Policy on Consideration of Environmental, Social and Governance Issues for Investment Purposes

August 2023

1. SUMMARY

Environmental, Social and Governance ("**ESG**") issues are an integral component of the Magellan Asset Management Limited ("**Magellan**") investment analysis process, as gaining a robust understanding of these issues is a key part of assessing the outlook for future cash flow generation and risks of an investment.

Where material, the investment team engage with investee (or prospective investee) companies in regard to ESG exposures, their management of the risks and potential opportunities. The objective of such engagement is to enhance the certainty of long-term cash flow generation we expect from the company. Engagement can extend beyond risk management, including seeking clarity on proxy proposals, to provide feedback and to effect change.

Magellan is a signatory to a number of industry initiatives and associations that support our commitment to responsible investment, transparency to stakeholders and ability to elevate key company and industry issues such as climate change. One of our commitments includes United Nations- sponsored Principles for Responsible Investment ("**PRI**"), of which Magellan is a signatory. The principles provide a framework by which all investors can incorporate ESG issues into their decision-making and ownership practices. The principles are not a prescriptive set of rules, and are to be applied as appropriate within each asset class and investment approach. Magellan has considered these principles in our approach detailed below, and as part of our broader responsible investing policies.

For the determination of investment grade status, ESG issues are incorporated into the approval for each strategy's investable universe and monitored. The ESG ratings reflect the material issues faced by the industry that the company operates in and the company's practices. For some strategies, this is explicitly discussed as part of the research report, at initiation, completed for each company. These scores are discussed by the Investment Committee ("**IC**"). For other strategies, companies are initially screened for ESG criteria, and are excluded from the universe if they fail. This is further discussed in the sections below.

As part of the ongoing analysis of companies held in our portfolios, ESG issues are continuously monitored and ESG scores reviewed at minimum on an annual basis.

2. INTRODUCTION

This policy outlines for Magellan's registered managed investment schemes ("**funds**") and designated investment mandates ("**mandates**"):

- how ESG issues are linked to Magellan's investment analysis framework;
- how ESG issues are incorporated as part of the investment process; and
- how analysis of ESG issues as part of the investment analysis framework should be evidenced.

3. WHY ESG ISSUES SHOULD BE CONSIDERED AS PART OF THE INVESTMENT ANALYSIS PROCESS

Magellan's actively managed funds seek to identify high quality investments and acquire such investments at prices assessed as representing an appropriate margin of safety. As part of the assessment of a company's intrinsic value, Magellan seeks to consider all issues that may materially affect the investment outcomes for a company. ESG issues affect the investment outcomes for a company and Magellan specifically considers these issues as part of its analysis of agency and business risks.

The investment objectives of Magellan's funds are to (a) minimise the risk of permanent capital loss and; (b) achieve superior risk-adjusted returns over time. For its actively managed investment portfolios, Magellan seeks to achieve these objectives by investing in companies that meet Magellan's investment grade requirements and for which the share price represents an appropriate discount to the assessed intrinsic value.

The investment grade rating of potential investments are evaluated by the Magellan investment team by applying the following qualitative assessment criteria:

1. **Economic moat** – Magellan seeks companies with sustainable competitive advantages and a consequent ability to generate high returns on capital for a long period of time;
2. **Moat trend** – direction of the moat over time. Direction is an important indicator of the future opportunity of the company;
3. **Reinvestment potential** - Magellan seeks companies with the potential to continue to reinvest capital into the business at high incremental returns;
4. **Business risks** – Magellan seeks investments with predictable cash flows and earnings. The assessment of business risk for each company is not an attempt to measure the volatility of the shares, but rather the predictability

and strength of the underlying business; and

5. **Environmental and Social** – assessment of the environmental and social risks and opportunities of the company. We assess the exposure to the material risk, and the potential impact.
6. **Agency risk** - A key assumption inherent in a standard discounted cash flow valuation ("**DCF**") is that free cash flows are returned to shareholders or are reinvested at the cost of capital. However, cash is often reinvested by companies at returns below the cost of capital. In these cases, businesses can end up being worth substantially less than implied by a DCF analysis. We term the risk surrounding the deployment of the free cash flow generated by a business as "Agency Risk".
7. **Governance** – assessment of the risks presented by the company's governance practices and policies.

Environmental Issues

In order to fully understand the issues facing a company, investors should consider environmental risks and opportunities that might affect the future operations of a company including issues such as climate change, natural capital usage, water stress, waste disposal, the use of toxic chemicals, the formal license to operate in communities, and other issues that can impact the environment.

Magellan believes climate change is a particularly important environmental issue for global businesses and investors to consider. In order to enhance assessments of the company-specific risks and opportunities associated with climate change, Magellan is a Signatory of CDP's climate change program through its parent company, Magellan Financial Group Limited. As a Signatory, Magellan is able to access companies' detailed climate disclosures including data on carbon emissions and climate change mitigation activities. Research reports include a discussion of climate change related risks and opportunities facing companies, including emissions intensity[1].

Magellan, as part of the Net Zero Asset Manager initiative[2], has developed a Stewardship strategy – climate related risks and opportunities available at https://www.magellangroup.com.au/about/responsible-investing/

As part of this Stewardship strategy, Magellan's Investment Team reviews climate related targets and commitments of companies in all strategies, at least annually. This includes but is not limited to:

1. Ambition: A commitment to net-zero by 2050;
2. Targets: Near- and medium-term emission reduction targets with a preference for external validation;
3. Strategy: Alignment to reporting in accordance with the Taskforce for Climate-related Financial Disclosures ("**TCFD**") and a credible strategy to achieve targets.

We consider these commitments represent prudent risk management in a transitioning economy to net zero.

A key input is our analyst's view on the credibility of a company's initiatives and climate strategy to achieve their targets. We also consider disclosure of emissions (Scope 1, 2, 3) and the progress towards targets.

Utilising both Magellan proprietary analysis and other data (including company statements, press articles, external data providers, Science Based Targets Initiative and expert networks), each company is assessed for their alignment to net zero. This assessment is undertaken in accordance with the Net Zero Investment Framework[3], with companies classified as aligned to net zero, aligning, committed or not aligned to net zero.

Social Issues

Social issues, such as human rights, worker rights, health and safety, product safety, labor relations, supply chain labour standards and diversity, equity and inclusion play an important role in the public's perception of companies, attraction and retention of employees and protecting consumers. News of a poor safety record or the use of forced labour has the potential to damage a reputation, which can, in turn, adversely affect revenue or prompt new regulatory burdens. The social risks that threaten the reputation and brand integrity of companies is a component of business risk.

Magellan believes that companies engaging in business that undermines the rule of law or that have major detrimental impacts on human health warrant particularly close scrutiny by investors. Such business models may be the subject of future government regulation or changes in consumption patterns, making them a high risk investment from investors' perspective. Magellan excludes companies with material exposures to the production of tobacco from its investible universe.

As outlined in Magellan's Modern Slavery Statement, additional analysis is done for all portfolio companies on modern slavery risk. Each company is assessed for exposure to modern slavery risks and management of this risk exposure. Risk

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[1] Emissions intensity is the total Scope 1 & 2 CO_2 equivalent emissions of a company in tonnes per million US dollars of revenue (t/$m). Scope 1 emissions are those produced directly by the company. Scope 2 emissions are those from purchased energy including electricity and steam.

[2] https://www.netzeroassetmanagers.org/commitment/

[3] https://www.iigcc.org/resources/net-zero-investment-framework-implementation-guide

exposure considers the industry, geography and material controversies alleged or confirmed. The investment team assesses the management of this risk at least annually. Magellan strives to engage directly with portfolio companies where we have formed the view that material modern slavery risk exists. The objective of these engagements is to better understand how the company is managing Modern Slavery risks and to influence. For companies rated as 'High risk' following our annual assessment, we commit to engaging.

Governance Issues

Corporate governance is concerned with the way corporate entities are governed, as distinct from the way businesses within those companies are managed on a day-to-day basis. Strong governance structures, appropriate executive control and high levels of transparency are amongst the factors likely to provide confidence as to the level of agency risk. For further information on the approach to governance issues please see Magellan's Corporate Governance Principles and Proxy Voting Policy, available at https://www.magellangroup.com.au/about/responsible-investing/

4. HOW ESG ISSUES ARE INTEGRATED INTO THE INVESTMENT ANALYSIS PROCESS FOR EACH STRATEGY

Investment Funds: Global Equity, Global Plus, High Conviction, Select Infrastructure, Sustainable, Core International, Core ESG

For the purposes of these strategies, the attainment of investment grade status for a company requires a research report assessing the company to be completed and approved by the Investment Committee. The quality criteria used by Magellan to assess investment grade status include economic moat, moat trend, business risk, environmental & social, agency risk, governance and re-investment potential.

As outlined above, ESG issues are completed as part of the research report. The template shown as Appendix 1 provides a guide to the analyst of ESG issues to consider when undertaking investment research. It is not exhaustive and other ESG risks and opportunities that are material to the industry and sector will be considered. This materiality assessment is influenced by SASB's assessment of industry materiality and internal industry research, to identify relevant ESG issues facing companies.

Environmental and social issues are reviewed in the research report for a company as part of the analysis of Business Risk issues with each company under review receiving a specific rating for its Environmental and Social profile. The rating for the Environmental and Social profile will be A, B or C. The rating will reflect the Environmental and Social issues faced by the industry that the company operates in and the company's environmental and social practices. If a stock is to be awarded a Low rating for Business Risk then as a pre-condition the stock must be awarded an A rating for Environmental and Social issues.

Governance issues are reviewed in the research report for a company as part of the analysis of Agency Risk issues with each company under review receiving a specific rating for its Governance profile. The rating for the Governance profile will be A, B or C. The rating will reflect the Governance issues faced by the industry that the company operates in and the company's governance practices. If a stock is to be awarded a low rating for Agency Risk then as a pre-condition the stock is required to achieve an A rating for Governance issues.

As part of the ongoing analysis of companies held in our portfolios, ESG issues are continuously monitored and ESG scores reviewed at minimum on annual basis. The focus of this analysis will be whether and how ESG issues affect the potential distribution of future cash flow generation and, accordingly, whether the qualitative ratings for the company appropriately reflect underlying risks.

For Magellan's Sustainable and Core ESG portfolios, the investment universe includes the application of our proprietary low carbon framework, and additional exclusions related to industries viewed as socially detrimental to society are applied. For Magellan's Core ESG portfolio, the ratings for Environmental and Social and Governance are explicit considerations in the rules-based portfolio construction. All else being equal, a more positive ESG assessment results in a larger portfolio position and vice versa.

Investment Funds: Core Infrastructure, Energy Transition

As a rules based, highly-diversified strategy, the constituents of Magellan's Core Infrastructure and Energy Transition portfolios are not required to be approved by the Investment Committee and therefore constituents do not undergo explicit ESG scoring as described above.

In determining eligibility of companies for inclusion in the Core portfolio, Magellan does consider significant ESG issues that pose a material threat to the investment fundamentals (such as the future cashflow expectations of the business). Namely:

- Companies must meet acceptable governance standards, with the particular focus around the holding structure and alignment of minority shareholders. Companies that fail to meet acceptable governance standards may be excluded from Magellan's approved universe; and

- Material Environmental & Social risks are assessed and monitored. Companies may be excluded if these risks are considered by Magellan to significantly impact the investment fundamentals. Examples of risks may include exposure to environmental damages or safety standards in operations.
- Detailed Climate Risk reviews: Magellan undertakes a detailed review of companies exposed to climate risk (as outlined above)

Investment Funds: All funds

Proxy voting and engagement for all portfolios are conducted in line with our Proxy Voting Policy and Corporate Governance Principles. Stewardship outcomes are reported in the annual 'Stewardship Report' for each strategy available at **https://www.magellangroup.com.au/about/responsible-investing/**

APPENDIX 1 - ESG ISSUES CONSIDERED FOR MATERIALITY, RISK AND IMPACT

ESG ISSUES

Environmental

Climate Change

Climate transition risk and opportunity

- Company Strategy and alignment with the Paris Agreement
- Exposure of the company to risks and opportunities as a result of the transition of the global economy towards net zero emissions
- Net Zero Carbon emission targets
- External validation of emission reduction targets

Scope 3 emissions management including: Financed emissions, Supply chain emissions
Physical Climate risk, mitigation and adaptation
Climate opportunities
Just or equitable transition for communities and workers

Natural Capital

Biodiversity on land and water
Sustainable raw material sourcing
Deforestation
Clean water and sanitation

Circular Economy

Waste & Hazardous materials management
Packaging material and waste
Electronic waste

Social

Labour and human rights

Labour relations and standards
Modern slavery including serious exploitation such as forced labour; debt bondage; deceptive recruiting for labour or services; and the worst forms of child labour.
Diversity, Equity and Inclusion
Education and human capital
Culture
Corporate conduct and controversies

Health and safety

Workplace health and safety
Consumer health and safety
Product safety
Privacy and data security
Food security

Social - Other

Social licence to operate
Community relations and engagement
Animal welfare
Political contributions and disclosure of lobbying
Political risk of involvement in high risk countries
Financial inclusion
Sustainable Digitisation – oversight, data protection and privacy, misinformation and content monitoring and controls.

Governance
Shareholder rights Dual-class share structure Majority voting Takeover defenses/market for control
Board composition and independence Board independence Director skills and diversity Director capacity and over-boarding Equity ownership and alignment with shareholders Separation of chairman/CEO position Governance and oversight of key risks and opportunities including ESG risks such as climate, cybersecurity
Executive compensation Remuneration structure Quantum relative to peers Performance metrics (incl. ESG metrics) and hurdles Equity alignment
Corporate accountability Compliance Bribery and Corruption Anti-competitive practices Conflicts of Interest Accounting and audit quality