



# Ethical investment and stewardship approach

September 2023

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# Glossary and links

<b>ACCR</b>	Australasian Centre for Corporate Responsibility
<b>ACSI</b>	Australian Council of Superannuation Investors
<b>CDP</b>	Carbon Disclosure Project
<b>CFA</b>	Chartered Financial Analyst Institute
<b>ESG</b>	Environmental, social, governance
<b>FSC</b>	Forestry Stewardship Council
<b>GICS</b>	Global Classification Industry Standard
<b>GBCA</b>	Green Building Council of Australia
<b>GRESB</b>	Global Real Estate Sustainability Benchmark
<b>GRI</b>	Global Reporting Initiative
<b>ILO</b>	International Labour Organization
<b>ISO</b>	International Organization for Standardization
<b>ISS</b>	Institutional Shareholder Services
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>PRI</b>	United Nations Principles for Responsible Investment
<b>RIAA</b>	Responsible Investment Association of Australasia
<b>SDGs</b>	United nations Sustainable Development Goals
<b>TCFD</b>	Task Force on Climate-Related Financial Disclosures
<b>UCA</b>	Uniting Church in Australia
<b>UNGC</b>	United Nations Global Compact
<b>UNGP</b>	United Nations Guiding Principles on Business and Human Rights

## Introduction

Our Ethical Investment and Stewardship Approach is designed to explain how we implement our Ethical Investment Policy. It contains the following sections:

- Ethical investment
  - Overview
  - Ethical and ESG screening
  - ESG integration
  - ESG controversies
- Stewardship
  - Approach to stewardship
  - Engagement prioritisation process
  - Stewardship through voting
  - Tracking and monitoring

## Ethical investment

### Overview

U Ethical pursues a values-based, risk-adjusted and, where possible for equities, SDG-aligned approach to investing. Our investment process seeks to ensure that our portfolio holdings are aligned with our clients' financial and ethical expectations.

The application of our Ethical Investment Policy varies depending on the asset class.

Asset class	Negative screening	Positive screening	ESG integration	Active stewardship
Cash, cash equivalents and term deposits	Limited	No	No	Limited
Fixed income	Yes	Limited	Limited	Limited
Australian equities	Yes	Yes	Yes	Yes
International equities	Yes	Yes	Yes	Limited

We incorporate a top-down approach that defines our investable universe by excluding companies and issuers operating in industries or involved in business activities or practices that do not align with the Ethical Investment Policy, subject to stringent materiality thresholds.

U Ethical targets companies with a minimum ESG rating of BB, while generally excluding companies with very severe controversies as well as ESG laggards (CCC and B rated companies).



[MSCI ESG Research]

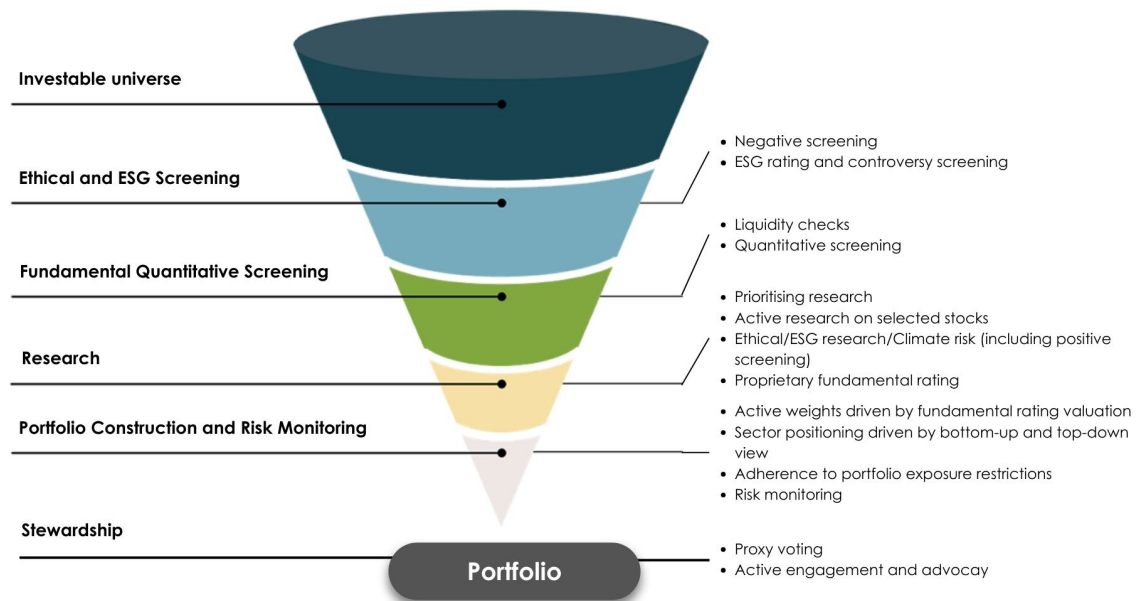
U Ethical's investment process integrates ESG considerations with the aim of minimising investment risk and identifying investment opportunities. Informed by our ethical investment philosophy, we seek out companies producing goods or providing services that appropriately manage their impact on society and the environment according to industry best-practice, industry standards and/or voluntary frameworks. Examples include alignment

with ISO standards, certifications such as FSC, GBCA and GRESB, and frameworks such as CDP, GRI and TCFD.

U Ethical relies on these considerations to inform and prioritise its stewardship activities and to contribute to the collaborative investor initiatives in which it participates.

We monitor companies and issuers on an ongoing basis through ESG alerts, broker research and media outlets. We conduct a full annual review, as well as quarterly and interim reviews where necessary—for example, in the event of a significant controversy case, misconduct event or egregious business conduct.












**Figure 1: Investment process - Australian equities example**



## Ethical and ESG screening

U Ethical utilises MSCI ESG Research data, ISS governance data, broker research and other market intelligence and analytics to assist with both negative and positive screening. For further details on our screening criteria and materiality thresholds, please see Appendix 1 - definitions in the Ethical Investment Policy.

### Negative screening

<b>Zero tolerance negative screening</b>	We do not invest in companies and issuers directly deriving revenue or earnings from the following activities (see definitions in the Ethical Investment Policy):
	Defence and weapons – controversial and nuclear weapons
	Tobacco production
	Nuclear power
<b>5% materiality for negative screening</b>	We do not invest in companies and issuers which exceed a materiality threshold of 5% of revenue or earnings directly from the following activities (see definitions in the Ethical Investment Policy):
	Fossil fuels – coal mining, oil and gas production, power generation and equity ownership
	Uranium mining
	Defence and weapons – civilian and conventional weapons
<b>5% materiality for negative screening (cont'd)</b>	Predatory lending
	
	Gambling
	Adult entertainment
	Animal cruelty and exploitation
	Alcohol production

<b>Business involvement screening</b>	<p>Business involvement screening measures companies' direct and indirect exposures to specific products and services, quantified as percentages of total company revenue and total company ownership.</p> <p>We use MSCI business involvement screening to provide another lens of analysis which captures revenue and earnings exposure for companies and issuers covering a parent or holding company and direct company subsidiaries.</p> <p>'Ownership of' involvement – this factor captures companies that own from 20% to 49.99% of a company with involvement in the business activity listed in U Ethical's negative screening list; and</p> <p>'Ownership by' involvement – this factor captures companies that are 50% or more owned by a company with involvement.</p>
<b>Controversy screening</b>	<p>U Ethical monitors companies or issuers who are or have been involved in controversies. We generally exclude companies or issuers involved in very severe controversies in the last 12 months.</p> <p>If more than 12 months have passed since a company or issuer had a very severe controversy, a qualitative analysis is undertaken to review the company's response and its efforts to resolve and – where required – remediate.</p> <p>We also screen out companies that fail to meet international global norms and conventions, including the UNGC, UNGP, ILO Conventions (core and broad) and OECD Guidelines for Multinational Enterprises.</p>

Cash, cash equivalents and term deposits are only exposed to the financial services sector (predominantly banks) and given the nature of the underlying investments this limits full application of negative screening. The focus on screening for these issuers is on issuer controversies and overall ESG profiles.

### Positive screening

We seek to invest in companies that align with our ethical investment philosophy through positive screening. Positive screening is utilised for Australian and international equities. However, there is limited application for fixed income and it is not relevant for cash, cash equivalents and term deposits.

For Australian and international equities, we utilise the MSCI ESG Sustainable Impact Metrics (SIM) framework for initial positive screening where relevant. This assesses alignment with the SDGs.

### United Nations Sustainable Development Goals (UNSDG)

The UNSDGs aim to foster collaboration within and between international private and public stakeholders to address critical global challenges such as poverty, inequality, climate change, environmental degradation, peace and justice.



Source: "About the Sustainable Development Goals" – United Nations;  
<https://www.un.org/sustainabledevelopment/sustainable-development-goals/>

All 17 SDGs are assessed in the net alignment analysis from Strongly Aligned to Strongly Misaligned. This is followed by an internal review and investment team discussion. We also screen for companies that indirectly support SIM categories across the value chain and are aligned to longer-term investment themes.

### MSCI Sustainable Impact Metrics Taxonomy

Pillar	Themes	Categories
Environmental impact	Climate change	Alternative energy Energy efficiency Green building
	Natural capital	Sustainable water Pollution prevention and control Sustainable agriculture
Social impact	Basic needs	Nutrition Major disease treatments Sanitation Affordable real estate
	Empowerment	SME finance Education Connectivity – digital divide

Source: MSCI ESG Research, *MSCI ESG Business Involvement Screening Research, Global Sanctions, and Sustainable Impact Metrics Methodology Summary Guide for Corporate Issuers*, October 2022.

In assessing alignment with the SDGs, the factors considered include:

- SDG alignment by total revenue
- Net SDG alignment by product, services, accounting for possible controversies (both historical and current)
- Environmental impact solutions, and
- Social impact solutions

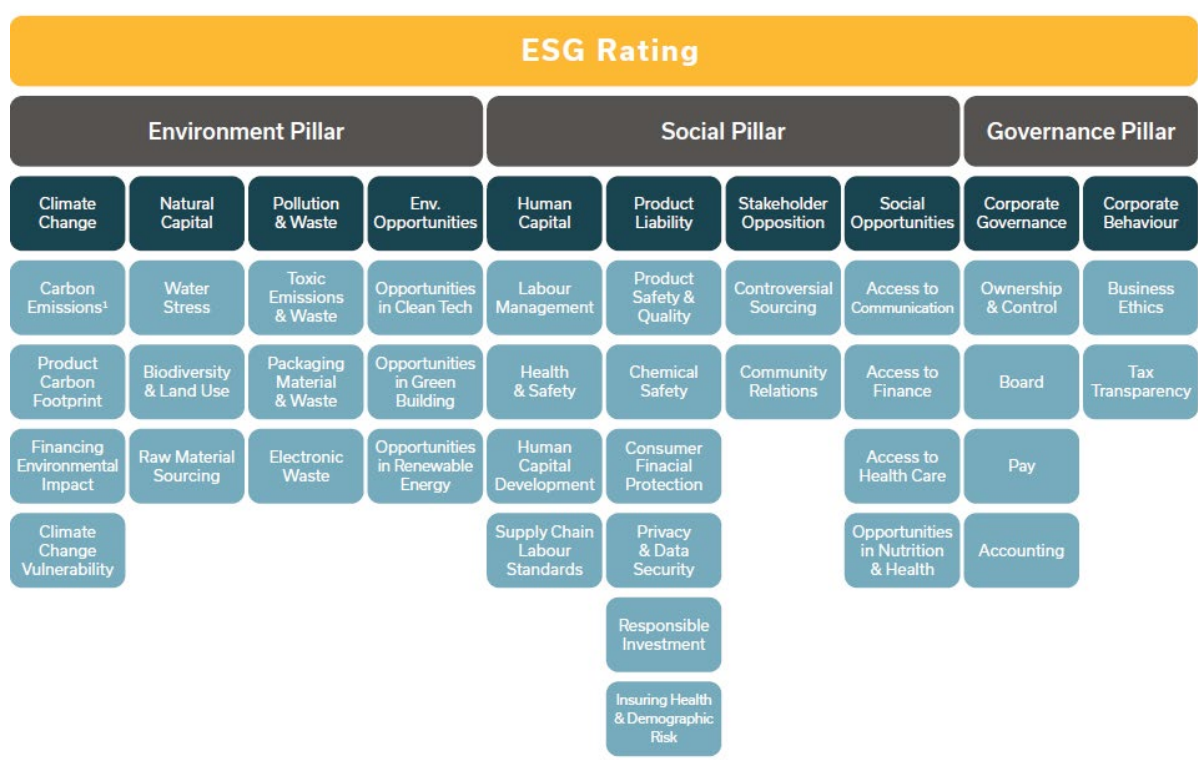
We monitor and report on net SDG alignment for equity portfolios, which aggregates exposure at a company level for both products and services. We also provide case studies of companies with higher net SDG alignment in regular reports to clients.

For fixed income securities, we positively screen for green, social, sustainable and sustainability-linked (GSS) bonds and loans that target identifiable environmental, social or sustainability impact from the issuance and use of proceeds. However, any allocation to these securities is subject to other portfolio construction, investment performance and risk management criteria. Positive screening is not relevant for cash, cash equivalents and term deposits.

## ESG integration

To ensure compliance with our ethical investment philosophy, a qualitative and quantitative ESG analysis is conducted across all new holdings prior to investment. ESG factors vary according to industry and company.

We utilise MSCI ESG Research's industry risk intensity data to assess the most financially material risks for listed securities in line with the GICS sub-industry level risks. This includes analysis of specific business segments, geographic risk exposure and related management practice. The chart below summarises the factors that contribute to MSCI's ESG ratings.



[MSCI ESG Research]

For Australian and international equities, ESG profiles which incorporate positive screening may affect portfolio weightings and the prioritisation of active stewardship activities. While ESG analysis is performed on new fixed income and cash issuers, the application is more limited, as is the availability of ESG data. However, the majority of financial services issuers (particularly the banks) are covered through their inclusion in portfolio equity holdings.

Both qualitative and quantitative ESG assessments help us to:

- Ascertain whether companies breach any of our exclusion criteria
- Identify risk-adjusted performance drivers
- Assess the contribution to the SDGs, and
- Evaluate which are better positioned for a low carbon world

For example, within the governance (G) pillar, we prioritise board structure and composition (e.g. skills, gender diversity), pay and remuneration, ownership and shareholder rights, accounting practice and tax transparency.



We also cover:





- Corporate behavior
- Whistle-blower protection
- Business ethics, and
- Corruption and instability

Under the environment (E) pillar, among other issues, we cover the carbon footprint and low carbon transition management capacity of companies. Additionally, we consider climate risk as detailed in our [Climate Risk Report](#).

## ESG controversies

U Ethical monitors ethical and ESG controversies to ensure that companies and issuers held in portfolios comply with the Ethical Investment Policy. The investment team uses a range of sources to monitor controversies. These include MSCI ESG Research alerts, ISS governance research, broker reports, news publications, Bloomberg, Factset, industry bodies such as RIAA, PRI, CFA and relationships with not-for-profit organisations such as the UCA Justice and International Mission Cluster (JIM), ACCR and ShareAction.

**Restricts investment in securities with any exposure to the following activities:**

FLAG	FLAG DESCRIPTION	
	<b>RED:</b>	Indicates that a company has been involved in one or more recent very severe controversies.
	<b>ORANGE:</b>	Indicates that a company has been involved in one or more serious recent controversies that are just shy of the criteria of the red flag.
	<b>YELLOW:</b>	Indicates that the company has been involved in significant recent controversies.
	<b>GREEN:</b>	Indicates that the company is not involved in major recent controversies. It may have involvement in one or more less significant controversies.

	Very Serious	Serious	Medium	Minimal
Extremely widespread	Very Severe	Very Severe	Severe	Moderate
Extensive	Very Severe	Severe	Moderate	Moderate
Limited	Severe	Moderate	Minor	Minor
Low	Moderate	Moderate	Minor	Minor

Source: MSCI ESG Research Controversies and Global Norms Methodology

The type of controversy helps to determine whether it is the result of underlying problems or structural failings at the company or issuer. The status of a controversy case reflects whether it is concluded, ongoing or a historical concern and is used to understand the timeline and progress of events.

### **Ethical analysis of new companies and issuers**

Ethical analyses are integrated with the investment analysts' research notes for all new portfolio holdings. The ethical analysis section aims to demonstrate in detail how new companies and issuers under review comply with (and do not breach) U Ethical's ethical framework. It also considers whether companies and issuers meet or exceed operational or product-level best practice and their future prospects. The section covers:

- **Ethical framework analysis** – summary across compliance, risk management and forward-looking information
- **ESG strengths** – best ESG aspects with an indication of positive screening and material contributions to social or environmental impact and/or good climate risk management
- **ESG weaknesses** – any business involvement or ESG practice that *could or may* contravene any of U Ethical's frameworks, exclusionary criteria or values, and
- **ESG controversies** – an overview of the most recent controversies watch list

## Stewardship

### Approach to stewardship

As an ethical and responsible investor, we hold the companies in which we invest to high standards. Beyond screening and evaluating potential new investments, our stringent investment process also applies to existing portfolio companies. Stewardship takes place through a diverse range of engagement activities: direct, collaborative industry initiatives and advocacy.



#### **Direct engagements**

Individually communicating with companies and issuers in our investment portfolios



#### **Collaborative engagements**

Working with industry peers for greater leverage and a unified voice, targeting portfolio companies and issuers (as well as some outside our portfolios) and critical themes for responsible investors



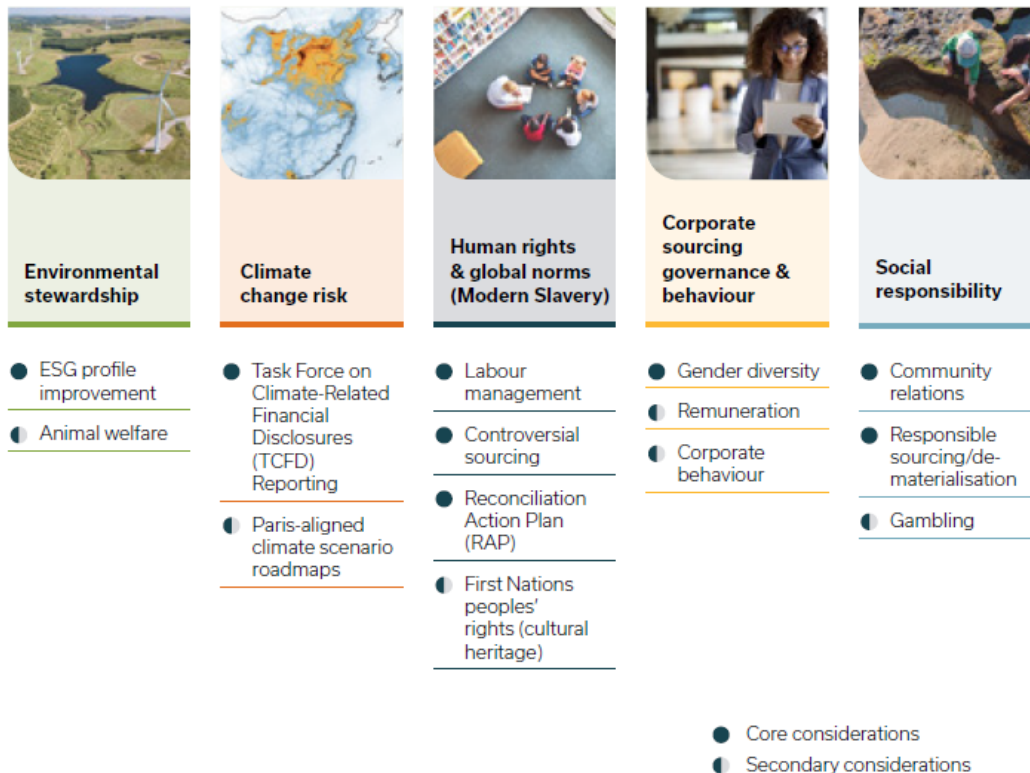
#### **Advocacy initiatives**

Individually and collectively addressing systemic risks by influencing decisions within political, economic and social institutions

It is through this stewardship approach that U Ethical seeks appropriate and continuous disclosures on ESG matters. The core aim is to encourage companies not only to improve on general governance best practice and operational profile, but also to seek a greater ambition to deliver social and environmental outcomes, drive innovation and become, or continue to be, an industry leader.

For specific controversy cases, we engage with company management to ensure that they are taking immediate and appropriate action, including remediation and process improvements to pre-empt future cases from occurring. Ongoing dialogues and collaborations contribute to long-term outcomes: financially as a result of good governance, and for society by reducing or pre-empting social and environmental impacts.

In order to ensure our active stewardship is focused, we refer to a series of themes that guide our priorities for engagement activities. These themes are segmented into core and secondary considerations.



## Engagement prioritisation process

For all portfolio companies, the investment decision-making process enables us to prioritise engagements that aim to improve general ESG performance. These are also based on thematic areas identified by the investment team.

The focus of engagement is on Australian equity holdings where U Ethical's access to company management is greatest. A prioritised approach means that engagement does not cover all portfolio companies and issuers. The following steps are taken:

1. Consider involvements\* in business activities that might be in breach of our Ethical Investment Policy. We prioritise companies with poor ESG profiles and performance and/or ESG-related controversies of a severe (orange flag) or very severe (red flag) nature.
2. Analyse industry specific, financially material ESG issues as prioritised by MSCI ESG Research's ESG Rating model and other available research.
3. Select engagement themes in line with focus areas outlined in the previous section.
4. Choose the type (direct, collaborative or advocacy) and the medium (letter, email or call) of engagement.
5. Reference the internal engagement guidelines for key ethical considerations relevant to the industries in which we invest. This document provides guidance for critical questions that the investment team may need to address to maintain compliance with our Ethical Investment Policy criteria.

\* These involvements go beyond GICS and look at issuers' corporate structures and equity involvements

The investment team typically engages with the management of portfolio companies after their interim and full year results. Ethical and ESG considerations relating to stewardship are

discussed daily or on an *ad hoc* basis by the investment team. ESG analyses and voting records are reported quarterly to U Ethical's investment committee, and the main ethical, ESG or proxy voting concerns are discussed with U Ethical's independent ethical advisory panel at its meetings which are generally scheduled quarterly.

## **Direct engagements**

Direct engagements provide opportunities at the highest corporate level to discuss the ESG performance of a company and to encourage further improvement and disclosures.

All communication is addressed to either the company secretary, head of investor relations (IR) or general counsel and augmented by regular or on-going communication with IR and senior executives at the company.

## **Collaborative engagements**

Beyond direct engagement, collaborations with both internal stakeholders and external peers across non-government organisations and industry associations help to achieve positive outcomes over the medium to long term.

Internally, U Ethical works closely with the social justice experts from UCA's Justice and International Mission (JIM) Cluster on matters of human rights locally and globally.

Externally, existing collaborations include the following organisations and respective campaigns and/or working groups:

- Responsible Investment Association Australasia (RIAA)
  - RIAA's Human Rights Working Group
  - RIAA's Policy and Advocacy Technical Expert Group (TEG)
  - RIAA's Human Rights Working Group
- United Nations Principles for Responsible Investment (UNPRI)
  - UNPRI's Tax Reference Group
  - UNPRI's Global Policy Reference Group (GPRG)
- The Investor Group on Climate Change (IGCC)'s ClimateAction 100+
- Investors Against Slavery and Trafficking (IAST)
- B Lab Australia & New Zealand
- Banking and Finance Oath Limited (signed by individual team members)

## **Advocacy initiatives**

U Ethical has a history of advocacy to drive regulatory change. In cases where we realise we cannot affect change as an individual investor, we encourage or join collaborative endeavours. In some instances when third parties aligned with our values and ethical investment philosophy approach us for support, we engage collaboratively.

U Ethical has historically played a strong advocacy role in influencing policymakers and political representatives within the commonwealth government through UCA's JIM Cluster. The JIM Cluster meets regularly with policymakers and acts as expert witness in parliamentary inquiries. U Ethical provides varying degrees of support to the key thematic areas of JIM's advocacy work. They are:

- Protecting people on temporary visas from family violence,
- Climate Justice Action
- Online safety and curbing online child sexual exploitation, and
- Online gambling advertising reform

U Ethical's advocacy work is also increasing its focus on vaccine equity, tax transparency and the climate change leadership of the Australian government and sovereign entities.

We vigorously pursue our ethical values and objectives within the constraints of our scale and resources. While naturally concerned about the range of ethical issues that are prevalent at any point in time, we elect to focus our attention on those where we believe our efforts will be best rewarded in achieving the desired outcomes.

## Stewardship through voting

When our research uncovers companies held in our portfolios that have subsequently become involved in unacceptable activities or practices, our preference is firstly to initiate a process of direct engagement as a means of advocating and encouraging remediation and/or change consistent with evolving stakeholder expectations.

If engagement yields an unsatisfactory response, we will vote against at least one of the following (in descending order):

1. The chair of the board
2. The chair of the nominations committee
3. A member of the nominations committee or the longest serving director seeking re-election

U Ethical will actively vote through our proxy adviser or by direction consistent with the following principles:

- Companies with < 40% female representation at board level and/or no plan to reach it
- Evidence of enhanced gender diversity at both senior and executive level
- Disclosure of decarbonisation roadmaps and/or TCFD-aligned climate risk reporting
- Falling short of a climate risk ambition
- Failing to set robust decarbonisation targets—in other words, targets that do not adequately cover the emissions scopes (1, 2 and 3) of a company's core operations and value chains
- Shareholder resolutions – additional review of and voting on each environmental and social proposal

These principles guide when and how we apply stewardship and communicate with company management, whether a current or prospective investment, on issues related to our Ethical Investment Policy.

## Proxy voting

Actively exercising our proxy vote is an integral part of U Ethical's stewardship and signals the intent of our ethical investment philosophy.

Before voting against a resolution at a company's annual general meeting, we strive to speak or meet with the company's management to raise our concerns.

When portfolio companies are involved in controversy cases of a certain severity, we also seek first to have a conversation with the company's management and to follow up with formal correspondence and future meetings.

## **Board diversity**

During voting season, prior to a company's annual general meeting, U Ethical reviews and then votes on the structure and diversity of a company's board of directors.

Diversity is a material factor to U Ethical, which we champion in our advocacy work. We use our rights as shareholders to vote and engage with companies who do not meet the 40% female board-diversity minimum threshold in line with ACSI's recommendations\*.

We also seek information on current gender diversity in the executive team and at senior management level to ensure greater diversity and inclusion is present throughout the organisation.

\* <https://acsi.org.au/our-issues/gender-diversity>

## **Shareholder resolutions**

Following a review of each shareholder proposal, and in line with our Ethical Investment Policy, we review and support shareholder proposals of an environmental or social nature.

We vote on all shareholder resolutions, considering each on a case-by-case basis in relation to our ethical investment philosophy. Where votes are cast against management, U Ethical may discuss with the company why the decision was made.

Climate change-related proposals against corporate boards have recently grown in importance. Aligned with climate science, we look for three key dimensions of decarbonisation targets: comprehensiveness, robustness, ambition and feasibility.

## **Public disclosure**

Our annual voting records and statistics, including voting rationales, are disclosed on our website.

## Tracking and monitoring

All communication and engagement with companies—letters, company meetings, ethical and ESG-related questions raised on earnings calls or dedicated calls or at meetings—are recorded on Proxy Exchange, the online platform of our governance service provider, ISS.

These activities are reviewed and reported quarterly or biannually to monitor and evaluate the outcomes of U Ethical's engagement work. Engagement and advocacy statistics and overviews are included in the following materials:

- Investment committee papers and reports
- Quarterly newsletter to clients
- Client presentations, and
- U Ethical's website

For details on the outcomes of engagement in these areas, please refer to the most recent [Stewardship Report](#).

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