The Net Zero Investment Consultants Initiative – Frontier Advisors Annual Report

September 2024

Frontier Advisors

Contents

Frontier Advisors Pty Ltd
Level 17, 130 Lonsdale Street
Melbourne VIC 3000
Wurundjeri Woi Wurrung Country
Telephone: 03 8648 4300
CAN: 074 287 406
ABN: 21 074 287 406
AFSL: 241266

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$659 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 2023, 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, which consolidated on efforts in the preceding calendar year:

  – In our annual Property configuration review, we noted that real estate is a significant contributor to global emissions. We highlighted that a strategy to decarbonise a property portfolio would likely strengthen resilience of that portfolio, mitigate several risks and provide stability of returns. We encouraged clients to actively monitor asset managers' commitment to net zero objectives and their effectiveness in implementing these objectives.

  – Our Infrastructure configuration review provided guidance on the broader investment opportunities available to investors that would enable them to participate in the transition to a decarbonised economy and the role that such allocations play within the portfolio. We also emphasised the critical role that infrastructure plays in this process and provided a roadmap for implementation of a net zero strategy for this asset class

  – 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.

  – Our listed equities configuration reviews focussed on the challenges and opportunities of decarbonising portfolios. In those reviews, we advocated a holistic approach to decarbonisation including an active approach to stewardship. We also emphasised that participating in decarbonisation of the real economy is more in keeping with an authentic net zero strategy, over an objective to reduce emission footprints in portfolios over the short to medium term

  – The fixed interest and debt configuration reviews provided updated 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. This is an enhancement on what was provided in the previous year

- Led by the Responsible Investment Team, we continue to develop elements of a more wholistic net zero service framework for clients to assist them in aligning to net zero investment objectives. Over time, 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 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 developed capital markets assumptions for specific asset classes that are aligned to a decarbonised economy. These complement the more traditional asset classes with respect to listed equities, unlisted property and unlisted infrastructure. We are also actively developing enhanced methodologies that are designed to quantify return impacts from decarbonisation scenarios that is applicable across a wide range of asset classes and is also applicable to client portfolios broadly.

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.

We have continued working on expanding our capacity to offer carbon (and climate-related) reporting services to clients that would include unlisted asset classes such as property, infrastructure, private equity and private debt. This is a challenging area, involving greater complexity and cost relative to listed asset class carbon reporting. However, we are mindful of the importance of our clients' ability to access such information in light of mandatory climate-related financial disclosures coming into force in Australia from 1 January 2025 onwards.

Appendix C provides a summary of the ongoing development of Frontier's climate reporting service.

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 addressed issues relating to Net Zero and decarbonisation. An example included a research paper dealing with the role that active ownership of listed equities can play in participating in a decarbonising economy.

We also included sessions at our annual client conference that were relevant to implementing Net Zero investment strategies. The conference achieved a record attendance of our clients and a wider stakeholder group. One session included a panel consisting of representatives from an asset owner and asset manager; both of whom we would consider as industry leaders in pursuing Net Zero Alignment. They discussed the challenges, opportunities and learnings from their experience which resulted in useful guidance for attendees. As an adjunct to the conference, we also hosted a roundtable event which was attended by our university clients. The discussions at that event had a strong focus on the issues that needed to be addressed in aligning with a decarbonising economy and managing stakeholder expectations through that process.

Subsequent to the reporting period, we provided video sessions at an investor sustainability forum held in Japan that was widely attended by Japanese institutional investors. One of the sessions canvassed the recent trend in more standardised climate disclosures across a growing number of jurisdictions with a focus on forthcoming regulatory developments in Australia and Japan.

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 should be readily able to compare asset managers across these dimensions when selecting investment products from our rated manager lists. This is articulated in a ESG scorecard which is a key element in the overall product rating has addresses climate change specifically. Individual clients have undertaken detailed reviews of these scorecards as an effective tool for engagement with their appointed managers.

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 2023 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 regularly attend meetings and workshops with industry groups, such as the IGCC, to keep abreast of climate-related engagements on policy and regulations. The IGCC is actively involved in policy discussions with government and other key participants, on behalf of members. We participated in a collective submission regarding the forthcoming legislation on climate-related financial disclosures that was coordinated by the IGCC. Subsequent to the reporting period, we also provided input for a policy submission by the IGCC to the Australian government which sought the adoption of more ambitious emission reduction targets in the medium-term. Our input included estimates on return impacts under different policy scenarios, which highlighted the potentially more severe negative impacts on retirement savings under a weaker policy setting.

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 2023.

Table 1 – Key performance indicators

KPI	Description/type	Number of clients	Assets under management ($bn AUD)
1.	Meaningful education	14	381.6
2.	Baseline carbon emissions data	21	601.9
3.	Net zero ambition	15	580.7
4.	Net zero target/intention to be Paris-aligned	5	210.4
5.	Climate solutions	11	211.8

Regarding KPI 1, we reiterate here that 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 for the reporting period, there was 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.

While the Australian Government has taken steps over recent years to encourage voluntary action on climate change by asset owners and investors more generally, mandatory climate reporting will now come into force from 1 January 2025 (with the first mandatory reporting period for institutional asset owners being the year ending 30 June 2027). 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 2023

Emissions category	Estimated emissions (kg CO_2-equiv.)
Scope 1 + 2	92,715
Scope 3	62,040
Total	**154,755**

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 (extension to unlisted asset classes)

Frontier undertook a lengthy process to establish a carbon emissions/climate reporting service for our small to medium sized clients who typically did not 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.

The current scope of the reporting service extends to listed equities and corporate debt. We were mindful that the asset class coverage needed to extend to other asset classes, particularly unlisted property and infrastructure, but also private equity and private debt. Many of our clients have significant exposures to these asset classes and they are also exposed to sectors of the economy that have a pivotal role to play in real world decarbonisation.

We have undertaken an extensive due diligence of relevant product offerings that will allow us to extend this capability to clients. In seeking to partner with a data vendor as a specialist in this area, we recognise the complexity of measuring and estimating carbon emission metrics across these asset classes and the need to report metrics that are accessed via a standardised methodology that will satisfy industry conventions and regulatory requirements. We have encountered some relatively newer entrants to this product space with some sophisticated product offerings that also extend beyond historical carbon emissions measurement. This has been an extensive process to understand the relative strengths of the vendor platforms, socialise the opportunity set across the relevant internal research teams. Finally, we have canvassed with our client base the notion of offering an unlisted carbon reporting service, and in doing so have sought some more granular feedback from them on the characteristics they are seeking from such a service. Ultimately, we are emphasizing to our clients that they need to have access to climate data that is decision-useful.

We are in the midst of considering commercial arrangements with a view to move to a development phase for the service offering.

Level 17, 130 Lonsdale Street
Melbourne, Victoria 3000
Wurundjeri Woi Wurrung Country
Tel: +61 3 8648 4300
frontieradvisors.com.au
@frontier_adv

Frontier Advisors Pty Ltd ABN 21 074 287 406. AFS Licence No. 241266.