PERFECT STORM SUPER

SCRIPT for Questions and Answers 1 to 8

QUESTION 1: Resolution 4

Richard: Thank you Board. This is a question about resolution four and timeframes, and we talked about how to budget based on two degrees warming. I just wanted to ask whether that's overly optimistic, it's looking increasingly unrealistic that we will keep to two degrees and do we need to be more realistic about that and accept a worse outcome. And it goes to the issue of stranded assets as well, stranded assets might be a problem we'd dearly wish to have, but we won't get the regulatory tightening that is going to make that happen.

Frank: Well when you look at the two degrees, we're looking at aggregates, what's happening globally. If we believe - and that's - our belief system is based on so that we're developing all the policies around that. But if we really believe it's going to be six degrees, that's a different consequence. So we've got to believe that government action, regulators and things that are being done around by companies, individuals, different states within different countries, will keep - and their aim is to keep it at 2%, two degrees warming.

So in aggregate I think we should work towards the two degrees as part of that policy framework. To go six, it's just a guess.

Garry: I think it doesn't really matter whether the two degrees is a high degree of political probability or a relatively low degree. What matters is that you accept that it will be tough to get there, and therefore a fair bit has to change to get there. That's what will drive out thinking, that we believe that an effort will be made, either gradually over time or suddenly in a rush some years down the track to actually get there or somewhere near that target. So the precise number I think is far less important than believing for example that there is virtually no chance of warming. If you believe that, then I think we wouldn't be here.

Kath: Can I just add to that? I think that's exactly what four and five when you read them together, suggest that our best guess is that there will still be a focus on reducing carbon emissions rather than just abating the impact of warming. So that's what four and five together mean. We might be wrong about that, that's really the bet that we're taking. So we're not sceptics about human induced climate change and we're taking a bet that the likely direction of regulatory reform, global regulatory reform is reduction in emissions.

QUESTION 2: Scenario planning and adaptation

Sarah Barker: I just wanted to follow on from Richard's question. First of all to what extent should you be engaging in scenario planning rather than just focusing on that two degree, four degree, six degree, because of the inherent uncertainty and focusing on flexibility, in building flexibility into your portfolio and looking at the classes that you're investing in. Secondly, I'm a little bit concerned about the lack of emphasis on adaptation and the lack of recognition of the degree of climate change that is already locked in unavoidably into the future as a result of past emissions. And I'd be interested to hear how the trustees propose to deal with asset classes, not only that are low carbon, but also the risk exposures in terms of their failure to adapt to climate change, whether or not they're a high carbon or a low carbon industry themselves.

Garry: I think the biggest problem with flexibility is that no-one ever manages the date very well. I mean you can have a lot of flexibility if you're entirely in liquid markets. So you can be either entirely in the share market for example. You've got a lot of flexibility as long as the market doesn't completely break down, a lot of flexibility, but usually the market adjustment is all over before you've actually woken up to what's happening. So I think trustees and fund managers have proven time and time again they can't time markets. So I think you need more than - you might want a certain amount of flexibility, that's fair, but to put all your eggs in the basket of flexibility that you can adapt just in time, I think would be a big mistake. But I do agree with you on adaptation, I think there are certain things that could bear much more research currently in terms of adapting.

Cate: I'd just comment that for a super fund board, where most boards are at, that level of sophistication to move beyond trying to come up with a baseline scenario that is reasonable and defensible and gives you a framework to act within, to scenario testing is just like too far in the future at this stage. It's too big an ask for most super fund boards that I know of.

Sarah Barker: There is a lot of public information, both published by the IPCC and institutions like PWC and Mercer where they have established four or five likely scenarios that can be modelled from. It's not like you're working from scratch, and I'm thinking 10 or 20 years down the track when the question gets asked why didn't you see this when it was so - benefit of hindsight is obviously a wonderful thing. But it's not like the information isn't readily publicly available now.

Cate: But you're presuming that if this is adopted today that it will be here in 20 years. It's got to be…

Sarah Barker: Oh no, that's where the flexibility and iterative nature of the consideration happens of course, but I think just by saying okay we're going to presume that two degrees is where we're going to be at, and that's what we're going to govern the investment strategy for, might be a little bit conservative I think was the word that was used. Based on the information that we have now.

Kath: But that - as Garry said during the discussion, the resolution four does hint at the physical impacts of climate change. So it hints at adaptation rather than abatement. And so…

Sarah Barker: But then the investment allocation is really just in low carbon and resilience to climate change risk and exploiting opportunities is so much more than low carbon.

Garry: Yeah, but we don't actually have - we haven't actually got to the point - I mean I think I agree with the sentiment of where you're come - we haven't actually got to the point of what is the policy that we're going to try and implement here, and a debate we would need to have would be to what degree and how quickly do we move on certain things. And I'm sure that we have a variety of views.

For example, personally I would be very supportive of taking the risk - it's actually not risk, it's a departure from the herd measure - of getting completely out of any form of electricity generation that emitted above 800kg per megawatt hour for example and doing that tomorrow. I'd be very comfortable with that, but that's a sort of a subsequent debate I think we have to have.

QUESTION 3: LEADERSHIP

Chris Bryant: Yeah so Chris Bryant from Parametric. I just wonder whether the Board is probably - clearly this is a board who broadly supports climate change. I worry whether to 50% of Americans for example totally genuinely not believing it, whether the Board has adequately considered the risk of members who might well be your most wealthy members most likely to go off to SMSFs, and therefore the scale issues that Garry mentions, whether the Board has thought about the potential implications of being a leader in this space, and just how you think about that risk of losing members, from doing something that's entirely rational, that completely makes sense, because members as noted recently are not necessarily rational beings.

Geoff: Yeah I mean I think that's a good point. I mean I'm personally a supporter of action on climate change, but at the same time though I suppose action more focused in the government space, like I think this is a place the government should be more active on than what we're used to at least, or looks like we're going to have to get used to in the next medium term ahead of us. And I think there's a real risk for industry super funds in the way that they approach these issues, because they will be seen as being bleeding hearts, taking action ahead of the game and running the risk of some members forming a view that philosophy is winning out to just a more hard nosed look at investment returns.

Garry: Look the other way of looking at that question though too is what a fantastic opportunity. If the market is actually set and values have been set on the basis of 50% ignorance in the most powerful and richest nation on earth, what an opportunity to actually anticipate that position becoming less ignorant in the future. That's not a bad bet, I think I would probably take that bet and say the market's been set for that level of understanding, and that level of understanding likely - it may not, after all certain institutions suppress the idea that the sun might be the centre of our solar system rather than the earth, that was suppressed for hundreds of years. So it's possible they may not get smarter quicker, but on balance you'd expect that knowledge to change and improve, and as it does the market moves to it and you're already there, it's not a bad bet.

Cate: But I think also it's a question of how you communicate the actions that we're taking and the changes in our policy to our membership, and I think it's fairly carefully framed in terms of risk and opportunity and we have to - and there's no view of moving from our long term targets in terms of returns. So we have to make sure we communicate carefully and don't scare the horses.

Jon: And also we have members who will support what we're trying to do here, so we mustn't ignore that. Yes there's always risk, risk of losing members but there's also the positive risk of retaining or gaining members.

QUESTION 4- COMMENT ON RESOLUTION 2 AND 6

Kate Alty: Yeah, Kate Alty, I'm the Commissioner for Environmental Sustainability, so I'm sort of from the government. But a couple of points, I just wanted to say it is about communication, I don't think there's any doubt about that, and in our work we see it all the time. And I think that if I was the Board I might have changed some of where your resolutions sat and what I called them. I wouldn't have called resolution two policy implementation, because essentially it's reporting. And I would have taken your resolution six about measurement and sliced it straight in behind resolution two, because then you've got an argument which is policy, policy reporting and measurement, and that in itself sends a very clear message to whoever's reading what you're doing. That's the first thing.

The second thing that I wanted to say is that in my job we've heard a lot about opportunities, and we hear everybody talking about opportunities in government. And what it really means is plausible deniability, because if you've got an opportunity we don't have to do anything. And it's really refreshing to see boards talking about competitive, about performance and about being at a point of differentiation and leaders. And I think that's something that you shouldn't overlook in terms of persuading your members of what it is you're doing. But it is all about communication and I think every document is one that you can use to further the message. Sorry that wasn't a question but you might want to comment.

Garry: You should write the minutes I think. [LAUGHTER]

QUESTION 5- CAPITAL ALLOCATION

Helga Birgden: One of the questions I have for the Board is to what extent do you think the actual portfolio can reflect the changes? I know that is a matter for the investment committee, but what we do see is there is a lot of policy work being done by funds, there's a lot of funds signed up to initiatives. But when we look to where the capital is actually being allocated, we see very little evidence for money moving to help address some of these issues, whether it be from a risk point of view or an opportunity point of view. Would the Board like to comment on their appetite for actually allocating capital to such investments?

Cate: Well I think it - this is this board, and like I - we could answer it two ways, we've got a motza of money, huge amounts of money so if we haven't been doing it either we've got - we haven't had the right policies or we've got very conservative internal investment management advice in terms of what we're doing. If we're a small fund, we don't have - we're dependent on consultants and advice and they're not twigged onto it, because fundamentally a lot of it comes down to there is will but there is also resources and advice I guess.

Kath: For me, when I think about it, I was thinking about where your opportunities sit along the risk and return curve, and you're really thinking - when you first think about this you're thinking infrastructure. And it's the lumpiness of the assets and the lumpiness with which they come before you and when you've actually got money to allocate and what's before you. So we don't - I don't know whether we haven't done the work, but I haven't got any money to allocate so - I'm at home painting the house, that's what I'm doing.

But when you think about that, and you think about well how easily could you divest from something that you're in and get into something else in infrastructure, it's not - that's where the barrier sits to me. In other asset classes I'm not aware of having - I certainly haven't done the work myself and I'm not aware of enough work having been done for me to sort of be able to comment. But in infrastructure you can look at energy generation and toll roads and those sorts of things and say well could you get out and get into something else. And it's what comes across your desk in the six months lead that you've got to put a lump of $20 million or $40 million or $100 million or whatever you've got into an infrastructure investment. And so we do rely on our fund managers to bring some of that to us and that's important.

Garry: Well I think it's really important not to confuse our green credentials in the investment with the entire risk spectrum because it's far from the case. I mean there are many very green assets which are very, very conservative assets compared to non-green assets. For example I would much rather invest in a 100 year old - and have actually - in a 100 year old run of river hydro outfit with a long contract for offtake of its electricity and a track record over 100 years than to invest in a start up diesel generator in outback Australia for example.

So it's not - there are opportunities at all points of the risk spectrum across the renewable and across the green investment horizon. If for example you want to think about an investment in unproven technologies, emerging technologies, say in renewable energy then my advice would be one to have great expertise, but two, to do it on a highly diversified basis so that you don't back a single start up technology just because there's some smart talker - and there's plenty of them. There's thousands of them. The US breeds them at an incredible rate and most people lose their money in those. So you need to diversify, you need to be spread across a whole lot of start up technologies if you're going to go into that area. As you move down the risk spectrum to more established type operations obviously you can take bigger single bets with some equanimity.

Jon: However I think your concern might be that having heard the alacrity with which we took up the suggestions and agreed and adopted them as policy that you'll come back and read our annual report in 12 months' time and find we've done nothing. And maybe one way we can assuage this fear of yours is we can look at our passive equity program, both domestic and global. And very quickly with the help of our consultant identify some ways of either enhancing the portfolio or diminishing it by removing stocks that will show we have a clear commitment to this program.

QUESTION 6- FUND COLLABORATION

Xinting Jia: Xinting Jia from Mercer. It's quite interesting to hear the Board talking about part of the resolutions to engage specialist consultants. But as a consultant I'm not going to talk about that, but you know I'd like to ask about in terms of whether you've got any strategy engaging with other managed funds, because if you look at what's happening globally, especially with large funds they all have a home base, it means they also have an understanding of their home markets. So what's your strategy especially in engaging with big funds in emerging markets?

Jon: Are you asking will we form partnerships with other asset owners to make investments of this kind? The way I think about it is we've been doing this for decades, but it's always been the fund manager who comes to us and syndicates a unit membership of the fund. I think your point's a good one, we should start to turn this around and go and find likeminded asset owners and join them in a syndicate and find managers who can manage the assets.

Xinting Jia: Or even collaborate with likeminded investors and actually look at this from a high level to look at the risk, climate change risk major funds are facing.

Garry: Well subject to cost I think you know, that's the first thing. We're not going to turn the policy into a sort of trustees of the air travel policy you know. The other thing, you know I think there's a lot of positives in it. The other big negative in it, is it's often very hard to get a single board to make a decision and you've got to multiply that when it's multiple boards with multiple options. So it's not always easy to get a single - any result. It's not impossible as there are examples, but it's not easy.

Cate: But that raises the question of consultants too, the ease with which you can get boards to make decisions about new or alternate or innovative investment proposals.

Garry: Well we're here obviously in support of the idea that consultants should lead on the issue. And if they don't, they have a big risk.

QUESTION 7- re RESOLUTION 1 AND 6

Brett Lazarides: It's Brett Lazarides. There was a lot of discussion by the Board around the potential risks and opportunities, but there was a lot of focus on communication policy and the reputation risks that could come from bad press and how best to communicate. I guess if I was in the context of perhaps a climate sceptic or devil's advocate, I'd look at resolution six against resolution one being the policy. One expresses a belief in the long term systematic risk, but six adopts a methodology to measure exposure to climate change risk. Would it be a lower risk and potentially lower cost strategy for the Board to conduct six first to justify all these changes and to actually establish quantitatively what level of risk the fund faces from this issue.

Garry: Can't we just assume we're absolutely prosaic as a fund and almost identical in asset allocation to every other fund of our type? I think that's the basis upon which we've been - if you look at our returns, volatility over the years, that's a pretty safe bet. So we're at pretty much where everyone else is at and we don't need to know what the starting point is, we need to know what difference we can make from here on in I think is probably the answer to that.

And also, I don't take that resolution as meaning we're going to try and actually find out our share of the total greenhouse emissions made by every company we're invested in across the globe, I don't take it to mean that. I take it to mean finding a reasonable practical way of measuring where we're at as a benchmark from which we move forward. And really we're interested in the degree of movement away from the median, rather than the absolute I think.

Brett Lazarides: Right I was hearing it to say well if you haven't measured your exposure to the risk why make all these changes before measuring.

Garry: Well what does it tell you if you find out that you have the same exposure as every other super fund and that on balance you're exposed to a world or a country in the case of Australia, which has the following level of total greenhouse gases, we know that. We know where we're at. We're pretty much invested in the marketplace.

Frank: In the public market, so the fact that we invest across the public market tells us that we are exposed to all the carbon intensive industries and that's - the starting point is not to measure it, because we're in the market we're part of it.

Nathan: And I can just add to that by saying that a lot of funds do some assessment work and I think in our hypothetical situation we've done that before they've come to this meeting. So in practice you're probably right, but Garry's comment about where we're heading I think is - and Frank's comment as well. People don't necessarily undertake those steps I think is what you're saying, it makes perfect sense.

So we have one more question before we'll grab a drink and let those go who need to. But I'd just like to recognise and thank Chris Brien from Parametric who's going to have the honour of the last question. Chris sponsored the event today which has allowed us to film it and have a really good record of it so that we can use and promote this message. So thank you Chris for sponsoring the event. We're determined to get some recognition from our peers around the world not just here, so hopefully your money is well spent. So last question to you. So the pressure is on now, it'd better be a good question.

QUESTION 8: RETAIL SECTOR vs FOR PROFIT FUNDS

Chris Brien: I have a sneaking suspicion that the Perfect Storm Super Board is from the profit for members sector, and I know that I can ask this question without anybody sort of taking pot shots etc. But I just wonder about the Board's view about what some of the different drivers around these decisions might be for the retail sector relative to the profit for members sector.

Garry: A very good question, a very good question and I think one has to assume that all sectors want to succeed. If there's a slight difference in the motivation of the retail sector, being that you have to feed an external shareholder as well, they still want to succeed and they're still going to be measured on performance including relative performance. They're still going to have their cost base affected by whether they gain or lose members and they're still going to have be accountable and transparent - well transparent is probably not the case currently. They don't have to be transparent, but they do have to be ultimately accountable to the marketplace for their actions.

So I don't really see why they need to be radically different in their approach, unless they don't have a stable flow of contribution income that does change things. But that's a broader issue about liquidity and getting an investment premium for foregoing liquidity.

Jon: But also let's not forget, and I made reference to this a couple of times before, we have an obligation under what we say in our PDS to provide good inflation adjusted returns for our members. That doesn't make reference to all the other funds out there, whether they are retail funds or industry funds, and what we're doing with regard to climate change is a chance for us to step out on our own with self-confidence to generate good returns for our members in an absolute sense.

Kath: I'd see the two distinguishing things being one about liquidity and that's changing I guess as more and more members potentially move around - not that much, but for industry funds that's an issue to think about, which means that we have to look in other asset classes other than just the illiquid asset classes, and the other one's cost. I think that the issue around competing on cost was one that was opened up a couple of years ago. I don't think it should be the only basis upon which competition occurs, but that's one of the reasons why cost was raised in our discussion. So if you are marketing a very low cost product, and that's the basis upon which you're competing, then you're going to have some difficulty in the implementation I guess. But they can deal with that, their fees are sufficient that they can deal with that.

Cate: Yeah, you could also relate to - on that question, if the retail fund is part of a larger institution that has resources directed towards these areas, they might be able to leverage that. I agree with Garry that the impetus is there for them to consider it as much as anyone else.

Nathan: That's great, folks thank you. I'm just going to say a piece to camera for the end of the session. So everyone if you would please join with me to recognise and thank the organisations who helped us put this event on today. So firstly to AIST who helped us with the organisation and of course giving us the Chair's time. A special thanks must go to Mercer and especially Helga Birgden and Richard Fuller who arranged the room for us today, the space and spent so much time on the script and putting together the thinking for this session. So thank you very much.

And of course thank you to our trustee board who really jumped into the deep end for this event. But I think started the conversation, took it to a deeper level and will help all of our investment community take it even further. So please, thank them.

END Q&A TRANSCRIPT