

## ESG Policy

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## 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 (non ESG preferences-based) 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.

Australian equities and global equities systematic and fundamental-based strategies managed by MIM Australia adopt an investment approach incorporating fundamental risk considerations, and started including ESG-related preference-driven considerations from October 2021. The systematic and fundamental-based strategies which adopt a set of "norms based" ESG exclusions to reflect the preferences of ESG focused investors, and the specific set of ESG exclusions that are applied, are shown in Appendix A of this ESG policy.

MIM Australia launched Sustainable Managed Accounts, a suite of ESG multi-asset products, in February 2022. The Sustainable Managed Accounts adopt an investment approach incorporating ESG risk considerations alongside ESG-related preference-driven considerations. The specific set of ESG exclusions that are applied to our Sustainable Managed Accounts are shown in Appendix B of this ESG policy. Morningstar Investment Management also offer ESG multi-asset products in the United States of America and the United Kingdom, which adopt preference-driven investment approaches based on local investors' preferences.

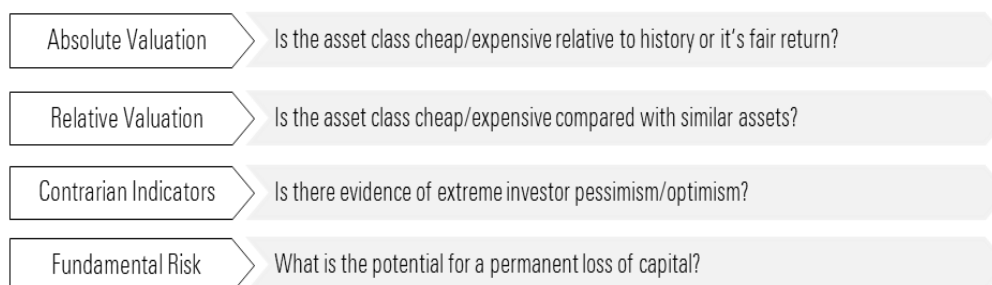
ESG-related investment practices are the primary focus of the ESG Global Best Practice squad which guides the firm's ESG policies, as well as integrating ESG considerations across various stages of the investment process: fundamental research, investment selection, and portfolio construction. ESG investment 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 passively managed strategies, ESG investing considerations are primarily considered at the fundamental research stage of our investment process for the relevant asset class.

Australian equities and global equities systematic and fundamental-based strategies managed by MIM Australia adopt an investment approach incorporating fundamental risk considerations, and started including ESG-related preference-driven considerations from October 2021. The Sustainable Managed Accounts adopt an investment approach incorporating ESG risk considerations alongside ESG-related preference-driven considerations.

Please see Appendix A and Appendix B of this ESG policy for further details regarding the ESG-related exclusions applied within the systematic and fundamental-based strategies, and the Sustainable Managed Account products, respectively.

For externally appointed actively managed equities strategies, ESG investing considerations are incorporated in the investment selection 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, where applicable.

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 investment selection process, 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.

Australian equities and global equities systematic and fundamental-based strategies managed by MIM Australia, and Sustainable Managed Accounts managed by MIM Australia, also include ESG preference considerations at the portfolio construction stage.

### **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/>). In January 2022, MIM appointed our "sister" company Sustainalytics to develop an engagement program and Glass Lewis as our global proxy advisory services provider. Our Stewardship Policy, which includes our engagement policy and proxy voting policy, is available on our website (<https://morningstarinvestments.com.au/about/proxy-voting-policy/>).

In January 2022, Morningstar and Sustainalytics enhanced our capabilities to support ESG reporting for fixed income, with a particular focus on sovereign bonds. This initiative has enabled MIM to produce more detailed ESG reporting for our multi-asset funds.

### Future Planned ESG Developments within MIM

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

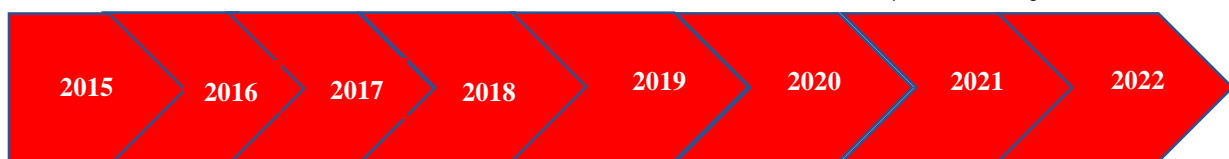
- Incorporate ESG considerations into our fundamental research analysis for Fixed Income asset classes; and
- UNPRI status – While Morningstar has been a signatory to the United Nations Principles for Responsible Investment (“UNPRI”) since 2016, MIM is not currently a signatory to the United Nations 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 and MIM’s ESG Journey to Date

- Morningstar and Sustainalytics announce strategic partnership
- Morningstar acquires 40% stake in Sustainalytics
- Sustainalytics acquires GES, a leading provider of engagement services
- Launch of MIM UK ESG Managed Portfolios
- MIM sets up ESG Global Best Practice Squad
- ESG Commitment Level scores conducted for external active managers held by MIM Australia
- ESG-related preferences incorporated into Australian and global equities systematic strategies.



- Morningstar becomes a signatory to UNPRI
- Morningstar acquires Fund Votes Research
- Launch of MIM US ESG Asset Allocation Portfolios
- Morningstar acquires Sustainalytics
- Morningstar launches the ESG Commitment Level scores for funds, and formally integrates ESG into equities research
- MIM commences formal integration of ESG considerations within Fundamental Research and manager selection
- MIM appoints Sustainalytics for engagement services, and Glass Lewis for global proxy advice.
- MIM Australia launches Sustainable Managed Accounts.

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 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

## Appendix A

Australian equities and global equities systematic and fundamental-based strategies managed by MIM Australia adopt an investment approach incorporating fundamental risk considerations, and started including ESG-related preference-driven considerations from October 2021.

The systematic and fundamental-based strategies managed by MIM Australia that adopt ESG-related exclusions are the Morningstar Australian Shares Fund, the Morningstar Global Shares Fund, the Morningstar International Shares (Unhedged) Fund, the Morningstar International Shares (Hedged) Fund, and the Morningstar International Shares Active ETF.

The strategies noted above, in Appendix A, will not have exposure to the following GICS Industry Groups (unless they are included as part of an equity index futures basket or as part of an exchange-traded fund exposure):

- 302030 Tobacco;
- 101020 Oil, Gas and Consumable Fuel; and
- 101010 Energy Equipment and Services

The strategies noted above, in Appendix A, will not have exposure to the following GICS Sub-Industry Groups (unless they are included as part of an equity index futures basket or as part of an exchange-traded fund exposure):

- 25301010 Casinos and Gaming;
- 30201010 Brewers; and
- 30201020 Distillers and Vintners

The strategies noted above, in Appendix A, will not have exposure to stocks that have controversial weapons exposure as determined by Sustainalytics (unless they are included as part of an equity index futures basket or as part of an exchange-traded fund exposure).

Equity index futures and exchange-traded fund exposures may be included in the Australian equities and global equities systematic and fundamental-based strategies for liquidity management purposes, and/or to provide access to equities markets that are difficult to access via direct stock holdings. These exposures, in aggregate, are expected to comprise a small portion (typically, less than 5%) of the total portfolio holdings for the Australian equities and global equities systematic and fundamental-based strategies.



## Appendix B

MIM Australia launched the Sustainable Managed Accounts portfolios, a suite of ESG multi-asset products, in February 2022. These portfolios adopt an investment approach incorporating ESG risk considerations alongside ESG-related preference-driven considerations.

The Sustainable Managed Accounts include the following products: Sustainable All Growth Managed Account, Sustainable High Growth Managed Account, Sustainable Growth Managed Account, Sustainable Balanced Managed Account, and Sustainable Moderate Managed Account.

The products noted above, in Appendix B, will not have exposure to the following GICS Industry Groups (with the exception of small holdings in equity index futures baskets or broad market exchange-traded fund exposures, either held in exchange traded funds or the Australian equities and global equities systematic and fundamental-based strategies noted in Appendix A of this Policy, which may be held by the Sustainable Managed Accounts portfolios):

- 302030 Tobacco;
- 101020 Oil, Gas and Consumable Fuel; and
- 101010 Energy Equipment and Services

The products noted above, in Appendix B, will not have exposure to the following GICS Sub-Industry Groups (with the exception of small holdings in equity index futures baskets or broad market exchange-traded fund exposures, either held in exchange traded funds or the Australian equities and global equities systematic and fundamental-based strategies noted in Appendix A of this Policy, which may be held by the Sustainable Managed Accounts portfolios):

- 25301010 Casinos and Gaming;

For the Sustainable Managed Accounts products noted in this Appendix, controversial weapons will also be excluded using Sustainalytics data (with the exception of small holdings in equity index futures baskets or broad market exchange-traded fund exposures, either held in exchange traded funds or the Australian equities and global equities systematic and fundamental-based strategies noted in Appendix A of this Policy, which may be held by the Sustainable Managed Accounts portfolios).

The Sustainable Managed Accounts portfolios include investments in the Australian equities and global equities systematic and fundamental-based strategies managed by MIM Australia, which are listed in Appendix A of this policy. Equity index futures and exchange-traded fund exposures may be included in the Australian equities and global equities systematic and fundamental-based strategies for liquidity management purposes, and/or to provide access to equities markets that are difficult to access via direct stock holdings. These exposures, in aggregate, are expected to comprise a small portion (typically, less than 5%) of the total portfolio holdings for the Australian equities and global equities systematic and fundamental-based strategies, and are expected to be held on an infrequent basis.

With the exception of small holdings in equity index futures and exchange-traded fund exposures held by exchanged traded funds, and the Australian equities and global equities systematic and fundamental-based strategies for liquidity management purposes, where an exchange-traded fund held in the Sustainable Managed Account portfolios is found to directly hold securities in controversial weapons, and/or non-permitted GICS Industry Groups and GICS Sub-Industry Groups, the exchanged traded fund will be divested from the portfolio within 60 days of the discovery.

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