

# IML'S APPROACH TO RESPONSIBLE INVESTMENT AND ESG

## INTRODUCTION

Investors Mutual Limited (IML) recognises the importance of responsible investment, the impact that it can have on our client portfolios, and the broader power to shape society at large. We believe that we have a fiduciary duty to act in our clients' best interests, and that integrating environmental, social and governance (ESG) considerations into our investment decisions, as well as engaging with investee companies to positively influence corporate behaviour, are key components of exercising this duty.

As we implement IML's investment process and conduct our research operations, we regularly see the impact that ESG factors are having on companies and markets. For example, companies that are involved with high carbon emission sectors, such as thermal coal production, may face restrictions in their access to insurance or debt markets; the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry highlighted poor governance practices and drove significant change in the financial sector; and stocks exposed to ESG risks are often valued at a discount to their peers. To maximise investment performance, it is therefore critical that these factors be integrated into our investment analysis and decision-making.

As a fundamental investor with a long-term orientation IML has the requisite knowledge, experience, and relationships with companies to allow effective influence through corporate engagement and informed proxy voting. Where appropriate, we seek to improve both investment performance for clients, and ESG outcomes, by encouraging companies to improve their ESG risk management and to develop more sustainable business practices. We believe that companies that implement such practices will outperform those which do not.

Our commitment to responsible investment was formalised in 2008 when we became a signatory to the **United Nations Principles of Responsible Investment (UNPRI)**, the world's leading proponent of responsible investment. The principles that we have committed to are:

- **Principle 1:** We will incorporate ESG issues into investment analysis and decision-making processes.
- **Principle 2:** We will be active owners and incorporate ESG issues into our ownership policies and practices.
- **Principle 3:** We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- **Principle 4:** We will promote acceptance and implementation of the Principles within the investment industry.
- **Principle 5:** We will work together to enhance our effectiveness in implementing the Principles.
- **Principle 6:** We will each report on our activities and progress towards implementing the Principles.

In addition to adhering to the principles of the UNPRI, IML also takes into account the **UN Sustainable Development Goals** and progress by our companies towards these goals. IML is also supportive of the **Task Force on Climate- Related Financial Disclosures (TCFD)**. As a bottom-up fundamental investor, the sustainability of a company's business model is highly pertinent and a relevant consideration when assessing the investment outlook for a company.

Approved by IML CEO: 20 December 2023



The following sections of this policy outline in greater detail the process by which ESG considerations are integrated into our investment decisions and engagement activities.

## **ESG integration**

IML views the integration of ESG considerations into our investment analysis as a critical aspect of responsible stock selection. ESG is included within our quality scoring system, and discussion of key ESG issues is included in our investment research reports. Portfolio Managers subsequently determine portfolio positions considering this view on quality and valuation.

## **IML ESG checklist**

Each analyst is required to complete an IML ESG Checklist for a stock before we invest. The content of this ESG Checklist is informed by the Sustainability Accounting Standards Board (SASB) Engagement Guide and aims to ensure that all key ESG issues are identified for each company. Given the evolving nature of ESG risks, the content of the ESG Checklist likewise evolves over time as new issues emerge. The ESG Checklist will also highlight issues that may require further research or engagement with the company.

Outcomes for individual items in the ESG Checklist range from -1 to 0 to +1.

- Score of -1: negative or below expectations
- Score of 0: average or in line with expectations
- Score of +1: positive or better than expectations

For example, “Is the chairperson independent?”

While this question looks to have a “yes” or “no” outcome, our assessment allows us to have a more nuanced response. For example, if the chairperson is not independent, we would likely score the company a “-1” if the answer is simply “no”. However, if our answer is “no”, only because they used to be an executive of the business, but they are a very important value driver for the business and someone we’re happy is chairperson to represent shareholders and oversee management then we may respond with “0”.

The ESG Checklist ensures consideration of broad range of issues that may be relevant to companies such as:

## **Environmental factors**

- Contribution to climate change through greenhouse gas emissions and energy consumption
- Resource depletion
- Production of waste, including plastics
- Pollution
- Stranded asset risk

## **Social factors**

- Risk of modern-day slavery in the supply chain
- Human rights
- Maintenance of social licence to operate
- Occupational health and safety record
- Social impacts and community relations



## Governance factors

- Independence of the Board and Chairperson
- Board and management alignment with shareholder interests
- Board composition and skills, and the conduct of directors
- Remuneration
- Relationships between key personnel and stakeholders
- Accounting/ reporting and transparency of corporate decisions

Completing the IML ESG Checklist helps to inform the analyst ESG Quality Scores which are part of our overall quality scoring framework.

## ESG within the IML quality scoring framework

IML assigns quality scores to all companies in our investment grade universe. The overall quality rating is a score out of 20 that reflects the strength of the company's franchise, quality of management, exposure to ESG factors and financial strength. When selecting stocks for IML's portfolios, portfolio managers seek to include stocks with the most attractive combination of quality and valuation.

ESG Quality Scores are quantitative outputs but based on our qualitative assessment of a company based on our fundamental research. A score of 1 is the worst score and 5 is the best:

- Score of 1: far below average or expectations
- Score of 2: below average or expectations
- Score of 3: average or in line with expectations
- Score of 4: above average or expectations
- Score of 5: far above average or expectations

ESG Quality Scores represents 25% of the overall quality score, with separate E, S and G component scores. The overall ESG score is the minimum of the E, S and G component scores, rather than the average, recognising that poor performance in one ESG area presents risks that cannot be offset by good performance in another.

FRANCHISE	MANAGEMENT	ESG	FINANCIAL STRENGTH
Competition & Bargaining Power	Operational Execution	Environmental	Balance Sheet
Capital Intensity	Capital Deployment	Social	Transparency
Exogenous	Alignment	Governance	Earnings predictability
<b>Total Score out of 5</b>	<b>Total Score out of 5</b>	<b>Total Score out of 5</b> (Lowest score applies, rather than the average)	<b>Total Score out of 5</b>

As discussed above, the ESG Checklist helps to inform our ESG Quality Scores, however as the ESG Checklist is a broad set of questions, there is not a definitive relationship between the ESG Checklist and the ESG Scores. For example, a company may score positively in several sections of the Governance assessment, however if we don't feel the board is acting in the best interests of shareholders and score negatively for this one item, we may still score the company a 1 or 2 in our ESG Quality Scores as we perceive the negative issue more than outweighs the positives in the ESG Checklist.



When an analyst puts a stock on a BUY recommendation, our investment reports include a rationale for the ESG scores, which is peer reviewed by other members of the team as part of our investment process.

For companies we own, ESG scores are reviewed by the covering analyst at least bi-annually as part of our half year earnings review. There is a risk that our proprietary scores do not capture all ESG metrics, or that apply higher importance to some data than other relevant metrics, resulting in our interpretation of scores differing from individual investor or market views.

### ***Traffic light alert system***

Stocks that score 3 or above for the ESG section of the quality score are designated 'Green'; stocks that score 2 are 'Amber'; and those that score 1 are 'Red'. We show these traffic light colours on portfolio level reports. The aim of this designation is to alert portfolio managers and analysts to the stocks that require additional attention and vigilance from an ESG perspective.

Stocks designated 'Red' face additional hurdles before being included in portfolios. Red stocks require a written 'ESG Considerations' note which will discuss the relevant ESG risks, and analyst models are required to demonstrate how ESG risks have been specifically factored into earnings forecasts and/or valuations. Additionally, a company scored either Red or Amber will likely lead to engagement with the company on the respective issues we have identified and the pathway for improvement.

### ***External vs internal ESG research***

IML may utilise external ESG research services to supplement, but not determine, IML's views on key ESG issues. While external research can be a useful source of relevant information, our own fundamental in-depth research, deep knowledge of companies, and experience with many key executives and board members in the Australian market still forms the basis of the ESG ratings that we give to each stock.

### ***Controversies***

As part of our monitoring and assessment of controversies, we subscribe to specialist external professionals to provide third party input and assessment of controversies. We receive a regular email of controversies which we review and action where required.

If a company is involved in a *significant* Controversy, we initially make an assessment about whether the controversy is likely to affect our valuation, investment thesis or quality scores.

This assessment can involve:

1. speaking with the company to better understand the controversy
2. speaking to other relevant parties, if appropriate, to better understand the controversy
3. undertaking a reassessment of the impact to our investment thesis, quality scores or valuation
4. an analyst writing a written recommendation as to whether we should add to our holding, hold our existing position or sell some/all of our holding
5. Determine if any ongoing monitoring or additional engagement is necessary

## Engagement process

IML is an active investor and believes it is a fiduciary duty to our clients to ensure management and the board of investee companies are acting in our investors' best interests.

The IML Investment Team maintains regular contact with our investee companies, and other companies in our investment grade universe. We generally meet with companies of interest quarterly following half-year and full-year results announcements, investor presentations and other occasions. These meetings are held with senior management, the board &/or other company representatives.

When we have major concerns regarding a company, we initially escalate the issue directly with management or the board. If we are unsatisfied with the response to our concerns, our escalation process can involve:

- Writing letters to the board
- Engaging other fund managers and shareholders
- Engaging the media
- Proxy voting / shareholder resolutions

To determine which company representative is engaged to address topics, we provide the following general guide:

Company representative	Engagement topic
Chair, Committee Chair or other Director	Corporate governance <ul style="list-style-type: none"> <li>• Proxy voting</li> <li>• Remuneration</li> <li>• Management performance</li> <li>• Board composition</li> <li>• Succession planning</li> <li>• Capital allocation</li> <li>• Shareholder returns</li> </ul> Insights on business strategy Insights on high-level risks and opportunities
CEO, CFO, Divisional Heads	Business strategy Execution of business strategy Operational insights Diversity and inclusion Employee / customer / corporate / product NPS Controversies Climate change/net zero targets Corporate disclosure Details regarding specialised topics, e.g. sustainability
Investor Relations	Any additional information we are looking for or to put us in touch with someone within the organisation

We believe that engagement is generally the best option for addressing issues, including those related to ESG. However, if we believe that a material issue is not being sufficiently addressed, even after escalation, we do not believe that increasing our investment is the appropriate course of action and are unlikely to remain shareholders of the company.

## **Proxy voting**

IML believes that proxy voting is a key aspect of share ownership, as it provides the valuable opportunity for shareholders collectively to determine company policy. IML seeks to encourage sustainable business practices and positive ESG outcomes by voting proxies accordingly.

We endeavour to vote on all resolutions with the aim of maximising returns for our clients through improved business and ESG outcomes. We also believe that voting against the re-election of directors who have overseen poor business and/or ESG outcomes provides a strong incentive for companies to improve their behaviour and is a key mechanism enabling shareholders to hold board members to account.

We consider the merits of all resolutions put forward, regardless of the proponent of the resolution. For issues we consider to be material, may provide feedback to the company on our voting intention, including where we are voting against the recommendation of the company.

Where IML votes against either the company's or our proxy advisor's recommendations, we endeavour to record our rationale for the decision.

## **Guiding principles on proxy voting**

**Our primary objective when voting is to maximise the value of our clients' investments.**

The following provides a guide on how we think about different types of resolutions, however, there are situations where our vote on specific issues or for specific companies where our vote may deviate from these principles:

Resolution type	Comment
Structure of the board	<p>We are strong advocates for strong corporate governance and believe this is best achieved with the following structure:</p> <ul style="list-style-type: none"> <li>• Majority independent directors</li> <li>• The Chair should be independent</li> <li>• The roles of Chair and CEO should be held by different individuals</li> <li>• Sub-committees should be formed for specialty functions, including Remuneration and Audit</li> <li>• Appropriate composition of skills, experience, track record of success and diversity</li> <li>• Directors should be free of any conflict and have an appropriate schedule to discharge their responsibilities</li> </ul>
Director re-election	<p>When considering the re-election of directors, we consider the following:</p> <ul style="list-style-type: none"> <li>• The time commitment and number of other positions they hold</li> <li>• Attendance track record at board and committee meetings</li> <li>• Ongoing suitability and effectiveness in the role</li> </ul>

Resolution type	Comment
	<p>Where we believe the director has been ineffective in their role, we will vote against the member. For example, members of the remuneration committee who approve CEO/management remuneration that we believe to be excessive or unduly dilutes other ownership interest of our investors.</p>
Remuneration	<p>Remuneration can be a strong driver of financial outcomes and management/company behaviour. As such, we encourage companies to include non-financial, but measurable targets when setting remuneration outcomes, including ESG measures and customer / employee Net Promotor Scores, where they are considered material and meaningful.</p> <p>When considering our support for executive and board remuneration, we also consider:</p> <ul style="list-style-type: none"> <li>• Whether the remuneration is aligned with the interests of long-term shareholders (particularly STIs &amp; LTIs)</li> <li>• Remuneration relative to other comparable roles</li> <li>• Remuneration relative to the financial performance of the company</li> <li>• The boards rationale</li> <li>• The risk and difficulty for the executive to achieve their targets, including maximum and minimum potential outcomes</li> </ul>
Shareholder proposals	<p>Shareholder proposals are becoming increasingly common. As with all resolutions, we review each shareholder proposal on its own merit and our voting outcome is determined based on the specifics of the proposal and its impact on each company.</p> <p>In considering shareholder proposals, we take into account:</p> <ul style="list-style-type: none"> <li>• The materiality of the proposal</li> <li>• The alignment of the proposal with positive shareholder and sustainability outcomes</li> <li>• Alignment with our internal views on the best direction for the company</li> <li>• The company’s response to the proposal and whether it has sufficiently addressed the proposal</li> </ul> <p>We will only vote in favour of shareholder resolutions where we believe it is in the best interests of our investors and is consistent with our fiduciary obligations. As with all resolutions, where we vote against either management or our proxy advisor, we endeavour to record our rationale for the decision.</p>

While we will always consider each resolution on its merit, we will comply with a client’s voting instruction where they have a specific mandate with us, although any instruction from a mandate client will not impact the votes we exercise on behalf of other clients.

**External proxy voting research**

We subscribe to external proxy voting research provided by Institutional Shareholder Services (“ISS”) and use its reports as an input into our voting decision-making process. However, we ultimately vote based on our own knowledge and opinions that have formed through all aspects of our investment process.

**Reporting on engagement activities**

Where we vote counter to either ISS or Management recommendations, we record a brief rationale for our vote in our Proxy Voting Register.

We report to clients on the outcome of our engagement and proxy voting activities on request.