

Information request regarding AustralianSuper investment manager Vanguard Investments Australia Ltd

1. I am a member and beneficiary of AustralianSuper.
2. As an AustralianSuper member, I am entitled to documents and information about how **AustralianSuper** Pty Ltd (ABN 94 006 457 987), the corporate trustee of the AustralianSuper superannuation fund (ABN 65 714 394 898) and its board members are investing and managing beneficiaries' money, including the management of financial risks.
3. This request concerns the material financial risk of climate change and AustralianSuper's \$1.4 billion investment in Vanguard funds, in circumstances where AustralianSuper must understand Vanguard's investment capabilities and Vanguard:
 - (a) does not appear to treat climate change as a material financial risk;
 - (b) does not appear to have any real capability to manage the investments risks of climate change; and
 - (c) does not appear to comply with AustralianSuper's commitment to net zero emissions.
4. Based on the concerns set out below, I request documents and information in accordance with my rights under s 1017C of the *Corporations Act 2001* (Cth) (**Corporations Act**) and in equity.

AustralianSuper's climate commitments

5. On page 32 of its 2021 Annual Report, AustralianSuper made the following commitments concerning climate change:

During FY21, AustralianSuper made a commitment to achieve net zero carbon emissions in the investment portfolio by 2050. This commitment builds on the actions we are already taking to manage climate related risks and opportunities in our portfolio and is consistent with our objective of helping members achieve their best financial position in retirement.

Our emissions target aligns to the international scientific consensus of reductions required to meet the goals of the Paris Agreement as outlined by the Intergovernmental Panel on Climate Change (IPCC). We believe meeting the Paris Agreement goals will result in the lowest economic cost climate change outcome, thereby supporting our investment objective. AustralianSuper is implementing a comprehensive net zero transition program across its investment, stewardship, measurement and reporting, and collaboration and advocacy activities to reduce emissions in the portfolio.

6. AustralianSuper has also made the following commitments:

- (a) to invest \$1.2 billion in renewable energy investments and a 41% reduction in carbon intensity since 2013;¹ and
- (b) to require that companies in its portfolio “incorporate the transition to net zero by 2050 into their strategy”.²

Climate change as a material financial risk

7. It is now well established by Australian regulators and the legal community that climate change is a material financial risk.³ I am aware of the risks posed by climate change, including the risks to financial investments in business, particularly those that are directly involved in or support industries that extract fossil fuels or contribute to the release of greenhouse gases into the atmosphere.⁴
8. In its 2021 Climate Change Report, AustralianSuper identified climate change as a material issue for its investment portfolio.⁵

AustralianSuper’s investment in Vanguard

9. According to AustralianSuper’s 2021 Annual Report, the value of AustralianSuper’s investment in **Vanguard Investments Australia Ltd** at 30 June 2021 was \$1,437,291,000 .⁶ I understand all the investments are in AustralianSuper’s “Indexed Diversified” investment option.
10. A table of AustralianSuper’s investments managed by Vanguard Investments Australia by fund name as at 30 June 2021 per AustralianSuper’s website is at Annexure A (**The Vanguard Funds**). The table links to what I understand to be the current Product Disclosure Statements (**PDS**) for each of The Vanguard Funds.⁷

¹ AustralianSuper 2021 Annual Report, p 33.

² AustralianSuper “Climate Change Report: Task Force on Climate-related Financial Disclosures (TCFD) update” 2021, p 6.

³ Hutley SC and Mack (2021), Memorandum of Opinion, Superannuation Trustee Duties and Climate Change, available at <https://equitygenerationlawyers.com/wp/wp-content/uploads/2021/04/Hutley-SC-Mack-Superannuation-Trustee-Duties-and-Climate-Change-Memo-2021.pdf>.

⁴ See, for example, Hutley SC and Mack (2016, 2019 & 2021), Memorandum of Opinion, Climate Change and Directors’ Duties, available at <https://cpd.org.au/wp-content/uploads/2019/03/Noel-Hutley-SC-and-Sebastian-Hartford-Davis-Opinion-2019-and-2016.pdf> and <https://cpd.org.au/wp-content/uploads/2021/04/Further-Supplementary-Opinion-2021-3.pdf>.

⁵ AustralianSuper “Climate Change Report: Task Force on Climate-related Financial Disclosures (TCFD) update” 2021, p 9.

⁶ AustralianSuper 2020 Annual Report, p 80.

⁷ <https://www.australiansuper.com/investments/what-we-invest-in/our-superannuation-investments>; <https://www.australiansuper.com/investments/what-we-invest-in/our-retirement-investments>. This letter does not deal with AustralianSuper’s Member Direct Investment Options which include Vanguard Exchange Traded Funds (**ETFs**).

11. The issuer of each PDS and the investment manager for The Vanguard Funds is Vanguard Investments Australia Ltd (ABN 72 072 881 086 / AFS Licence 227263).⁸
12. All of The Vanguard Funds are index funds. None of the linked PDS refer to climate change as a risk, let alone a material risk, or a financial risk that is managed by the investment manager.
13. Two are passive index funds and three are active funds that exclude certain securities. None of the funds appear to exclude or underweight underlying securities based on the material financial risk of climate change risk. However, the PDS for the *Vanguard Ethically Conscious Global Aggregate Bond Index (Hedged) - AUD Hedged* fund, comprising \$172 million of the \$1.4 billion of The Vanguard Funds, excludes securities of issuers “that engage in activities in, and/or derive revenue from fossil fuels”. The construction of the index that forms the basis of the fund is independent of Vanguard Investments Australia and is based on ethically conscious criteria not financial risk. Whilst fossil fuel-based exclusions are encouraging given my concerns, the ethical grounds on which certain securities are excluded and Vanguard Investments Australia’s lack of involvement in assessing the exclusions provide no certainty as to Vanguard Investments Australia’s capability to manage the material financial risk of climate change.
⁹ Documents relating to the remaining 88% or \$1.265 billion of The Vanguard Funds held by AustralianSuper exhibit no evidence of exclusion criteria related to climate change risks at all.

The Vanguard Group Inc

14. The Vanguard Group Inc (USA) (**Vanguard**) is the ultimate holding company of Vanguard Investments Australia.
15. Vanguard’s mutual fund structure, and the fact that it is not a publicly traded company, appear to hinder Vanguard’s and in turn, Vanguard Investments Australia’s, ability to assess or guard against climate risk. Vanguard has been criticised for failing to assess and manage climate change risks. In particular:
 - (a) Vanguard has publicly refused to be part of the ClimateAction100+ initiative stating it wishes to engage with companies instead and voted against all of the Climate Action 100+ key resolutions in 2020;¹⁰

⁸ The relevant PDS state Vanguard Investments Australia “is solely responsible for the management and administration” of the fund and “is also the investment manager” for the fund.

⁹ Supplementary Product Disclosure Statement, *Vanguard Ethically Conscious Global Aggregate Bond Index (Hedged) AUD Hedged*, 10 March 2021, p5:
<https://api.vanguard.com/rs/gre/gls/1.3.0/documents/17249/au>.

¹⁰ **IEEFA**, Vanguard Group: Passive About Climate Change, June 2021 at 34:
https://ieefa.org/wp-content/uploads/2021/06/Vanguard-Group_Passive-About-Climate-Change_June-2021.pdf. Cf. AustralianSuper’s public commitment to undertaking direct company engagement both individually and as part of Climate Action 100+ (of which AustralianSuper was a co-founder) to actively manage the risks and opportunities of climate change, including seeking that companies articulate net zero business strategies and actionable progress on emissions reduction trajectories.

- (b) Vanguard also ranked 69 out of 75 of ShareAction’s 2020 ranking of the 75 world’s largest asset managers’ approach to responsible investment. Vanguard was awarded an “E fail” rating (the lowest possible) on the themes of responsible investment governance, climate change, biodiversity and human rights;¹¹
- (c) Vanguard, in its USD holdings, holds US\$227bn of fossil fuels exposure in their passive equity funds. The Institute for Energy Economics and Financial Analysis (IEEFA) analysis of Vanguard’s USD holdings estimates that its portfolio of funds contains almost US\$300bn in fossil fuel asset exposure with approximately \$90 billion in thermal coal;¹²
- (d) according to IEEFA, Vanguard is “lagging” behind its publicly listed competitors in terms of maximising risk-adjusted investor returns by, for example, divesting value-destructive fossil fuel exposure;¹³
- (e) Vanguard holds over 80% of its equity in passively invested index-tracking funds, and does not apply a standard of exclusion to its passive funds to screen against carbon-intensive emitters, for example;¹⁴
- (f) IEEFA says “it would be reasonably uncomplicated for Vanguard to divest the highest carbon intensive fossil fuel holdings from its actively managed funds” and that “Vanguard’s actively managed fixed income funds lack transparency”;¹⁵
- (g) according to Universal Owner, Vanguard holds the second-most equity in thermal coal among institutional investors and the assets owned by Vanguard “are responsible for the production of 40 million tons of coal every year”;¹⁶
- (h) Vanguard’s stewardship priorities have remained unchanged. Neither climate, environment, nor ESG is represented as a primary pillar in their standards of good governance;¹⁷
- (i) Vanguard faces enormous unhedgeable risk from climate change. Universal Owner has estimated that Vanguard’s US equity alone stands to lose \$3 trillion from an increase in average global warming of 2°C by the year 2050;¹⁸ and
- (j) the value of Vanguard’s portfolio is particularly dependent on the systemic health of the market due to the distribution of its holdings of over US\$7.2 trillion in assets

¹¹ IEEFA, p 25.

¹² IEEFA, p 42.

¹³ IEEFA, p 27.

¹⁴ **Universal Owner**, Vanguard and Universal Ownership, September 2021 at 12:

https://aae3a3a4-223a-4abf-a8f5-690b8f339311.filesusr.com/ugd/4e1fd6_6239fbd9a384892889efaf1e610e6e4.pdf

¹⁵ IEEFA, p11.

¹⁶ Universal Owner, p12.

¹⁷ IEEFA, p 33.

¹⁸ Universal Owner, p 4.

under management across over 10,500 companies around the world and in every sector.¹⁹

16. Much of the analysis above appears to apply to and influence Vanguard Investments Australia's lack of capability to manage climate risk. For example, with respect to thermal coal Vanguard continues to invest in **Whitehaven** Coal Ltd.²⁰ In contrast, AustralianSuper sold its holdings in Whitehaven in 2020 in line with its commitment to achieving a net zero portfolio by 2050.²¹

AustralianSuper's obligations

17. AustralianSuper is a registrable superannuation entity (**RSE**) licensee for the purpose of the Corporations Act and the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**). As an RSE licensee it must comply with Australian Prudential Regulation Authority (**APRA**) prudential standards.²²

18. Prudent superannuation trustees must ensure that their processes relating to financial risk are adapted to understand and manage the financial risk posed by climate change. In order to comply with their obligations under superannuation law, the joint 2021 opinion of Noel Hutley SC and James Mack on Superannuation Trustee Duties and Climate Change suggests that a two-step process be undertaken: the first step is to *understand* the risk posed by climate change to investments; the second step is to *manage* any identified risk.²³ As part of the first step, Hutley SC and Mack suggest that the board of a superannuation trustee must ensure adequate processes are in place to enable it to understand and manage the financial risk posed by climate change.²⁴

19. Vanguard Investments Australia is one of AustralianSuper's investment managers.²⁵ As an investment manager, Vanguard Investments Australia provides an outsourced material business activity, as its activities have the potential to have a significant impact on AustralianSuper's activities and its ability to manage risks effectively.²⁶

20. As a trustee, AustralianSuper has a duty to seek information from its investment managers that enables it to assess the capability of its investment managers to manage any financial risk posed by climate change. In particular, AustralianSuper is under an

¹⁹ Universal Owner, p 10.

²⁰ See, for example, holding details for Vanguard's Australian Shares Index Fund, available here: <https://www.vanguard.com.au/adviser/products/en/detail/wholesale/8100/equity>.

²¹ Charlotte Grieve, 'AustralianSuper dumps Whitehaven Coal, commits to net zero by 2050', *The Sydney Morning Herald* (Sydney, 12 November 2020), available at <https://www.smh.com.au/business/banking-and-finance/australiansuper-dumps-whitehaven-coal-commits-to-net-zero-by-2050-20201112-p56e0h.html>.

²² SIS Act, ss 34C and 34D.

²³ Hutley SC and Mack (2021), Memorandum of Opinion, Superannuation Trustee Duties and Climate Change, paragraph 5, available at <https://equitygenerationlawyers.com/wp/wp-content/uploads/2021/04/Hutley-SC-Mack-Superannuation-Trustee-Duties-and-Climate-Change-Memo-2021.pdf>.

²⁴ *Ibid.*

²⁵ SIS Act, ss 10, 102; AustralianSuper 2021 Annual Report, 51.

²⁶ APRA, 2013, *Prudential Standard SPS 231: Outsourcing*, para 9, available at <https://www.legislation.gov.au/Details/F2012L02223>.

obligation to ensure that any agreement with its investment managers enables them to require the investment manager to “*provide such information as is necessary to enable the trustee, or the trustees, of the entity to assess the capability of the investment manager to manage the investments of the entity*”.²⁷

21. The obligation to assess an investment manager’s capability entails conducting due diligence and monitoring of investment managers and their approach to climate risk,²⁸ and determining appropriate measures to monitor the performance of investments when entering into an agreement with an investment manager,²⁹ and on an ongoing basis.³⁰ Such measures include requesting that investment managers “*provide information as to the exposure of investments to the financial risk posed by climate change*.”³¹ AustralianSuper is therefore under an obligation to ensure that when entering into any investment management agreement with Vanguard Investments Australia, the investment manager is made subject to a proper assessment including, for example, ongoing due diligence review, consideration of any changes to the risk profile of activities managed by Vanguard Investments Australia and how any changed risk management profile is managed in AustralianSuper’s risk management framework, and that any such agreement has been approved by the Board.³²
22. AustralianSuper must also have a risk management framework to appropriately manage risks to its business operations for which AustralianSuper’s board of directors is ultimately responsible.³³ That framework must include “*systems, structures, policies, processes and people within an RSE licensee’s business operations that identify, assess, manage, mitigate and monitor all internal and external sources of inherent risk that could have a material impact on the RSE licensee’s business operations or the interests of beneficiaries*”,³⁴ including climate change.
23. Vanguard and Vanguard Investments Australia do not appear to have the necessary capability to manage the material risk of climate change. The nature of Vanguard Investments Australia’s investments are also at odds with AustralianSuper’s climate risk assessment and policies. In the circumstances, it appears difficult for AustralianSuper to assess and be satisfied with Vanguard Investments Australia’s capability to manage AustralianSuper’s investments under s 102(1)(a)(ii) of the SIS Act.

²⁷ *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**), s 102(1)(a)(ii).

²⁸ REST, *Rest reaches settlement with Mark McVeigh*, 2 November 2020, available at <https://rest.com.au/why-rest/about-rest/news/rest-reaches-settlement-with-mark-mcveigh>

²⁹ APRA, 2013, *Prudential Standard SPS 231: Outsourcing*, para 19, available at <https://www.legislation.gov.au/Details/F2012L02223>.

³⁰ *Ibid*, para 19(c), (d).

³¹ Hutley SC and Mack (2021), Memorandum of Opinion, *Superannuation Trustee Duties and Climate Change*, para 10(c), available at <https://equitygenerationlawyers.com/wp/wp-content/uploads/2021/04/Hutley-SC-Mack-Superannuation-Trustee-Duties-and-Climate-Change-Memo-2021.pdf>.

³² APRA, 2013, *Prudential Standard SPS 231: Outsourcing*, paras 19, available at <https://www.legislation.gov.au/Details/F2012L02223>.

³³ APRA, 2020, *Prudential Standard SPS 220: Risk Management*, paras 5-7, available at https://www.apra.gov.au/sites/default/files/sps_220_risk_management_december_2018_1.pdf

³⁴ *Ibid*, para 6; 12(g).

24. My concerns are magnified in circumstances where, according to IEEFA, “Vanguard investors are prevented from accessing basic information about a fund’s exposure to climate risk”.³⁵ Further, Vanguard Investment Australia’s mandate raises concern about AustralianSuper’s overarching risk management systems and the possibility that more of the fund’s investment managers do not have adequate capability to manage climate change risks or inform AustralianSuper about those risks. I also expect that investment manager agreements reflect the climate ambitions of the super fund.³⁶ The concern about Vanguard Investments Australia is important to me and aligns with the relevant subsections of s 1017C of the Corporations Act that apply to the superannuation entity as a whole.
25. There is an apparent inconsistency in the way The Vanguard Funds are managed and AustralianSuper’s net zero commitment. I am concerned about whether or not AustralianSuper has a reasonable basis to make the representations above in paragraph 5 on its net zero commitment given the apparent lack of capability of Vanguard Investments Australia to manage climate change risk and that AustralianSuper has not disclosed any apparent plan or intention to address the investment manager’s shortcomings.³⁷
26. The trustee and trustee directors of AustralianSuper are bound by the duties set out in ss 52 and 52A of the SIS Act to act prudently and in the best financial interests of beneficiaries. I am concerned that the possible breaches set out above mean that the trustee and trustee directors of AustralianSuper may fall short of the requisite standards.

Request for information under section 1017C Corporations Act

27. In order to address my concerns, and pursuant to s 1017C(2) of the Corporations Act, I request that AustralianSuper provide:
- (a) a copy of all investment management agreements between AustralianSuper and Vanguard Investments Australia entered into or valid since 1 January 2016;
 - (b) a copy of AustralianSuper’s ESG policy and any documents or policies (including internal documents) that demonstrate AustralianSuper requires its internal and external investment managers to identify, assess, manage and report on climate change risk, and to act in accordance with AustralianSuper’s public commitments on climate change;

³⁵ IEEFA, p 14.

³⁶ Matthew Smith, ‘Fund agreement resets to flow from REST climate precedent’, *Investment Magazine* (4 November 2020), available at <https://www.investmentmagazine.com.au/2020/11/fund-agreement-resets-to-flow-from-rest-climate-precedent/>.

³⁷ See N Hutley SC and S Hartford Davis, *Climate Change and Directors’ Duties: Further Supplementary Memorandum of Opinion*, 23 April 2021, available at: <https://cpd.org.au/wp-content/uploads/2021/04/Further-Supplementary-Opinion-2021-3.pdf>.

- (c) information concerning steps AustralianSuper has taken to require Vanguard Investments Australia to manage AustralianSuper's investments in accordance with AustralianSuper's commitment to net zero by 2050;
- (d) AustralianSuper documents that seek information from Vanguard Investments Australia on:
 - (i) the climate risks of its investments, including whether it requires information on climate change mitigation, net zero emissions targets, or reports on scope 1, 2 and 3 emissions; and
 - (ii) Vanguard Investment Australia's activities and actions to manage climate change risk, including in accordance with AustralianSuper's public commitments;
- (e) information Vanguard Investments Australia has provided to AustralianSuper in relation to the subject matter in (d) above;
- (f) information before the board of AustralianSuper on the capability of Vanguard Investments Australia to manage AustralianSuper's investments;
- (g) documents created since 1 January 2016 recording the outcome of any AustralianSuper due diligence reviews and assessments of any changes to the risk profile of Vanguard Investments Australia's activities;
- (h) documents recording AustralianSuper's analysis of the financial impact of climate change on its investments with Vanguard Investments Australia; and
- (i) documents recording actions AustralianSuper has taken as a result of due diligence analysis on Vanguard Investments Australia with respect to climate risks.

28. I reasonably require the above information in order to, among other things, understand AustralianSuper's investments and to make an informed judgment about the management and financial condition of the fund.

29. I look forward to your response within 28 days.

Annexure A – AustralianSuper’s investments in The Vanguard Funds at 30 June 2021

Asset Class/ Classification	Investment Name	Value as at 30 June 2021 (\$)	Index Diversified Option (%)	Active/ Passive	PDS	Climate risk addressed
Australian Shares	Vanguard Australian Shares Index Fund	335,152,688 (Super) 100,693,588 (Retirement)	27.94	Passive	PDS , 10 July 2020	No
International Shares	Vanguard International Shares Select Exclusions Index Fund	350,735,932 (Super) 105,375,432 (Retirement)	29.24	Active	PDS , 10 July 2020	No
International Shares	Vanguard International Shares Select Exclusions Index Fund (Hedged) - AUD Class	155,300,972 (Super) 46,658,770 (Retirement)	12.95	Active	PDS , 10 July 2020	No
Fixed Interest & Credit	Vanguard Australian Fixed Interest Index Fund	131,893,340 (Super) 39,626,159 (Retirement)	10.99	Passive	PDS , 10 July 2020	No
Fixed Interest & Credit	Vanguard Ethically Conscious Global Aggregate Bond Index Fund	132,150,410 (Super) 39,703,393 (Retirement)	11.02	Active	Supplementary PDS , 10 March 2021	Not recognised as a material risk.

	(Hedged) AUD Hedged					Fossil fuel exclusion on ethical grounds. ³⁸
Sub-total (Superannuation)		1,105,233,342				
Sub-total (Retirement)		332,057,342				
Total Value of Indexed Diversified		1,437,290,684	92.14			

³⁸ Supplementary PDS, 10 March 2021, at p5: “The Fund seeks to track the return of the Bloomberg Barclays MSCI Global Aggregate SRI Exclusions Float Adjusted Index hedged into Australian dollars (AUD) (Index) before taking into account fees, expenses and tax... Bloomberg Barclays (the Index provider) constructs the Index based on ethically conscious criteria with research data supplied to the Index provider by MSCI. Index construction and any securities that are excluded based on the ethically conscious criteria, is independent of Vanguard...In constructing the Index, using MSCI research, the Index provider excludes the securities of issuers that engage in activities in, and/or derive revenue (above a threshold specified by the Index provider) from, fossil fuels, nuclear power, alcohol, tobacco, gambling, weapons and adult entertainment...The screening process does not review government securities, and certain securitised assets and company structures, particularly government related corporations and non-listed companies. Accordingly, securities issued by non-screened entities may also be contained in the Index that is tracked by the Fund... Vanguard does not take into account labour standards, environment, social or ethical considerations when selecting, retaining or realising investments in the Fund to track the performance of the benchmark index. Vanguard has engaged Bloomberg Barclays to provide an index of securities for the Fund that excludes companies with significant business activities involving fossil fuels, nuclear power, alcohol, tobacco, gambling, weapons, adult entertainment and conduct related to screens based on severe controversies.”