

Pendal Sustainable Balanced Fund Sustainability Objectives and Investment Process

31 December 2024

This document details the sustainability goals of the Pendal Sustainable Balanced Fund (the Fund) and the investment process that underpins them. These sustainability goals encompass the positive environmental, social, and governance (ESG) factors, attributes, or outcomes that the Fund aims to achieve, either at the level of individual securities or in aggregate. Additionally, the Fund incorporates ESG integration and stewardship to manage risks and opportunities effectively.

Sustainability Objective

Sustainability Objective: The Fund aims to support the transition to a more sustainable economy, by aligning 50% or more of its capital (within the Australian shares, International shares, Australian fixed interest and International fixed interest and part of the Alternative investments¹ asset classes of the Fund) in aggregate with investments that advance this transition.

We aim to do this by allocating capital to investments that:

- support positive environmental and/or social change via their investment processes, use of capital and/or active ownership²; and
- avoid exposure to companies with business activities that Pendal considers to negatively impact the environment and/or society³.

We define a sustainable economy as an economic system which balances environmental, social, and economic factors.

The Fund's Sustainability Objective does not apply to derivatives.

²Pendal defines active ownership (or stewardship), as exercising our voting rights through proxy voting and select engagement with investee companies or issuers.

³As defined by the exclusionary screens and gross revenue thresholds.

Sustainability Assessment Framework

At Pandal, our investment philosophy is grounded in the belief that integrating Environmental, Social, and Governance (ESG) factors into our investment process enhances long-term value creation and risk management, as well as increasingly being aligned with our stakeholders' values.

Long-Term Value Creation

We believe that companies and assets that effectively manage ESG risks and opportunities are better positioned to deliver sustainable long-term returns. By focusing on ESG factors, we aim to identify investments that are not only financially sound but also contribute positively to society and the environment.

Risk Management

Incorporating ESG factors into our investment analysis helps us to identify and mitigate potential risks that may not be captured by traditional financial metrics. ESG issues such as climate change, regulatory changes, and social unrest can have significant impacts on asset values. By proactively addressing these risks, we seek to protect our investments and enhance their resilience.

Alignment with Stakeholder Values

We understand that our investors increasingly seek to align their investments with their personal values and societal goals. By integrating ESG factors, we aim to meet the growing demand for responsible investment options that reflect our stakeholders' commitment to sustainability and ethical practices.

To implement the Sustainability Objective (SO), the following four Primary Sustainability Actions (PSA) are carried out throughout the Fund:

1. The application of integrated ESG investment processes,
2. Avoiding exposure to companies with business activities that Pandal considers to negatively impact the environment and/or society,
3. Tilting the aggregate Fund's holdings towards supporting positive environmental and/or social change, and
4. Employing active ownership - which includes aligning proxy voting and select engagement activities with investee company management.

These four primary sustainability actions are implemented at various portfolio levels, primarily within asset classes as applied by the underlying selected investment funds. Generally, we view sustainable investing "lives within asset classes", via the security selection processes. The SO mainly guides the investment selection of underlying investment funds and by extension the underlying invested companies, ensuring their aggregate business activities align with the SO. Where relevant, this also extends to the selection of other securities, such as government bonds.

We evaluate both the individual contributions of the underlying investment funds towards the SO and the overall impact of their actions. This collective impact is measured, monitored, and controlled at the total Fund level to ensure the SO is effectively implemented.

Our approach to Sustainability Integration is illustrated via the six Primary Sustainability Steps (PSS) below:

Sustainability Objective (SO)	Primary Sustainability Actions	Investment Selection	Total Portfolio Management	Monitor and Control - Investments	Monitor and Control - Total Portfolio
Transition to a more Sustainable Economy	<p>Applied across all levels of the Fund where possible:</p> <ul style="list-style-type: none"> • ESG integration • Activity screening • Sustainability tilting • Active ownership 	<p>Funds that are generally aligned with the SO</p> <p>Each fund will have its own specific RI process for security selection & stewardship</p>	<p>Top-down management to ensure intentional alignment with the SO, including sustainability tilting and stewardship</p> <p>Judicious management of ESG active risk taken, using a risk budgeting method</p>	<p>Quarterly review of their holdings (e.g. WACI, SDGs) and stewardship activities</p> <p>Annual Strategic Sustainability Review</p> <p>Engage where necessary</p>	<p>Quarterly tracking of aggregate Fund SO alignment and a positive sustainable tilt e.g. WACI, SDGs, stewardship</p> <p>Engage with underlying funds and/or enhance the sustainable tilt where necessary</p>
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In addition to the above, Regnan is a significant collaborator providing sustainability research, advice and support across all levels of the Fund, such as:

- Activity screens
- Controversies
- Engagement
- Proxy voting
- Advocacy
- Regulatory compliance
- Data tools e.g. Horizon, Affinity
- Best practice sustainable investment management

Selection of Investment Funds

When selecting, retaining or realising the Fund's investments, Pandal evaluates each investment's alignment with the Fund's Sustainability Objective (SO), which aims to support the transition to a more sustainable economy. To be considered for the Fund, investments are reviewed based on the primary sustainability actions: ESG integration, screening, positive tilt, and stewardship. Additionally, any potential adverse impacts of holding the investment on the SO are considered.

For every fund (manager) considered for the Fund, we complete a sustainability due diligence questionnaire (DDQ). This questionnaire helps determine the extent to which the prospective fund contributes to a more sustainable economy. We review the fund's holdings, investment and stewardship approach, stewardship activity, ESG integration approach, activity screening, sustainable themes and/or tilts, and the sustainability objective of the fund, where applicable, along with available reporting.

Regarding exclusionary screens, we expect at a minimum exclusion of businesses with activities that could cause significant harm, such as the:

- production of tobacco (including e-cigarettes and inhalers); or
- manufacture controversial weapons (including cluster munitions, landmines, biological or chemical weapons, nuclear weapons, depleted uranium weapons, blinding laser weapons, incendiary weapons, and/ or non-detectable fragments).

For ESG integration, we expect the underlying investment processes of invested funds, where we are shareholders or lenders to companies, to systematically integrate ESG factors into investment research, analysis, and decision-making. This includes:

- Conducting thorough ESG due diligence on potential investments.
- Incorporating ESG criteria into financial models and valuation frameworks.
- Engaging with companies to understand their ESG practices and encourage improvements.

We aim for at least 50% of the Fund's assets under management to contribute towards a positive sustainability tilt. This means these investments should demonstrate a positive impact on environmental and/or social factors.

At an overall Fund level, we aim to maintain the WACI at least 15% below that of the benchmark (for equities and listed property). We will monitor changes in the portfolio WACI and engage with underlying managers to understand their rationale and mitigation strategies.

Not all underlying funds and securities held within the Fund will have a positive sustainability tilt or objective. The Fund has both a return and a sustainability objective. These objectives must be balanced to meet the best interest of investors.

Portfolio Construction

Pendal integrates ESG insights into the portfolio from both the top down and the bottom up, actively considering and managing unique factor risks and biases faced by investors investing in sustainable funds.

While we believe that sustainability primarily resides within asset class via company selection investment processes, we also believe that portfolio construction can further bolster the whole of portfolio positive sustainable tilt and provides an opportunity to judiciously manage the unique risk aspects of sustainable portfolios. As such we consider sustainability throughout the entire portfolio construction process, from asset allocation to total portfolio risk allocation.

The following are examples of consideration within the asset allocation process:

- **SAA process:**
 - Business activity screening effectively serves as an asset allocation process, defining (limiting) the investable universe for each asset class.
 - We've introduced a new sub asset class, sustainable LICs, within the Alternatives asset class. This sub asset class provides a positive sustainable tilt towards operational renewable energy (wind and solar), energy storage (batteries), as well as digital (fibre-optic networks and data centres that facilitate replacing hydrocarbons with electrons) infrastructure assets. In the context of whole of portfolio risk management, it also provides an ESG hedge against negative energy sector screens within the equity asset classes. Across-asset classes the positive tilt to renewable energy companies provides a natural hedge to the negative tilt from fossil fuel energy companies.
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- We may implement our SAA process by holding additional sustainable fund exposure beyond the SAA target. For example, within Australian shares, we use non-screened futures to short the excess exposure. This effectively leverages our exposure to sustainable companies, by providing additional gross exposure to sustainable companies funded by unscreened indices.
- Our Capital Markets Assumptions process considers the well documented leakage of the translation of economic growth to earnings growth within emerging markets, typically attributed to the lower quality governance and higher levels of corruption that can materially affect minority shareholders.
- **TAA process:**
 - Our preferred approach to implementation within our sustainable funds for overweight positions is via physical sustainable funds, whilst for underweight positions via unscreened futures positions. This further positively tilts towards sustainable companies over time. However, this approach is not possible in all circumstances, given its impact on cash levels, marginally higher transaction costs vs futures, liquidity considerations, and availability of suitable sustainable funds we can overweight. As such we find this process tends to suit longer term valuation-based TAA insights, than shorter term technicals insights.
- **Total portfolio risk allocation:**
 - We apply a risk budgeting approach to portfolio construction. The risk budget represents the amount of risk an investor can tolerate in pursuit of an investment objective. We measure and judiciously allocate all sources of total portfolio risk.
 - For a sustainable investor, they have an additional sustainable objective which induces additional active risk (active risk being performance difference to the benchmark). A sustainable investor tends to have an active risk tolerance and a sustainability risk tolerance, allowing for conscious deviation from passive market cap benchmarks. Thus, a sustainable investor has two sources of active risk: the active risk of pursuing outperformance (alpha) and the active risk of having sustainability investment preferences.
 - Our model is used in the capital allocation process to various alpha strategies to ensure an appropriate balance of alpha contributions to the Fund. It also considers the degree of active risk arising from sustainability induced exposures. We seek opportunities to diversify sustainability active risk, to ensure the portfolio attains a positive sustainability tilt with the most efficient level of active risk consumed. We find material benefits in diversifying between alpha risk and sustainability risk. Additionally, we aim to find sources of sustainability risk hedges. Sustainable investment management tends to have a number of biases, such as: sector biases such underweight the energy sector; country biases; market cap biases; and style biases in particular towards growth style companies. It's important to monitor and control these biases, by finding other investments that provide a natural hedge. The sustainable LICs mentioned earlier are an example, as is the use of value strategies to balance the typical growth bias, and impact strategies that tend to have material small cap biases requiring offsetting with large cap exposures.

Portfolio Monitoring against the Sustainability Objective

We monitor the sustainability characteristics of each fund by a range of metrics pertaining to each underlying fund and the Fund's overall strategy. These metrics may include Weighted Average Carbon Intensity (WACI), carbon footprint, SDGs, stewardship activity and other measures supporting the sustainability objectives of the Fund.

The underlying funds are assessed for their ongoing suitability for the Fund. The investment team is responsible for monitoring the sustainability characteristics of the underlying funds and the overall Fund. The following table outlines the frequency of monitoring for each sustainability characteristic.

Sustainability Characteristic	Monitoring Frequency
ESG exclusions (generally carried out by underlying funds)	Daily (monitoring), monthly (review); LICs carried out quarterly and at initial investment
WACI / Carbon Footprint (underlying funds and total portfolio)	Quarterly
SDG revenue alignment (underlying funds and total portfolio)	Quarterly
Engagement activity (underlying funds and total portfolio)	Quarterly
Proxy Voting activity (underlying funds and total portfolio)	Annually
Underlying investment funds Strategic Sustainability Review	Annually

The Fund Selection DDQ must be reviewed at least annually by the investment team, as part of the Strategic Sustainability Review. Wherever possible, evidence of investment activity, stewardship activity and tracking against sustainability objective should be sought.

If we determined that an investment no longer meets the Fund's sustainability criteria, we may choose to engage with the underlying investment fund manager, company or issuer to address the issue. If the engagement is unsuccessful, we will divest the holding (usually within six months) having regard to the interests of investors. The time it takes for divestment depends on factors including but not limited to the size and liquidity of the investment (which may have an impact on the Fund's performance returns), and the time it takes for Pandal to assess suitable replacement investments that meet the Fund's exclusionary screens and sustainability criteria.

Adverse Impacts Assessment against the Sustainability Objective

At overall Fund level we will use external ESG data providers to track sustainability factors such as overall WACI and carbon footprint. We will identify the underlying funds and/or securities with the largest contribution towards these portfolio measures and assess that alongside the underlying investments' purpose and overall contribution to the Fund (e.g. financial, risk management, stewardship etc.). We will disclose this in our Annual Fund Sustainability report along with the rationale for our assessments.

Active Ownership (Stewardship)

We believe in the power of active ownership to drive positive change. Through proxy voting and direct engagement with investee companies, we advocate for better ESG practices and hold companies accountable for their performance.

We set engagement objectives on a company-by-company basis. Examples of ESG related engagement themes are business ethics and corporate conduct, board structure (e.g. skills, diversity), reporting and disclosures (including climate change-related disclosures), worker health and safety as well as cyber-security. ESG engagements are often collaborative involving objectives

set by the portfolio manager, in consultation with analysts, the Head of Responsible Investments, and Regnan.

The criteria we use to identify and prioritise engagement activities include:

- Materiality of ESG factors
- Systematic risks to global portfolios
- Exposure (holdings)
- In reaction to ESG impacts which have already taken place
- In preparation ahead of a voting decision or as follow-up in response to a voting decision

In the majority of cases, we monitor the actions that companies take following our engagements.

Our fund selection due diligence questionnaire specifically assesses the stewardship approach of underlying funds for their alignment with our sustainability objective. Stewardship activity is conducted by the portfolio managers and analysts representing each underlying fund or by Regnan on behalf of the underlying fund manager.

We assess engagement logs and engagement case studies on a quarterly basis to confirm that engagement activity is aligned with supporting the transition to a more sustainable economy.

We assess proxy voting activity of underlying funds annually.

Engagement with Investment Teams of Underlying Funds

The investment team of the Fund will engage with the investment teams of underlying funds (managers) to address any sustainability-related questions that arise out of monitoring the sustainability characteristics of that fund. Triggers for engagement with portfolio managers may include, but are not limited to:

- Requesting additional information relating to engagement activity
- WACI or carbon footprint increases requiring rationale
- Holdings that are flagged under our adverse impact assessment e.g. very high carbon emitters, requiring rationale
- Understanding proxy voting decisions
- Any changes to investment or ESG process

Governance over Sustainability Objective

The Fund's holdings and engagement activity are monitored against its Sustainability Objective on a quarterly basis by the Active Ownership Panel (AOP).

The Governance and Oversight Report of the Fund monitors the following information:

- Compliance with exclusionary screens
- Portfolio WACI versus the benchmark
- Proportion of the Fund by FUM in underlying funds and securities that support the transition to a more sustainable economy

- Assessment of engagement activity of underlying funds against the Fund's Sustainability Objective

Specifically in regard to WACI, the Multi-Asset team aims to manage the portfolio with a weighted average carbon intensity (WACI) 15% below that of the benchmark (for equities and listed property). The portfolio manager can utilise several methods to manage this, including engagement with the managers of the underlying strategies, changing the underlying strategy(s), and, where a multi-asset class fund invests in equities directly or utilises an equity model portfolio, the portfolio manager can choose to reduce position(s) or exit the problematic stock(s) held entirely.

Should the WACI score of the Pendal Sustainable Balanced Fund exceed that of the benchmark at any point in time, the manager will aim to reduce this 15% below the benchmark WACI as soon as it is practicable, having consideration for market timing, the likelihood of the issue being due to short term factors rather than a longer term expected portfolio characteristic, and the impact this may have on other portfolio characteristics including risk factor exposures and overall portfolio diversification.

Responsibilities

The investment team, assisted by the Investment Solutions and Oversight (ISO) team, is responsible for assessing, selecting and monitoring underlying funds for their alignment with sustainability criteria outlined in the Fund's DDQ.

The investment team will review the investment holdings, investment process and stewardship approach of each underlying manager at least annually to determine if the strategy still aligns with the Fund's Sustainability Objective.

The investment team will monitor the WACI and carbon footprint of the Fund, as well as the same metrics for each underlying fund, at least quarterly and document the reasons for any increases in the WACI score or where the WACI exceeds the Fund's aim of achieving a WACI of 15% below that of the benchmark.

The investment team will monitor other sustainability characteristics of the Fund as well as of the underlying funds such as alignment of revenues with the Sustainable Development Goals (SDG's). This is not the explicit target of the fund but will be used as an indicator of the Fund's overall alignment with its Sustainability Objective.

The ISO team is responsible for producing the Annual Sustainability Report for the Fund, collating the quarterly engagement evidence from the underlying funds, and supporting the investment team (as an internal client) with the interaction and collation of ad hoc information on the underlying funds as needed.

Conclusion

Our investment philosophy at Pendal is founded on the belief that ESG factors are crucial for achieving sustainable, long-term investment success across multiple asset classes. By incorporating ESG considerations into our investment process at both the asset allocation and security selection levels, we strive to deliver superior risk-adjusted returns while contributing to a more sustainable and equitable world.

We hold ourselves accountable to these objectives at both the individual portfolio level and the overall portfolio level through rigorous position-level scrutiny. This approach helps us identify companies that can be targeted for engagement, ensuring that our investments align with our ESG principles and drive positive change.



Appendix

Exclusionary screens for the Pandal Sustainable Balanced Fund

Excluded business activities are outlined in the Additional Information Booklet accompanying the Fund PDS:

[Insert Link]

For more information, please visit pandalgroup.com

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