The Net Zero Investment Consultants Initiative – Frontier Advisors Annual Report

November 2023

Frontier Advisors

Contents

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Frontier – Description of services

Frontier has been advising Australian institutional investors as a full-service asset consultant since 1994. We provide advice on around A$630 billion of assets across the superannuation, charity, public sector, insurance and higher education sectors. Frontier also has a proprietary investment technology offering.

The majority of our asset owner clients engage Frontier on a full-service, retainer basis, though we also regularly complete project assignments for a range of investors. Additionally, several investors subscribe to our technology platform with no other formal engagement with Frontier. All of Frontier's revenue is generated via the provision of investment consulting and technology subscription services. We do not offer discretionary asset management services or investment products.

Frontier's advisory services cover areas which include investment policy and related issues, strategic and dynamic asset allocation, capital markets updates, sector configuration reviews, investment manager research, policy and governance, responsible investment, regular reporting and other specialist services such as advice and due diligence for direct real assets. We also provide a technology platform that gives clients access to tools and research to guide their investment analysis and decision making.

Frontier's progress toward commitments

Commitment 1. Integrate advice on net zero alignment into all our investment consulting services as soon as practically possible and within two years of making this commitment.

We began integrating net zero considerations into our client advice before joining NZICI and continue to refine our approach with that commitment in mind. Responsibility for leading and overseeing this effort lies with our Responsible Investment Group, which consists of senior representatives across the business and determines the firm's responsible investment strategy. Execution of the strategy is the responsibility of all research and consulting personnel, with the Responsible Investment Team providing support and developing specialist services.

For the year ended 31 December 2022, there were a range of examples of net zero related activities undertaken across the firm as noted in the following:

- We included considerations relating to net zero alignment in clients' sector configuration reviews.
- In our annual Property configuration review, we provided guidance on the definition of net zero, and what was involved in setting a net zero target for a property portfolio. We also provided an outline of a 'roadmap' for net zero alignment within that sector and illustrated some of the present challenges in establishing alignment.
- Our Real Assets Team's sector configuration was further complemented by two dedicated research publications which explored the concept of net zero as it applied to a property configuration and the issues to be navigated in seeking net zero alignment.
- We have provided guidance in our listed equities configuration reviews on different approaches for clients to decarbonise their listed equities portfolios.
- The fixed interest and debt configuration reviews provided information on some of the climate-aligned bond indices that could be accessed and their performance characteristics to date. This was designed to enhance understanding of managing climate change risks and opportunities with a fixed interest or debt portfolio. We have also conducted internal training on net zero that was made available to all research and consulting staff. This session covered definitions of net zero, investor frameworks, and the tools and analytics that are available to assist clients. The session also covered a client case study with an outline of their journey undertaken so far and an indication of the challenges along the way. The training session was widely available and documentation was produced that has been used to introduce clients to net zero on a targeted basis.

Led by the Responsible Investment Team, we are currently developing a more wholistic net zero service framework for clients to assist them in aligning to net zero investment objectives. This is expected to cover a comprehensive range of activities as identified by the more widely accepted net zero investment frameworks such as NZAOA and the PAII, with a focus on those areas where we consider there is a strong complement with our existing advisory and research services.

Key performance indicators representing progress metrics on our net zero journey are provided in Appendix A.

Commitment 2. Work with our institutional asset owner clients to identify the investment risks from climate change, highlight the importance of net zero alignment and, where applicable, support our clients in developing policies that align their portfolios to a net zero pathway.

Our client base includes different asset owner types with a wide range of assets under management, depth of internal investment teams, and resources. Our larger clients who have been addressing climate change for several years now are relatively well-progressed with establishing net zero commitments and implementing towards alignment. For these clients, there has limited need to assist with revising investment policies or to provide foundational education that addresses net zero alignment. These milestones and practices have already been established by and large. For small to medium sized clients, we have conducted education programs for a number of trustee boards and senior internal teams that progressed their understanding of climate change and in particular, what net zero entails. We have also been actively involved in reviewing and developing investment and responsible investment policies for this segment of clients that integrate net zero alignment or enable that alignment to occur.

To assist clients with identifying the investment risks from climate change, we have quantified investment risks as in the form of forecasted return impacts on specific asset classes under various temperature scenarios that emphasise either transition or physical risks. This includes a 1.5-degree scenario aligned to both smooth and delayed policy responses. This is a top-down approach which illustrates the differing time scales of these categories of risks, plus the regional markets that are potentially more at risk. We plan to continue enhancing and complementing this with other quantitative analysis such as bottom-up scenario analysis and stress testing.

In addition to broader support for our client base in aggregate, we have conducted bespoke research for individual clients to explore material and effective means for decarbonising their portfolio in the short to medium-term, while aligning with their stated investment objectives. For some clients embarking on the journey of addressing climate change, we have conducted workshops with their Boards and Investment Committees to canvass their unique beliefs and philosophies. This both educates and identifies points of tension that should be addressed before formulating a climate change policy.

Appendix C provides a summary of the development of Frontier's climate reporting service which was launched during the reporting period.

Commitment 3. Support efforts to decarbonise the global economy by helping our clients prioritise real economy emissions reductions, reflecting the target of 50% global emissions reduction by 2030 or sooner using existing decarbonisation methodologies.

We have been meeting frequently with asset managers that are providing investment products with climate solutions within a framework that potentially meets clients' risk-adjusted return objectives. Several of these products have progressed to full ratings and we have subsequently seen clients allocating capital to these strategies.

We also have provided clients with research publications that presented to them opportunities to invest in activities that contribute to the decarbonisation of the real economy. Examples include research papers on renewable energy, the energy transition, and battery storage with a focus on specialised investment programs. We also hosted a session at our annual client conference on proptech and energy efficiency measures that could be harnessed within a property portfolio.

We have communicated internally, with clients, and publicly with the broader industry that our 'house-view' definition of a net zero commitment is not premised on shorter-term, accounting-based, reductions in the emissions profile of the portfolio but should instead be focused on driving emission reductions in the real economy. We emphasise that this is a more complex and potentially challenging task than simply reducing one's 'footprint'. We have assisted clients in identifying and assessing investment opportunities that support this effort. These include strategies in listed equities (low carbon and thematic products), property and infrastructure, several of which have been rated formally. The top-down research we conducted in carbon derivatives, renewable energy and the energy transition, has been followed by identifying investment products through which clients are most likely to gain favourable access to this theme.

Commitment 4. Assess and monitor asset managers on the integration of climate risks and opportunities in their investment decisions and stewardship and reflect this evaluation in our client recommendations.

Climate change is a standing element in our ESG-related research and monitoring of asset managers, and it has been designated as one of the key assessment areas in our product rating process. While a standard consideration, our ESG assessment framework allows for individual flexibility in the climate change approach taken by managers given their investment strategies and objectives will of course vary widely. We also include in our manager questionnaires for listed equities and unlisted property and infrastructure, specific questions on emissions profile, target setting, use of offsets and revenue proportions linked to climate solutions. Our specialist sector research teams have primary responsibility for undertaking the analysis and determining our view on a given manager's approach on ESG, meaning that they can bring their full domain expertise to this process rather than ESG being a separate consideration.

The capability and credibility of asset managers with respect to climate change competency and net zero integration are meaningful drivers of an investment product's rating on ESG and rating overall. Clients are readily able to compare asset managers across these dimensions when selecting investment products from our rated manager lists. We are in the process of revising and updating the formal process of assessing and monitoring asset managers in light of net zero considerations and in particular our NZICI commitments.

Our annual property configuration review provided a comprehensive list of Australian unlisted property managers that are positively rated by Frontier. This list provided an outline of what net zero commitments they have made with scope of emissions and timeline of interim targets. This was designed to inform clients the strength of the commitment that the domestic property managers they have exposure to have undertaken. We have also provided recommendations to clients in specific research publications that have identified asset managers with specialist skills in the energy transition and in proptech. Exposure to these themes provides clients with an opportunity to invest in climate change solutions that advance the economy towards decarbonisation.

Commitment 5. Align with the Net Zero Asset Manager Initiative as soon as practically possible and within two years of making this commitment

We do not offer discretionary services to clients, so this commitment is not directly applicable.

Commitment 6. Set emissions reduction targets across all our operational emissions in line with 1.5°C scenarios.

As a professional services firm, our carbon emissions from operational activities are relatively low in intensity compared to the broader economy. In terms of emissions from ongoing business activities, these primarily relate to energy use from office occupancy and from air travel. We have been quantifying the Scope 1 to 3 emissions from these activities since July 2020. Our property manager has provided guidance on the emissions associated with office occupancy and we have referred to a specialist provider regarding the calculated emissions from air travel. These emissions are summarised for the year ended 31 December 2022 in Appendix B of this report. We are in the process of exploring options to offset current and ongoing emissions. We will consider actioning such options once we have assurance that such offsets are available with sufficient credibility and that are cost-effective, along with considering other actions to reduce emissions over time.

Our estimated operational emissions are provided in Appendix B.

Commitment 7. Where suitable net zero methodologies do not exist, work collaboratively for the benefit of our clients to address these challenges, seeking harmonised methodologies.

We are investigating methodologies for net zero alignment in asset classes that are more challenging such as private debt, cash and derivatives. We have been engaging with specialist third party providers and collective initiatives with a view to contributing to and adopting a standardised approach. This endeavour is at a preliminary stage while we focus on implementation for asset classes such as listed equities and real assets where the methodologies are more established.

Commitment 8. Engage, independently or as a group, with regulators and policymakers, to facilitate the transition to net zero carbon emissions, addressing any barriers to our clients adopting and achieving their net zero targets.

We have undertaken discussions with Australia's prudential regulator, APRA, on overall client positioning toward managing climate change risk with some exchange of ideas on how best to overcome existing barriers to implementation. We expect this kind of dialogue to be further enhanced once the understanding and adoption of net zero investment programs becomes more widely undertaken.

We have also regularly attended meetings and workshops with industry groups, such as the IGCC, to keep abreast of engagements on policy and regulations. The IGCC is actively involved in policy discussions with government and other key participants, on behalf of members.

Commitment 9. Report progress by our firm against the commitments made here at least annually in public domain.

The information contained in this report sets our progress on our NZICI commitments in line with the framework agreed to by its signatories. The report will be published annually on our company website.

Appendix A – Summary of key performance indicators

We present the key performance indicators (KPI) that have been agreed to as part of the Reporting Framework obligations.

Metrics are presented as at 31 December 2022.

Table 1 – Key performance indicators

KPI	Description/type	Number of clients	Assets under management ($bn AUD)
1.	Meaningful education	12	338.8
2.	Baseline carbon emissions data	14	516.6
3.	Net zero ambition	10	509.6
4.	Net zero target/intention to be Paris-aligned	5	210.4
5.	Climate solutions	6	183.7

Regarding KPI 1), we reiterate here that some of our larger clients are well progressed in developing policies and implementation programs to address climate change issues and achieving net zero alignment. These clients are sufficiently resourced to have organised for education on net zero alignment; there is not a direct need to assist these clients with meaningful education in this area.

We note that at present, there is no formal regulatory obligation for institutional asset owners to articulate and implement a climate change risk management approach, decarbonisation/net zero strategy, or report on climate-related financial risks.

The Australian Government has taken steps over recent years to encourage voluntary action on climate change by asset owners and investors more generally and it is expected that mandatory climate reporting will come into force from 1 July 2024 (with the first reporting period ending 30 June 2025). It is expected that these regulatory developments will meaningfully drive the uptake of asset owner actions around climate change competency and decarbonisation.

Appendix B – Estimated operational emissions

A summary of our operational emissions is set out in Table 2. While there are some activities that are not included in these estimates, those not covered below are marginal in terms of the quantum of carbon emissions. Hence, the estimates below cover the vast majority of our operational emissions footprint.

Table 2 – Estimated operational emissions for the calendar year ended 31 December 2022

Emissions category	Estimated emissions (kg CO_2-equiv.)
Scope 1 + 2	109,117
Scope 3	41,270
Total	**150,387**

Note: The Scope 3 emissions are unadjusted estimates relating to flight activity. They do not include a loading factor for the intensified impacts of flight activity at higher altitudes, as recommended by the UK Department for Environment Food & Rural Affairs (DEFRA).

Appendix C – Case study: Carbon/climate reporting service

Frontier undertook a lengthy process to establish a carbon emissions/climate reporting service for our small to medium sized clients who typically did not previously have access to such services due to a lack of direct access to relevant data, limited internal resources, and cost constraints for each individual asset owner.

After an initial screening of a range of service providers, we entered trial subscriptions to test the service offerings of a select number of providers. This culminated in the selection of a preferred service provider and establishing a partnership enabling Frontier to provide carbon emissions/climate reporting to eligible clients. Under this agreement, we offer clients reporting on carbon emissions in their externally managed portfolios covering the more conventional metrics including exposures to fossil fuel revenues, some forward-looking metrics such as estimated future emissions from fossil fuel reserves, and exposure to companies with climate-aligned solutions in their revenue base.

In addition to reports available to the clients for individual manager portfolios, we have developed in-house asset class configuration or 'Fund of Fund' reports that illustrate the relative contribution individual managers make to a sector configuration. This is crucial a starting point for most of the clients we expect to be servicing under this arrangement, as it will assist them establish baselines for target setting towards a net zero objective. This will also provide guidance to clients on manager selection and allocation, and effectively engaging with those managers to progress towards their net zero target.

The current scope of the reporting service extends to listed equities and corporate debt. We are mindful the asset class coverage will need to extend to other asset classes, particularly unlisted property and infrastructure and are considering options in these sectors.

We also acknowledge the reporting of carbon emissions and climate metrics will be largely based on historical data and there will be a need to evolve to where forward-looking metrics and analysis are employed to examine carbon/transition risks more comprehensively. However, our current service proposition is a reasonable starting point for these clients to better understand the relevant exposures in their portfolios, and to begin the process of integrating climate change considerations into portfolio construction and developing an implementation plan within a net zero investment framework.

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