People's bond deal, though Cooper says it was not the only consideration.

He argues that although the Kangaroo deal was not an ESG-specific trade, the fact that the Australian market is focused on this area was a positive factor given the entire Places for People business is focused on social responsibility. It certainly contributed to a positive pricing outcome.

"We have a large, liquid sterling bond which acts as a benchmark and the pricing on the Kangaroo bond compared very favourably with this," Cooper adds. "We are very keen on diversification and getting a range of investors interested in investing in Places for People."

Courville explains: "Shared value really frames sustainability as a competitive strategy to deliver business value while also creating societal value. It is looking at how to deliver competitive advantage, create new business opportunities and generate revenue while also solving for social and environmental problems."

By way of comparison, Courville explains that in philanthropic works the value lies with society. From a bank's perspective, this could mean grants given for community benefit to address social or environmental challenges. There is no expectation of a commercial return – in fact the nature of philanthropy definitionally denies one.

In corporate responsibility, meanwhile, the value largely lies with the business. While it reduces environmental impact to be carbon-neutral, for instance, it is also good for a business. Offering employees a community-volunteering programme is also of value to a company, in part because it boosts employee engagement, productivity and loyalty.

"You don't make money from corporate social responsibility initiatives, you do them because they are right thing to do and they are good for the business in indirect ways," Courville explains to *KangalNews*.

The critical difference with shared value is that its benefits accrue both to the business and society. Courville says this means trying to find a business model that also solves for social and environmental challenges. The explicit intent is to generate revenue, however. The goal is to find new and untapped markets, redefine productivity in the value chain, and look at new ways of leveraging a corporate position to bring stakeholders together for both better business and social outcomes.

Successfully delivering shared value depends on three elements. There has to be a real business opportunity, a real societal need and the responsible entity has to leverage its own core assets and expertise. "What we have at NAB is leaders who have been able to identify the social need and the business opportunity and also put the weight of their expertise towards it," Courville suggests.

SHARED VALUE IN ACTION

One of the interesting things about shared value is that it does not necessarily need to be applied to areas that might naturally be considered as the basis for straightforward philanthropic or social-responsibility projects. This is particularly relevant in a banking context.

"Shared value is looking at how to deliver competitive advantage, create new business opportunities and generate revenue while also solving for social and environmental problems."

SASHA COURVILLE



ACU AND THE **GROWING MATURITY** **OF SUSTAINABLE DEBT** IN AUSTRALIA

Australia had seen green bonds and a social bond before Australian Catholic University (ACU) made its issuance debut, in July 2017. But the issuer was the first to combine elements of both in a domestic transaction.

The deal was for A\$200 million (US\$159.9 million) and had 10-year maturity. National Australia Bank (NAB) arranged and was one of two lead managers on what was Australia's first sustainability bond and the first from a university to price anywhere in the world.

The issuer capped the deal's volume and attracted A\$500 million of demand according to NAB, while three-quarters of

the final print was placed with domestic investors.

Scott Jenkins, chief financial officer at ACU in Sydney, says the projects backing the ACU bond have both green- and social-bond principles. Some proceeds will be reserved to acquire or develop potential eligible assets in future.

Another NAB-driven initiative in the Australian debt market helped ACU develop the

confidence required to green-light a mixed deal format.

"We initially considered bringing a green bond but following NAB's social bond (gender equality) we recognised that our philosophies encompassed both the ideologies of social and green bonds," Jenkins explains. "When the new sustainability-bond guidelines were released in June 2017 we found a close alignment

with ACU's mission of social inclusion, research and development – and our desire to build sustainable buildings."

ACU was keen to issue its bond transaction at 10-year tenor, a point on the curve at which pricing was particularly favourable for corporate issuers during much of 2017. Jenkins is also confident ACU will be able to access the local market for its future debt-funding requirements.

As an example, Lambert highlights the collections department at NAB. Its fundamental role is trying to get money back from customers – never a popular task. But the way NAB has developed its customer engagement has resulted in customers giving the bank's collections department the highest relative ratings for service. "They have done a phenomenal job at getting money back faster and earlier, but in a way that's not dehumanising and is actually supportive of clients," Lambert comments.

NAB has saved A\$70 million (US\$55.6 million) in reduced loan defaults and operational efficiencies in the last financial year alone, Courville adds. The bank measures customer feedback using advocacy scores, specifically referring to the net promoter score as a check on how the bank is viewed by its customers. This score for NAB Assist is reliably at plus 60 and above.

The same general principle applies to unexpected financial hardship and the need for financial resilience to deal with adverse events if they occur. Lambert says NAB has extensive historic data about how customers have got into trouble. The bank is now using this wealth of data to see if it can pick the early warning signs before customers get into difficulty. Using this data, NAB can give customers an idea of their resilience score and offer them ways to build resilience.

INSTITUTIONAL APPLICATION

Shared value has helped NAB kick a succession of goals in the institutional space, too. NAB understands that the growing global interest in impact investing is at the intersection of for-purpose organisations that require finance to grow and the rise of responsible investment. Stepping in to develop the impact-investment market in Australia, using philanthropy and corporate responsibility, has forged the path for business opportunities that enable innovative financial solutions to address a wide range of environmental and social issues.

"We have been doing a lot of work in the responsible-investment space, both with our own corporate footprint and the work we're doing with customers – including investors and borrowers," Lambert reveals.

The rubber has been hitting the road in a big way when it comes to the specific aspect of providing responsible-investment products. NAB has been a market leader as an arranger of socially themed bonds including for global corporate borrowers visiting the Australian capital market for the first time (see box on p35).

In the social space, shared value has led NAB to leverage funding outcomes from the banking business it already conducts. For instance, social projects often spring from pre-existing



"Our work in the environmental space has been built on using our balance sheet to support activities in renewable-energy lending, project finance and bonds structured off the back of utilities. We have used this same skillset to focus on the individual and society."

STEVE LAMBERT

NAB BECOMES FIRST MEMBER OF **AUSTRALIA'S SOCIAL CLUB**

Australia's burgeoning green-bond market was supplemented on 17 March 2017 by the issue of the country's first benchmark social bond, by National Australia Bank (NAB).

The bond enables institutional fund managers to invest in Australian organisations that champion women and equality in a positive way.

Proceeds are not tied to specific projects. Instead, the companies to which NAB lends the bond proceeds all qualify as "employers of choice for gender equality" with Australia's Workplace Gender Equality Agency (WGEA) and meet NAB's own social-bond framework requirements.

The 14 organisations included in the initial portfolio are concentrated in – but not limited to – the professional-services sector. Two of these – Monash University and Stockland – are already leaders in Australian sustainability finance, having issued their own green bonds in international markets.

NAB raised A\$500 million (US\$397.2 million) of five-year debt via its gender-equality bond at a pricing level the issuer

says was flat to its mainstream wholesale-funding curve.

According to James Waddell, director, product and channel development at NAB in Sydney, the social bond was around 18 months in the making. Impetus was provided in June 2016 when the International Capital Markets Association (ICMA) published its guidance for issuers of social bonds.

"We were already thinking about and discussing a social

transaction by this point, but we received positive investor feedback around the ICMA guidelines and the appetite for the product from this point on," adds David Jenkins, Sydney-based director, sustainable capital markets at NAB.

Steve Lambert, NAB's executive manager, capital financing, says the social-bond initiative ties into wider corporate strategy. "The bigger picture for us is the shared-value approach we have adopted to completely rethink parts of our core business. This has involved creating products and services that address social and environmental issues, to give the investor community choice in how they invest their money in more meaningful ways."

work around communities and social justice sparked by NAB's historical role as a major banker to community organisations and through capacity-building support of the growing number of social enterprises developing new ways to tackle longstanding societal challenges.

Unlike the maturity of carbon accounting in the environmental space, the social-impact-measurement framework is complex and varied. This presents an opportunity to increase transparency through consistent measurement frameworks.

As this develops, NAB is adapting to provide investors with a range of socially responsible investment options from positive screening to the rigour of impact investment.

These options at the institutional level include arranging Australia's first sustainability bond (see box on facing page) and becoming the issuer and arranger of the country's first social bond (see box on this page).

As far as shared value is concerned, Lambert explains: "This ties in and is congruent with us being Australia's largest renewable-energy lender. Increasingly, the way we're thinking about it is around adaptation finance instead of just mitigation. We are also on many external industry bodies – Australian, regional and global – so we are not just doing this ourselves but looking at changing the broader ecosystem."

Lambert adds: "Our work in the environmental space has been built on the major balance sheet we have devoted to activities in renewable-energy lending, and project finance and bonds structured off the back of utilities. We have used this same skillset to focus on the individual and society – social issues such as housing and recidivism. We have worked on taking the power of the bond or specialised-finance business and channelling this thinking into areas where we can make a difference."

LONG-TERM PAYOFF

If shared value works, it should be a virtuous circle for its agent. "I see it as a cycle of innovation," Courville tells *KangaNews*. "You start off with an idea, then you prove you can simultaneously deliver business and social returns from this idea. By doing so you build your understanding, your capability and your expertise – then you keep expanding."

Capital markets have provided one of the clearest examples of the principle of shared value in practice for NAB, starting with the bank's leadership in the clean-energy and project-finance spaces, and off the back of this developing expertise in green bonds that subsequently progressed into social and sustainability bonds.

"These constant cycles of innovation feed each other because we learn every time we move them forward," Courville adds. "We learn from our customers and from investors, we build our capability and, as we raise awareness of the power of shared-value thinking as a key vehicle to deliver on our organisational strategy within the bank, we find more opportunities to connect the dots across the business."

The next step in capital markets could be widening the scope of client buy-in on sustainability goals. For instance, NAB has introduced a natural-value programme with its agribusiness customers, working on how the bank and its clients understand natural capital risks like water scarcity, soil health, energy and biodiversity loss.

Courville comments: "What we want to do is really think about these areas in the sense of being actual assets our customers have. This means looking at how we support them in managing the risks and demonstrating they are managing them well. This makes them more resilient businesses." •

MAJOR-BANK SUSTAINABILITY FOCUS: **COMMBANK**

PURPOSE: *Do good as good
business practice*

For **Commonwealth Bank of Australia** (CommBank), it is more important than ever to have corporate responsibility at the heart of what the bank does. Using its lending book as an example, the bank demonstrates how it is putting its principles into practice for the benefit of all stakeholders.

Corporate responsibility at CommBank is not just about supporting environmental or social projects. Instead, the bank is working to place its principles at the heart of its business in a way that makes them the driver. Kylie Macfarlane, general manager, corporate responsibility at CommBank in Sydney, explains: “We have a vision that guides what we do as an organisation. Our vision is to secure and enhance the financial wellbeing of people, businesses and communities.”

The bank has a refreshed roadmap on corporate responsibility that has evolved from a set of eight Opportunity Initiatives – which are set to be reviewed in November 2017. These are areas CommBank sees as being of strategic importance to the organisation, broadly covering education, innovation and good business practice.

Opportunity Initiatives is CommBank’s corporate-responsibility plan, outlining a set of goals and associated targets the bank is focused on delivering and reporting against. The initiatives are mapped to the United Nations’ Sustainable Development Goals (see table on facing page). They are delivered in collaboration with stakeholders across the government, nongovernment, not-for-profit and corporate sectors.

CommBank has also been involved in education initiatives for more than 85 years, including providing the world’s largest financial education programme of its kind, Start Smart. Focused

on building financial capability, over the last decade more than 2.7 million Australian school children have participated in a Start Smart session.

“We see innovation as part of the CommBank DNA, and what are we doing here is ‘innovating for good’ through the organisation,” Macfarlane explains. “This includes the digital solutions we’ve been developing around financial wellbeing and the role CommBank’s Innovation Lab plays in creating a collaborative environment to work with community partners across the government, non-government, not-for-profit and commercial sectors.”

The bank’s focus on good business practice covers a broad spectrum of initiatives from diversity and inclusion through to the role it plays in limiting climate change to below two degrees and how the bank lends, invests and procures responsibly.

Working with partners is an important component of the Opportunity Initiatives, whether this is with CommBank customers or in the wider market – illustrated by its partnership with the Clean Energy Finance Corporation (see box on p40).

In August 2017, CommBank released its inaugural Climate Policy Position Statement which was a goal under Opportunity Initiative #8. The statement formalises CommBank’s commitment to playing its part in limiting climate change to well below two degrees, in line with the Paris Agreement, and supporting the responsible global transition to net zero emissions by 2050. This commitment goes to the top: the bank’s board will



“We have a vision that guides what we do as an organisation. Our vision is to secure and enhance the financial wellbeing of people, businesses and communities.”

KYLIE MACFARLANE



COMMBANK, CEFC AND ENERGY-EFFICIENT LENDING

In 2016, Commonwealth Bank of Australia (CommBank) and the Clean Energy Finance Corporation (CEFC) launched the energy-efficient equipment-finance programme. This programme is an addition to a partnership the bank has had with the CEFC since 2012, as the first major bank to strike an agreement with the investment firm.

The programme supports business investment in energy-efficient and lower-emissions vehicles, equipment, machinery and fixtures that meet the CEFC's investment guidelines. Eligible investments include fuel-efficient vehicles, energy-efficient lighting and fittings, farm machinery,

commercial lighting and rooftop solar panels.

Approved borrowers will gain a 70 basis point discount on CommBank's standard asset-finance rate on amounts between A\$10,000 (US\$7,944) and A\$5 million. Initially for A\$100 million

of lending, the programme was extended due to strong interest from customers.

"We do an assessment of the asset and its energy efficiency and the CEFC agrees to it, as the assessment is done on the basis of boundaries the CEFC sets," explains Joanna White,

managing director, business lending at CommBank. "The asset needs to be better or 'greener' than its previous iteration, or recognised by the CEFC as industry-leading in its fuel efficiency."

White adds: "The programme has encouraged CommBank customers to upgrade the assets they use in their businesses to become more fuel-efficient, and therefore less costly and better for the environment. It has been received well and is a great way we've helped our customers reduce their energy costs and emissions as a part of what we do every day."

oversee and monitor the effectiveness of its measures, including adopting the recommendations of the Taskforce on Climate Related Disclosures (TCFD) and undertaking climate scenario analysis.

CommBank's corporate-responsibility team has oversight of the policy, but Macfarlane says it was critical from the start that the policy is embedded across the business. "It has to live and breathe within the organisation and it has to reflect what we're doing today as well as what we will be doing in the future," she tells *KangaNews*.

The policy has therefore been put together in collaboration with CommBank's institutional bank (Institutional Banking and Markets), business bank, wealth-management, and other pertinent stakeholders internally – such as the group's property division. For example, CommBank's sustainable-property strategy speaks to the goal to reduce its own direct carbon footprint, down to 2 tonnes of carbon dioxide emissions per employee by 2020 from 2.6 tonnes today.

RESPONSIBLE LENDING

Perhaps an even greater focus is how CommBank can bring a positive influence to bear externally, among its client and supplier base. Again, the first step is making sure the bank's principles and policies –

which are designed to cover both its own behaviour and its role in society – are embedded in specific business areas.

Corporate responsibility operates as a matrix structure throughout the organisation, to make sure the bank has a holistic view and can help advise, guide and embed it throughout the

COMMONWEALTH BANK OF AUSTRALIA'S EIGHT OPPORTUNITY INITIATIVES

CATEGORY	INITIATIVE	LINKS TO UN SUSTAINABLE DEVELOPMENT GOALS				
Education	Teach children the value of money	4 QUALITY EDUCATION	5 GENDER EQUALITY	8 DECENT WORK AND ECONOMIC GROWTH	10 REDUCED INEQUALITIES	
Education	Help prepare the workforce of the future	4 QUALITY EDUCATION	5 GENDER EQUALITY	8 DECENT WORK AND ECONOMIC GROWTH	10 REDUCED INEQUALITIES	
Innovation	Use our innovation capability to empower people, businesses and communities	8 DECENT WORK AND ECONOMIC GROWTH	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE			
Good business practice	Mirror our community's diversity and role-model reconciliation	3 GOOD HEALTH AND WELL-BEING	4 QUALITY EDUCATION	5 GENDER EQUALITY	8 DECENT WORK AND ECONOMIC GROWTH	10 REDUCED INEQUALITIES
Good business practice	Contribute to our communities	8 DECENT WORK AND ECONOMIC GROWTH	10 REDUCED INEQUALITIES			
Good business practice	Listen to and balance stakeholder needs	1 NO POVERTY	8 DECENT WORK AND ECONOMIC GROWTH	10 REDUCED INEQUALITIES		
Good business practice	Lend, invest and procure responsibly	7 AFFORDABLE AND CLEAN ENERGY	12 RESPONSIBLE CONSUMPTION AND PRODUCTION	13 CLIMATE ACTION		
Good business practice	Play our role in limiting climate change to two degrees	7 AFFORDABLE AND CLEAN ENERGY	13 CLIMATE ACTION			

SOURCE: COMMONWEALTH BANK OF AUSTRALIA OCTOBER 2017

RENEWABLES LENDING AND SUNDROP

Commonwealth Bank of Australia (CommBank)'s lending exposure to renewable-electricity generation continues to increase. At 30 June 2017, it stood at A\$2.8 billion (US\$2.2 billion) – up by A\$600 million year-on-year. Recent years have also seen the completion of landmark transactions in Australia and overseas.

"We are very proud of our A\$2.8 billion renewables portfolio, which we have been working really hard to build," says Louise Hatton, CommBank's executive director, responsible lending. "There's a big presence offshore and our local business has also grown a lot in the last 12 months."

CommBank has been able to find local renewables-lending opportunities despite ongoing policy uncertainty in Australia, which has been a challenge for many in the industry.

Hatton adds: "We have been actively supporting the domestic renewables market when we can find the opportunities, but there are also a lot of assets we lend to in Europe, North America and Canada. Wind and solar projects are the main sources

of growth both domestically and offshore."

Domestic opportunities

Among CommBank's Australian projects is the Sapphire Wind Farm in the New England tablelands, near the Great Dividing Range. Sapphire Wind Farm is New South Wales's largest wind farm and will power 100,000 homes from 75 wind turbines when complete in mid-2018.

On the solar front, innovation is at the fore in projects like Sundrop Farms (Sundrop). CommBank is a financing partner to Sundrop's large-scale solar farm, seawater desalination plant and greenhouse operations in Port Augusta, South Australia.

The "Sundrop system" is a unique proprietary technology using concentrated solar power

to create the heat, electricity and desalinated water needed to feed and power Sundrop's growing horticulture operations.

The solution addresses the fresh-water scarcity issues typical of arid regions, like Port Augusta, and uses renewable energy instead of fossil fuels to produce water and energy.

The investment allows Sundrop to scale up its existing operations in Port Augusta by financing a 20-hectare greenhouse facility that will produce more than 15,000 tonnes of vegetables annually for markets across Australia.

The project was the first large-scale commercial farm of its kind. It is also the first integrated, sustainable-energy and water system of this type in the world.

Hatton comments: "This really was the first of its kind in Australia and globally. In addition to being a neat and interesting way to use solar to desalinate water and run a greenhouse, the project-financing model that sits behind this innovative renewable technology was the first of its type."

She adds: "Our role is to ensure we can help the market for renewable energy grow in a sustainable way as we transition to a low-carbon economy. This means actively looking for renewable projects to finance that are sound deals in their own right. Innovative projects like Sundrop support local economies and social development, in addition to paving a way for the renewables industry to grow through the deployment of innovative financing techniques."

organisation. Responsible lending is a key example of this concept in practice.

Joanna White, managing director, business lending at CommBank in Sydney, says: "The backdrop is the public expectation, which we share, that we can build stronger communities by being more conscientious about the assets to which we choose to lend."

Louise Hatton, executive director, responsible lending at CommBank in Sydney, sits within the project-finance team of the institutional bank. She is in daily contact with personnel from across the bank, from corporate responsibility to client coverage, risk, finance, and product. Her role sees her involved in multiple group projects relating to sustainability and responsible lending.

Responsible lending is not a new commitment for the corporate-lending business at CommBank, though. Hatton has been with the team for nearly four years, initially focusing on signing CommBank up to the Equator Principles – which was achieved in May 2014 – and contributing significantly to the issuance of the bank's first climate bond, in March 2017. To date, this is the largest Australian dollar climate bond from an issuer in the bank sector.

Although CommBank was already doing a lot of the required due diligence on its own initiative, it did not rush to sign up to the Equator Principles. Hatton explains the catalyst was growing desire from investors and shareholders that CommBank commit to the principles, combined with the bank's view that the latest



"What we have developed is like nothing I've seen anywhere else in the market. It requires our front-line bankers – those who are closest to the customers – to go through a really robust process of understanding the ESG impacts of any particular client."

JOANNA WHITE



version of the principles, EP3, which was launched in 2014, had greater governance and was more stringent.

“We have committed to embedding these environmental, social and governance [ESG] principles and guidelines into our project-finance practice,” Hatton explains. “Our lending due diligence includes a lot of steps covering environmental as well as social aspects. Every project that qualifies goes through detailed due diligence and considers environmental elements as well as social aspects like stakeholder engagement, community consultation, grievance mechanisms and the like.”

Fast forward to 2017, and CommBank now reports on the assessed carbon emissions of its lending book each year. Macfarlane says: “We are the first bank in the world to report on the emission intensity of the whole lending portfolio. Our annual financed emissions reporting is an important part of our ongoing disclosures against our target to decrease the average emissions intensity of our business-lending portfolio over time.”

Formalising the process through initiatives like the Equator Principles and now CommBank’s own principles framework is very important, Macfarlane adds. “It’s one thing to be doing something, but it’s quite another to have formal mechanisms and governance around how we do it, ensuring our people understand how and why they are doing it, and then being able to report continuously on the impacts and outcomes of this process,” she tells *KangaNews*.

ESG IN PRACTICE

CommBank’s more recent work around its lending book has therefore been focused as much on understanding and reporting the ESG component as it has on changing its composition. The bank’s renewables book has reached A\$2.8 billion (US\$2.2 billion), and has involved some extremely innovative project-lending techniques and case studies (see box on facing page).

White explains: “We didn’t have specific concerns about the quality of our loan book or the risks inherent in it. However, going back a few years, we didn’t have a formal mechanism for tracking ESG and there also wasn’t anything we could point front line employees to that made our ESG standards clear when they were originating or refinancing loans.”

The first step was to put together responsible-lending commitments, to make clear CommBank’s lending appetite based on individual borrowers’ ESG risks. The bank also wanted a tool to assure itself it was appropriately assessing the risks within these customers and clients.

Hatton says the tool CommBank designed fits into its credit-decision process and the outputs end up on the back of credit papers. “ESG issues are discussed in any credit process, and in depth,” she explains. “It goes into a fair bit of detail – looking at seven factors including biodiversity, pollution, climate and energy, water use, labour and human rights, workplace health and safety, and anti-corruption and governance.”

White adds: “What we have developed is like nothing I’ve seen anywhere else in the market. It requires our front-line bankers – those who are closest to the customers – to go through a really robust process of understanding the ESG impacts of any particular client. We can record this and thus get a good understanding of the ESG risks we are taking within our book.”

Once more, the underlying principle is integrating ESG into the heart of the CommBank business. “The most important thing for me is that our people have a good understanding of who their customers are. Everything else flows from this. To have everyone be clear on what our appetite is, and then to have these conversations with their customers, is the key,” White says.

MOVING FORWARD

The balance sheet is only the first step. White continues: “The vast majority of customers in the institutional business borrow from us. But there are some that don’t – they might, for example, have more liability products. The next phase is to look at customers in even more depth – whether or not they borrow from us – and roll out ESG impact assessment.”

When it comes to group-wide buy-in, CommBank offers its institutional bank employees an ESG fundamentals e-learning course and more than 5,000 employees have been trained on responsible lending, investing and procurement policies and practices.

“This gives everyone an understanding of the expectations and what we want from our clients,” Hatton tells *KangaNews*. “Our people have to do a lot of e-learning but we have had many people tell us the ESG topic is really interesting and that it is about issues that mean something to them.”

To date, 1,800 CommBank staff are trained on the detailed ESG tool and the bank has also conducted face-to-face training on the Equator Principles. “There is a lot of awareness and capability building,” Hatton confirms. “As these considerations have escalated, the conversation has become much deeper and better informed in senior review panels. We are certainly aware we are building the capability of the whole organisation.” •

“We have committed to embedding these environmental, social and governance principles and guidelines into our project-finance practice. Our lending due diligence includes a lot of steps covering environmental aspects as well as social aspects.”

LOUISE HATTON



MAJOR-BANK SUSTAINABILITY FOCUS: **WESTPAC**

VISION: *To be one of the world's great service companies, helping our customers, communities and people to prosper and grow*

Westpac Banking Corporation (Westpac) has an extensive history of engagement with and commitment to environmental, social and governance (ESG) goals. But it is not resting on its laurels, as the way the bank is thinking about the future of sustainability demonstrates.

Westpac has a legitimate claim to be an Australian banking pioneer in the sustainability sector, and indeed one of the world leaders. It put out its first report on sustainability in 2002, in the process becoming the first Australian bank to do

so. Even before this, in the 1990s Westpac was one of the first organisations to get involved in the Australian government's Greenhouse Challenge of voluntary greenhouse-gas reporting.

Westpac has now completed 16 years of sustainability reporting as part of its suite of annual reporting, and in September 2017 the latest iteration of the Dow Jones Sustainability Index (DJSI) rated Westpac as the world's most sustainable bank globally for the fourth year running and the 10th year overall. The DJSI is a key global benchmark for corporate sustainability and Westpac is not just Australia's leading bank in the index but also the shining light for the nation across sectors (see box on facing page).

Siobhan Toohill, group head of sustainability at Westpac in Sydney, says the starting point for the bank is having a clear understanding of what sustainability means in a changing world. She points to the emphasis Westpac placed in its first sustainability strategy on the idea of a bank's role in ensuring each generation "lives better than the last".

This overarching goal continues to define how a sustainability strategy is developed across the bank. For instance, while environmental considerations are clearly critical as the world confronts the reality of climate change and the immediate need for the corporate sector to play its part in mitigation, this is far from the only aspect of an ESG approach defined by a desire to promote an ongoing upward prosperity trajectory.

In looking at how Westpac is looking to take sustainability forward, Toohill tells *KangaNews* aspects such as promoting financial literacy and social inclusion are equally integral to the

whole. In fact, engagement with environmental issues is a product of the central purpose rather than a driver of it.

This approach also encapsulates significant governance commitments within the bank. Westpac is a supporter of the Banking and Finance Oath, for instance – a set of principles for individuals in the sector that seeks to improve society by raising moral and ethical standards within banking.

BUILDING THE STRATEGY

Although Australia emerged from the financial crisis in better shape than most developed-world nations, it is still confronting many of the same change agents. Income inequality, sluggish wage growth and dissatisfaction with the political landscape are all evident in Australia. The need for decarbonisation is playing out against this backdrop, in a nation that features among the world's biggest commodity producers – including fossil fuels.

All this plays into Westpac's thinking around sustainability. "Contemplating how we continue to push forward on sustainability we've reflected on an environment in which people may find life difficult, and the role a bank can best play. For example, housing affordability is tougher and people are more conscious of it than they have been in the past," Toohill comments. "But we are also really mindful of our role in supporting vulnerable Australians. We have been highlighting this in our sustainability programmes more so than we have done in the past."

Describing the world today as "a really interesting time for us to stop and pause", Toohill refers again to the essential premise of sustainability as helping future generations have a better standard of living. This outcome might have been taken for granted as recently as a decade or two ago but now appears to be at significant risk. Toohill continues: "Helping the next generation live better than the last is a really difficult concept to think about

WESTPAC'S **BENCHMARK PERFORMANCE**

On 7 September 2017, Westpac Banking Corporation (Westpac) received the accolade of the world's most sustainable bank in the latest Dow Jones Sustainability Indices (DJSI) review. Westpac says its long-term market-leading performance in the index suite highlights its commitments on sustainability.

The 2017 DJSI review marks the fourth year running in which Westpac is rated the leading bank globally, the 10th time it has taken top spot overall and the 16th consecutive year in which it has qualified for the global index.

To put this achievement in context, there are 28 banks in the DJSI World Index for 2017, while the index from 2001 – when Westpac first joined – included 21. Just six featured on both. On this basis, Westpac is an undeniable national champion in the DJSI.

Only one other Australian company – Mirvac Group (Mircac) – took top spot for its sector in the DJSI for 2017. While impressive, this is the first time Mirvac is rated the world's

most sustainable property-sector company.

Westpac received a sustainability score of 94 per cent from the DJSI in 2017, including sector-leading marks for corporate citizenship, business risks and opportunities, environmental and social reporting, climate strategy, anti-crime policy, materiality and labour practices.

"To be recognised as the most sustainable bank globally in our 200th year of operation says a lot about how deeply committed we are to doing the right thing," says Westpac's Sydney-based chief executive, Brian Hartzer. "In the last 12 months we've renewed and extended many of these

commitments. Receiving external validation for the strength of our sustainability practices shows that we are on the right path."

Launched in 1999, the DJSI World index claims to represent the "gold standard for corporate sustainability".

It is the first global index to track the leading sustainability-driven companies and is based on RobecoSAM analysis of financially material environmental, social and governance (ESG) factors and S&P Dow Jones Indices' index methodology.

The goal is to create an index recognising companies' commitment to sustainability across the full ESG spectrum.

It is based on an integrated assessment of economic, environmental and social criteria with a strong focus on long-term shareholder value.

Every year, RobecoSAM assesses the world's largest companies via its corporate sustainability assessment, which uses a consistent, rules-based methodology to convert an average of 600 data points per company into one overall score. This score determines inclusion in the DJSI.

In 2017, a total of 3,484 companies around the world were invited to participate in the process and 2,086 were assessed – roughly half each based on submitted questionnaires and publicly available information.

"TO BE RECOGNISED AS THE MOST SUSTAINABLE BANK GLOBALLY IN OUR 200TH YEAR OF OPERATION SAYS A LOT ABOUT HOW DEEPLY COMMITTED WE ARE TO DOING THE RIGHT THING. RECEIVING EXTERNAL VALIDATION FOR THE STRENGTH OF OUR SUSTAINABILITY PRACTICES SHOWS THAT WE ARE ON THE RIGHT PATH."

BRIAN HARTZER WESTPAC BANKING CORPORATION



right now, but we don't shirk away from doing so. Now, more than ever, we are focused on how we support this big idea."

In the past, the bank's sustainability focus has been on demographics, economic solutions to environmental challenges and helping people have a better relationship with money. According to Toohill, the big-picture thinking is now about clearer, more specific guidance on similar issues, and a stronger focus on serving the needs of customers.

She explains: "We're now looking to place a stronger focus on helping people really understand their money and making sure they have the right solutions in place for them. We're also thinking how we as a bank can be there when life throws a curve ball. And finally, it's about being forward looking – helping everyone prepare for the future."

LOOKING AHEAD

When it comes to better financial decisions, Toohill says Westpac's aim is to help people increase their own financial capabilities but also ensure they have the right products and services to meet their needs best. As an example of a real-world outcome of the principle, she points to a new credit-card product Westpac launched in 2017 that responds to customer concerns by offering a low credit limit and a lower interest rate.

The bank continues to work very closely with groups like Mission Australia and the Salvation Army, because it believes it can have an even wider impact on financial literacy via relationships of this type. This complements the work of Westpac's own financial-literacy group, the Davidson Institute.

INVESTMENT AND ESG INTEGRATION

When BT Financial Group (BTFG) – the asset-management arm of the Westpac Banking Corporation group – introduced its new investment access platform, Panorama, it made sure environmental, social and governance (ESG) considerations were at the heart of the new product.

Panorama is the fruit of a A\$500 million (US\$397.2 million) investment designed to deliver a market-leading integrated banking and wealth platform for management of and reporting on investments.

It allows financial planners, direct investors, accountants and anyone who administers or trades any financial product across BTFG to access everything from transaction services to reporting across all asset classes and financial products.

In line with its commitment to providing insights and information to help make more informed investment decisions, Panorama partnered with global research houses to integrate sustainability scoring on selected investments. The sustainability scores for

investments are a set of scores which identifies a company's recent performance in relation to ESG factors.

The sustainability scores are available for the ASX200 listed companies and those managed funds that invest primarily in Australian and international shares.

"Our view was always that we would try to integrate an ESG sleeve onto the Panorama platform," reveals Emma Pringle, head of customer governance and sustainability at BTFG in Sydney.

She continues: "We also wanted to give financial planners and direct investors access to sustainability ratings. We also wanted to drive their awareness of ESG and sustainability scoring, and their input into

their own investments and managed funds."

There were several motivating factors. Pringle says BTFG strongly believes in the value of the ESG component and wanted to be visible in its commitment to sustainability. It was also willing to be ahead of the curve – even with regard to its own customers' level of ESG engagement.

"We know that sometimes people don't want what they don't know, so we wanted to engage and educate investors in the conversation," Pringle explains. "We think it's really important to consider a range of factors when making investment decisions, and the ESG aspect gives financial planners another way they can engage with their customers – and add value."

The results of the latest BT Australian Financial Health Index, published in February 2017, show signs of changing investor behaviour. While less than 20 per cent of Australians believe it is extremely important for their investments to be in sustainable companies, more than 90 per cent believe it is somewhat important. According to Pringle, the degree of interest is higher still among younger investors.

"We also know millennial investors don't really know what it means or how to access solutions or products or investments that are aligned with their values. Panorama allows us to talk to the next generation of investors and provide something meaningful to them," Pringle suggests.

The ESG element is front and centre on the Panorama screen. When a user logs on and looks at a single stock or a managed fund, they see all the traditional market data but also an ESG sustainability score. If the user clicks on the sustainability score they see scores and performance for each aspect of ESG. Controversies that might be associated with a stock are also available.



"WE THINK IT'S REALLY IMPORTANT TO CONSIDER A RANGE OF FACTORS WHEN MAKING INVESTMENT DECISIONS, AND THE ESG ASPECT GIVES FINANCIAL PLANNERS ANOTHER WAY THEY CAN ENGAGE WITH THEIR CUSTOMERS – AND ADD VALUE."

EMMA PRINGLE BT FINANCIAL GROUP

Toohill explains: "It's about partnering for a deeper impact, but we are also being quite targeted in how we do this. What we want to do when we're teaming up with a large organisation is find out how we can best work together to help the more vulnerable Australians in the areas we know best – which is around financial capability. It's about collaborating and getting the optimal outcome together."

On the idea of supporting people when they need it most – that arguably speaks most to the social backdrop informing the revised approach. Social issues like housing affordability relate to the potential virtually every bank customer has of becoming financially vulnerable, and thus to a bank's possible role in adding value for people in stressed circumstances.

Toohill explains: "Crises can happen to anyone. It might be because someone in the family is becoming sick, it could be a divorce, retrenchment or a death in the family. Finance always comes up during life's critical moments, so we want to think about how we can be there at these times – to provide the necessary support and ensure people and their families get access to their finances at key moments."

The precise nature of Westpac's role is not just a set of principles determined exogenously by a group strategy team. The bank is using its own data in ongoing research to help it identify when problems are likely to happen, how it can lift clients out of them faster and then how it can help make sure they stay out of trouble in future.

“Helping the next generation live better than the last is a really difficult concept to think about right now, but we don’t shirk away from this. Now, more than ever, we are really focused on how we support this big idea.”

SIOBHAN TOOILL WESTPAC BANKING CORPORATION



And the goal of helping create a more prosperous nation has the biggest forward-looking element. It aims to address the change Australia faces as a nation – including the impacts of technology and climate change.

For instance, Westpac wants to have a central role in building the workforce of the future by understanding how it can best support its own employees to have the right skills in place for the changing nature of work. “We know work is going through a significant rate of change right now so there’s a lot to be done around building different kinds of skills,” Tooill comments.

CLIMATE-CHANGE SOLUTIONS

Included here, too, is the work Westpac has in place around climate-change solutions. This includes a commitment to fund A\$20 billion (US\$15.8 billion) of climate solutions by 2020 and A\$25 billion by 2030. The numbers are not guesswork. Westpac engaged ClimateWorks Australia to research what would be an appropriate scale for its own funding contribution, with these figures being the end point of this process.

The bank’s climate-change policy, launched in April this year, adds specific goals around how Westpac will lend to climate solutions. It has specific commitments to supporting mechanisms like climate bonds, including to facilitate up to A\$3 billion of climate-change solutions via green bonds and similar structures by 2020. It also sets out more specific lending criteria – in line with working towards net carbon zero and building on Westpac’s climate-scenario analysis undertaken in 2016.

“In the same way we are backing the growth of climate-change solutions, we also want to continue our role in backing housing-affordability solutions,” Tooill adds. “This includes continuing our commitment to affordable housing lending – particularly via community-housing providers.”

Westpac is also reaffirming its desire to invest in ideas and people with the capacity to shape Australia including organisations, companies and individuals. In this context, Tooill highlights the Westpac Bicentennial Foundation and its commitment to backing an additional 100 scholars each year. By 2020, the foundation will have a cohort of 500 scholars receiving support from the bank.

IMPLEMENTATION AND MEASUREMENT

Good intentions are one thing, but Westpac says it wants to understand and measure the real-world outcome of its sustainability commitment. Tooill’s team is a “centre of excellence” at the bank and sits within corporate affairs. There are

also sustainability leads in different parts of the organisation. For instance, Michael Chen is head of sustainability within Westpac Institutional Bank in Sydney.

Tooill explains: “What’s really important is that my team in corporate affairs is working in partnership with the different business units. Working like this, as a broader sustainability team sitting across the group, means we are able to touch various parts of the organisation but are also able to listen to different parts of the group and share sustainability perspectives with them.”

This approach helps drive outcomes across the Westpac group. One example is the Australian Financial Health Index introduced by BT Financial Group in February 2017 (see box on facing page).

Impact measurement is also vital. For instance, the Westpac Foundation works with its community partners to measure the number of jobs that have been created via its social-enterprise initiatives.

On the issue of giving support when it matters most, Tooill says success is measured through customer feedback and retention – which itself demonstrates a way in which sustainability and business growth do not need to be mutually exclusive.

Outcomes like these are arguably mostly about success at a micro level. For the bigger picture, Westpac is exploring how it integrates the United Nations Sustainable Development Goals (SDGs) into its sustainability approach. It has identified where the goals sit within its sustainability strategy and is monitoring work about the best ways to monitor SDG delivery – tapping into emerging SDG reporting guidelines – and with the guidance of Westpac’s external stakeholder advisory council.

“We want to be very mindful of this ongoing research, but reporting has always been really important for us and, as we work on the current sustainability report we are looking at how we map back to the SDGs,” Tooill adds. “We have been measuring against many of these goals already and now we are looking at how we align with them even better.”

While the SDGs are broad principles and require interpretation to define specific implementation and performance outcomes, Tooill says their most positive aspect is the fact that there is now an agreed set of 17 goals that business, governments and civil society are focused on. Using the SDGs to underpin sustainability strategies directs the conversation.

For instance, improving financial decision-making relates to the SDGs of reducing inequality and education – helping people be more educated about the decisions they are making. Helping customers when they most need it is also informed by the SDG covering inequality, and by the partnership goal. •

MAJOR-BANK SUSTAINABILITY FOCUS:

ANZ

PURPOSE: *To shape a world where people and communities thrive*

ANZ Banking Group (ANZ) believes transition to a more holistic sustainability approach is effectively mandated by the changes taking place in the wider world. Key executives outline how the bank is making environmental and social considerations integral to its strategic direction, and how this approach affects its relationships with clients and customers.

At the heart of ANZ's approach to environmental, social and governance (ESG) issues is its corporate sustainability framework. This informs the way the bank deals with its corporate and retail customers, and feeds through into major financing initiatives especially around environmental concerns.

But the foundations go even deeper within the bank. At the centre of the corporate-sustainability framework is ANZ's organisational purpose, which the bank recently re-examined and refreshed under the direction of its chief executive, Shayne Elliott. This process was no less than a root-and-branch review of how – and why – ANZ conducts its business.

Bank executives involved in developing and embedding the refreshed organisational purpose and the corporate-sustainability framework describe the process as, at least in part, a response to a changing world and the consequent need for banks fundamentally to understand their role in society and the economy. Consideration for environmental sustainability is one part, but not the only one.

"The reality is that the world is moving away from a reliance on fossil fuels and transitioning towards a cleaner economy. The key question is how fast the transition will occur," says Christina Tonkin, managing director, loans and specialised finance at ANZ in Sydney.

Tonkin tells *KangarooNews* firms in the financial sector need a strong and clear alignment of corporate strategy, at chair and board level as well as within senior leadership teams, to make progress in this context. This requires an explicit strategic drive, to avoid what could otherwise become a piecemeal and therefore less effective approach.

"The alignment between the core strategic direction, what we're looking at from a governance perspective, and what drives the business has been a focus at ANZ," Tonkin affirms.

HISTORIC ECHOES

Tonkin says ANZ's focus on environmental and socially responsible lending especially in large projects has been in place for well over a decade, and perhaps closer to 20 years. The bank has been a signatory to the Equator Principles since the middle of the last decade. The principles provide a risk-management framework for determining, assessing and managing environmental and social risk in projects, and are primarily intended to provide a minimum standard for due diligence to support responsible risk-based decision making.

"In some respects it's easier to ringfence funds in project lending and therefore develop a clear understanding of environmental and social issues," Tonkin explains. "The complexity has been about how this transitions into corporate lending and other types of facilities. We've seen this happen over time."

Within ANZ, developing the bank's purpose has led to greater internal collaboration on issues relating to sustainability. Group functions such as risk, investor relations, corporate affairs and strategy are working together with the business to drive change throughout the organisation. "It's the most aligned and focused it has ever been, and a clear change from the historical position where we may have been aiming for a common goal but each area of the business had different priorities," Tonkin says.

ORGANISATIONAL PURPOSE

The foundations for an integrated approach lie in ANZ's organisational purpose, which speaks to the role of the bank as a whole – including its place in, and relationship with, society. Anita Fleming, ANZ's Melbourne-based executive manager, group strategy, says the goal of the organisational purpose review was "to determine how we take the bank back to its core purpose and what we have been in the business of doing

CASE STUDY: **WOMEN'S LIVELIHOOD BOND**

In July 2017, Impact Investment Exchange (IIX) – a pioneer of impact investment in Asia – closed its Women's Livelihood Bond (WLB). ANZ was one of two placement agents in a project the bank says demonstrates the application of its social purpose in a markets context.

Proceeds of the US\$8 billion WLB are on-lent to a group of microfinance institutions and impact enterprises, the activities of which benefit women in south-east Asia.

By enabling these borrowers to grow their businesses and scale their social impact, the WLB aims to help more than 385,000 women in Cambodia, Vietnam and the Philippines through improved access to capital and credit, market

linkages, and affordable goods and services.

Through this type of funding, IIX believes women will effectively be able to "transition from rural subsistence living towards sustainable livelihoods – through access to credit, market linkages and affordable goods".

While the market for impact investing has grown in recent years, ANZ says the WLB marks

the first transaction of its kind focused on lifting communities out of poverty through female entrepreneurship and access to funding.

When women have greater influence over economic decisions, a larger proportion of income is allocated to food, health, education, clothing and nutrition, breaking the cycle of poverty and giving these women the opportunity to build sustainable livelihoods.

"To see the potential for social uplift that can be achieved by bringing together entrepreneurship, innovation and capital is exciting and encouraging," says Tammy Medard, who was involved in ANZ's role in the projects in her then role as chief executive of the bank in Laos. "It aligns closely to ANZ's purpose and to the United Nations Sustainable Development Goals, which guide many of the bank's sustainability targets."

for the past 185 years – enabling individuals, businesses and the wider community to thrive".

Fleming says the group strategy team went back to the archives to look at what predecessors and forebears at ANZ stood for and which of their values hold true today. It also spoke to a range of external stakeholders – including regulators, suppliers, academics, key institutional customers, retail customers and long-serving ANZ staff.

"We asked them what society expects of banks today, what is the role we need to be delving into, and what is unique about ANZ compared with our competitors that we should play to as strengths," Fleming tells *KangaNews*.

Essentially, this was a process of examining the bank's heritage, customer expectations and the world situation. Fleming adds: "Delivering our purpose is fundamentally about creating financial and social impact. We're focused on how we remain a profitable business that also has a heightened sense of its social and environmental impact, so everyone benefits today and in generations to come."

ANZ's purpose is to shape a world where people and communities thrive. It wants to build a balanced and sustainable society in which everyone can take part and build a better life. In markets and institutional banking, one of the ways the social aspect of the organisational purpose is reflected is ANZ's

involvement in a unique bond project in Singapore that funds microfinance opportunities for women in south-east Asia (see box on this page).

The next critical step is hardwiring the organisational purpose into ANZ's corporate DNA and the way ANZ does business. Fleming describes the purpose as a "statement of ambition", and a touch stone for business decisions. In this respect, she says governance changes are really important – making the organisational purpose a leading agenda item at board and management level.

ANZ has established a responsible business committee, chaired by Elliott, which puts in place a core group of people whose job it is to make sure the bank fulfils its purpose and makes the purpose live. The committee looks at fundamental issues like who and what ANZ banks, informing choices around specific sectors and customers, and their alignment with the bank's values and purpose.

CORPORATE SUSTAINABILITY

The lens through which ANZ's organisational purpose shines its light in the sustainability arena is the bank's corporate-sustainability framework. This was refreshed in 2016 on the basis of the work the group-strategy team was doing around organisational purpose.

"We're focused on how we remain a profitable business that also has a heightened sense of its social and environmental impact, so everyone benefits today and in generations to come."

ANITA FLEMING



CASE STUDY: **INVESTA PROPERTY GROUP'S GREEN-BOND BRACE**

Investa Office Fund (IOF) printed the Australian dollar market's first true-corporate green bond in March 2017. Another member of the Investa Property Group (Investa) family followed soon after as Investa Commercial Property Fund (ICPF) printed its green bond in mid-April.

IOF's deal was a A\$150 million (US\$119.2 million), seven-year note with ANZ as sole lead while ICPF priced A\$100 million of 10-year bonds with ANZ acting as one of two joint leads. Both deals are certified by the Climate Bonds Initiative.

The success of the transactions highlights the steady but accelerating growth in interest in certified green debt in the Australian investor base. For instance, demand for the IOF deal saw its book grow

to A\$350 million while 30 accounts participated. ANZ data also show just over half the transaction was placed with green-mandated investors – 22 per cent to “dark green” accounts and 30 per cent to “light green”. Australian investors took 81 per cent of the bonds, with Asia accounting for 15 per cent and the balance going to New Zealand.

Ed Waters, executive director, debt capital markets at ANZ in Sydney, says the level of

demand from green-mandated investors is a particularly encouraging sign for local-market development. “We expected a bond from an issuer like IOF to be well received, but seeing this level of specialist demand bodes well for other issuers that wish to extend their commitment to sustainability in new and different ways.”

Investa's corporate commitment to sustainable development eased the path to printing Australia's first

domestic corporate green bond. ANZ's Sydney-based head of sustainable finance, Katharine Tapley, says getting to the point of issuance is typically driven by a strong sustainability agenda at the organisational level, then good connection between the sustainability and treasury teams at the transactional level. “Across Investa and IOF, these two teams are peers. This really helped clear the path to successful green-bond issuance”, Tapley explains.

“We wanted to make sure our corporate sustainability framework reflected the bank's purpose,” explains Anna Stewart, ANZ's Melbourne-based head of corporate sustainability. “We also talked to many stakeholders – both external and internal – about the issues which matter most to them, particularly through our annual materiality assessment which delves into the risks and opportunities facing the bank.”

The refreshed framework is based around three priority areas. The first is social and economic participation, focusing on creating opportunities for people to participate in society supported through ANZ's financial-inclusion programmes, employment programmes for under-represented people – including those with disabilities, refugees, aboriginals and Torres Strait islanders – and workplace-diversity initiatives.

The second priority is sustainable growth, which is about understanding and managing the social and environmental impacts of the bank's lending decisions and giving balanced consideration to stakeholder needs and concerns.

Third is fair and responsible banking. This looks at how ANZ treats its customers and employees, sustainability in the bank's supply chain and human rights. “This covers all the basics of what one would expect a big organisation to be doing to be a good corporate citizen,” Stewart adds.

Again, ANZ's aim is not just to develop convincing language on sustainability but to make it part of the *raison d'être* of the whole organisation. Stewart tells *KangaNews*: “Sustainability needs to be part of the bank's DNA, informing strategy, lending decisions, governance and risk management, and organisational culture. Integration of sustainability into the way we do business is the end game.”

CORPORATE RELATIONSHIPS

While ANZ has its own internal corporate commitments to sustainability, deploying this agenda at client level is clearly easier when the other side of the table is sympathetic. “For corporates globally, the issue of ESG has crept up the importance list in as a driver of strategic agendas,” Tonkin comments.

The environmental plank of the strategy is naturally the most visible – and the evidence that ANZ's corporate clients are as interested in environmental transition as the bank is evidenced by the work ANZ has done on green debt with Investa Property Group in Australia (see box on this page) and Contact Energy in New Zealand (see box on facing page).

“The environmental aspect has been amplified as climate change has become a mainstream conversation,” Stewart notes.



“Sustainability needs to be part of the bank's DNA, informing strategy, lending decisions, governance and risk management as well as organisational culture. Integration of sustainability into the way we do business is the end game.”

ANNA STEWART

CASE STUDY: **CONTACT ENERGY'S GREEN BORROWING PROGRAMME**

In August 2017, Contact Energy (Contact) finalised a NZ\$1.8 billion (US\$1.3 billion) green borrowing programme – the first such certification completed by a New Zealand issuer and the first green certification of an entire debt programme globally. ANZ assisted the implementation.

This is also the largest-ever single green certification by the Climate Bonds Initiative (CBI). The proceeds of the programme will be used to finance existing and future renewable generation assets that meet the CBI's green-bond principles and climate-bonds standard.

The bulk of Contact's geothermal assets already qualify, and the company believes standards for hydro-power inclusion should emerge in the relatively near future.

All Contact's existing bank debt, commercial paper and

term bonds are now certified as green under the programme. The company also finalised a new NZ\$75 million bank facility with ANZ as its first new green-certified debt issuance.

Louise Tong, head of capital markets and tax at Contact in Wellington, credits the expertise of the ANZ team. ANZ guided Contact through the programme's establishment, using what Tong calls its "good understanding of what was required and [ability to] explain how it all worked, help us devise the approach, and provide assistance with written material and documentation".

Katharine Tapley, head of sustainable finance at ANZ in Sydney, says advancing environmental sustainability through its clients is core to the bank's purpose. "In partnering with Contact on its green borrowing programme, we created a solution giving investors and lenders access to a range of debt instruments that fund low-carbon activity and align to the goal of a net zero carbon economy by 2050," comments Tapley.

This synergistic approach demonstrates ANZ executives' belief that corporate clients are making their own

commitments to sustainability at the same time as the bank. This is clearly the case for Contact, because although Tong points to a longstanding corporate focus on sustainability she also highlights the recent emergence of critical mass on the funding side.

"I was also aware of a groundswell of interest in sustainable finance coming from the financial-markets community. It got to the point where it seemed apparent to me that these two trends were really starting to cross over," she tells *KangaNews*.

But this focus does not mean social considerations take a back seat – quite the contrary. Stewart continues: "The two areas overlap in many ways, and the corporate sustainability framework helps articulate what this looks like. There's so much crossover now between social and environmental issues, they don't just sit in separate buckets."

Conversations about these issues are taking place in corporate boardrooms across the world – and indeed on all sides of capital markets. "Numerous leading companies have picked up on the importance," Tonkin says. "We have also clearly seen where the investor community has been moving, as well as the direction global sovereign-wealth funds are taking."

TRANSITION AND IMPACT

ANZ acknowledges that a true commitment to sustainability will inevitably be a long game, and that it is facing a trust deficit with community stakeholders. The fact that all gains cannot be made overnight only accentuates this latter point.

Tonkin tells *KangaNews*: "We want to be a leader in helping our customers – and the industries and communities they're part of – be proactive in thinking about environmental issues and to transition from a carbon-based economy."

Stewart says ANZ has deliberately set measurable, quantifiable and public sustainability targets so stakeholders can measure the bank's progress. Some of these targets have been informed by the United Nations' Sustainable Development Goals (SDGs).

"The SDGs are really important to what we are doing from a corporate-sustainability perspective, so we went through a mapping exercise last year with each of our targets," Stewart reveals.

ANZ is focused on the SDGs that are most aligned with its business – such as goals relating to climate change and reduced inequalities. Stewart adds: "We are also seeing increasing interest from investors in how we're contributing to this globally agreed agenda. The scope provided by the SDGs to drive greater cross-sector collaboration to solve some of society's most complex social and environmental challenges is really exciting." •

"The reality is that the world is moving away from fossil fuels and transitioning towards a cleaner economy. The key question is how fast the transition will occur."

CHRISTINA TONKIN





CALL TO ACTION

Some of Australia's most significant institutional investors in the socially responsible investment (SRI) space share perspectives on the importance of incorporating environmental, social and governance (ESG) principles in their investment strategies. They also discuss the relationship between ESG and credit ratings, sectoral hurdles and the myths around the risk-return equation.

PARTICIPANTS

- **Pablo Berrutti** Head of Responsible Investment, Asia Pacific COLONIAL FIRST STATE GLOBAL ASSET MANAGEMENT
- **Tim Kelly** Fixed Income Portfolio Manager AUSTRALIAN ETHICAL INVESTMENT ■ **Matthew Moore** Head of Ethical Investments UNITING FINANCIAL SERVICES ■ **Adrian Trollor** Head of Portfolio Construction and Sustainability BT FINANCIAL GROUP
- **Yen Wong** Head of Credit Research ALTIUS ASSET MANAGEMENT

MODERATOR

- **Helen Craig** Deputy Editor KANGANEWS

INVESTMENT SPECIFICS

Craig It would be interesting to get some colour on how ESG investing has evolved at your firms. Is your focus on ESG as a general credit-analysis overlay or do you offer SRI-specific funds?

■ **MOORE** Uniting Financial Services (UFS) is the treasury arm of the Synod of the Uniting Church in New South Wales and the Australian Capital Territory (Uniting Church). We manage a balance sheet that provides distribution back to the synod and a multi-asset fund, called an ethical diversified fund (EDF). Both the balance sheet and the EDF integrate the ethical and ESG investment policy of the Uniting Church into the portfolio construction of every asset class.

The EDF has a fixed-income component which currently comprises approximately 44 per cent of the fund. This is made

up of international and domestic credit – which is managed by two external managers – and an internally managed, short-duration domestic credit fund. This fund is offered to our church clients.

The Basis of Union established Uniting Church in 1977. UFS began investing ethically in the 1980s and compiled a formal policy in the 1990s, with a significant review in the early 2000s and regular reviews over the last 15-16 years. The most significant review was in 2013, when UFS implemented a fossil-fuels divestment strategy using a three-year time frame.

■ **KELLY** At Australian Ethical Investment all our investments, including fixed income, must align with the principles of our ethical charter, which is designed to promote the interests of people, animals and the environment. Our charter has not changed over our 30-year history, but we regularly update our assessment of the social and environmental impacts of individual industry sectors.

The investment team is actively involved in the ethical-assessment process, including consideration of ESG factors, to take these factors into account in our investment-risk and valuation analysis.

Our ethical charter defines our investible universe but this does not mean our mandates restrict us to buying green or social bonds. For instance, our fixed-income universe incorporates state-government and Australian Commonwealth government bonds in the Australian market. We are able to buy what is a large, liquid part of the market while at the same time funding health care, education and other socially important aspects of society.

■ **WONG** Altius Asset Management (Altius) runs a sustainable bond fund as well as a traditional bond fund which has ESG integrated in it. Our sustainable bond fund is nearly three years old. We work closely with our core investors to put a rigorous ESG framework around this fund. It has many screening levels and an external committee oversees the fund and monitors the investments.

ESG values and beliefs are fully ingrained in the way we think about investments at Altius. I have only been with the firm since June 2017 but it has been a welcome surprise to see the extent of the buy-in from across the team.

Our ESG approach filters through to our mainstream funds from our sustainable-bond fund. We buy green bonds and green use-of-proceeds bonds issued in the Australian market for both. We also have the capability to buy bonds that aren't strictly green for these funds, but they have to pass our internal ESG assessments.

■ **TROLLOR** Integration of ESG factors is motivated by the desire to improve risk-adjusted returns across equities and fixed income. We don't necessarily prefer ESG as a general credit-analysis overlay or managers to offer SRI-specific funds – we have investments in both dimensions. We have embedded significant effort in this space because of the quantum of financial risk and return we manage.

What we are clearly seeing, though, is increased appetite for traditional SRI product and for the screening of portfolios, albeit under more developed and targeted criteria. Historically, ESG integration was contrasted with SRI practices, which are largely exclusionary. Now the grey area between them is evolving, so higher-risk securities can be screened out on this basis alone. Having said this, our preference is to engage with companies before any screening activity is undertaken.

BT Financial Group became a United Nations (UN) Principles for Responsible Investment (PRI) signatory in 2008, and since this time we have evolved our integration practices. Our approach focuses primarily on engagement. While it is fair to say this has come from an equity-ownership perspective, it is beginning to get some traction in fixed income, particularly with large, institutional fixed-income fund managers.

Five or so years ago, mainstream fixed-income portfolio managers or analysts weren't across ESG integration. Now we are seeing ongoing analysis and subsequent engagement on fixed-income matters. The bigger institutions are combining fixed-income and equity analysis in engagement meetings – and fixed-income analysts are even engaging directly themselves.

■ **BERRUTTI** We also look at ESG very much through a financial lens – of how ESG factors will affect a company's ability to pay back a loan.

We have been integrating ESG into all our investment processes for more than a decade. We aren't only concerned with ESG for specific products – we have integrated ESG into each and every investment process across the organisation.

More recently, we have started to investigate the potential for product solutions to meet specific needs, because of the trend towards institutional investors looking for, say, lower-carbon portfolios or portfolios linked to the UN Sustainable Development Goals (SDGs). We think these trends will continue to evolve and we need to be able to develop products to meet these needs.

We believe each asset class is different and the types of companies we invest in require different tools to be able to properly understand the ESG risks and opportunities associated with them. So each investment team has developed the approach that best fits both their existing investment philosophies and the types of assets they are investing in.

In corporate credit, ESG is one factor we consider in our internal credit ratings. It can comprise zero to 100 per cent of the internal credit rating, depending on how material the issues are to the particular issuer.

There is a clear correlation between our ESG assessment and our internal credit ratings. There are also some companies for which we don't provide an internal credit rating because the ESG risks are so apparent that we see these firms as uninvestible.

■ **MOORE** We also rate all our investments from an ethical and ESG perspective, with the help of an external consultant. We

“In the very early days of ESG integration everyone was very focused on demonstrating outcomes through performance-related evidence. But thought processes have evolved since this time, as has the amount of evidence.”

ADRIAN TROLLOR BT FINANCIAL GROUP



STAKEHOLDERS STEP UP

Institutional investors' end clients are becoming increasingly engaged with the socially responsible nature of their investments.

■ **CRAIG** Is the push for more environmental, social and governance (ESG) analysis coming from your institution or your end clients?

WONG From both. Altius Asset Management's beliefs and values have ESG firmly embedded in them. But investor demand is also increasingly acting as a driver.

There are a range of factors at play. Since the adoption of the Paris Agreement there has been growing recognition that the financial sector has a role to play in the transition to a low-carbon economy. There is a group of institutional investors that are drawn to companies which have clear social and environmental objectives and good ESG practices. This group is only going to grow.

BERRUTTI Engagement is growing from a low base and there are real differences

between leading asset owners and the rest.

In the early days we believed integrating ESG was a better way to invest because we could make better-informed investment decisions. We did this even though there was limited client interest. Today we find it comes from both sides. We see increasingly obvious risks and opportunities associated with these issues for the companies we invest in, but at the same time there is a growing push from clients to have robust processes for considering ESG issues.

KELLY Australian Ethical Investment was the fastest-growing super fund in 2016, and we've just received the SuperRatings 'Fast Mover' award for the fastest-growing fund this year. This is a good indicator of Australian interest in sustainable investment. All choices – in our personal,

business and investment lives – have positive and negative impacts. The foundation of sustainable investment and a sustainable future is to maximise the goods and minimise the harms, and to make a positive difference with the capital we deploy.

Regarding whether the push for analysis is coming from within our institution or from our end clients, Australian Ethical Investment was founded to operate under socially responsible investment principles and so our ethical *modus operandi* is really part of our DNA rather than a response to investor pressure.

At the same time, our clients are very engaged, and we value their input and their perspectives. Our Facebook page hosts a very active dialogue about our investments, in particular about the factors we take into account.

MOORE At this stage our end-client is exclusively the Synod of the Uniting Church in New South Wales and the Australian Capital Territory, and we manage all funds according to its ethical and ESG policy. The push from the synod to do this started more than 30 years ago and even recently the church was ahead of the game in its view on fossil fuels in the portfolio.

Our stakeholders want to have clear visibility of our investments, including feedback on how we're investing and the results we're seeing. Investors ask about performance but we don't believe we give this up by investing ethically.

It is important we demonstrate that ethical investing is doing what the synod wants. We do this by engaging with the firms in which we invest, and we use the feedback we receive to demonstrate this engagement to our stakeholders. In other words, we're not just implementing our policy but following through.

assign each individual security with a rating from A to E with the aim of targeting companies with a very good ethical and ESG score.

If the individual security score is E this doesn't automatically mean we are unable to buy it. The security may be issued by a company that is transitioning to a low-carbon economy, one that might be doing some good work in other areas of sustainability or it might have good corporate-governance record. It is possible that parts of a business bring the rating of the whole down.

It's more likely than not that a company with an E score won't be in the portfolio, though. It tends to be the instruments scored C and D that our ethical investments monitoring committee – the committee that discusses all our exposures from an ethics perspective – talks about the most.

CREDIT ANALYSIS

Craig Is there much evidence to support the idea that a commitment to ESG factors and strong financial performance are interlinked?

■ **BERRUTTI** There is quite overwhelming evidence to show that incorporating ESG can contribute to adding value both in equity and fixed income, and for direct assets like infrastructure and property. Regarding fixed income specifically, Barclays and others have carried out research and data has been collected over 30 years.

■ **KELLY** Comprehensive ethical and ESG research of companies contributes to a better understanding of company risks and prospects, for the purpose of equity and credit valuation and investment.

■ **TROLLOR** In the very early days of ESG integration everyone was very focused on demonstrating outcomes through performance-related evidence. But thought processes have evolved since this time, as has the weight of evidence.

If you accept a couple of high-level points as given – there is value at risk from potential ESG risks to a corporate and there is information outside traditional analysis that could have an impact on investment performance – the process becomes one of working out how we can get access to more informed analysis and information, and how we establish its potential materiality to a company.

“Rather than a trade-off, investors recognise that companies with good employee engagement, community relations and environmental stewardship will perform better over the long run.”

PABLO BERRUTTI COLONIAL FIRST STATE GLOBAL ASSET MANAGEMENT



Yes, we have seen an evolution in the data available from service providers in the ESG space, though it is still in its infancy in comparison with the quality and breadth of standard data available to investors. Logically, having satisfied some criteria on the quality of the information, the question becomes ‘how’, not ‘why’, I should include this data in analysis, in a way that it best fits exposures and the type of company and environment the company is operating in.

Proof points are important but if we wait for decades of evidence, given the evolution happening in this space and the types of nonfinancial data points we are talking about, the point of ESG integration will have been missed.

Craig How are investors incorporating both quantitative and qualitative findings into their risk assessments of companies?

■ **MOORE** ESG is an important part of the way we assess an organisation on several fronts. From an environmental perspective, we want to understand how companies are positioning themselves for a two-degree world. We want to know if they are stress testing their balance sheets, as this supports our policy of a transition to a low-carbon economy.

We also want to know if there are likely to be any positive shock events or structural changes to balance sheets. For example, whether resource-driven companies are actively seeking ways to transform their balance sheets as part of the transition to a low-carbon economy.

Green bonds support the transition to a low-carbon economy. We observe many companies seeking ways to manage and fund their balance sheets and allocate capital. We are supportive of engaging with companies around how they’re transitioning towards a low-carbon economy, including through the issuance of green bonds.

■ **BERRUTTI** As I mentioned, ESG can be zero to 100 per cent of our internal credit rating. At Colonial First State Global Asset Management we have looked at the relationship between our internal credit ratings, our ESG risk rating and the rating agencies’ credit ratings. Our findings are that where we give a company a very high ESG risk rating it tends to have a lower internal credit rating than the credit rating agencies provide. This relationship indicates that we take ESG risks more seriously than the rating agencies. Our internal credit rating drives the risk-allocation parameters our portfolio managers

must meet and also influences the return they expect from a particular bond.

We certainly find this benefits us when it comes to avoiding default. If you invest in our global credit fund the default experience is much lower than if you invested according to the buckets the rating agencies provide.

We have published these findings for the last three years in our responsible-investment report.

■ **WONG** We factor ESG into our overall risk assessments and we use ESG analysis to add another layer to our research. It also provides additional insights into risk management and can act as a red flag for potential problems or as a trigger to look more closely into some companies.

Through the 15 years I have been undertaking credit analysis into ESG, it is particularly the ‘G’ risks that can and do have an impact for corporates in our credit funds.

Craig Do others find governance has more of an impact on the credit view than environmental and social issues?

■ **BERRUTTI** This has been our experience, however corporate governance has been researched for much longer and is better understood. Good governance also directly influences how well environmental and social issues are managed. However, meta-analysis by Hamburg University found similar performance benefits for the ‘E’ and ‘S’. As environmental and social issues are better researched and as company disclosure improves, the performance benefits should become more apparent.

We see this with green bonds. Originally the bonds performed in line with regular issuance from the same organisations. As the market has responded to the increase in issuance, green bonds are performing better. There seems to be something deeper going on even where there is full recourse to the parent issuer.

There is a real desire by investors to gain exposure to environmentally and socially positive investments. These offer lower risk over the long run because when governments come to regulate these issues you are less likely to be caught out if you align your interests with the broader interests of society.

■ **KELLY** Our ethical-investment process integrates ESG considerations through its impact on both our investment universe and our investment insight within this universe. In defining our universe, environmental, social and other ethical

MEASURING UP

Investors say the United Nations Sustainable Development Goals (SDGs) are useful for measuring impact, but matching the 17 global goals and 169 individual targets is a challenge. Their firms are developing their own approaches to gauging impact.

■ **CRAIG** How do investors measure the impact of their socially responsible investment (SRI) allocations and are the SDGs useful in this respect?

WONG SDGs are one way to measure impact. It goes a lot further, though, because what we need to do is build a

sustainable and resilient future for all the people on the planet. I think this is an important call to action for all countries and stakeholders.

Even so, measuring impact is difficult as there is no single measure that can capture the benefit to society. This is why the SDGs are useful, because

they break the measurement down into several different goals and targets. But it is also important not to neglect other areas when you're addressing one goal or target.

BERRUTTI We don't have specifically targeted SRI products, as we look to integrate environmental and social governance (ESG) across our investment processes.

The asymmetric nature of bond investment returns and risks means fixed-income investors naturally focus more on the downside, meaning it's somewhat unnatural for fixed-income investors to focus on the positives.

In addition to shifting mindsets, good-quality information is important. However, measuring impact is still a relatively new concept. We are looking for data providers that can give us some insight although sourcing good-quality information is challenging.

TROLLOR Many large institutions have started to contemplate this challenge, including ourselves. The SDGs give a reasonable framework but matching the criteria can be challenging.

The opportunity is to give end investors some additional – and interesting – information about their portfolios. This will help increase investor engagement with our portfolios. But we are still a way off being able to implement this effectively.

Arguably it is only in the last 5-10 years that mainstream institutional investors have woken up to the potential to include ESG factors into decision making. With improvements in communication, for example



“THE SDGS ARE USEFUL, BECAUSE THEY BREAK THE MEASUREMENT DOWN INTO SEVERAL DIFFERENT GOALS AND TARGETS. BUT IT IS ALSO IMPORTANT NOT TO NEGLECT OTHER AREAS.”

YEN WONG ALTIUS ASSET MANAGEMENT

factors are important. Governance is another aspect but our charter drives us to consider far more than just governance issues.

RISK AND RETURN

Craig What is your response to those who think you have to give up returns to invest responsibly?

■ **KELLY** This is not our experience, and it's not supported by broader market research. Responsible Investment Association Australasia (RIAA) compares the performance of ethical and impact funds against mainstream funds, and has consistently found that ethical and impact funds have performed better over most asset classes and time periods.

This is unsurprising. A focus on businesses creating a better future helps build portfolios of companies with robust growth prospects and helps avoid companies exposed to a higher risk of negative action from consumers and government.

■ **TROLLOR** The answer depends on how you define responsible investment. ESG integration isn't about giving up returns – it's about improving risk-adjusted returns.

If you look at various approaches to responsible investment, which invariably include screening or tilting portfolios, there is evidence coming from, say, carbon-tilted portfolios that you are able to minimise tracking error to a broad mainstream index without significant detractor, if any, from the return outcome. Many approaches are being adopted and we are seeing a lot of action by index providers and active managers alike to develop carbon-tilted portfolios.

The answer is also linked to the time horizon and governance capability of the investor. It's important that those seeking to link their own responsible-investment preferences and motives are sufficiently resourced or seek appropriate support to ensure their portfolios reflect those preferences in the best possible way and they are aware of the potential outcomes.

Investment techniques are getting better at integrating responsible-investment priorities and identifying and managing potential impacts on returns.

■ **WONG** The time frame is clearly important. RIAA's responsible-investment benchmark report from 2017 shows that sacrificing financial returns to do good is a myth. We have been running our sustainable-bond fund since November 2014

progress in reporting against SDGs, and through technology, I expect there will be a point where the people whose money we manage will be more engaged and have greater ability to express their individual preferences in an informed way.

■ **CRAIG** How do you prove to your clients that the investment they are making is making a difference?

WONG This is an interesting question because we have asked our key investors for their thoughts on carbon footprinting and their response is: 'It's a nice-to-have but not a need-to-have.'

This is in part driven by the charter in our sustainable-bond fund which, of itself, defines an acceptable level of investment. We use these standards to communicate what we are investing in and not investing in – and what is acceptable and unacceptable – and to engage both with our end investors and the companies in which we invest.

MOORE Initially we do this through our ethical investments monitoring committee. The committee decides which companies we might want to engage with and we publish the results of this engagement in our weekly newsletter or quarterly update.

We've recently set up a Facebook page and are using this as another communication tool. In addition, we have regular reports to the full synod meetings, held every 18 months, and also to the synod standing committee which meets bimonthly.

KELLY We also use many channels to report our impact, from more formal annual reporting to online blogs and social media. We combine stories about the positive change achieved by individual investments with portfolio-level reporting to demonstrate the overall impact of our ethical-investment process – which could be from carbon footprint to revenue earned from major disease treatment and sanitation.

and have demonstrated that there is no significant difference in returns between sustainable and mainstream portfolios.

■ **MOORE** Why does everyone think unethical investments are the best performers? This is just not correct. I believe, and historical data back this up, investors don't have to give up performance to invest ethically and responsibly. The data show that while there will undoubtedly be short periods of time where ethical investing will underperform the wider market – because there are certain sectors we can't gain exposure to – over a longer period the performance of an ethical fund will not underperform the market.

The largely buy-and-hold nature of our investments means we seek smooth, long-term returns and lower volatility. Investing ethically and responsibly over the long term can provide these.

■ **BERRUTTI** This is the myth that won't die! No matter how much evidence there is to show investing responsibly can add value the belief persists that it will deliver lower returns.

Part of the reason is that responsible investment has a religious and ethical history, where avoiding harmful industries was the focus and the financial consideration was secondary. Mainstream investors believed anything that reduced the

investible universe must detract from performance. But on average these types of strategies haven't underperformed. This suggests manager selection, rather than whether or not they are running an SRI strategy, is a greater influence on performance.

However, since the establishment of the PRI, investors have increasingly recognised the value that can be added through integration of ESG factors as a financial consideration. Rather than a trade-off, they recognise companies with good employee engagement, community relations and environmental stewardship will perform better over the long run.

Interestingly, we are now seeing some overlap between these approaches. This emerging trend is a recognition that issues like corporate conduct or climate change can significantly undermine the integrity of financial, economic, social and environmental systems as well as pose risks for the individual firm. It also recognises that investors can influence better outcomes through the allocation of capital and active ownership, and so have stewardship responsibilities. It is for these reasons we are seeing increased focus on SDGs as an investment framework.

MARKET DEVELOPMENT

Craig Is there enough product to fulfil your demand for SRI? Would you like to see more offerings in the Australian market, or can you buy green and social bonds offshore?

■ **WONG** There has been growth in green-bond issuance locally in 2017 and greater sectoral diversification – which is important. This is positive, but what we'd like to see is an increase in issuance from the nonfinancial sector, particularly from corporate issuers, and more social-bond issuance.

■ **KELLY** We're also always keen to see more green and social bonds, whether or not they bear that label. And we'll always look beyond the label. To invest in a climate bond, for example, we need the issuer to satisfy us that the underlying projects are in substance supporting the economic transition needed to limit warming to well below two degrees. We are not able to buy green and social bonds issued offshore at this point.

■ **MOORE** The green-bond market has grown significantly, domestically and internationally, over the last decade and we've seen a clear evolution in Australia over the last 2-3 years. We welcome the diversity of issuance and issuers green bonds offer and we would like to see the market continue to grow.

We have a stated intention to support the transition to a low-carbon economy and allocating capital towards green bonds helps with this transition as well as fulfilling our ethical principles and policy.

Social-benefit bonds also form part of our EDF. We have participated in four transactions in 2017 and we think there's a good opportunity for continued growth. Transaction volumes are small but industry collaboration between investors and issuers could support the typical A\$5-10 million (US\$4-7.9 million) current deal size reaching A\$50 million or more.

BUSINESS **LEADS**

The political environment is a clear constraint on Australia moving to a low-carbon economy. So business is taking over.

■ **CRAIG** Would a supportive political environment help your drive towards ethical investments?

KELLY Australian climate policy is a disaster. Having said this, investors and issuers are getting on with the job. I would point to the progress of green bonds in Australia. We have banks that are willing to fund and investors that are willing to back green bonds.

Another factor to consider is how Commonwealth government policy failure

can be mitigated by state-government energy targets.

MOORE The federal government has agreed to certain targets within the Paris Agreement and as a country I think we'll continue to collectively aim for these.

I agree with Tim Kelly that, in the absence of government actions, the states have not only taken this on but are delivering. We're seeing this in South Australia and I think we will begin to see it in other states too.

BERRUTTI The political environment has been a big problem and we are all paying more for energy than we should as a result. Climate and energy policy has lost at least a decade in Australia, and this has held back investment. We have, at different times, effectively seen an investment 'strike'.

Having said this, it has been less directly relevant in our fixed-income business than it has in infrastructure, where we have renewable-energy assets but they are all located offshore! We would love to invest in renewables here in Australia and we have tried to do so, but lack of regulatory certainty is a concern.

The cost of renewables and other clean technologies is

falling. Despite the regulatory gap, companies are engaging in things like direct power purchase agreements with renewable-energy producers. This has become a purely economic decision with renewables getting cheaper all the time.

This is a good thing, of course, but it's not enough and introduces a range of risks to existing assets including to the networks.

To get the scale of investment needed to transition to a low-cost, resilient and low-carbon energy system we need a policy framework that drives new investment. We also need to recognise this transition is happening globally with big implications for Australia.

WONG It is also a very real financial risk. There is a failure in public policy in taking advantage of the falling cost of renewable energy and investing in new projects to ensure we remain competitive. More political certainty would certainly be welcome in this context.



"AUSTRALIAN CLIMATE POLICY IS A DISASTER. HAVING SAID THIS, INVESTORS AND ISSUERS ARE GETTING ON WITH THE JOB."

TIM KELLY AUSTRALIAN ETHICAL INVESTMENT

■ **TROLLOR** What fixed income offers is the connection between the purpose of funding and the way the funds are deployed. I see this as an incredible opportunity for product that aligns to how portfolios want to position themselves in relation to their underlying exposures. This goes beyond green or impact bonds.

There is a lot of discussion around SDGs and, at the very least, trying to articulate how to align investments to these goals. In fixed income, developing the range of strategies beyond green-bond structures should be a significant opportunity for issuers and fund managers.

■ **BERRUTTI** We need to transform the global economy so that it reaches net-zero carbon emissions by 2050. The International Energy Agency and other leading bodies estimate that to achieve this we need trillions of dollars of investment.

While green bonds have grown significantly they still only represent about 1 per cent of overall bond issuance. This means the scale of green-bond issuance must grow sufficiently to be transformational.

There is also some product which, even though it carries the label, isn't necessarily green. Equally, many issuers have

a positive social or environmental impact but they don't label their bonds green or social. While it is great to have an increasing amount of product, partly because it allows for easy identification, there are still opportunities for fixed-income investors to look more deeply at the existing capital markets for SRIs.

FUTURE CHALLENGES

Craig It is clear we need exponential growth in the level of investment – including but not limited to green bonds – to transform the global economy. What other challenges are there to the development of the impact-investment market?

■ **MOORE** One of the biggest challenges is to disperse the myth that by investing ethically or responsibly investors are giving up returns. If we say we're investing ethically the immediate response can be, 'in that case, what am I giving up?' We do not believe this is true – and, as stated before, the long-term performance data support this.

“One of the biggest challenges is to disperse the myth that by investing ethically or responsibly investors are giving up returns. If we say we’re investing ethically the immediate response can be, ‘in that case, what am I giving up?’”

MATTHEW MOORE UNITING FINANCIAL SERVICES



The Financial Stability Board has carried out a lot of work via its Taskforce on Climate-Related Financial Disclosures. This aims to develop consistent, climate-related financial risk disclosures for companies to provide information to investors, lenders, insurers and other stakeholders.

This is voluntary for companies, which means there will be challenges for asset owners and investors to try to encourage companies to report on climate-change issues as well as to challenge them to do this as part of their normal reporting requirements.

Another challenge is finding a high-yield bond manager that does ESG well.

■ **TROLLOR** I agree that climate-risk management is the main challenge, in both equities and bonds. We have seen the first evolution of investment solutions in equity indices and we expect to experience a similar evolution on the fixed-income side.

A degree of sophistication supported by data improvements should assist in better risk management.

■ **WONG** There are challenges faced by the funds-management industry in general, one of which is the short-term focus on returns being at odds with the long-term need to invest sustainably – and the ramifications of sustainable investing on long-term returns.

Gaps in regulatory oversight and a lack of recognition of the financial risk of climate change may exacerbate this challenge. We are hopeful, though, that this will change with the Australian Prudential Regulation Authority acknowledging the potential financial risk for banks, insurance entities and the funds-management industry including superannuation. In the near term we hope the interpretation of updated fiduciary obligations will act as a long-term positive driver.

Our biggest concern is superficial integration – the tick-the-box exercise – of ESG. There are organisations that offer SRI or ESG-type products but that are poorly resourced – they have very little specialist ESG personnel. This could damage the SRI industry’s promise of offering a true risk assessment of ESG.

■ **BERRUTTI** Our approach has always been to integrate at the process level, meaning we are better positioned to develop credible products going forward. But as Yen Wong says, the adequacy of ‘tick-the-box’ exercises is a valid concern for the market more broadly.

There is a bifurcation between truly sustainable and ESG-tinted mainstream investment portfolios. An increasing number of investors are considering ESG issues in mainstream portfolios but not necessarily with a sustainable-development focus. They are looking at the incremental gains they can achieve through the incorporation of ESG issues in their investment decisions but not at the scale of some of the challenges we face. So there are some big questions around adequacy.

Organisations like World Bank and World Economic Forum publish report after report outlining the significance of these challenges. A total of 168 countries has ratified the Paris Agreement on climate change, which calls for net-zero emissions by 2050 and requires a significant shift in the economy. Even more countries support the SDGs, which also call for significant shifts in the way economies function. Yet mainstream financial markets by and large still seem to be unprepared for and uncommitted to these changes.

The culture and conduct of investment markets isn’t necessarily conducive to sustainable investment due to the prevalence of short-termism. Returns are benchmark-relative and in this context we should be asking whether we are even using the right benchmarks.

The quality of information is improving but good-quality ESG research is hard to find and the bulk of it is targeted at equity investors. It is particularly hard for bond investors to find information on subsidiary companies or unlisted entities.

There is also an educational component. Within the CFA designation the amount of training on ESG integration is very small relative to the rest of the programme.

The history of ethical investment has also caused its own challenges. Analysts would screen out ‘nasty’ investments before handing over to a portfolio manager, who would not really consider ESG issues.

■ **KELLY** As others have alluded to, gathering reliable data to allow assessment of individual companies in accordance with these frameworks is a real challenge. We’ve seen great progress in measurement and disclosure by companies and ESG research providers, but this needs to continue in order to build the credibility of impact measurement and scoring.

This is essential both internally, for more effective sustainable-investment management, and externally for public transparency and accountability for the difference we make. •



ALEX STRUC
HEAD OF ESG PORTFOLIO MANAGEMENT, PIMCO

GLOBAL INVESTOR **PERSPECTIVE**

Alex Struc, head of ESG portfolio management at **PIMCO** in London, talks about how his team scores and manages environmental, social and governance (ESG) risk for PIMCO's investments. He outlines how the United Nations (UN) Sustainable Development Goals (SDGs) are proving a useful tool for the measurement of impact, and how investing in socially responsible fixed-income investments (SRI) can ensure continuity and positive progress.

How did you end up in the ESG world? PIMCO signed the United Nations Principles of Responsible Investment (PRI) in 2011. In 2012, David Blood from Generation Investment Management came to talk to us about ESG investment. This really sparked my interest because a lot of principles he was highlighting were in line with how I was analysing credit over the long term. He put a factor attribution on what I thought was a 'gut feel', and he called it ESG. This made a lot of sense: while gut feel may be difficult to explain, ESG is very scaleable as framework.

■ What does your role as head of ESG portfolio management encompass?

My role is to incorporate ESG in our investment process across fixed income. We have developed ESG-specific scoring for credit, which we launched formally in the second quarter of 2016.

Our credit analysts scored 960 credits in Q2, 1,000 in Q3 and 1,070 in Q4. This score is comprehensive, it analyses 'E', 'S' and 'G' separately. We have also developed a proprietary materiality weighting. For example, utility would have the environmental pillar weighted at 60 per cent, with social and governance having lower weightings. For banks, social and governance would account

for 85 per cent versus the environmental pillar at 15 per cent.

We have also introduced active ownership or engagement as a key pillar of our ESG platform. Scores mainly help us ascertain historical performance. Engagement takes care of the potential future value.

My team's job is to provide this intelligence across all PIMCO holdings. How portfolio managers factor these into the equation highly depends on individual mandates.

■ How does the engagement score work?

We have a dedicated engagement resource. In addition to credit analysts speaking with management, we have a dedicated ESG analyst who develops ESG engagement. Our approach to engagement is very structured – it features four key themes.

The first is social licence to operate. Here, we care about how companies are mapping their revenues versus the SDGs.

Secondly, there is culture and conduct, which has 10-15 subthemes depending on the industry.

Third is risk management – anything that has to do with running the company. Cyber security, for example, will be included in this category. It's an extraordinary item that is not necessarily

covered in context of traditional reporting.

The fourth theme is transparency – we measure companies' communication on ESG factors. Here, we look out for sustainability reports, for example.

■ How has ESG investing evolved at PIMCO?

Historically, SRI manifested itself in exclusionary screens. PIMCO's first SRI fund was launched in 1991, in the US. It was created out of demand from religious organisations and it had quite a bold execution of exclusionary screens. Excluded were alcohol, tobacco, gambling but also anything to do with contraception and abortion. As a result, the entire US healthcare sector was excluded.

In 1996 we launched the short-duration version of the same fund. Since then, if you look at the performance of these funds versus their twins, they don't trawl back on performance at all.

Since we signed the PRI in 2011 a growing number of clients has moved in a similar direction, but the real uptake happened between 2015 and 2016. Last year alone, the assets under management that we manage that feature some kind of ethical or responsible exclusion almost tripled.

At the beginning of 2016 we had around US\$200 billion under

management in assets that featured one or more SRI-type exclusions. By year-end we had US\$570 billion under management.

The demand is coming mainly from asset owners, who are being pressured by their beneficiaries and shareholders to show a responsible approach to investing. The simplest manifestation of this is to draw a line in the sand below which are the issuers in which they won't invest.

Another way for an investor to act responsibly is through some form of active ownership. Increasingly, people want to see owners of risk engaging

■ How do you measure active impact at PIMCO?

In 2015 and 2016 we saw a massive pick-up in interest from retail and institutional investors who wanted, in addition to screens, to align their investments with particular goals that are of a non-investment nature. For example, social bonds. For us, it was a very challenging task. If an investor says they want to help society, it could be a very open remit. So how do you define it and therefore measure whether you are achieving it?

When the SDGs were developed, it was quite helpful to us because it is a

Investing in bonds that are dedicated to renewable projects could enable better-quality reporting: for example, 1 per cent of our portfolio is invested in clean and affordable energy – SDG seven. Investing in infrastructure or municipal bonds in the US could mean 2-3 per cent of our portfolio is dedicated to SDG 11 – sustainable cities and communities. If we invest in National Australia Bank's gender-equality bond, we can track some of our portfolio invested towards SDG five – gender equality.

Getting the SDG footprint of your portfolio is a major step forward. If

“When the United Nations Sustainable Development Goals were developed, it was quite helpful to us because it is a neutral framework with which everyone agrees, they are vetted by countries, and more importantly, they are very specific. These kinds of things become like targets. As a bond manager, we like targets because they help create factor attribution.”

with companies to help them better manage risks.

■ Is there a difference between SRI, ESG and impact investing?

For us, SRI is more often passive, where clients indicate to us what they don't want to be investing in. In simple speak, this translates into guideline change – things we are not allowed to finance. On the other hand, ESG incorporates an active approach. In addition to excluding, our clients want us to assess ESG risks plus show active engagement. Impact tends to be about aligning investments with values.

■ Is impact the most important element here? Because if all you're doing is excluding something, you aren't really showing you care about the impact.

Some of our clients choose to make an impact by divesting or not investing in the first place. They could be doing so by withdrawing financing from companies through the world's largest fund manager. It could be effective but more passive in nature.

neutral framework with which everyone agrees, they are vetted by countries and, more importantly, they are very specific. These kinds of things become like targets. As a bond manager, we like targets because they help create factor attribution and we can line up a particular social goal with an investment.

■ How does impact measurement using the SDGs work in practice?

Think about green bonds. 'Green' is an unfortunate term because the remit allowed by the principles is broad but investor expectations are very specific. As a result, when some investors look at green bonds they often struggle to analyse the 'greenness' of a bond. In our world, we don't know what 'greenness' means, instead we choose to focus on impact.

A green bond or a social bond may have different outcomes but what all these bonds are looking to measure is impact. If this is the case, SDG number seven – clean and affordable energy – is one way to measure the 'greenness' or impact of, for example, renewable-energy projects.

you think about the investment-grade world, companies have been borrowing for 'general corporate purposes' for a very long time so the reason for issuing bonds was quite murky to start with. With SDG or purpose bonds investors could be getting a great deal of clarity. For us, this step towards clarity is really factor attribution.

■ Knowing an investment is contributing to an SDG is one thing. How can investors be sure they are making a difference, though?

The big question from investors is whether an investment makes a difference. Often implied in this is whether you do anything new by investing in these bonds.

Thinking of impact in an immediate, T+0 way could be limiting as any transition takes time. As fixed-income fund managers we have always been investing for the long term, and over the cycle it tends to give us a different perspective. For example, having a 5 per cent renewable portfolio today is great, but the challenge is guaranteeing that it will be there tomorrow. Green bonds –

or impact bonds – can secure continuity. If you issue a term financing against your renewable portfolio, it allows you to lock into a commitment over that term.

In credit, the more you like it the longer you want it. Applying the same logic to green financing means saying the more it's useful the longer you want it for. France's 22-year green bond and European Investment Bank's 30-year bond are interesting from this perspective. While at T+0 you may be just locking in the financing that was there anyway, going forward you are securing that the same financing is consistently there at times when it is needed as projects roll off.

With impact bonds, we have an opportunity to employ additional liquid

The reason for this is they have taken a very exclusionary and reactive approach.

In a way, their construct is exactly opposite to how you'd expect to manage credit. Investors want to buy credit when it's cheap and cheapening. What these indices tend to do is to rebalance when something becomes cheap – for example in response to an ESG event.

■ **Do you stress the fact that for ESG investing you're not expecting to give up return?**

I would de-emphasise the ESG element altogether and approach it more as a mathematical exercise. The more explicit you are with your exclusions the more likely you are to lower your return. So return becomes completely subjective

client is focused on ethical considerations that are only measured today, it has a higher potential of affecting returns. But if you have a client who is looking for an ESG approach to impact transition to a low-carbon economy, the returns can be higher because their approach is a lot more comprehensive.

In fact, this kind of investor could actually enhance returns because it also benefits from the tailwind of regulation – many legislative systems are also moving in this direction. Effectively what you are doing is not only looking at the past but also capturing some future value. It's good business planning.

There's no right or wrong here. What we have learnt is that client demands are highly correlated to the needs of their

“If you think about the investment-grade world, companies have been borrowing for ‘general corporate purposes’ for a very long time. So the reason for issuing bonds was quite murky to start with. With SDG or purpose bonds investors could be getting a great deal of clarity.”

capital markets to secure continuity and progress in the right direction.

■ **There is still a perception that if you invest in SRI you will need to give up performance.**

There is a lot of academic work showing that ESG investing leads to outperformance in the equity space. To be clear, this is not the message we promote for fixed income. We think investors should expect similar returns, without giving up anything.

Based on our experience, if you look at PIMCO's total-return SRI fund from 1991, the performance is really close to its twin. The same goes for the low-duration fund from 1996. This is quite a decent time horizon.

Could ESG investing lead to outperformance? Potentially. We choose not to promote it actively as there are a number of dedicated ESG benchmarks that have underperformed traditional benchmarks in the fixed-income space.

depending on what the end investor wants.

With our ESG platform launch we have created a number of public funds where, through our SRI exclusions, we draw a line in the sand beyond which we won't go. We think we have found a good common denominator for exclusions, but we are constantly refining it. With the list we currently have – which is tobacco, pornography, weapons and coal in the Global ESG GIS Fund – we think we are capturing 80-90 per cent of the investor universe that is looking to invest in public ESG funds.

■ **Would you say the returns are as subjective as the ethical or ESG considerations?**

The question of returns is directly related to what the client is asking. An ethical approach to investing does not live in the realm of money, and so can potentially affect the money outcome. But it's an approach driven by the client. If the

beneficiaries. Some beneficiaries have more flexibility, some less.

■ **Can you give a specific example of how certain companies could be excluded from one investor's portfolio but included in another's?**

Let's take an energy company that derives 35 per cent of its revenues from coal but issues a green bond against its renewable business. If you are an ethical investor with a very low threshold, this company would be excluded from your portfolio because the revenues from coal are considered too high.

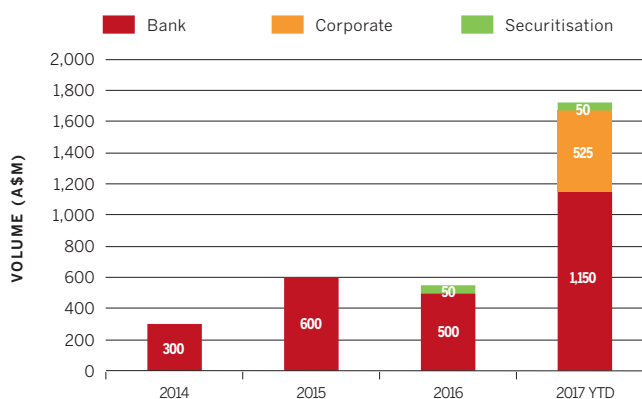
But say the same company had 75 per cent of its revenue derived from coal in 2000. So in a historical context it has moved to 35 per cent of coal from 75 per cent, while at the same time substantially increasing its renewable business. For a client that is looking to facilitate transition to a low-carbon economy this is one of the best investments they can make. •

MARKET TREND ↑

Australian dollar credit deal flow gathers momentum

All four of Australia's major banks have issued green bonds domestically, with the most recent debut coming in 2017 – the same year as the local market saw its first-ever true-corporate green bond. Deal flow remains sporadic, but aggregate credit issuance has picked up (see chart on this page).

AUSTRALIAN DOLLAR CREDIT GREEN- AND SUSTAINABLE-BOND ISSUANCE



SOURCE: KANGANEWS 19 OCTOBER 2017

Australian dollar credit green and social bonds, 2017



Issuer: **National Australia Bank (NAB)**
 Deal type: **social bond (gender-equality)**
 Use of funds: **lending to Workplace Gender Equality Agency-approved employers**
 Rating: **AA-/Aa2/AA-**
 Pricing date: **17 March 2017**
 Maturity date: **24 March 2024**
 Volume: **A\$500 million**
 Margin: **95bp/swap**
 Investor type: **8% "dark green", 53% "light green", 39% other**
 Lead manager: **NAB**



Issuer: **Commonwealth Bank of Australia (CommBank)**
 Deal type: **green bond**
 Use of funds: **12 projects including solar, wind and hydro power, energy-efficient buildings and low-carbon transport**
 Rating: **AA-/Aa2/AA-**
 Pricing date: **28 March 2017**

Maturity date: **31 March 2022**

Volume: **A\$650 million**

Indicative volume: **A\$300-500 million**

Margin: **92bp/swap**

Geographic distribution: **80% Australia, 18% Asia, 2% EMEA**

Lead manager: **CommBank**



Issuer: **Investa Office Fund**
 Deal type: **green bond**
 Use of funds: **five low-carbon buildings in IOF's existing portfolio**
 Rating: **BBB+ (S&P)**
 Pricing date: **30 March 2017**
 Maturity date: **5 April 2024**
 Volume: **A\$150 million**
 Total book: **A\$450 million**
 Margin: **168bp/swap**
 Investor type: **22% "dark green", 30% "light green", 48% other**
 Lead manager: **ANZ**



Issuer: **Investa Commercial Property Fund**
 Deal type: **green bond**
 Use of funds: **five low-carbon buildings in ICPF's existing portfolio**
 Rating: **A- (S&P)**
 Pricing date: **12 April 2017**
 Maturity date: **21 April 2027**
 Volume: **A\$100 million**
 Margin: **155bp/swap**
 Investor type: **28% "dark green", 43% "light green", 29% other**
 Lead managers: **ANZ, CommBank**
 Accreditation: **Climate Bonds Initiative**



Issuer: **Australian Catholic University**
 Deal type: **sustainability bond**
 Use of funds: **financing or refinancing green and social projects**
 Rating: **Aa2**
 Pricing date: **25 July 2017**
 Maturity date: **3 August 2027**
 Volume: **A\$200 million**
 Total book: **A\$500 million**
 Margin: **97bp/swap**
 Initial price guidance: **105bp/swap**
 Geographic distribution: **75% Australia, 24% Asia, 1% Europe**
 Lead managers: **NAB, UBS**

ISSUER PERSPECTIVES



ALEX BISCHOFF
 HEAD OF GROUP FUNDING
 WESTPAC BANKING CORPORATION

"When we set up our green-bond programme we decided to gold-plate it at an international-standard level. We have all learned a lot from what other banks and

issuers have done globally, and as a result we have set up a framework that is top of our peer class for reporting and disclosure."

"We will continue to use this programme but I don't expect it to save us basis points in our cost of funding. I don't think this product is about spread. The way we see it is that the incremental A\$500 million of sustainable issuance we may place annually will open up a new pool of investors and also align with the group's strategy."

"In the last 12 months, we have also released our climate-change action plan which, above our lending commitments, puts in place a commitment both to issue and to help other issuers raise A\$3 billion of green and social bonds by 2020."



PETER MENEGAZZO
 EXECUTIVE DIRECTOR AND
 CHIEF INVESTMENT OFFICER
 INVESTA GROUP

"We looked at the reporting standards and what we needed to achieve to issue green bonds, and to be honest they were all things we've been doing for years.

It was a really easy conversation. We want to continue to evolve as an organisation, and we saw this as a logical progression."

"I actually question the idea that green bonds don't offer a pricing benefit. Our experience, once we got in contact with investors around bringing a product to market, was of a very strong response sufficient to give momentum going into both transactions. I firmly believe we got some pricing benefit, particularly at the back-end through knowing we had good support going into the deals."

"Doing green-bond deals certainly opened our eyes to one thing in particular – that the capital wanting to look at green debt-finance products is growing quite substantially and it just doesn't have the products to invest into."



PATRICK BRYANT
HEAD OF TERM FUNDING
COMMONWEALTH BANK OF AUSTRALIA

"The funding world has changed, in the sense that issuers need to be more aware of their social, environmental and economic impacts. It is a huge focus

for us – just as it would be for most other corporations – to be more engaged and proactive on both social and environmental issues. This is one part of our long-term commitment to focusing on good business practice."

"Right now, what we are not seeing so far is the benefit of a pricing advantage – which I would like to see as an outcome rather than the sole reason for issuing a green or social bond. However, we are starting to see the first signs that there will be a distinct cost advantage to doing green and social bonds – particularly in Europe."

"When CommBank issued its green bond we got the feedback that this is something investors want to see more of, they would like to invest a small amount, and they were doing this based on the assumption that their end investors were interested in the product. We need to see a change in mandates for further growth to happen."



EVA ZILELI
HEAD OF GROUP FUNDING
NATIONAL AUSTRALIA BANK

"Once we decided to pursue a deal we further developed our existing climate-bond framework specifically for social bonds and were mindful of using

this framework for additional SRI issuance. This meant working with our legal and capital-financing teams to develop a robust product that adheres to the ICMA green-bond principles for social bonds."

"There was an overwhelmingly positive response from investors domestically and offshore, with real enthusiasm for the introduction of new

SRI options. But we think it is vital to offer the highest product standards in a new asset class like this, including making sure we have sized the bond appropriately with regard to the reference pool."

"The challenge at present is finding loans in sufficient quantity to support a reference pool for other types of issuance. Although we are not expecting our typical benchmark-sized Australian dollar deals, we view issuance size of around A\$200-300 million as appropriate for these thematic bonds. For now there isn't the volume of assets to issue in all sectors."

SCOTT JENKINS
CHIEF FINANCIAL OFFICER
AUSTRALIAN CATHOLIC UNIVERSITY

"We initially considered bringing a green bond but following NAB's social-equality gender bond we recognised our philosophies encompassed both the ideologies of social and green bonds. When the new sustainability-bond guidelines were released in June 2017 we found a close alignment with ACU's mission of social inclusion, research and development."

"We found it was a really good time to come to market. Investors were very keen to understand the story of ACU – how we operate, our multicampus approach, our impressive student growth and our social and green initiatives."



MOSTYN KAU
HEAD OF GROUP FUNDING
ANZ BANKING GROUP

"There is a very strong dialogue at ANZ between our sustainable-finance and funding teams, that has increased since we issued our green bond."

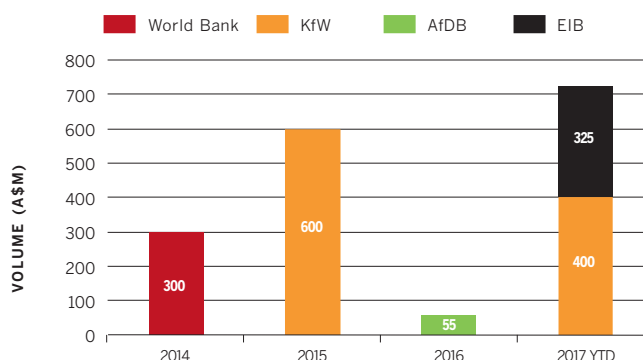
"In general I agree that the market will continue to grow. As the world has become more socially aware, so demand for this product has increased. I would love to see investors become more economically involved in these assets."

MARKET TREND ↑

SSAs continue to hover over Australasian green markets

The first issuer to bring a green bond to the Australian market came from the supranational, sovereign and agency (SSA) sector – and these borrowers continue to be close to the market (see chart on this page). New Zealand saw its first green bond issued in 2017, also by an SSA.

SSA KANGAROO GREEN- AND CLIMATE-BOND ISSUANCE



SOURCE: KANGANEWS 19 OCTOBER 2017

SSA Kangaroo and Kauri green bonds, 2017



Issuer: **European Investment Bank**
Deal type: **climate-awareness bond**
Rating: **AAA/Aaa/AAA**
Pricing date: **25 July 2017**
Maturity date: **3 February 2028**
Volume: **A\$200 million**
Margin: **55bp/swap, 66.5bp/ACGB**
Lead managers: **J.P. Morgan, Nomura, TD Securities (TD)**



Issuer: **International Finance Corporation**
Deal type: **green bond**
Rating: **AAA/Aaa**
Pricing date: **28 July 2017**
Maturity date: **9 August 2027**
Volume: **NZ\$125 million**
Margin: **58bp/swap, 90.5bp/NZGB**
Lead managers: **ANZ, BNZ**



Issuer: **KfW Bankengruppe**
Deal type: **green bond**
Rating: **AAA/Aaa/AAA**
Pricing date: **1 August 2017**

Maturity date: **2 July 2020**

Volume: **A\$200 million**

Margin: **18bp/swap, 35bp/ACGB**

Lead managers: **RBC Capital Markets (RBCCM), TD**



Issuer: **European Investment Bank**
Deal type: **climate-awareness bond**
Rating: **AAA/Aaa/AAA**
Pricing date: **20 September 2017**
Maturity date: **3 February 2028**
Volume: **A\$125 million**
Margin: **54bp/swap, 57bp/ACGB**
Lead managers: **J.P. Morgan, Nomura**



Issuer: **KfW Bankengruppe**
Deal type: **green bond**
Rating: **AAA/Aaa/AAA**
Pricing date: **18 October 2017**
Maturity date: **2 July 2020**
Volume: **A\$200 million**
Margin: **14bp/swap, 24.25bp/ACGB**
Lead managers: **RBCCM, TD**

ISSUER PERSPECTIVES



FRANK CZICHOWSKI
TREASURER
KfW BANKENGRUPPE

"For KfW, green bonds have broadened the investor base – it's surprising, given how long we have been issuing

bonds, that we can still find new investors – and we have also increased the dialogue we have with new and existing investors."



OTTO WEYHAUSEN-BRINKMANN
VICE PRESIDENT AND
HEAD OF NEW ISSUES
KfW BANKENGRUPPE

"We do impact reporting on a portfolio basis. Though we are sometimes asked for individual project

information it is probably not in anyone's interest to do so – because the underlying renewable-energy programme comprises more than 1,000 individual loans each year.

There are also issues of privacy."



KEITH WERNER
CHIEF TREASURY OFFICER
AFRICAN DEVELOPMENT BANK

"Our green-bond framework is relatively conservative. When considering our pipeline

for the rest of the year, the size and maturity available in the Australian market offered us a great opportunity to provide Australian dollar SRI investors exposure to the AfDB name."



FLORA CHAO
SENIOR FUNDING OFFICER
INTERNATIONAL FINANCE CORPORATION

"We met with several investors [in New Zealand] and it's clear

there is a very keen investor interest in green bonds. Now we have done the first New Zealand green issue our hope is either our direct peers or those elsewhere along the credit curve will follow our path to market."

"We were very happy with the fact that domestic banks and fund managers bought a large proportion of the transaction. It is only because the bond is green that some of these accounts were comfortable to go to 10 years."



MARCIN BILL
FINANCIAL OFFICER – FUNDING
INTERNATIONAL FINANCE CORPORATION

"I believe the next stage of SRI market development will be standardisation. We are very much in support of this concept, which includes initiatives like the development of the social-bond

annexe to ICMA's green-bond principles. Social bonds provide an opportunity to fund projects designed to support particular groups of people – in IFC's case this might include female entrepreneurs or those living below the poverty line, or who are under-served in finance, healthcare or education access."



EILA KREIVI
DIRECTOR AND HEAD OF CAPITAL MARKETS
EUROPEAN INVESTMENT BANK

"Investor engagement is a very important part of the green-bond process and actually I feel these conversations have intensified over perhaps the past three years. It is only in this period

of time, for instance, that investors have started demanding detailed impact reporting."



ANDREA DORE
LEAD FINANCIAL OFFICER AND
HEAD OF FUNDING
WORLD BANK

"We would be happy to issue more green bonds in Australia if we see interest from investors looking for climate-focused products. Our goal is to

offer strategic bond issuance for specific investors. We are open to repeating the approach we took with our debut Australian green bond – of building around a lead order."

"The growth of the green-bond market is important, but what's especially interesting is the increasing diversity of issuers. In this context, the integrity of the market is key. The most important factor is ensuring transparency regarding the respective definition and the expected impact of use of proceeds."

MARKET TREND ↑

Australian states dip their toes in green waters

By late 2017, two Australian state funding agencies – Queensland Treasury Corporation and Treasury Corporation of Victoria – had issued green bonds. At A\$750 million (US\$595.8 million), the latter is the local market's largest transaction so far.

Issuer: **Treasury Corporation of Victoria**

Deal type: **green bond**

Use of funds: **low-carbon buildings, renewable energy, public transport and energy-efficient water treatment**

Rating: **AAA/Aaa**

Pricing date: **19 July 2016**

Maturity date: **27 July 2021**

Volume: **A\$300 million**

Margin: **19.75bp/ACGB**

Geographic distribution: **87% Australia, 13% Asia**

Lead manager: **National Australia Bank (NAB)**

Issuer: **Queensland Treasury Corporation**

Deal type: **green bond**

Use of funds: **energy efficiency, clean energy, low-carbon transport and property development, emissions reduction and climate-resilient infrastructure**

Rating: **AA+/Aa1**

Pricing date: **15 March 2017**

Maturity date: **22 March 2024**

Volume: **A\$750 million**

Margin: **33.5bp/ACGB**

Investor type: **35% "dark green", 56% "light green", 9% other**

Lead managers: **ANZ, Bank of America Merrill Lynch, NAB**

ISSUER PERSPECTIVES



GRANT BUSH DEPUTY CHIEF EXECUTIVE AND MANAGING DIRECTOR, FUNDING AND MARKETS, QUEENSLAND TREASURY CORPORATION

"We undertook a domestic roadshow and also placed calls into Europe and the US time zones. Given this was our first green-bond

transaction, we felt it was important to explain the framework, the other parties involved in the transaction and the assets involved."

"We didn't enter into this transaction with preconceived ideas around the shape of the final book – our main objective was to focus on diversification."

"We were particularly pleased by the support from European investors, which was greater than we have seen in our vanilla benchmark transactions of late. We certainly felt we achieved our objectives of investor diversification, including by attracting investors we had not previously seen in our primary books."



JUSTIN LOFTING GENERAL MANAGER, TREASURY, TREASURY CORPORATION OF VICTORIA

"When we combined investor demand with the state government's agenda to invest in climate-change mitigation and adaption strategies, the issuance of a TCV green bond provided a unique opportunity to meet our investor and stakeholder requirements."

"We started off looking to satisfy the needs of SRI-specific mandates, and we have been careful to construct an issue that would meet the requirements of these investors. However, I see no reason why future such transactions cannot have a healthy level of both SRI investors and those without a specific SRI mandate."

"We see the green-bond market as a place where we complement our benchmark bonds through establishing smaller issue sizes. Exploring the possibilities of this growing market also makes good economic sense."

MARKET TREND

Institutional investors circling social-benefit surge

The arranger of Australia's latest social-benefit bond (SBB) says institutional investors are taking a more proactive interest in the asset class – though substantial allocations remain a work in progress. The frequency of impact-investment transactions has grown in 2017. *KangaNews* speaks to arrangers of one of Australia's first and its most recent SBBs about institutional-investor interest.

AUSTRALIAN SOCIAL-BENEFIT BOND PROJECTS

YEAR	ORGANISATION	PROGRAMME	VOLUME (A\$M)	STATE	PURPOSE OF FINANCING
2013	Uniting Care	New Parent Infant Network	7	New South Wales	Diverting children from out-of-home care
2013	The Benevolent Society	Resilient Families	10	New South Wales	Supporting families of children at risk of going into care
2017	Uniting Care	New Parent Infant Network	6	Queensland	Addressing indigenous disadvantage via a programme to reunify children living in out-of-home care with their families
2017	Flourish Australia	Resolve	7	New South Wales	Improving the lives of people with a lived experience of mental-health issues
2017	Churches of Christ	Youth CONNECT	5	Queensland	Support young exiting statutory care and are homeless or at risk of homelessness
2017	Social Ventures Australia	Aspire Programme	9	South Australia	Building independence and resilience of people experiencing homelessness
2017	Life Without Barriers	MST Programme	8.2	Queensland	Reduce reoffending risk for young people in south-east Queensland

SOURCE: NATIONAL AUSTRALIA BANK 27 SEPTEMBER 2017

ARRANGER INSIGHTS

- **Simon Ling** General Manager and Global Head of Debt Markets **Commonwealth Bank of Australia**
- **Craig Parker** Executive Director and Head of Structured and Asset Finance **Westpac Institutional Bank**
- **James Waddell** Director, Capital Markets Origination **National Australia Bank**

How significant is institutional interest in SBB deals?

WADDELL Institutional investors at the Life Without Barriers roadshow were predominantly there to learn – though in a few cases they were actively interested in participating and one major institution did so.

These transactions are currently small so we are really thinking about what sort of interventions governments will pay for that will lend themselves to transactions of scale.

LING When we brought the SBB for The Benevolent Society in 2013, many

investors were very enthusiastic early on but when the rubber hit the road the idea was probably too early for some buyers. It was something very new for the Australian market and a lot of investors didn't know how to value the bond or what benefit it would bring.

PARKER Notwithstanding this, if we were to issue the bond today I think we would be knocked over in the rush of demand. Back then conventional investors would say the bond didn't meet their mandates. So it took us a while to look for sources of investable funds. Today, many portfolios have allocations in their fund-management policies that allow them to participate quite easily in these types of transactions.

What does the future look like for Australian SBBs?

PARKER We knew deals like The Benevolent Society would be what people would learn from and end up as

precedent for future SBBs. That's why the *pro-bono* aspect of the project was so significant – because we knew the future impact would be substantial.

LING We are five years on from when The Benevolent Society's SBB first launched and we are still working on perfecting it. The challenge is that it is massively time consuming for all three parties, so we hope to make the process for SBBs more efficient in future.

There is certainly a lot of activity brewing in the space, but it takes time to build momentum in this type of market.

WADDELL Momentum could come in the health space, where significant challenges are expected in the next 10-20 years, and in housing. Governments are already active in initiatives like the Social and Affordable Housing Fund in New South Wales and there is political will to do more. Impact investing is a trend we are seeing governments engaging in more and more.

CERTIFIED GREEN AND SOCIAL BONDS ISSUED IN AUSTRALIA

DEALS PRICED 1 APR 2014 – 18 OCT 2017

SETTLEMENT DATE	ISSUER	VOLUME (A\$M)	MATURITY	COUPON TYPE	COUPON (%) /MARGIN	BOOKRUNNER(S)	ISSUER/ISSUE RATING		
							S&P	MOODY'S	FITCH
29 Apr 14	World Bank	300	29 Apr 19	Fixed	3.50	RBC, WIB	AAA	Aaa	AAA
16 Dec 14	National Australia Bank	300	16 Dec 21	Fixed	4.00	NAB	AA-	Aa2	AA-
2 Apr 15	KfW Bankengruppe	600	2 Jul 20	Fixed	2.40	JPM, Nomura, RBC	AAA	Aaa	AAA
3 Jun 15	ANZ Banking Group	600	3 Jun 20	Fixed	3.25	ANZ	AA-	Aa2	AA-
27 Apr 16	FlexiGroup	50	1.37 years*	FRN	225/1m BBSW	CB, NAB		NR/Aaa	NR/AAA
3 Jun 16	Westpac Banking Corporation	500	3 Jun 21	Fixed	3.10	WIB	AA-	Aa2	AA-
27 Jul 16	Treasury Corporation of Victoria	300	27 Jul 21	Fixed	1.75	NAB	AAA	Aaa	
15 Dec 16	African Development Bank	55	15 Dec 31	Fixed	3.50	Nomura	AAA	Aaa	
17 Feb 17	FlexiGroup	50	1.49 years*	FRN	127/1m BBSW	CB, NAB		NR/Aaa	NR/AAA
22 Mar 17	Queensland Treasury Corporation	750	22 Mar 24	Fixed	3.00	ANZ, BAML, NAB	AA+	Aa1	
24 Mar 17	National Australia Bank	500	24 Mar 22	Fixed	3.25	NAB	AA-	Aa2	AA-
31 Mar 17	Commonwealth Bank of Australia	650	31 Mar 22	Fixed	3.25	CB	AA-	Aa2	AA-
5 Apr 17	Investa Office Fund	150	5 Apr 24	Fixed	4.262	ANZ	BBB+		
21 Apr 17	Investa Commercial Property Fund	100	21 Apr 27	Fixed	4.25	ANZ, CB	A-		
3 Aug 17	Australian Catholic University	200	3 Aug 27	Fixed	3.70	NAB, UBS		Aa2	
3 Aug 17	European Investment Bank	200	3 Feb 28	Fixed	3.30	JPM, Nomura, TD	AAA	Aaa	AAA
8 Aug 17	KfW Bankengruppe	200	2 Jul 20	Fixed	2.40	RBC, TD	AAA	Aaa	AAA
28 Sep 17	European Investment Bank	125	3 Feb 28	Fixed	3.30	JPM, Nomura	AAA	Aaa	AAA
25 Oct 17	KfW Bankengruppe	200	2 Jul 20	Fixed	3.30	RBC, TD	AAA	Aaa	AAA

*Weighted-average life

CERTIFIED GREEN AND SOCIAL BONDS FROM AUSTRALIAN-ORIGIN ISSUERS ISSUED OUTSIDE AUSTRALIA

DEALS PRICED 1 NOV 2014 – 18 OCT 2017

SETTLEMENT DATE	ISSUER	VOLUME (M)	MATURITY	COUPON TYPE	COUPON (%) /MARGIN	BOOKRUNNER(S)	ISSUER/ISSUE RATING		
							S&P	MOODY'S	FITCH
Nov 14	Stockland Trust Management	€300	Nov 21	Fixed	1.50	HSBC, UBS	A-		
May 15	Hallett Hill No.2 Wind Farm	A\$99	May 27	Fixed	3.78	BNPP, NAB	BBB		
May 15	Hallett Hill No.2 Wind Farm	A\$56	May 27	Fixed	4.78	BNPP, NAB	BBB		
Dec 16	Monash University	A\$30	Dec 31	Fixed	4.74	CB	AA+		
Dec 16	Monash University	US\$37	Dec 31	Fixed	3.64	CB	AA+		
Dec 16	Monash University	US\$50	Jun 33	Fixed	3.80	CB	AA+		
Dec 16	Monash University	A\$70	Dec 36	Fixed	4.90	CB	AA+		
Feb 17	Westpac Banking Corporation	US\$50	Feb 27	Fixed	3.21	WIB	AA-	Aa2	AA-
Mar 17	National Australia Bank	€500	Sep 22	Fixed	0.35	Citi, HSBC, NAB	AA-	Aa2	AA-
Apr 17	QBE Insurance Group	US\$300	Oct 22	Fixed	3.00	CACIB, HSBC, Lloyds, MS	A-	Baa1	A-

SOURCE: BLOOMBERG, KANGANEWS 18 OCTOBER 2017

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