

# Fact sheet: Our approach to ESG integration

April 2023

Alphinity believes that the integration of environmental, social and corporate governance (ESG) considerations into investment management and ownership practices is essential as these factors can have a material impact on a company's financial performance.

As active investment managers, we have the responsibility to understand and integrate these risks appropriately wherever possible, which reflects our fiduciary obligation to our clients to both maximise returns and manage risk. Stewardship efforts, such as company engagement, proxy voting activities, research and thought leadership, and collaborative engagements are important parts of ESG integration. These activities have the potential to influence company behaviour, improve practices, reduce headwinds for a business, and ultimately improve returns over the long-term.

### **Purpose**

This fact sheet summarises Alphinity's ESG integration approach, describes our ESG materiality process and how we consider ESG in investment decision making. Please find related information in our <u>ESG Policy</u>, <u>Stewardship Policy</u> and supporting fact sheets that outline our <u>climate change</u> and <u>modern slavery</u> approaches. Our annual ESG and Sustainability report provides more detail on our responsible investment principles and includes examples of ESG integration, engagement and case studies.

### **ESG snapshot**

Alphinity assesses material ESG risks and opportunities using an in-house ESG methodology and process. Integrating ESG into investment decisions is the responsibility of the portfolio management team and viewed as a key component of their fundamental investment analysis. Our ESG approach is illustrated below and includes research, a structured risk review process, ESG considerations in investments, reporting and review and engagement. The process used to integrate and assess ESG risk is consistent across all portfolios managed by Alphinity. Our ESG policy outlines the overarching principles and guidelines we apply to ensure that ESG is adequately considered in our investment process.

ESG

integration

**Risk review** 

Investment

considerations

#### ESG DATA AND RESEARCH

- Using company disclosures, external ESG research providers, engagement, and third-party research we form perspectives on ESG-related topics
- Where required, we seek advice from external experts or industry bodies on specific ESG issues
- Thematic research is relevant for companies across our portfolios, or stock specific deep-dives

#### ENGAGEMENT

- We actively engage to better understand ESG risks and opportunities and encourage better practices
- We engage with a range of company representatives including Board, Executive, Senior Managers, and topic specialists
  - We set engagement objectives and track progress where appropriate

#### **REPORTING AND REVIEW**

- We integrate ESG factors into internal reporting tools (eg
- portfolio carbon emissions, ESG risk level)
  We review company and portfolio levels ESG risks, opportunities, engagement priorities, and controversies on an ongoing basis
- We report outcomes of ESG integration in our annual ESG and Sustainability Report

#### **RISK REVIEW**

- Material ESG issues are identified using an in-house materiality framework
- We set an internal ESG risk level for each company to prioritise engagement and next steps
- Material ESG topics are assessed by both the ESG team and the investment team. Responsibility for determining the management of issues sits with the investment team

#### INVESTMENT CONSIDERATIONS

- The means of integrating ESG issues into our investment process varies depending on the specific ESG risk that's been identified
- Factors may be qualitatively considered or quantitatively incorporated into fundamental analysis where relevant
- Consideration of ESG factors may result in the outright avoidance of a company, adjustment to the portfolio weights, the establishment of specific engagement objectives, the execution of voting rights, or specific research being undertaken



### **Features of our ESG approach**

#### **Risk-based approach**

We scale our ESG research effort depending on the extent of possible risks for each company. The nature of ESG research and input from the various members of the team is dependent on the investment stage and overall ESG risk level, as illustrated in Figure 1.

#### **Consistent across investment strategies**

All Alphinity portfolios use the same approach to ESG assessment and integration. Companies considered for our two Sustainable funds are subject to an additional level of analysis related to alignment with the UN's Sustainable Development Goals. However, the assessment of ESG risks and the management of potential impacts to the investment case remains consistent.

#### ESG materiality assessment and risk levels

Our in-house ESG materiality framework supports the investment and ESG teams to consistently identify and assess the most material aspects of ESG for each company. The outcome is a determination of all material ESG issues as well as the designation of an overall ESG risk level for each company. This process is completed by the ESG and investment teams together.

#### Shared responsibility and collaboration

The management of all aspects of ESG is shared between the ESG and the investment teams. The teams work together to identify ESG issues, research particular topics or risks and designate the appropriate management response. This is a critical part of our overall ESG approach as it ensures that the investment team retains the ultimate responsibility for integrating ESG within the portfolios.

#### **ESG** engagement

The outcomes and insights gained through engagement are critical for effective analysis of material ESG issues. As engagement is a key part of our investment process and fundamental analysis, we endeavour to have the relevant member of the investment team attend ESG meetings.

## **Process: ESG materiality assessment** and risk levels

#### Materiality assessment

It is important to focus on the most meaningful aspects of ESG for each company. Our ESG materiality framework supports this assessment, covering ~30 material issues and assigning one of six materiality indicators to those relevant to each company and/or sector. Examples of ESG topics within the framework include:

Environment	Physical climate risk	
	Transition climate risk	
	Water	
	Waste	
	Biodiversity	
	Supply chain	
	Animal welfare	
Social	Cybersecurity	
	Workforce (H&S, culture)	
	Diversity, equity, inclusion	
	Modern slavery	
	Social licence	
	Product ethics	
	Customer relations	
Governance	Corruption and bribery	
	Board composition	
	Remuneration	
	Controversies	
	Regulatory change	

#### **Thematic guidelines**

Complex and material ESG themes can often benefit from a structured top-down assessment approach. Our proprietary frameworks and guidelines inform our views on topics such as climate change, modern slavery and workplace culture. As mentioned above, the outputs from these assessments are used as used to assign the indicators within the materiality assessment.

#### **Internal ESG risk level**

Depending on the number and extent of various threats and opportunities identified in the materiality assessment, a risk level from 1 (low) to 4 (avoid) is assigned to each company in the portfolio. This designation is made by the investment team in consultation with the internal ESG specialists. Any company that is assessed at the highest risk level of 'avoid' has not met our minimum ESG risk criteria and will not be considered for investment. This is reviewed on an ongoing basis. Various research and data inputs, direct engagement and peer comparisons can inform this outcome. This process can help to define engagement objectives for specific issues.



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#### Ongoing monitoring and review

Formal touchpoints and a structured review process drive consistency and accountability across the various teams.

- **Company-specific**: The ESG materiality assessment and ESG risk levels are reviewed with each member of the investment team, covering their relevant stocks with the ESG team at least twice a year.
- Portfolio level: The ESG team conducts a review session with the investment team at least twice a year to discuss ESG risk levels, ESG characteristics at the portfolio level, prioritise engagement and review material controversies with regulatory developments.

# Considering ESG in investment decisions

ESG risks and opportunities are dynamic and can change over time. Our materiality assessment and company engagement enables us to discuss and assess ESG issues regularly, changing our position and views when required. Some ESG risks can have an immediate material financial impact, while others can be longerterm in nature, with broader potential impacts linked to reputation or social licence.

Recognising the dynamic nature of ESG issues, we integrate ESG into our investment decisions in a range of different ways. Integrating ESG considerations into the investment process varies depending on the individual industry and company circumstance, the relative exposure in our funds and the materiality of the ESG topic. The investment team is responsible for determining the best integration approach for a specific issue, or set of issues.

We have a zero tolerance for tobacco producers and manufacturers of controversial weapons and exclude these from all portfolios. We exclude thermal coal producers from all portfolios with a 10% revenue threshold.

Integration approach	Description
Portfolio management	The investment team may adjust the size of a portfolio position (positive or negative) to manage a material ESG issue. This could be in response to an individual ESG event or issue or may be due to the overall ESG risk level and fundamental ESG view of the analyst.

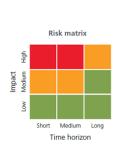
	INVESTMENT MANAGEMENT
	Example: A material legal case threatens future development opportunities and results in a decrease in portfolio weight.
Financial modelling	Where an ESG issue is quantifiable, with a direct identifiable financial impact, it may be integrated into financial models to measure the impact to the investment case.
	We may also test the potential impact of ESG issues with longer time horizons, or less certain financial outcomes, through sensitivity analysis or scenario modelling.
	Example: Company is facing a delay in production due to a severe weather event. Modelling is adjusted to account for the delay.
Engagement	Company engagement informs our view on ESG risks and is used as a strategy to manage ESG risks over time.
	Where a risk does not warrant financial modelling or a change in the portfolio, an engagement objective may be set to achieve better reporting, management practices or outcomes over the immediate or longer term.
	Example: Company does not have medium term emission reduction targets in place. We view this as a potential longer-term risk to the business and initiate an engagement objective to encourage the company to set clear measurable targets.
Monitor	Not all ESG risks require immediate action. ESG risks that do not have an immediate material impact, are very uncertain, or are long term, are monitored by the investment and ESG team.
	Example: Potential regulatory changes may affect ESG reporting requirements for businesses increasing social licence risks.
Divestment	We might divest from a company if the ESG risks are perceived to be material enough to undermine the investment case. Typically, this may be related to a significant controversy, governance concerns or a change in operating conditions.
	Example: Removal of company CEO destabilises the company and impacts future company revenues.

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# Figure 1. Risk-based approach to ESG research and engagement

ESG efforts are typically concentrated in the pre-investment and investment phases. However, there is great value in monitoring progress of specific companies within our investment universes where that company may move back into the pre-investment phase, or where the company requires monitoring for benchmarking purposes.



	Monitoring investment universe	Pre-investment	Investment period
		<ul> <li>✓ Investment analyst considers material ESG exposures</li> <li>✓ Research input from ESG team, where required</li> </ul>	<ul> <li>✓ Annual review of ESG disclosures, including climate change and modern slavery risk assessments</li> <li>✓ Monitoring controversies and company ESG updates</li> <li>✓ Broad ESG engagement as part of financial meetings, by the investment analyst and ESG team where required</li> </ul>
ESG risk	<ul> <li>Company ESG/sustainability approach and updates</li> <li>Progress on controversies</li> <li>General company engagement within financial updates and group meetings, mostly by investment analyst</li> <li>Closer monitoring and engagement for high- risk companies</li> </ul>	<ul> <li>ESG materiality assessment</li> <li>Company ESG engagement</li> <li>Early input from Sustainable Compliance Committee for fund suitability</li> <li>ESG materiality assessment and summary report</li> <li>In-depth company engagement</li> <li>Third-party expert views and specific key issue research</li> <li>Early input from Sustainable Compliance Committee for fund suitability and ESG perspectives</li> </ul>	<ul> <li>Thorough review of ESG disclosures, company ESG updates and monitoring controversies</li> <li>Dedicated ESG engagement with focus on objectives, where appropriate</li> <li>Discuss at quarterly ESG review meeting with investment team</li> <li>Aim to engage regularly with companies and examine ESG disclosures in detail</li> <li>Comprehensive thematic research for material topics, with expert views where required</li> <li>Investment analyst is most engaged and is responsible for adjusting investment decisions based on ESG research outcomes</li> <li>Escalation of engagement objectives (for example, communicating issues to board)</li> </ul>

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