



# Climate Report

## Task Force on Climate Financial Disclosures (TCFD)

# Climate change: the risks and opportunities

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

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

The climate threat is also bringing climate investment opportunity. The latest IPCC report on climate

change mitigation, released in April 2022, identified over 40 categories of decarbonisation opportunity across energy supply, agriculture, forestry, buildings, transport and efficiency technologies. These include ammonia and hydrogen powered ships, zero emissions steel produced using hydrogen, concrete which absorbs carbon, and direct capture of CO<sub>2</sub> from the air.

We measure and report on our climate performance following the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD). Our reporting covers strategy, governance, risk management and the metrics and targets we use to measure and manage our climate performance.

# Our net zero investment targets

We have a 2040 net zero target for our company and other private sector investments; and 2050 for all our investments including government bonds and other public sector investments.

## Why 2040?

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

Our ambitious 2040 target and opportunity is achievable. For global emissions to reach net zero by 2050, the world will need diverse successful zero emissions businesses operating across the economy by 2040. Those zero emissions businesses which are leading in the management of climate risk and opportunity are the businesses we want to invest in, so that by 2040 we can offer our clients high performing, zero emissions portfolios. Setting a net zero 2040 target helps drive increased Australian Ethical capacity and innovation to make this a reality. While IPCC and IEA analysis makes clear the scale of action needed

for global net zero by 2050, current transition paths can still be accelerated through a range of factors including stronger climate policy, more rapid scaling and improvement of clean technologies, and increased corporate ambition and green consumer demand.

## What about public sector investment?

Our 2040 net zero target is for our investment in the private sector. We have a 2050 net zero target for our investment in government bonds and other public sector investments. Governments have a huge role to play in setting policies and allocating capital to drive the transition to net zero. However, we recognise that whereas a company can take action to decarbonise ahead of others, individual countries may have less flexibility to do this when they have responsibilities and activities across the entire economy and society. Some developing economies may be slower to transition, and responsible investors will have a role to continue to contribute capital to support this transition.

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

## Other targets

Our net zero targets are aligned with the emissions reduction needed to achieve a 1.5°C warming limit. We keep our climate objectives and actions updated against the growing impacts of climate change as well as growing opportunities to limit that change. This includes work setting interim emissions reduction targets aligned with the objectives of the Paris Climate Agreement and linked to specific and ambitious concrete action to drive a faster net zero transition.



# 2022 Carbon footprint of our share investments

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

Carbon measure	"Carbon intensity"	"Carbon emissions"	"Carbon exposure"
<b>Description</b>	Investor share of company carbon emissions / Investor share of company revenue	Investor share of company carbon emissions / Amount invested	Average of carbon intensity of companies invested in (weighted by % of investment portfolio)
<b>Climate significance</b>	Measures carbon relative to value of products and services	Measures carbon relative to \$ invested	Measures portfolio exposure to carbon intensive companies
<b>AE share investments</b>	40 <sup>20</sup>	23	50
<b>Benchmark<sup>19</sup></b>	175 <sup>20</sup>	79	153
	t CO2e per \$m revenue	t CO2e per \$m invested	t CO2e per \$m revenue
<b>AE % below Benchmark</b>	<b>77%<sup>20</sup></b>	<b>71%</b>	<b>67%</b>

19. The comparison benchmark is a blended benchmark of the S&P ASX 200 Index (for Australian and New Zealand share holdings) and MSCI World ex Australia Index (for international fund share holdings).

20. Data included in KPMG limited assurance scope. KPMG's assurance opinion is available on [page 57](#).

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

The carbon intensity of our share investments remains about one quarter of the share market benchmark, 77%<sup>20</sup> lower than the market. Since last financial year the carbon intensity of our share investments and the benchmark have reduced by about 16%, with the historical trends shown in the following graph. The other two carbon footprint measures for our share investments are also well below benchmark, though not to the same extent. The differences are due to the different calculation methods, and we discuss later how some of the higher carbon companies we invest in affect the different carbon footprint measures.

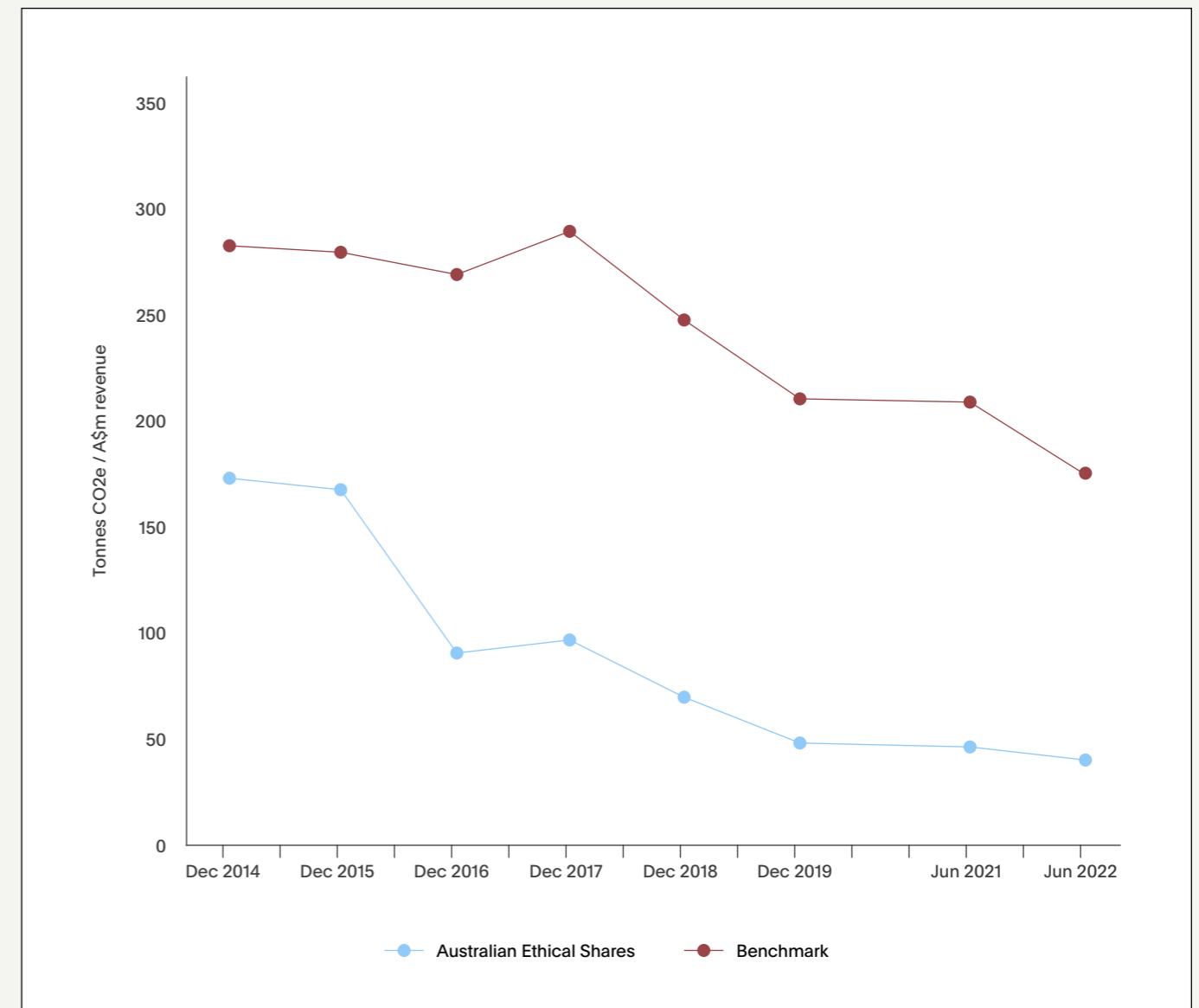
## Why is our carbon footprint low?

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

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

## Carbon intensity of our share investments

This chart shows the carbon intensity of our share investments at the end of calendar years 2014 - 2019 and end of financial years 2021 - 2022. The Benchmark is a blended benchmark of the S&P ASX 200 Index (for Australian and New Zealand share holdings) and MSCI World ex Australia Index (for international fund share holdings). The carbon intensity is calculated from direct and some indirect emissions (Scope 1 & 2 emissions) of the companies relative to their revenue.



**Fossil fuel reserves**

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

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

Our share investments	Share market benchmark
<b>Thermal coal reserves</b>	
Zero	3,133 tonnes CO2 equiv.
<b>Gas reserves</b>	
Zero	307 tonnes CO2 equiv.
<b>Oil reserves</b>	
Zero	229 tonnes CO2 equiv.
<b>Oil sands, shale oil and shale gas</b>	
Zero	149 tonnes CO2 equiv.

**Who are the most carbon intensive companies in our portfolios?**

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

Company	Country	Company Carbon Intensity*	Positive under our Ethical Charter
<b>NEXTDC Limited</b>	Australia	1,153	IT servers and data centre infrastructure. They are energy hungry but overall help efficient use of resources.
<b>Veolia Environnement SA</b>	France	684	Water and waste management and treatment
<b>Allkem Limited</b>	Australia	623	Lithium for Lithium-ion batteries for electric vehicles and storage.
<b>Digital Realty Trust, Inc.</b>	United States of America	557	Data centres
<b>Contact Energy Limited</b>	New Zealand	421	Renewable electricity (hydro and geothermal)
<b>Boral Limited</b>	Australia	413	Building materials including lower carbon concrete
<b>Cleanaway Waste Management Limited</b>	Australia	407	Recycling and waste management
<b>Owens Corning</b>	United States of America	388	Building materials including insulation
<b>CN (Canadian National Railway Company)</b>	Canada	361	Lower emissions transport (rail)
<b>CP (Canadian Pacific Railway)</b>	Canada	343	Lower emissions transport (rail)
<b>Pilbara Minerals Limited</b>	Australia	330	Lithium for lithium ion batteries for electric vehicles and storage.

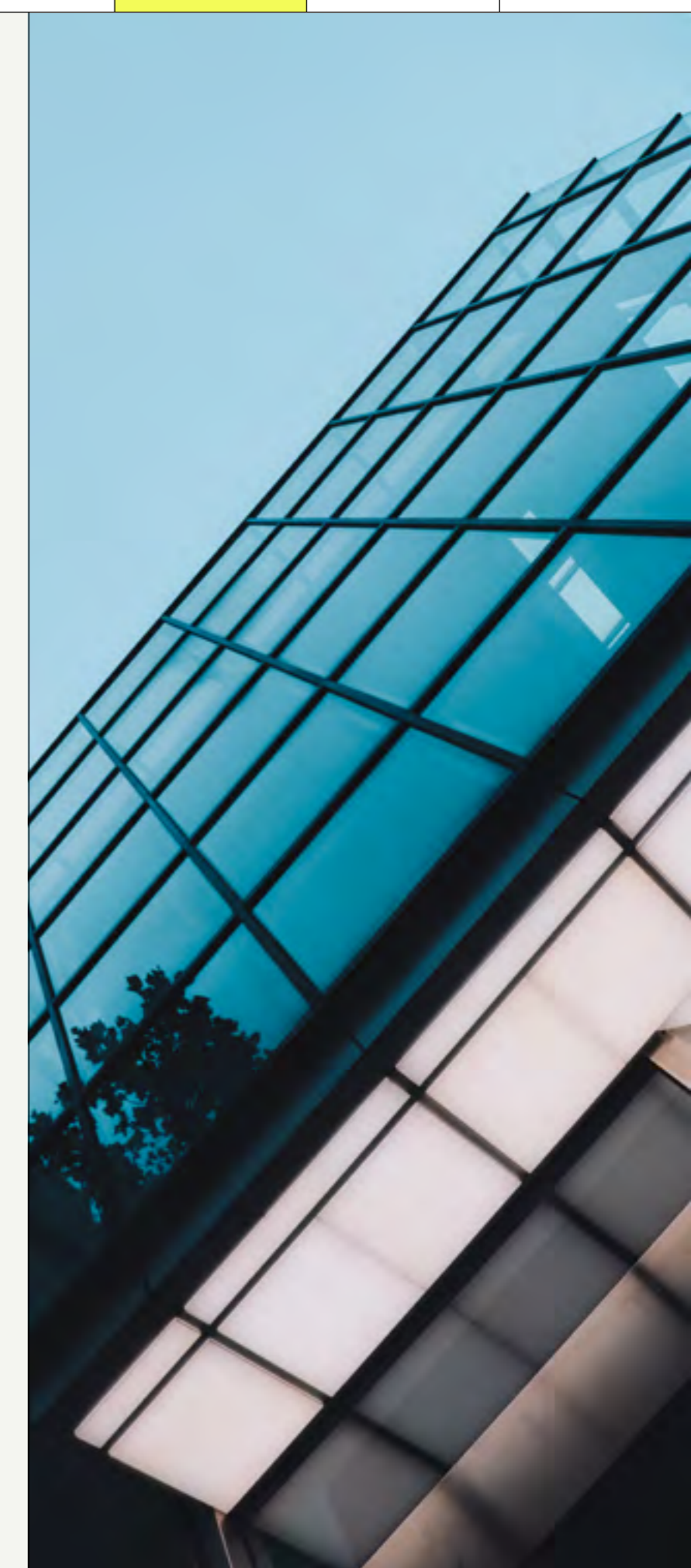
\* t CO2e / A\$M revenue.

**Carbon footprinting methods and limitations**

Company carbon data often includes estimates and errors, and so footprint and reserve calculations need to be used with caution. There are also different measurement methodologies, and different carbon metrics which can be used to assess carbon footprint, each with different strengths and weaknesses. There is more information on [page 104](#).

**Assurance**

KPMG have provided limited assurance over this year's carbon footprinting of our share investments disclosures in our climate reporting. Data points that are covered by the limited assurance are identified in the document. KPMG's assurance opinion is available on [page 57](#).





# 2022 investment in renewables and energy solutions for a zero emissions world

Investment in renewable power generation and other clean energy solutions is critical to support the massive global shift to renewables required to limit warming to 1.5°C. Our analysis this year showed that our share investment in renewables and energy solutions is proportionately 5.6 times that of the share market benchmark<sup>20</sup>.

This includes investment in renewable energy generation from wind, solar, geothermal, biomass, small scale hydro (25 MW or less) and wave tidal energy. Also included are biofuels, waste-to-energy, renewables equipment (e.g. solar inverters and wind turbines), transmission of renewable energy, and batteries and other energy storage supporting renewable energy.

This year we changed the method for calculation of our renewables investment as well as the source of data.

As a result the level of our investment this year is not directly comparable with previous years. There is more information about the change on [page 104](#).

## Impact data by fund and option

For this year's reporting to our customers, we are calculating and reporting climate and other impact-related metrics for individual Australian Ethical managed funds and superannuation investment options. This includes carbon intensity and renewables and energy solutions investment for listed company investments in our funds and options, as well as revenue earned by those companies from products and services contributing towards achievement of the Sustainable Development Goals (SDGs).

<sup>20</sup> Comparison based on shareholdings at 30 June 2022 and using analysis tools and data MSCI ESG Research which cover 88% of the listed companies we hold shares in by value. The comparison benchmark is a blended benchmark of the S&P ASX 200 Index (for Australian and New Zealand share holdings) and MSCI World ex Australia Index (for international fund share holdings). There is more information on [page 104](#).

# The impacts of climate change for our business

Under the emissions scenarios assessed in the 2021 IPCC reports, global average temperature increases are estimated at between 1.4 and 4.4 degrees above pre-industrial levels over the current century. Higher levels of warming will increase the impacts of climate change. The biggest direct impact of global warming on Australian Ethical's business is its effect on our investment portfolios. The prospects and value of the businesses we invest in are exposed to risks and opportunities flowing from the many effects of climate change.

Changes in temperature and rainfall are already affecting the productivity and viability of different types of agriculture. Physical impacts like sea level rise and extreme weather are changing where and how buildings and infrastructure can be safely built, with flow on effects to building and operating costs. Increased flood and

fire risk affects insurance costs, and whether property is insurable at all.

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

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

We've summarised the timing of key climate impacts in the following table. Although the most severe consequences

of climate change may arise only in the longer term, the regulatory and consumer action taken in the short term can accelerate both positive and negative impacts on the value of investments.

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

## Timing of climate impacts

### Short term

#### 0-3 years

- Nearer term physical impacts of temperature increase such as more extreme weather, fires, drought and flooding; and flow-on effects on climate sensitive sectors such as agriculture.
- Changes in customer demand due to evolving expectations for climate action by business.
- Changing government energy and climate policies and regulation such as tougher emissions standards and carbon pricing.

### Medium term

#### 3-10 years

In addition:

- Progressive physical impacts of temperature increase such as increases in sea level, and consequential technological, supply chain and other business and social disruption, including impacts on human health and well-being and buildings and infrastructure.
- Growing pressure on threatened species.
- Disruption of global trade from international disagreements about climate action and inaction. And from changing patterns of production and demand and growth.

### Long term

#### 10-100+ years

In addition:

- Social, political and economic disorder from climate harm suffered by people (including their displacement) and from increased inequality because different groups and countries suffer more harm than others.
- Disrupting effect of potential and actual conflict between countries.



# How we respond to climate change and pursue net zero

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

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

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

## Investment screening

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

Positive and negative investment screening can support change by improving access to capital and lowering cost of capital for positive activities, and restricting access and raising cost for unsustainable activities. It can also have an impact through its signalling effect to companies, governments, consumers and citizens, including by encouraging more ambitious climate action and promoting consumption choices which favour businesses helping to reduce greenhouse gas emissions while shunning big contributors to global warming.

In our day-to-day investing, climate change is the top factor we consider when applying our Ethical Charter

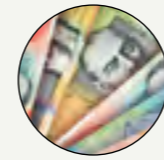
to companies because of its wide-ranging implications for people, animals and the planet. We don't invest in companies assessed to be obstructing the objectives of the Paris climate agreement to limit global warming to well below 2°C and to pursue a limit of 1.5°C. The way this test is applied depends on the company and its sector. Our ethical criteria also take account of the growing climate change threat and our increased climate expectations for companies in climate-critical sectors. For example:



## Energy

We seek out investment in clean energy solutions like energy efficiency, renewable energy and energy storage. Current investments include wind, solar, hydro and geothermal energy, battery storage, LED lighting, insulation, and clean energy technology start-ups (through the Artesian Clean Energy Seed Fund). We don't invest in oil, gas or coal companies, but we will invest in a transition company like Contact Energy which in the last financial year generated 87% of its electricity from hydro and geothermal renewables. Contact is also investing to grow its geothermal capacity to reduce the need to fall back on gas when low rainfall reduces hydro-power generation. When its new Tauhara geothermal project is up and running in 2023 the company expects renewable generation to increase to 95%.<sup>21</sup>

We won't automatically approve renewables companies under our Ethical Charter; we also consider whether they are operating their businesses responsibly. This year we divested from wind energy company Xinjiang Goldwind Science & Technology Co. We were concerned by [reported connections between the company and Uighur forced labour programs](#), and the lack of detail in the company's reporting about its management of human rights impact including human rights due diligence. Last year we divested from Siemens Gamesa Renewable Energy over concerns about use of the company's wind turbines to supply energy for the extraction of natural resources by Morocco in the occupied territory of Western Sahara.



## Financial services

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

This year we divested from Arthur J. Gallagher & Co and The Travelers Companies, Inc for not aligning their insurance services with a transition to net zero in accordance with the Paris Climate Agreement. Insurers and insurance brokers have an important role to help direct new underwriting and capital towards activities which support rather than obstruct a transition to a net zero economy.

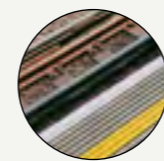


## Food sector

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

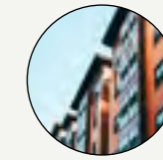
Through the Morrison & Co Growth Infrastructure Fund, we invest in Sundrop Farms which grows truss tomatoes in arid conditions in South Australia. They meet part of their energy needs from a concentrated solar power tower system, and part of their irrigation needs from desalinated sea water.

In our advocacy reporting we describe our involvement this year in carbon farming projects.



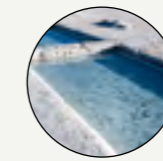
## Transport sector

We restrict investment in conventional cars and trucks and in air travel because of their high emissions intensity compared to rail, ships and buses and other forms of public transport. While we'll invest in low emissions transport like rail, in some cases we exclude companies for their business focus on fossil fuel freight, including Australian Rail Track Corporation (ARTC), Aurizon and Pacific National.



## Real estate sector

We will not invest in general purpose residential, office, retail or commercial property portfolios where they demonstrate below average environmental sustainability, with energy efficiency being a key factor.



## Mining sector

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

## Across sectors

Companies in any sector may be excluded for obstructing the Paris agreement objectives where they are assessed to be obstructing informed climate policy debate; they specialise in servicing the fossil fuel sector; or they show general disregard for energy efficiency in their operations where they are involved in production of emissions intensive products and services. In the building sector this year we excluded James Hardie Industries, Wagners and Brickworks for insufficient strategies and targets to lower the emissions intensity of their key building products. By contrast we assessed Boral and CSR to have credible emissions reduction targets.

21. Contact Integrated Report 2022 [indd.adobe.com/view/73533832-3a70-45c5-9382-bf9ac1f1c1f6](https://indd.adobe.com/view/73533832-3a70-45c5-9382-bf9ac1f1c1f6)

**Influencing companies**

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

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

Further details of our company climate engagement and advocacy are included in the advocacy section of this report, including in the banking, insurance, building materials and food sectors.

**Investment industry influence**

By sharing experience of investment climate opportunities and challenges, we can learn from other investors and encourage broader investor support for strong climate action. We are active participants in the climate focused work of the Investor Group on Climate Change (IGCC) and Climate Action 100+. This year we helped finance and contributed to an IGCC-commissioned report which examined potential new high impact Australian gas projects and the risk of their non-alignment with the Paris Climate Agreement. We share our perspective and experience privately and publicly, including at conferences and panels organised for investors and financial advisors.

**Public climate voice and policy advocacy**

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

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

**Investment portfolio management**

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

As another example, real estate and infrastructure are exposed to many physical impacts of different levels of global warming. Greater extremes of heat and cold raise operating costs and in some cases will threaten operational viability. Increased frequency and severity of wind, fire, storms and flooding across the globe mean many assets will suffer significant damage more often, increasing repair costs and the need for additional investment to protect them. Insurance may provide some short-term protection, but insurance costs will continue to increase. In some cases risks will be so extreme that insurance will become unaffordable, or simply not available at any price. We rely heavily on the management of climate-related risks by our external property and infrastructure managers.



We encouraged companies to show stronger climate ambition, and to demonstrate the action they are taking today to set strategies and allocate capital which puts them on a path to net zero by 2050.



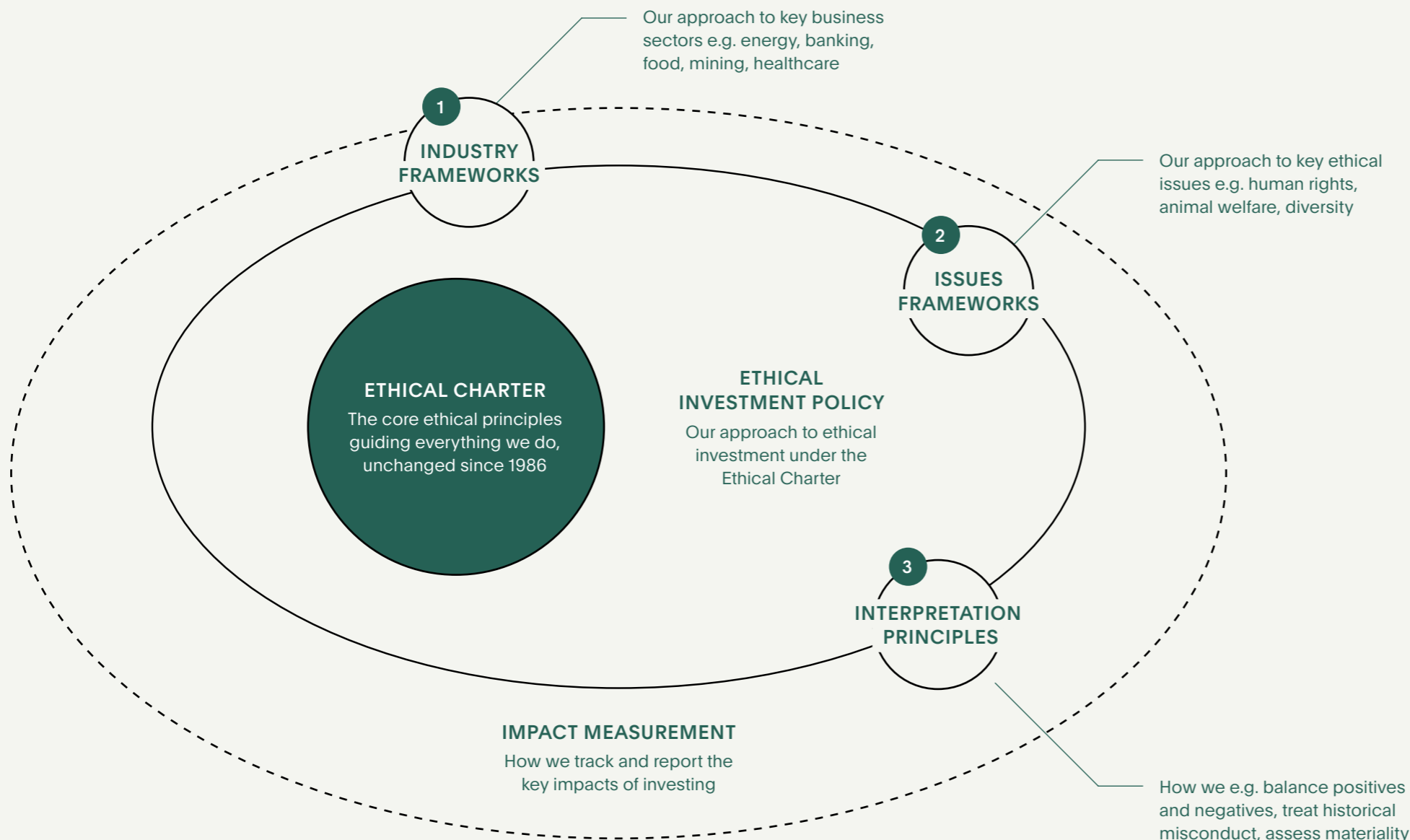
# Governing climate-related decision making

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

Our Chief Investment Officer and Head of Ethics Research are responsible for implementation of our Ethical Charter across our investment activities. They

approve new and updated ethical frameworks, which include our climate-related ethical screening criteria for emissions intensive sectors. The Board of directors has oversight of our ethical frameworks, with quarterly reporting to the Investment Committee and Board of changes to frameworks and critical ethical issues.

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



# Climate risk management

We identify, assess and manage material climate-related investment risks through our ethical investment process. For example, our investment screening and company engagement guides us to sectors and companies which are aligning their businesses with the transition needed to limit global warming to 1.5°C. These companies are better positioned to manage many climate-related risks, such as the risk of introduction or increase in carbon pricing. However, the effects of climate change will be felt across the economy and society. Higher global warming threatens to disrupt trade and financial markets and carries significant risk of loss to all investment portfolios.

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

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

# Measurement, transparency, accountability

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

We discussed our [net zero investment targets earlier in this report](#). We continue to work on setting interim emissions reduction targets which are aligned with the objectives of the Paris Climate Agreement and linked to specific and ambitious concrete action to drive a faster net zero transition.

The current focus of our ethical screening and engagement is the need to reduce emissions to limit dangerous climate change (mitigation of climate change), and the above measurement metrics reflect this mitigation focus. Of course it is also crucial that companies have business models, strategies and assets which are adaptable and resilient to the physical impacts of current and future climate change.

We do not currently report the impact of different emissions and temperature increase scenarios on the value of our investment portfolios. Our ethical investment approach recognises the power which investors have to help positively shape the future, including to help limit climate change which we expect to be positive for our portfolios. By shifting capital from fossil fuels to renewables, investors help to bring down the price of renewable energy and encourage investment in more flexible electricity grids and energy storage. They are also acting in the financial interests of their clients because we believe that risk-adjusted returns will be better in a low-warming world than a high-warming one. We have trialled some external tools to “stress test” our portfolios under different transition scenarios. The insight these provide has been limited by their restricted coverage of the companies and sectors we invest in.



## Our operational emissions

The following table shows our operational emissions for FY22 as well as historical emissions. The last three years’ emissions are significantly higher than the preceding years because we significantly expanded the scope of our measurement from FY20. This year our emissions further increased, with the majority of the increase due to continuing expansion of the indirect emissions we include in our reported footprint. For example, this year we added expenditure on external investment data and technology platforms. In addition, base building electricity use was higher with higher levels of work from the office, and we have expanded the scope of the working from home emissions we capture. Marketing emissions and IT continue to be the single biggest contributors to our operational emissions. While marketing emissions grew in FY22 due to increased marketing spend, emissions intensity reduced with greater inclusion of lower carbon platforms like radio and TV. There’s a more detailed breakdown of last year’s footprint on the following page.

Company	FY18	FY19	FY20	FY21	FY22
<b>Scope 1 &amp; 2 emissions (tonnes of CO2 emissions pa)*</b>	50.1	50.2	0	0	0
<b>Operational Scope 3 (tonnes of CO2 emissions pa)*</b>	36.5	54.7	449.5	349.8	569.6
<b>Full scope emissions per full time equivalent employee*</b>	0.86	0.77	6.9	4.4	5.5
<b>Full scope emissions intensity (total per \$A million revenue)*</b>	2.4	2.6	9.0	5.9	8.0
<b>Full scope emissions per \$A billion funds under management*</b>	31	31	111	57.6	86.6
<b>Offsetting of reported operational emissions</b>	100%	100%	100%	100%	100%

\* Figures are not directly comparable. Emissions measured and reported for FY18 and FY19 were limited to directly metered electricity and business travel with our purchase of renewable electricity incorrectly included under Scope 2 emissions. In each subsequent year we have expanded the scope of our operational emissions foot printing, increasing the emissions we report.

**Reducing emissions**

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

**Offsetting emissions**

We continue to offset our reported operational emissions. Carbon offsetting plays an important role for companies on the journey to net zero by 2050, provided they recognise the imperative to minimise emissions as much as possible before offsetting what remains. When offsetting our operational emissions, we look for opportunities for carbon abatement which also deliver additional benefits to people, planet and animals.

This year we offset our operational footprint with several different types of carbon credits. For half we continued to offset with ACCU carbon credits from Arnhem Land Fire Abatement (ALFA), an organisation created by Aboriginal landowners to support their engagement in carbon farming in Arnhem Land in the Northern Territory. ALFA support traditional owners to manage fire projects across an area of more than 80,000 square kilometres, encompassing savanna, sandstone escarpments, monsoon rainforest, river ecosystems, floodplains, and remote coastal areas. Through their partnership with community-based Aboriginal ranger groups, ALFA supports Traditional Owners in utilising customary fire knowledge to accomplish largescale fire management on country. Our purchase of ALFA carbon credits is aligned with the funding our Foundation has provided to the Mimal Land Management Aboriginal Corporation (Mimal) women's program via the Karrkad Kanjdji Trust. Ranger programs and the income they generate from offsetting programs have wide reaching benefits, not just for the climate but for the communities and people involved, as well as preserving species, land and culture.

We have purchased two other types of carbon credit for the other half of our offsetting. We purchased "Verra - REDD+ VCU" credits from the Rimba Raya Biodiversity Reserve, which protects critical rainforest and habitat from deforestation as well as supporting local employment, education and healthcare. We also purchased "Verra - VCU" credits from Indian wind projects contributing renewable energy to regional electricity grids in the Indian states of Andhra Pradesh, Madhya Pradesh, Rajasthan and Telangana.

**Detailed breakdown of our operational carbon footprint**

Activity/Service	Activity Data	Units	Emissions (tCO <sub>2</sub> -e/yr)	Percentage
<b>Utilities</b>				
Electricity	50,517.7	kWh	0.000	0.0%
Base Building Electricity	68,918.4	kWh	41.120	7.2%
Carbon Neutral Electricity	3,195.7	kWh	0.000	0.0%
Telecommunications	73,970.5	\$	11.499	2.0%
Water	0.2	ML	0.509	0.1%
Base Building Water	0.1	ML	0.000	0.0%
<b>Equipment</b>				
IT Equipment	20,070.7	\$	2.728	0.5%
Printing and Stationery	84,702.5	\$	21.842	3.8%
Merchandising	11,292.3	\$	4.287	0.8%
Office Furniture	29,260.0	\$	5.124	0.9%
<b>Employees</b>				
Employee Commute	228,627.0	passenger. km	20.962	3.7%
Working From Home	378,078.0	h	58.744	10.3%
<b>Flights</b>				
Business Flights	161,352.4	passenger. km	29.670	5.2%
<b>Transport Fuels-SCOPE 3</b>				
Privately owned/ controlled	1,837.3	L	4.475	0.8%
<b>Stationary Fuels</b>				
Diesel oil	9.1	L	0.026	0.0%

Activity/Service	Activity Data	Units	Emissions (tCO <sub>2</sub> -e/yr)	Percentage
<b>Third Party Services</b>				
Cleaning Services	54,708.6	\$	5.996	1.1%
Food & Catering	81,863.7	\$	16.019	2.8%
Postage	18,340.3	\$	4.339	0.8%
Couriers	2,651.9	\$	0.611	0.1%
Computer and technical services	600,732.8	\$	83.314	14.6%
Domestic Hotel Accom.	213.0	occupancy. nights	12.209	2.1%
International Hotel Accom.	19.0	occupancy. nights	0.263	0.0%
External Paid Media			124.440	21.8%
Taxi	39,449.5	\$	2.299	0.4%
Rideshare	3,990.1	\$	0.427	0.1%
Software	297,512.4	\$	48.551	8.5%
Services to Finance and Investment	908,800.0	\$	45.038	7.9%
Security Broking and Dealing	632,088.9	\$	18.469	3.2%
Miscellaneous Manufacturing	8,988.1	\$	3.412	0.6%
<b>Food &amp; Beverage</b>				
Drinks (Wine & Spirits)	1,158.9	\$	0.213	0.6%
Drinks (Soft drinks)	1,158.9	\$	0.075	0.0%
<b>Synthetic Gases</b>				
Refrigerant	1.5	kg of refrigerant	1.966	0.0%
<b>Waste</b>				
Landfill	0.6	t	0.818	0.3%
Recycling	0.2	t	0.0	0.1%
<b>Gross total</b>	<b>569.6</b>			<b>100%</b>

Activity values presented in this table may be a derived number expressed as the quantity unit for use with the NGA factors workbook or NGER (Measurement) Determination (whichever is relevant) as converted from raw data supplied.



Independent Limited Assurance Report to the Directors of Australian Ethical Investment Limited

**Conclusion**

Based on the evidence we obtained from the procedures performed, we are not aware of any material misstatements in the Selected Sustainability Information, which has been prepared by Australian Ethical Investment Limited in accordance with Management’s Reporting Criteria as reported at 30 June 2022.

**Information Subject to Assurance**

The Assured Sustainability Information as at 30 June 2022, as presented in the 2022 Sustainability Report (“the Report”) and available on the Australian Ethical Investment Limited (AEI) website, is comprised of the following:

Assured Sustainability Information	Value
Carbon footprint of AEI equity share portfolio (tCO2e per AUD \$ million revenue)	40
Carbon footprint of the blended S&P ASX200 Index and MSCI World ex Australia Index benchmark (tCO2e per AUD \$ million revenue)	175
Relative carbon intensity reduction of AEI equity share portfolio compared to the blended S&P ASX200 Index and MSCI World ex Australia Index benchmark (%)	77%
AEI portfolio-level sustainable impact revenue per \$1 million invested (\$USD) relative to a blend of the S&P ASX 200 Index and the MSCI World ex Australia Index (“the market”) (times market)	1.8
Affordable Real Estate sustainable impact revenue per \$1 million invested relative to the market (times market)	1.0
Alternative Energy sustainable impact revenue per \$1 million invested relative to the market (times market)	4.4
Connectivity sustainable impact revenue per \$1 million invested relative to the market (times market)	7.9
Education sustainable impact revenue per \$1 million invested relative to the market (times market)	14.6
Energy Efficiency sustainable impact revenue per \$1 million invested relative to the market (times market)	2.6
Green Building sustainable impact revenue per \$1 million invested relative to the market (times market)	3.5
Major Disease Treatment sustainable impact revenue per \$1 million invested relative to the market (times market)	0.3

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Assured Sustainability Information	Value
Nutrition sustainable impact revenue per \$1 million invested relative to the market (times market)	0.7
Pollution Prevention sustainable impact revenue per \$1 million invested relative to the market (times market)	3.5
Sanitation sustainable impact revenue per \$1 million invested relative to the market (times market)	0.6
SME Finance sustainable impact revenue per \$1 million invested relative to the market (times market)	1.1
Sustainable Agriculture sustainable impact revenue per \$1 million invested relative to the market (times market)	4.5
Sustainable Water sustainable impact revenue per \$1 million invested relative to the market as at 30 June 2021 (times market)	4.4

**Criteria Used as the Basis of Reporting**

The applicable criteria used as the basis of reporting by Management has been developed by AEI management (“the criteria”), and is presented in the Report.

**Basis for Conclusion**

We conducted our work in accordance with Australian Standard on Assurance Engagements ASAE 3000 (Standard). In accordance with the Standard we have:

- used our professional judgement to plan and perform the engagement to obtain limited assurance that we are not aware of any material misstatements in the Selected Sustainability Information, whether due to fraud or error;
- considered relevant internal controls when designing our assurance procedures, however we do not express a conclusion on their effectiveness; and
- ensured that the engagement team possess the appropriate knowledge, skills and professional competencies.

**Summary of Procedures Performed**

Our limited assurance conclusion is based on the evidence obtained from performing the following procedures:

- enquiries with relevant AEI personnel to understand the internal controls, governance structure and reporting process of the Selected Sustainability Information;
- reviews of relevant documentation;
- analytical procedures over the Selected Sustainability Information;
- walkthroughs of the Selected Sustainability Information to source documentation on a sample basis;



- evaluating the appropriateness of the criteria with respect to the Selected Sustainability Information; and
- reviewed the 2022 Sustainability Report in its entirety to ensure it is consistent with our overall knowledge of assurance engagement.

**How the Standard Defines Limited Assurance and Material Misstatement**

The procedures performed in a limited assurance engagement vary in nature and timing from, and are less in extent than for a reasonable assurance engagement. Consequently the level of assurance obtained in a limited assurance engagement is substantially lower than the assurance that would have been obtained had a reasonable assurance engagement been performed.

Misstatements, including omissions, are considered material if, individually or in the aggregate, they could reasonably be expected to influence relevant decisions of the Directors of AEI.

**Use of this Assurance Report**

This report has been prepared for the Directors of AEI for the purpose of providing an assurance conclusion on the Selected Sustainability Information and may not be suitable for another purpose. We disclaim any assumption of responsibility for any reliance on this report, to any person other than the Directors of AEI, or for any other purpose than that for which it was prepared.

**Management’s responsibility**

Management are responsible for:

- determining that the criteria is appropriate to meet their needs;
- preparing and presenting the Selected Sustainability Information in accordance with the criteria; and
- establishing internal controls that enable the preparation and presentation of the Selected Sustainability Information that is free from material misstatement, whether due to fraud or error.

**Our Responsibility**

Our responsibility is to perform a limited assurance engagement in relation to the Selected Sustainability Information as at 30 June 2022, and to issue an assurance report that includes our conclusion.

**Our Independence and Quality Control**

We have complied with our independence and other relevant ethical requirements of the *Code of Ethics for Professional Accountants (including Independence Standards)* issued by the Australian Professional and Ethical Standards Board, and complied with the applicable requirements of Australian Standard on Quality Control 1 to maintain a comprehensive system of quality control.

KPMG

Sydney  
22 November 2022

# Methods & limitations of investment impact measurement including carbon footprinting and sustainable impact revenue

## General limitations of impact measurement and data

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

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

Caution should be exercised when considering impact data because of its limitations, and because past performance is not a reliable indicator of future performance. Impact data is only one factor that may be considered when making an investment decision and this information should not be taken as a recommendation to buy, sell or hold a particular financial product. It is important to consider financial characteristics of investments (including fees and investment risk) when assessing potential investments to pursue your financial and other objectives.

## Carbon footprint metrics and data

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

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

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

More information on carbon footprinting methodology and metrics is available [here](#).

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

## What's not included in carbon footprint metrics

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

The same double counting issues apply to products that result in emissions reductions ('avoided emissions'), for example solar panels which over their life can reduce emissions by displacing other sources of electricity production like fossil fuels. These emissions savings are much more relevant to our ethically screened investment portfolios. It's important to calculate and allocate these savings, to help us better understand what emissions savings our investments are supporting.

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

## Sustainable impact including renewable and energy solutions data

We have used sustainable impact revenue data and analysis tools provided by MSCI ESG Research LLC for the sustainable impact revenue data in the Sustainable Development Goals (SDGs) section of this report and for the comparison of our investment in renewables and energy solutions in the climate section of this report. The links with the SDGs are based on links Australian Ethical has determined between MSCI's categories of sustainable impact solutions and selected SDGs.

Company reporting of the revenue they earn from different products and services may be inaccurate or incomplete, and MSCI may make estimates in breaking down and categorising company revenue. There are different methodologies and frameworks for classifying sustainable products and services and for taking account of negative impacts of a company's operations.

We changed the method for calculation of our renewables investment this year as well as the source of data. As a result the level of our investment this year is not directly comparable with previous years. One difference is that the new method does not include investment in renewable energy from large scale hydro, instead only lower footprint small scale hydro is included. Large scale hydro is excluded because of concerns about the social and environmental impacts of building big dams. Although we assess new large scale hydro dams as negative under our Ethical Charter, we will invest in companies like Contact Energy and Mercury which generate electricity from large dams that were built in the last century. Under the new method we only include that part of our investment in companies like Contact Energy and Mercury proportionate to their revenue from renewables other than large scale hydro. Another change is that the comparison now includes – in addition to renewable energy generation – investment in biofuels, waste-to-energy, renewables equipment (e.g. solar inverters and wind turbines), transmission of renewable energy, and batteries and other energy storage supporting renewable energy.

**Use of MSCI ESG Research LLC tools and data; Listed shareholdings at 30 June 2022; Timing of running of reports**

We used the MSCI ESG Research tools and data for our calculations and reporting this year on 22 July 2022, against shareholdings and benchmark weights at 30 June 2022. The analysis and comparison to benchmark is based on listed shares in those companies for which we have relevant data available from MSCI, being 88% of our listed share investments by value and over 99% of benchmark shares by value. MSCI ESG Research is not responsible for the way we have used their data and tools or for the information we have reported.<sup>4</sup>

More information on MSCI carbon footprinting and sustainable impact methodology and metrics is available here:

- <https://www.msci.com/documents/10199/2043ba37-c8e1-4773-8672-fae43e9e3fd0>
- [https://www.msci.com/documents/1296102/1636401/ESG\\_ImpactMetrics-2016.pdf/0902a64f-af8d-4296-beaa-d105b7d74dc3](https://www.msci.com/documents/1296102/1636401/ESG_ImpactMetrics-2016.pdf/0902a64f-af8d-4296-beaa-d105b7d74dc3)

For our annual sustainability reporting we update key metrics using MSCI ESG Research tools and data based on listed equities holdings and benchmark weights as the end of the financial year (30 June). Although this portfolio and benchmark composition doesn't change, the output of the analysis tools will change depending on when we run the analysis using the MSCI tools. This

year we ran the MSCI reports on 22 July 2022. Running the reports later can mean that company data is more current, because of the lag in company reporting and in MSCI's updating of company footprints. It can also affect results because the MSCI tool uses the market capitalisation of companies at the time the report is run. These effects apply to the analysis both of our listed shareholdings and of benchmark holdings.

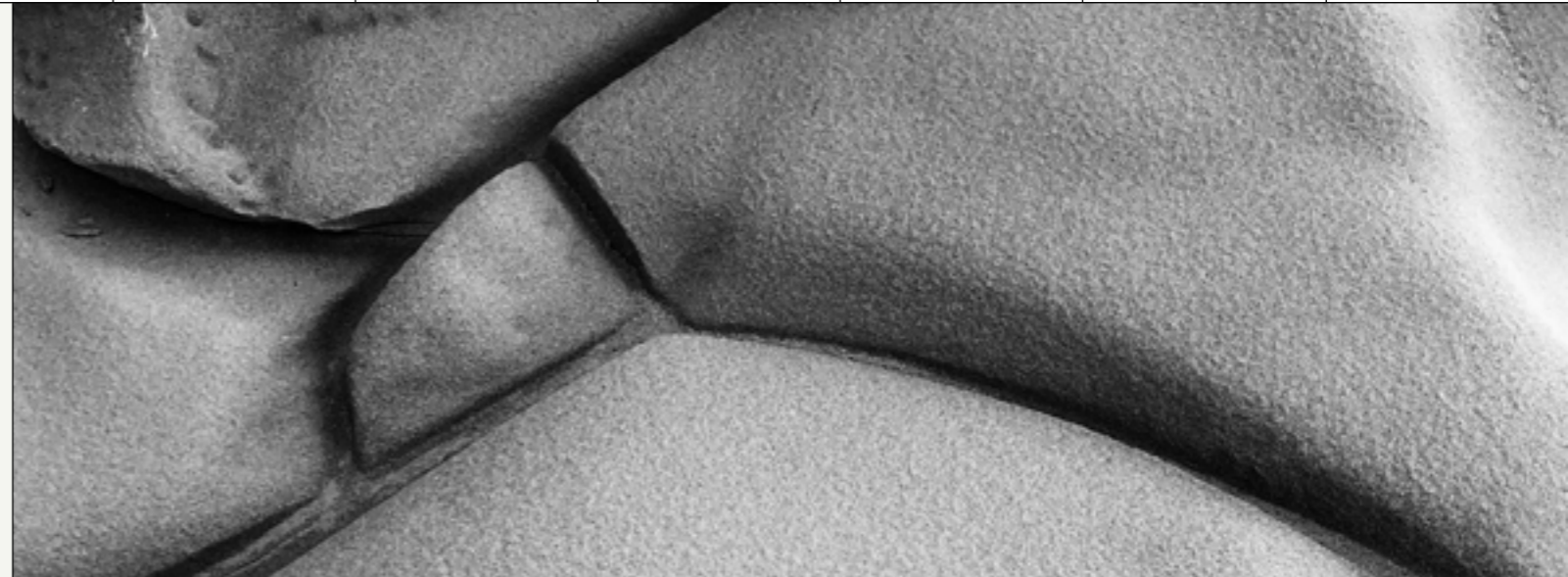
**Choice of benchmark for comparisons**

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

**Currency considerations**

Some of the data we use is provided in US\$ terms, and some of this data has been converted to US\$ using exchange rates selected by the data provider. Where we have needed to convert to A\$ for reporting of this this year's information we have used an average exchange rate as published by the Australian Taxation Office for the 2022 financial year.

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