Climate risk and our investments

October 2024

Investing in a bright future

Message from the Chief Investment Officer

Welcome to the seventh edition of *Climate risk and our investments*.

John Pearce
Chief Investment Officer

Whilst decarbonisation remains the most pervasive theme of our generation, it is becoming increasingly evident that the path to net zero is not going to be linear.

Ambition is meeting pragmatism as governments grapple with the trilemma of energy security, affordability, and reliability. Some corporates are now pulling back on overly optimistic 2030 targets. Investors are reluctant to invest in greenfields projects with highly uncertain long-dated pay offs. Public support for net zero remains strong, although consumers baulk at paying a "green premium".

Notwithstanding the enormity of the challenges, the direction of travel is clear, and there is much to be positive about. The energy transition is spurring a rapid industrialisation of the global infrastructure built over the past two centuries. The Inflation Reduction Act (IRA) in the US has provided the required market signals to incentivise renewable energy development. Fortunately, the spoils of the IRA are being spread across the republican and democratic states. Bipartisan support for the key tenets of the IRA remains the base case.

Much like the rest of the world, Australia cannot compete with the US regarding the scale of the initiatives being implemented. However, frameworks such as the Safeguard Mechanism and the "Future Made in Australia" bill are steps in the right direction. So too is the Climate Change Authority's Sector Pathways Review which outlines emissions reduction pathways for the key sectors in the Australian economy. On the other hand, the Australian political scene appears to be mired in climate wars. Let's hope that we can also find the bipartisan support required to provide the policy clarity corporate Australia needs.

The overarching nature of this report is to provide members with a level of comfort that we understand the risks and are seeking opportunities in a decarbonising world. I would like to draw your attention to the following aspects of the report.

INVESTING IN MACQUARIE ASSET MANAGEMENT'S GREEN ENERGY AND CLIMATE OPPORTUNITIES FUND

Page 11 highlights our first significant unlisted investment in the renewables sector. Macquarie is a leader in green financing with a global footprint, a pipeline of opportunities, and a track record of making profitable investments in a nascent industry. Importantly, Macquarie is investing along with UniSuper and other investors, so our interests are aligned. The Fund will focus on large scale, mature technologies, avoiding the riskier sectors such as nuclear and hydrogen.

VIEWING OUR INVESTEE COMPANIES' PROGRESS THROUGH THE LENS OF OUR TRAFFIC LIGHT REPORT

Our traffic light report (pages 19 to 20) is a proprietary initiative focusing on our Largest 50 Australian investments. These companies constitute over 65% of our Australian investments. They are the companies that we have direct access to and engage with the most. In summary:

- Paris aligned 2050 target: 48 of our Largest 50 Australian investments received a green light, up from 45 last year.
- Interim targets: 42 of our Largest 50 Australian investments received a green light, up from 39 last year.
- Action plan: 38 of our Largest 50 Australian investments received a green light, up from 36 last year.

The report also serves to inform us on potential areas for further engagement, particularly where companies are falling short of our expectations. The 50 companies involved receive a letter from UniSuper detailing the outcome of our assessment. Suffice to say that a negative assessment typically leads to a robust follow-up discussion between UniSuper and the company.

HIGHLIGHTING THE VARIOUS RESPONSES TO THE CLIMATE CHALLENGE

The climate challenge has impacted corporate Australia in myriad ways. Pages 26 to 31 contain various examples. To summarises at a high level:

Australian Banks

Fossil fuel exposure of the major banks has been in steady decline, and direct lending to fossil fuel related companies is typically well below 1% of loans exposures. Australia's largest banks have signed up to the Net Zero Banking Alliance (NZBA). The NZBA requires signatories to have targets set by 2050 covering all (or a substantial majority) of the carbon intensive sectors of their loan book where data and methodologies exist.

NEXTDC

Australia's largest listed data centre business is investing heavily in new technology, and best-in-class design. With the dawn of the AI era, data centres are quickly becoming a major source of the growth in the demand for energy. An estimated 18 GW of additional power capacity will be needed to service US data centres by 2030. For comparison, the total power demand for all of New York City is currently around 6 GW.

BHP, RIO, and BlueScope

Decarbonising steel production requires addressing challenges throughout the value chain. Suffice to say that there is a long way to go, and the technology to manufacture "green steel" at scale is not currently available.

Woodside

We voted against Woodside's "Say on Climate" as we felt it lacked ambition.

Santos

We voted for Santos' "Say on Climate" in support of investing in carbon capture and storage. We strongly feel that all potential technology solutions are required to provide any hope of achieving net zero.

Forico and HVP Plantations

Various initiatives are being put in place by our timber companies to improve their resilience to climate change.

ESTIMATING OUR CARBON FOOTPRINT

The final section of the report contains information on some of our individual investment options, including estimates of their carbon footprints. The section is included in the interests of full transparency, although it's caveated with the clear message that there are (potentially significant) limitations given that the source data is far from complete or uniform. Bear in mind that funds represent an aggregation of the equity and debt being held in companies. UniSuper has holdings in over 3,000 companies.

We welcomed the introduction of legislation dealing with the development of mandatory, standardised, internationally aligned climate reporting. Large super funds (including UniSuper) will be required to report from July 2026. Policymakers have acknowledged that the standards require a number of refinements to ensure they are fit-for-purpose for super funds. To ensure that we are part of the process and ready for implementation we have engaged with various parties on the legislation including:

- Commonwealth Treasury
- Australian Accounting Standards Board (AASB)
- International Sustainability Standards Board (ISSB)
- Auditing and Assurance Standards Board (AUASB)

As with our previous reports, this edition of our Climate Risk and our Investments report demonstrates our efforts to continually improve our climate risk assessments and reporting. In relation to the carbon footprint, whichever way one looks at it, there is obviously a very long way to go in order to achieve net zero. So how can we still be confident that we will get there? The two key reasons are: (i) it is a 2050 target and progress is likely to be in quantum steps—not linear, and (ii) over 87% of the investments we've assessed are already covered by net-zero targets, science-based targets, or commitments to cut emissions by more than 90%.*

Furthermore, over time (but before 2050) we have the option of avoiding or divesting any company that we believe is not on the path to net zero. The bottom line is that we remain confident that we will be able to construct a suitably diversified fund with a net zero profile before 2050.

John Pearce
Chief Investment Officer

* This analysis covers 76% of the Fund to understand look-through exposure which gives us a representative view of our transition risk across the Fund. See pages 35 and 45 for more information on how this was analysed.

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