

# Responsible Investment Principles

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## 1. INTRODUCTION

This paper outlines Magellan Asset Management Limited's ("Magellan") Responsible Investment framework and principles and provides an overview of how Magellan integrates environmental, social and governance ("ESG") risks into the investment process and Magellan's approach to proxy voting and engagement.

## 2. MAGELLAN'S APPROACH TO RESPONSIBLE INVESTING

At Magellan, we believe that successful investing is about identifying, and owning for the long-term, companies that can sustainably generate excess returns on capital for years to come. Our objectives are to achieve attractive risk-adjusted returns over the medium-to-long term whilst minimising the risk of permanent capital loss for our clients. To achieve this, we seek to identify high quality companies that are trading below our assessment of their intrinsic value.

It is within our assessment of a company's quality that ESG factors play an important role. As long-term investors, an assessment of ESG risks and opportunities are an inherent part of our investment 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.

As long-term owners we aim to act as responsible stewards of our clients' investment by exercising our proxy voting rights and having open dialogue with portfolio companies on a broad range of issues, including ESG-related issues.

Over the years, we have taken steps that highlight our commitment to responsible investing and we will continue to review and evolve our approach to responsible investment.

- In 2012, we became a signatory to the United Nations-sponsored Principles of Responsible Investment (PRI), the globally recognised accord for responsible investment;
- In 2016, we launched the first of a series of Sustainable strategies that implement a proprietary low-carbon overlay. We offer these strategies because we expect the world will take more steps to address climate-change risk by reducing carbon emissions and these measures have the potential to profoundly alter business models;
- In 2017, we became a signatory to the PRI's Montreal Pledge. Under the Pledge, Magellan commits to measure and disclose the carbon footprint of its actively managed investment portfolios;
- In 2017, Magellan became a signatory to the Responsible Investment Association of Australia; and
- In 2018, Magellan became a founding signatory to the Tobacco Free Finance Pledge.

## 3. OBJECTIVES

Magellan's ongoing Responsible Investment objectives are:

- To rigorously assess material ESG risks as part of the investment process; and
- To act as responsible owners by engaging with portfolio companies where a material ESG issue exists and exercising our proxy voting rights where appropriate.

## 4. INTEGRATION OF ESG INTO THE INVESTMENT PROCESS

For Magellan's actively managed valuation-based portfolios, Magellan's Investment team undertakes in-depth, proprietary company research, seeking to identify sustainable competitive advantages that enable businesses to generate excess returns on capital and predictable cash flow. Investment research includes an assessment of a company's inherent quality based on the following quality criteria:

1. **Economic Moat** – Assessment of the sustainability of a company's competitive advantage(s)
2. **Agency Risk** – Assessment of the extent that management will act in the best interest of shareholders
3. **Business Risk** – Assessment of the predictability and reliability of future cash flows and earnings
4. **Re-Investment Potential** – Assessment of a company's ability to reinvest profits back into its business at high incremental rates of return.

Analysis of ESG factors forms part of the suite of issues that affect these quality criteria. Gaining a robust understanding of these issues is a key element in the assessment of the outlook for, and risks to, future cash flow generation.

Importantly, Magellan is focused on materiality to cashflows and valuation that may manifest over our typical holding period of 3 to 5 years. Magellan's Investment team will make a determination about the ESG risks that are material for each company and will use sources such as Sustainability Accounting Standards Board to guide this view.

ESG scores are derived by consideration of Risk Exposure and Impact, for each individual material risk. The ratings will reflect the issues faced by the industry in which the company operates and the company's exposure and risk management practices. These scores form part of the overall quality score based on materiality.

A list of Environmental, Social and Governance issues that are considered when undertaking investment research is included in Magellan's ESG Policy. These are used as a guide for Magellan's Investment team, however it is ultimately the responsibility of the Investment Analyst dedicated to a portfolio company to determine which issues are material to that company. These are then considered and assessed by Magellan's Investment Committee. It is the responsibility of the Investment Analyst to monitor ESG risks on an ongoing basis.

## 5. PROXY VOTING

Magellan considers that proxy voting rights are an important power, which if exercised diligently can enhance client returns and should be managed with the same care as any other asset managed on behalf of its clients.

Magellan maintains a Proxy Voting Policy that outlines Magellan's process and policy for proxy voting and its process in the case of a conflict, or perceived conflict, of interest.

Magellan's ESG team is responsible for the analysis of proxy proposals and drafting recommendations for approval by each strategy's Lead Portfolio Manager. The Investment Analyst responsible for covering a particular company will be consulted on company-specific issues, where necessary. By way of example the Investment Analyst will be consulted on the appropriateness of specific remuneration performance hurdles or the appropriate use of shareholder monies in developing a report to shareholders on labour management.

Magellan will assess proxy proposals in line with Magellan's Corporate Governance Principles. Magellan will assess shareholder proposals on a case-by-case basis and consider whether the shareholder proposal will enhance the certainty of long-term cash flow generation that we expect from the company.

## 6. ENGAGEMENT

As a long-term investor, Magellan is committed to engaging with all portfolio companies on a broad range of issues. Matters of strategy, capital structure, performance and risk, etc are the responsibility of the Portfolio Manager and Investment team and are the subject of regular engagement. Magellan's ESG team is responsible for engaging with portfolio companies in regard to ESG issues. Where appropriate, engagement may be conducted in conjunction with the Lead Portfolio Manager.

Magellan focuses its engagement on material issues, particularly those which could affect future cash flows and valuation. We are also focused on safeguarding against short term actions by either companies or their shareholders which may not be in the best interests of our clients. The level of engagement on ESG issues is also considered in the context of the relative size of Magellan's shareholding.

Magellan's ESG engagement is on material issues that are identified by investment analysts in our proprietary ESG risk framework. Investment analysts identify key risks at the company level, which are then aggregated to identify material themes at the portfolio level. Key themes include climate change, diversity/equality/inclusion, circular economy, supply chain management and, responsibility for content and data privacy and health and wellness. Themes and key risks are anchors in our engagement.

Engagement in relation to ESG issues can take a number of forms and does not necessarily involve Magellan seeking to effect change. For example, many companies conduct annual shareholder outreach programs as a forum to discuss general corporate governance, sustainability, executive compensation, any changes or initiatives a company has made throughout the year and provides the opportunity for a company to solicit shareholder feedback and discuss views provided by other shareholders.

Magellan may also seek engagement to achieve a better understanding of the management of material ESG issues or to seek clarity in relation to a specific proxy proposal.

In some cases, engagement is a result of proxy voting. For example, depending on the materiality of the issue and the size of Magellan's holding, where Magellan has determined to vote against management's recommendation, Magellan will engage with a company by written and/or verbal means to the company outlining its rationale for the vote and providing advice on what the company should do to remedy the issue.

When seeking change, Magellan will typically begin engagement with company management, through investor relations, company secretarial or legal departments. Magellan may seek to escalate engagement from management to committee Chairs, Senior Independent Directors and/or Chair of the Board. Magellan will also consider collaborating with other shareholders who share similar perspectives or lodge a shareholder proposal at a company meeting as a means to address the issue.

**Appendix 1: Related Policies.**

In addition to Magellan's Responsible Investment Principles, Magellan maintains the following associated policies, all of which can be found on our website: [www.magellangroup.com.au](http://www.magellangroup.com.au)

- **ESG Policy**, which outlines in detail how ESG issues are incorporated into Magellan's investment analysis framework and investment process
- **Proxy Voting Policy**, which outlines Magellan's policy in relation to proxy voting
- **Magellan's Corporate Governance Principles**, which outlines Magellan's core principles of corporate governance

## Appendix 2: Background to Principles for Responsible Investment and Magellan's response.

### Background to the United Nations Principles for Responsible Investment

The United Nations-sponsored Principles for Responsible Investment (PRI) is a network of international investors working together to put Principles for Responsible Investment into practice. The PRI are a series of investing principles drafted by institutional investors who believe that ESG factors can affect the performance of investment portfolios. The principles support the signatories' belief that Investors fulfilling their fiduciary (or equivalent) duty need to give appropriate consideration to these factors and that the PRI provide a framework for making access to ESG information more widely available and for incorporating these factors into the decision-making process.

### Integrating PRI principles into the investment process

Investment managers that sign up to the PRI are committing to 6 principles. The principles are outlined below along with suggested practices to ensure the investment process for Magellan's actively managed funds are consistent with the principles 1 to 6.

#### 1. We will incorporate ESG issues into investment analysis and decision making processes

- a. Magellan will ensure that all investment professionals are aware of ESG considerations to ensure that the principles are adopted. Practically, ESG considerations will be specifically identified in Magellan's assessment of agency and business risk in company research reports.
- b. Additions to investment staff will be provided with Magellan's ESG policy. Any changes to this ESG policy will be advised promptly to all members of the Magellan investment team.

#### 2. We will be active owners and incorporate ESG issues into our ownership policies and procedures

- a. Where a company has a particularly poor ESG track record that has a material impact upon the risk associated with future cash flow generation, it is likely that Magellan will exercise its ESG policy through non-investment, rather than engagement. However, from time-to-time Magellan may engage with potential investee companies to discuss and/or request ESG process improvements (or intended improvements). Ultimately, the assessment of investment grade status for an investee company will reflect the future cash flow generation and associated risks for the investee company.
- b. Where we view a company's ESG risk exposures are manageable, it is likely that Magellan will exercise its ESG policy through engagement. Magellan's long-term investment horizon gives us the opportunity to engage with companies over an extended period on issues that are important to protecting and creating shareholder value and important to Magellan.
- c. Additionally, Magellan may be entitled to vote on issues relating to ESG matters for investee companies. To this end Magellan undertakes to vote in a manner that it considers most likely to maximize shareholder value using a long-term framework.

#### 3. We will seek appropriate disclosures on ESG issues by the entities in which we invest

- a. Magellan seeks reporting on ESG issues by investee companies to be integrated within the standard annual report or separately as part of a sustainability report. Governance disclosures are expected to be in line with the relevant regulations and jurisdictional best practice. Magellan seeks investee companies to disclose the Environmental and Social issues that are material to their business with a discussion of how the company is managing the risks and opportunities. Where Magellan views the disclosure is lacking, it may engage with company and consider voting against management recommendations on relevant resolutions at a general meeting.

#### 4. To promote acceptance and implementation of the Principles within the investment industry.

- a. Magellan will include Principles-related requirements in requests for proposals it answers.

#### 5. To work together to enhance our effectiveness in implementing the Principles.

- a. Magellan will address emerging issues and will support the use of investor reporting as a source of learning.

#### 6. To each report on our activities and progress towards implementing the Principles.

- a. This requires Magellan to complete an annual questionnaire each year in March/April. The questionnaire is approximately 100 questions long and deals with the extent to which Magellan uses ESG principles. The answers from the questionnaire are compiled with other investment managers to enable the PRI to assess the success of their promotion of PRI.

### Appendix 3: Background to CDP's climate change program

Each year on behalf of institutional investor signatories, CDP contacts large global companies asking them to disclose climate change related information.

CDP signatories believe that measurement of carbon emissions and disclosure of other climate change related information will improve investors' ability to manage the risks of climate change. Stakeholders such as investors, customers and governments have an important role to play in motivating disclosure and management of climate change issues by companies. Furthermore, CDP signatories believe it is part of investors' fiduciary duty to evaluate the possible impacts of climate change on the value of investments including:

- Taxation and regulation;
- Changes in the climate system;
- Technological innovations; and
- Shifts in consumer attitude and demand.

Signatories of CDP's climate change program commit to an annual Reporting and Assessment process. After an optional one year grace period, all investor signatories must participate in the annual Reporting and Assessment process. This process involves signatories completing a questionnaire on their carbon emissions and other climate change related activities. Questionnaires are assessed and scored by CDP-approved evaluators.

CDP holds the world's largest collection globally of self-reported climate change data. Signatories of CDP's climate change program are able to access detailed company disclosures made to CDP, including data on carbon emissions and any climate change mitigation activities, and use them for investment purposes. As a Signatory of CDP's climate change program, Magellan will be able to more rigorously assess climate change related risks and opportunities facing companies on behalf of clients.