

## ESG Policy

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# MORNINGSTAR®

## Environmental, Social and Governance Policy

Morningstar Investment Management Australia Limited (“MIM Australia”) is part of Morningstar Investment Management (“MIM”), a global multi asset business that is committed to delivering great performance outcomes for investors by taking a long-term and value-oriented investment approach. As we consider the future from a long-term perspective, it is clear that environmental, social and governance (ESG) issues are playing an increasingly important role in the behavior of consumers, regulators and investors. This, in turn, has an impact on asset prices, prospective returns and risk. It is essential that we, as value-oriented investors, consider ESG issues when making long-term investment decisions. It is intended that this policy will be reviewed and updated biennially to reflect relevant changes as markets and regulations evolve.

### ESG Investment Approaches

ESG investing covers a broad spectrum of strategies and the term can be confusing to many investors. We aim to overcome this confusion by focusing on two primary ESG investment approaches: ESG risk integration and preference-driven investing. The two investment approaches can be delineated by a difference in their primary investment goal outcomes – ESG risk integration looks to distinguish between investments based on an assessment of *value*, while preference-driven investing aims to distinguish investments based on an assessment of *preferences*. This delineation mirrors the pecuniary (financial) vs. non-pecuniary (non-financial) distinction made by many regulators and researchers. While this simplifies the discussion of ESG issues, many ESG products incorporate both investment approaches.

#### ESG risk integration

The ESG risk integration approach is primarily focused on assessing and managing the potential financial impact resulting from ESG risks on an investment asset, which may be experienced through a reduction in the future cashflows of an asset, and/or a permanent impairment of asset value. The relevance of individual ESG risks to different investments will vary according to the type of investment. Examples of ESG issues include poor safety at work practices, high carbon emissions, data security issues, and poor corporate governance practices.

#### Preference-driven investing

Preference-driven investing seeks to align the investments of a portfolio with the preferences and concerns of the investor with regard to ESG issues. Unlike ESG risk integration, this investment approach leads to investments which are driven primarily by the investor’s preferences, rather than being purely based on financial return outcome considerations (the approach may still have positive financial benefits but this is not the primary investment focus). This investing approach is commonly adopted by dedicated ESG products. ESG products may encompass exclusions, such as avoiding tobacco manufacturers, and/or reflect preferences, such as supporting alternative energy initiatives. As preferences are highly personal to each investor, co-mingled ESG products may not always perfectly match an individual investor’s personal preferences.

## **Morningstar Investment Management's Investment Approach**

As a value-oriented and long-term investor, Morningstar Investment Management Australia adopts the ESG risk integration investment approach across our multi-asset products, where the primary investment goal is to deliver superior investment returns. We believe that ESG risks form a sub-set of fundamental risks that need to be considered when evaluating investments on a risk-adjusted return basis. ESG risk considerations are integrated across several stages in the overall investment process: fundamental research, investment selection, and portfolio construction.

Morningstar Investment Management offer thematic ESG products in the United States of America and the United Kingdom, which adopt preference-driven investment approaches based on investors' preferences.

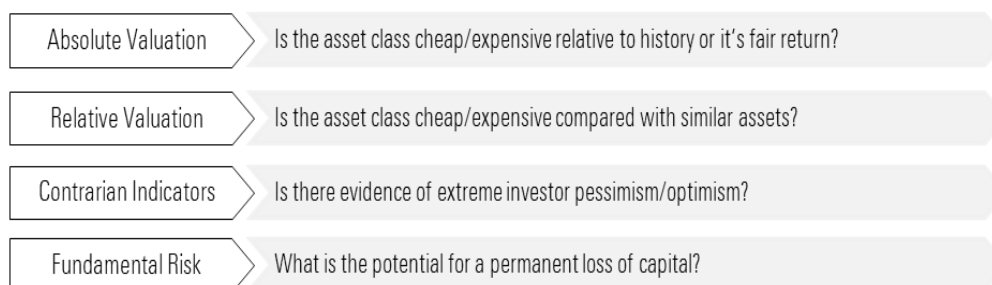
ESG-related investment practices are the primary focus of the ESG Global Best Practice squad which guides the firm's ESG policies, as well as integrating ESG considerations across various stages of the investment process: fundamental research, investment selection, and portfolio construction. ESG investment policies and practices are reviewed and approved by our Global Investment Policy Committee (GIPC). Once a policy and/or practice has been approved by the GIPC, it is "localised" (where relevant) and incorporated across MIM's regional teams.

### **Fundamental Research ESG Integration**

MIM adopts a valuation-driven asset allocation process to support the management of its multi-asset strategies around the world. To determine the attractiveness of a potential investment opportunity and allocate capital to assets that offer the highest reward for risk, MIM maintains asset class valuation models and assigns conviction ratings to a wide range of asset classes.

As shown below, asset class convictions are assigned based on four ratings: Absolute Valuation, Relative Valuation, Contrarian Indicators, and Fundamental Risk. Because ESG risks can expose an asset class to reduced future cash-flows and/or a permanent loss of capital, we seek to include ESG risks within the Fundamental Risk conviction rating for Growth assets (that is, equities, real estate and infrastructure). As ESG data-sets evolve, we plan to extend our assessment of ESG risks to Defensive assets (primarily fixed income securities).

Asset class conviction are based on 4 ratings:



Within the Fundamental Risk rating for Growth asset classes, the risk of ESG-related permanent loss of capital is calculated by:

- 1) identifying contingent events arising from high exposure to material ESG issues.
- 2) assigning probabilities to those events
- 3) assessing the probabilistic impact of each event on the fair value assumptions
- 4) summing the overall expected impact on Fair Value, which equals the expected permanent loss of capital

1)	2)	3)	4)
Contingent Events	Probability	% Impact of Event on Fair Value	Probability * % Impact of Event on Fair Value
Event arising from high exposure to material ESG Issue 1	20%	20%	4.0%
Event arising from high exposure to material ESG Issue 2	10%	10%	1.0%
Event arising from high exposure to material ESG Issue (x)	10%	25%	2.5%
Other Event contingent on fundamental risk	50%	10%	5.0%
<b>Total Probability * % Impact on Fair Value</b>			<b>12.5%</b>

### Investment Selection ESG Integration

For our passively managed strategies, ESG investing considerations are primarily considered at the fundamental research stage of our investment process for the relevant asset class. For externally appointed actively managed equities strategies, ESG investing considerations are incorporated in the manager research process. Our team forms judgments about whether portfolio managers and analysts are appropriately evaluating relevant ESG risks for individual portfolio holdings, and in turn, overall portfolios, using a combination of both quantitative and qualitative analysis.

Our team’s analysis includes assessing written ESG questionnaires, reviewing ESG policy documentation, regularly interviewing analysts and portfolio managers, reviewing the quality and depth of ESG data and people resources, analysing portfolio holdings (using Sustainalytics software to evaluate ESG risk and carbon risk portfolio exposures), and regularly reviewing proxy voting reports.

As an additional input into the manager research process, our investment professionals leverage research conducted by Morningstar, Inc.’s manager research team, which includes a relatively new ESG Commitment Level qualitative rating system. The MIM ESG Commitment Level rating process is largely based on the Morningstar Manager Research’s ESG Commitment Level rating process, with a total rating assigned following the team’s evaluation of four key pillars: Process, People, Data, and Parent. The MIM ESG Commitment Level for strategies is expressed on a five-tier scale running from best to worst: Leader, Advanced, Basic Plus, Basic, and Low.

### **Portfolio Management ESG Integration**

ESG-related considerations, as highlighted by our fundamental research and manager selection analysis, form an important part of fundamental risk assessment and are therefore considered by portfolio managers in the context of seeking superior risk-adjusted return outcomes for all our portfolios.

### **Reporting**

MIM is committed to providing timely and relevant external communication and reporting of our ESG-related investment efforts. We have collated summaries of proxy voting activities for Australian investors on our website (<https://morningstarinvestments.com.au/summary-of-our-proxy-voting-activities/>). Morningstar and Sustainalytics are enhancing our capabilities to support ESG reporting for fixed income, with a particular focus on sovereign bonds. This initiative will enable MIM to produce ESG reporting for our multi-asset funds in the near term.

### **Future Planned ESG Developments within MIM**

MIM is currently reviewing a number of ESG-related initiatives, which include the following:

- Partner with our “sister” company Sustainalytics to develop a *global* proxy voting reporting framework and company engagement program;
- Incorporate ESG considerations into our fundamental research analysis for Fixed Income asset classes; and
- UNPRI status – While Morningstar has been a signatory to the United Nations Principles for Responsible Investment (“UNPRI”) since 2016, MIM is not currently a signatory to the United Nations Principles for Responsible Investment (“UNPRI”). We are currently undertaking a review with our intention being to change this status in the future.

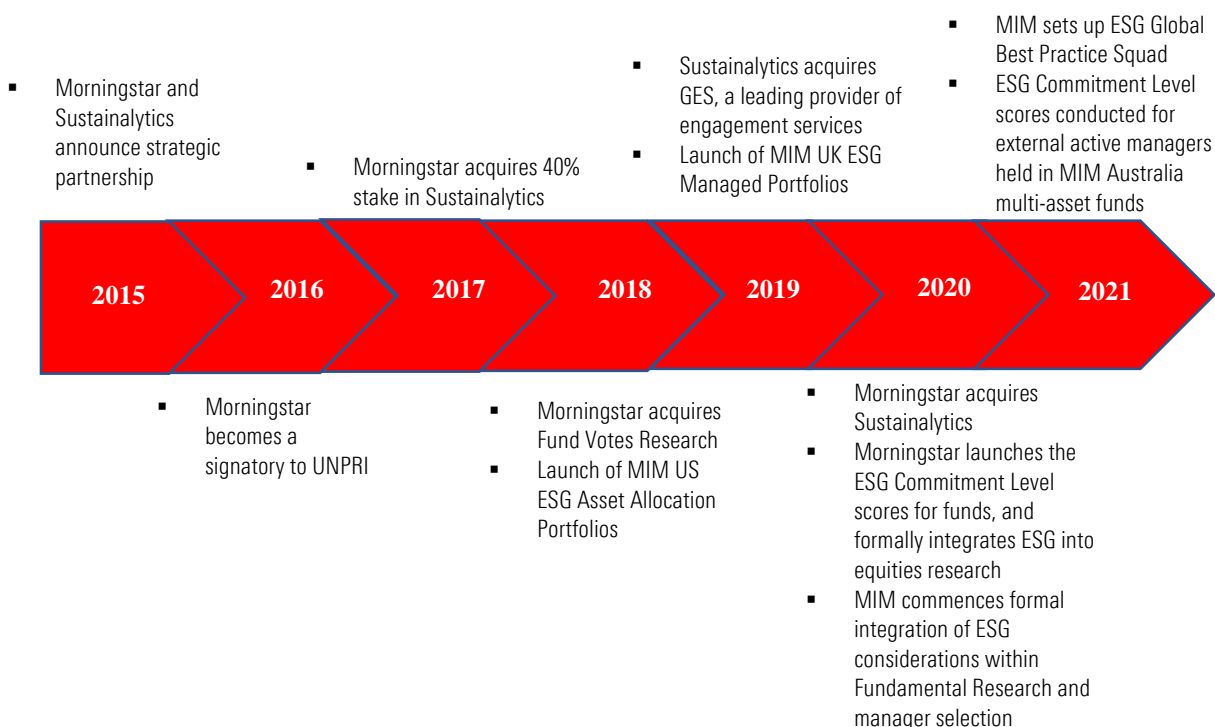
## ESG at Morningstar Inc.

Morningstar Inc. is one of the world’s largest financial data and research companies, and has a deep commitment to identifying ESG issues across the capital markets, and providing data, research, and products that enable investors to understand the impact of ESG considerations when making investment decisions.

Morningstar is committed to building a more sustainable and socially responsible future for our employees, clients, investors, and the broader community. Our thesis about corporate sustainability at Morningstar is two-fold:

- Our corporate sustainability efforts firstly contribute to 4 of our 5 corporate goals: support our efforts to exceed company-wide goals; establish a leading ESG position across each business unit; drive operational excellence to support growth; and build an inclusive culture that drives exceptional talent engagement and development.
- Our corporate sustainability efforts also contribute to the firm’s ancillary goal of positioning our firm for developing regulatory best practices, with the expectation that ESG data is likely to be recognized as representing financially material data and therefore ESG data disclosure becomes a requirement.

### Morningstar and MIM’s ESG Journey to Date



Morningstar first purchased an equity stake in Sustainalytics, one of the world’s largest ESG research businesses, in 2017. This was followed by Morningstar taking 100% ownership of Sustainalytics in 2020. By coming together, Morningstar and Sustainalytics intend to fast track Morningstar’s ability to put independent, sustainable investing analytics at every level in the hands of all investors. (We see ESG considerations as being synonymous with sustainable investing, and therefore use the terms “ESG” and “sustainable investing” interchangeably throughout this policy.)

### **Morningstar Inc. Enterprise Sustainability Team**

The Enterprise Sustainability Team’s key focus is to transform the company’s priorities and values into competencies, processes, and projects across the firm. This team is responsible for articulating and communicating the firm’s sustainability strategy and positioning the firm for leadership in sustainability relative to financial services industry peers. Each business unit within Morningstar, Inc. has a responsibility to drive ESG expertise in their functional role. Corporate Social Responsibility topics addressed within each business unit include:

- |   |                                  |
|---|----------------------------------|
| Governance Structure and Oversight              | Employee Engagement              |
| Business Ethics                                 | Employee Benefits                |
| Environmental Impact of Products & Services     | Training and Education           |
| Customer and Product Responsibility             | Community Involvement            |
| GHG Emission Reduction Targets and Action Plans | Diversity, Equity, and Inclusion |
| Climate Change Risks and Mitigation Strategy    | Data Information and Security    |



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