ASSET MANAGEMENT

Responsible investing update

September 2021

This update summarises MLC Asset Management Services Limited's (MLCAM) environmental, social and governance (ESG) approach and provides examples of recent ESG-related activities in client portfolios.

What is responsible investing?

There is broad agreement across the asset management community that ESG factors can materially impact investee companies' operational and financial performance, and thus investor returns. 'Responsible investing' is the shorthand for integrating the assessment of ESG factors into the investment process.

Drawing from extensive industry as well as academic evidence, responsible investing recognises companies that:

- ✔ act with an environmental duty of care
- ✔ have the support of communities in which they operate, and
- ✔ have transparent and robust governance processes and standards,

are more likely to deliver sustainable long-term investment returns than those that fall short on these grounds.

Intuitively too, responsible investing makes sense. If, for example, a company doesn't take into account physical risks such as risks arising from pollution (E), does not properly manage its human capital by underpaying workers (S), or has weak oversight of key management functions (G), it will likely experience adverse economic consequences at some point, which in turn will negatively impact its value.

Owing to all of this, we believe ESG factors matter when making investment decisions.

Examples of ESG factors include:

Environmental

- Climate change
- Water supply
- Energy use
- Pollution
- Biodiversity

Social

- Human rights
- Supply chains
- Health and safety
- Indigenous rights
- Modern slavery

Governance

- Board independence
- Remuneration
- Bribery and corruption
- Shareholder rights
- Human capital management

How does MLCAM consider ESG factors?

MLCAM uses the services of many specialist investment managers to select individual investments for clients' portfolios.

We expect active investment managers to consider all material factors, including ESG, that may impact investment performance. Rather than second-guessing our investment managers, and prescribing what they should do, we believe they are best placed to scrutinise ESG factors across all investments they consider.

Some of the ways in which ESG risks can be managed include:

- avoiding an investment, or reducing the position size
- engagement with the company or using proxy voting rights to influence positive change, or
- as a last resort, divestment or exclusion.

As part of our responsible investment practice, we work closely with MLC Investments Limited, the Responsible Entity that determines how proxy voting is conducted for our portfolios, to vote on AGM resolutions. Primarily via our managers, we also actively engage with companies with a view to improving companies' performance on ESG issues, which in turn is expected to enhance and protect the long-term value of clients' portfolios.

How does MLCAM monitor its managers' ESG incorporation?

As part of MLCAM's ongoing manager reviews, our investment managers' processes for assessing ESG factors are actively monitored to ensure alignment with MLCAM's **Responsible Investment Policy**. Assessments are done through regular face-to-face interactions as well as by reviews of managers' quarterly ESG reports.

We also undertake annual reviews of each manager's ESG policies and expect evidence of incorporation of ESG factors into their processes. A manager's ESG underperformance can contribute to its termination.

ESG activity

The following section highlights some of our investment managers' ESG perspectives and activities in MLC portfolios during the 1st half of 2021.

Environmental

Renewable energy opportunity

One of our managers held discussions with a mining company around the potential environmental risks associated with its rare earth processing requirements. Rare earth minerals are a critical component in the production of high-tech gear including smartphones, componentry in wind turbines and electric car batteries. A by-product of the rare earth enrichment process is a low level of radioactive waste.

The manager has spoken directly with the CEO, and other executives, who provided a number of reports into the radioactivity levels of the waste product, and analysis from a number of independent experts. From this analysis, the manager is comfortable that the risk of environmental impact from the company's operations is medium to low and will continue to reduce over time. The manager has also seen reports that state the radioactive levels from the residual waste material is similar to fertiliser and the company is speaking with the Australian Government about opportunities to reuse the waste product as fertiliser for agriculture. The company presents an opportunity related to the renewable energy and climate change thematic, with the manager believing there are very strong demand and supply dynamics given the expected surge in electric vehicles, windfarms and other technology requiring these minerals.

Taking back plastic

One of our managers held discussions with a leading international biopharmaceutical company regarding their plastic consumption. This discussion focused on their lack of publicly disclosed investments into alternatives for plastic in single use production systems. The company's view is that incineration of single use consumables is the best solution. This also generates thermal heat used for energy production. A fundamental issue is that chemicals used are very aggressive and to the extent materials were biodegradable, cell line organisms may eat the materials.

There are both practical and regulatory issues which continue to block development in this area.

Environmental continued

Emerging market companies integrating ESG disclosure

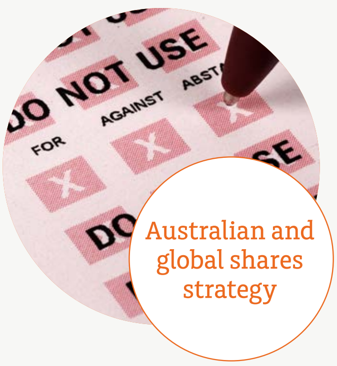
One of our managers engaged with management of two of its emerging markets debt portfolio companies in the energy sector, to provide feedback and recommendations on their integration of more robust ESG disclosure in their regular financial reporting packages. Management acknowledged the growing importance of strong ESG policy implementation and welcomed our manager's feedback as an opportunity for improvement. They committed to actively working to improve their reporting frameworks in the short-term (eg providing improved reporting transparency and frequency, including more detailed ESG metrics/key performance indicators, publishing annual sustainability reports in english, and adding/improving ESG portals on their corporate websites). Our manager believes this type of engagement and constructive feedback will effect positive change industry-wide and is essential for emerging markets companies.

Social

Workplace safety matters

One of our managers continues to have engagement with a steel producing company regarding its approach to safety following workplace fatalities in FY2019 and FY2020. Our manager's concern was based on their principles that companies owe a duty to provide a safe environment for their employees and ensure that every person returns home from work safely every day. The manager has engaged with the Board and management on several occasions over the company's low weighting to safety in management's short-term incentives (STIs), and a lack of discretion exercised to reduce STI payments in the event of fatalities. In June 2021, the manager met with the company to discuss a revised remuneration framework and were pleased to see their feedback had contributed to an increased weighting to safety and ESG factors in management STIs for FY2022. The company has also made a cultural shift from a focus on instructing employees to be safe in dangerous environments to reducing the degree of harm employees are exposed to in such environments.

Governance



Making proxy votes[1] count

For Australian companies, MLCAM works closely with MLC Investments Limited (MLCI), the Responsible Entity that determines how proxy voting is conducted for portfolios we manage. The process is designed to protect and enhance the investment value of our portfolios' share investments, recognising the strong link between good corporate governance and investment value. MLCI applies the Financial Service Council (FSC) Standard and Guidelines on proxy voting to its operational processes where applicable.

Refer to MLCI's **Proxy Voting Policy** for more details, including a summary of proxy voting records.

For global shares, we currently outsource proxy voting to our international investment managers as we believe they are best placed to vote on matters pertaining to international companies held in their portfolios.

1. Governance is an important component of ESG, as it's the governance of companies that ultimately determines the ethos of management and how robustly environmental and social risks are managed. Shareholder voting is a means by which shareholders can influence a company's operations, its corporate governance and activities of social responsibility. Proxy voting is where a vote is cast on behalf of a shareholder.

Modern slavery

Modern slavery describes situations where offenders use coercion, threats or deception to exploit victims and undermine their freedom. Practices that constitute modern slavery can include human trafficking, slavery, servitude, forced labour, debt bondage, forced marriage and child labour.

COVID-19 is no excuse

One of our Australian managers earlier this year met with a company that manufactures and sells hand and body protection products for the health care and industrial sectors. In our manager's meeting with the company, they discussed at length the company's pricing strategy during the pandemic, particularly in light of supply chain tightness and reported price gouging by competitors.

Our manager came away with greater assurance that the company's management team have taken a long-term view to sustainably manage pricing despite tight demand, which in our manager's view augurs well for its relationship capital and more broadly its social license to operate. The company also expressed that even in a tight market it has been uncompromising on taking on suppliers who do not meet their standards around the use of labour. Importantly, our manager has also received third party verification of the stringent standards to which the company holds its manufacturing suppliers.

This is particularly valuable at a time where COVID-19 has made independent audits of supply chain integrity difficult. This has given our manager greater confidence in the company's competitive position and its social license to operate, particularly as one of its key peers has come under ESG regulatory scrutiny.

Source: MLC Asset Management Services Limited. As our investment managers are constantly reviewing and making changes to their holdings, these investments may no longer be included in the portfolio.

MLCAM's Responsible Investment Policy is available at **mlcam.com.au/responsible-investment-policy**.
For MLC MySuper, MLCAM is also required to adhere to the **NULIS Responsible Investment Policy** available at **mlc.com.au/nulis-nominees-responsible-investment-policy**.