Perpetual Asset Management Australia

ESG Report 2021

Environmental, social and governance

Trust is earned.

Perpetual

Foreword

I am pleased to present Perpetual Asset Management Australia's (PAMA) annual ESG Report for 2021. This report showcases the actions we have taken during the year and the outcomes we have delivered in addressing and managing environmental, social and governance (ESG) issues across our investment portfolios.

PAMA has a longstanding commitment to ESG principles, joining the UN-supported Principles for Responsible Investment (PRI) in 2009, not long after it was formed in 2006. We acknowledge the growing focus globally and from our clients on the importance of ESG and this year we have taken additional steps to continue to improve our approach. As an active manager, our investment teams assess ESG factors through detailed bottom-up research and, where material, incorporate these factors into the investment research and decision making process.

A fundamental belief underpins this analysis – good governance is critical at all our investee companies – this is a key prerequisite for us to consider allocating client capital. Our deep experience in the Australian market and well-resourced investment teams allow us to probe deeper and prioritise key factors we believe are most important. Similarly, when it comes to environmental and social issues, we analyse on a bottom-up basis the most material issues for each company. The issues will vary across industries and sectors, but the most material issues may include climate change, human capital and other labour issues, supply chain, pollution and water.

Since we set up our first Ethical SRI Fund in 2002, we have been managing money specifically on behalf of responsible investors for two decades and have continued to evolve the suite of dedicated ESG investment strategies since that time. Most recently, in 2021, we launched the Perpetual ESG Real Return Fund and also launched our first active ESG ETF (Exchange Traded Fund) – ticker: ASX: GIVE.

This report is intended to provide our clients and stakeholders with more information on PAMA's approach to ESG issues and to highlight the key activities we have taken over the past year to further embed ESG into our investment process. Our approach is founded on the belief that ESG issues, risks and opportunities can have a material impact on investment outcomes. Our active, fundamental process is focused on identifying and analysing these issues and incorporating them into investment decision-making. We hope you find the report of value.

Amanda Gillespie
Group Executive
Perpetual Asset Management Australia

About Perpetual

Perpetual is a global ASX-listed financial services company, which has been serving clients since 1886.

Across our four divisions – Perpetual Asset Management Australia (PAMA), Perpetual Asset Management International (PAMI), Perpetual Private (PP) and Perpetual Corporate Trust (PCT) – we aim to protect and grow our clients' wealth, knowing that by doing so we can make a difference in their lives.

Our vision:

To be the most trusted in financial services

Our purpose:

Enduring prosperity

Perpetual Asset Management Australia (PAMA)

As an asset manager we provide a range of investment management services to institutional, wholesale and retail investors.

This report covers PAMA's investment management activities[1] (equity and credit funds management, and our multi-asset funds to the extent they employ these capabilities). The investment activities of other Perpetual businesses (PAMI, PP and PCT) are outside the scope of this report.

2021 ESG highlights

PAMA increased its focus on ESG products with the launch of the Perpetual ESG Real Return Fund. The Fund offers multi-asset exposure to a portfolio of selected assets based on a range of sustainable, ethical and financial criteria.

We also launched our first ESG ETF (Exchange Traded Fund) listed on the ASX (ASX: GIVE), based on the Perpetual Ethical SRI Share strategy. A proportion of the performance fees earned on this ETF are donated to charity.*

The Perpetual Wholesale Ethical SRI Share Fund was upgraded by research houses Lonsec (to Recommended) and Morningstar (to Bronze).

Further developments in identifying investment risks and opportunities from climate change within our Australian equity portfolios, including:

- Proprietary net zero review of the S&P/ASX 300 Index – see page 9 for more details.
- Expanded climate portfolio reporting to portfolio managers.

We continued to increase public reporting on our portfolios' exposure to climate risks (see page 10).

Further progress was achieved in the systematic integration of ESG factors into the management of our credit and fixed income portfolios, including formalised ESG risk scores (see page 8). Issuer engagement on ESG matters also increased (see page 13).

Perpetual Group retained the highest (AAA) ESG rating from MSCI ESG Research.

* Refer to https://www.perpetual.com.au/funds/perpetual-ethical-sri-fund-asx-give for more information

ESG themes for 2021

- **COP26 and Climate change**
- **Nature and biodiversity**
- **Corporate ethics**
- **Cyber risk**

Climate change re-asserted its place on the top of the ESG agenda for many investors over 2021. The United Nations Climate Change Conference in Glasgow (COP26) and the renewed focus on the issue in the US driven by the new Biden administration were key developments. While many were disappointed that the proposed agreement to 'phase out' unabated coal power was watered down to 'phasing down' it use, COP26 provided renewed grounds for optimism and some positive surprises. The Agreement on Article 6 of the Paris Agreement marks a significant global milestone for the development of a global carbon trading market. The Global Methane Pledge begins to address methane; a much more potent greenhouse gas for global warming than carbon dioxide. Over 140 countries have endorsed the Glasgow Leaders' Declaration on Forests and Land Use, reaffirming commitments to sustainable land use transition, working collectively to halt and reverse forest loss and land degradation by 2030.* Corporations, financial institutions and other key actors also announced further initiatives to do their part alongside governments.

Closer to home, the impetus for companies and governments to act on the issue continues to grow – the increasing climate litigation and shareholder pressure was noteworthy.

A related ESG issue that rose in prominence in 2021 was nature and biodiversity. Both investors and companies continue to develop a deeper understanding of the potential for systemic risks associated with biodiversity loss to materially impact global finance, business operations and broader society.

World leaders will convene in 2022 at the UN Biodiversity Conference (COP15) in Kunming, China, to develop immediate action to support net zero biodiversity loss and to build momentum in strengthening disclosure frameworks to assist in clear identification of relevant risks and opportunities related to natural capital. Newly emerging tools and regulation demonstrate the global commitment to act and report on evolving nature-related risks, such as the Taskforce on Nature-Related Financial Disclosures (TNFD) and the Sustainable Finance Disclosure Regulation within the European Union.

Cyber Risk emerged as another key theme – a rising threat to organisations and individuals following a series of ransomware attacks, targeting critical infrastructure providers and companies with valuable sets of consumer data. After a five day production interruption, JBS Foods, Australia's largest beef and lamb processing company, reported it had paid more than $14 million dollars in ransom to hackers.

The new normal regarding expectations of higher ethical standards of behaviour at companies was further reinforced over 2021 with yet more examples of companies forced into dramatic action, for example board and senior management departures, and handing back government assistance (like JobKeeper). Doing and being seen to be doing the right thing has never been more important.

The rise of the #MeToo movement overseas and in Australia, including revelations of unacceptable behaviour within institutions and even within the walls of Parliament House itself, has been a wake up call that all workplaces should be made safe from sexual harassment and abuse.

At the time of writing in 2022, the Russia and Ukraine conflict has presented new ethical investing challenges in areas such as divestment from autocratic states, the impact on energy security and whether investments in defense companies can be ESG compatible.

* Source: https://ukcop26.org/glasgow-leaders-declaration-on-forests-and-land-use/

What ESG means to us

- **We focus on improving the investment outcomes of our clients**
- **Improving ESG practices has broader benefits to our stakeholders and society**

Our policies – what we believe

Our **Responsible Investment Policy*** applies to our employees responsible for making active investment decisions, including investment analysts and portfolio managers. It is our policy that consideration of ESG factors is incorporated into our investment analysis, decision making and ownership practices.

Perpetual's **Principles of Internal Governance and Asset Stewardship*** provides information on our approach to investing, governance and asset stewardship, based on relevant internal governance and stewardship standards.

At PAMA, as an asset manager, we have always focused on achieving the best investment outcomes so we can create enduring prosperity for our clients.

In essence, we incorporate consideration of ESG factors into the way we manage client funds because we believe ESG issues can influence investment outcomes.

We are also aware of, and encourage, the broader benefits that improved ESG practices can bring including:

- Higher standards of ethical business conduct;
- Increased market efficiency;
- Sustainable environmental management;
- Improved outcomes for company stakeholders including employees, customers, suppliers and the broader community; and
- Ultimately a more cohesive and fairer society.

These benefits for society will also be better for our clients. We believe that if the investment management industry can help promote more sustainable economic growth, this should translate into higher and more consistent investment returns. For example, if investor engagement contributes to companies being better prepared for the regulatory and environmental impacts of climate change, a more efficient and less disruptive transition to a low-carbon economy becomes more likely.

For more information see https://www.perpetual.com.au/investments/institutional-investors/responsible-investing/

* For more information on our approach to ESG see https://www.perpetual.com.au/investments/institutional-investors/responsible-investing/

There are foundational elements of our approach to responsible investing which underpin our investment activities:

What we believe

- We believe ESG risks and opportunities impact the long-term investment performance of our clients' portfolios
- We believe that being active stewards of our clients' capital can improve the investment outcomes for our clients, including in regard to ESG issues
- We believe that improving ESG practises within the companies in which we invest can have broader benefits, like improved outcomes for our investee organisation's stakeholders and broader society
- We believe in supporting those clients who wish to align their investments with additional ESG principles or values
- We believe our success as a business is dependent on a sound approach to ESG within our own business

What we do

- We integrate consideration of ESG issues into investment analysis within investment portfolios
- We engage and advocate for positive change on relevant ESG issues where we can have influence with our investee organisations and other stakeholders
- We utilise our shareholder rights to vote at company meetings and lodge or support shareholder resolutions where appropriate
- We join industry and other collaborative initiatives with other like-minded investors to help achieve our ESG goals
- We fully disclose our approach to ESG to our clients and other stakeholders
- We offer specialist ESG investment strategies that incorporate additional ESG considerations for clients who want to align their investments with their values*
- We implement appropriate ESG principles within our own business

* More information can be found in the "ESG Strategies and Products" section on page 9.

What we do in practice

ESG Integration

It is our policy that investment managers incorporate material ESG issues or risks into investment analysis and decision-making[2]. By 'material', we mean assessed by the portfolio managers as relevant to the current or future financial performance of the investment (that is, potentially impacting the market value of the investment or the income generated by the investment). Material ESG issues or risks will differ depending on the strategy. Examples are environmental policy, worker health and safety, and corporate governance. It is prudent to recognise and act on material ESG issues, as not doing so could negatively impact our clients' investment outcomes. Issues that are not expected to impact the current or future financial performance of the investment would not be considered material.

This approach drives our ESG stewardship activities, where we may engage with our investee companies on material ESG risks. Our stewardship activities are discussed further in ESG company engagement and advocacy (page 13) and proxy voting (page 18).

ESG integration in Australian Equities

Within our Australian equities process, we consider ESG themes that are material to our investments. We believe that good governance is critical at all our investee companies – this is a key prerequisite for us to consider allocating client capital. While governance norms and standards are important, our deep experience in the Australian market and large equities team allows us to probe deeper and prioritise key factors we believe are most important – like board industry experience, motivation (e.g. director shareholdings) and track record. Similarly when it comes to environmental and social issues, we analyse on a bottom-up basis the most material issues for each company.

These themes will be more industry and stock specific than governance but the most material issues may include climate change, human capital and other labour issues, supply chain, pollution and water.

Over the year we continued to implement our proprietary integration tool – our **ESG Workbook**. It draws together both internal and external research using qualitative and quantitative data to highlight and assess ESG issues at companies.

This provides equity analysts with a comprehensive tool to analyse potential ESG issues at companies and present conclusions, allowing portfolio managers to incorporate consideration of these issues into investment decision-making.

The Workbook prompts the portfolio manager to consider:

- what ESG factors the investment is exposed to and whether any of these factors present risks to the investment
- what impact ESG factors are likely to have on the investment's prospects; and
- how well ESG factors are being managed by the company, and therefore how likely the possible impacts are to occur.

The ESG Workbook is also a powerful company engagement tool we can use with company management and boards in order to encourage increased focus on priority ESG issues.

Gaining a greater understanding of the climate change risks and opportunities facing our portfolio companies was a particular focus over 2021. At a portfolio level we increased our internal portfolio carbon reporting to portfolio managers. We also conducted portfolio stress testing to estimate the earnings impact on portfolio companies of a theoretical carbon price.

ESG integration in Credit and Fixed Income

Our Credit and Fixed Income Team has designed and implemented a more formalised process to systematically assess how material ESG risks may affect an issuer's credit profile. Corporate issuers are assigned an ESG risk score based on material credit risks and mitigation efforts by the issuer.

This acts as a tool to help portfolio managers manage credit risk in their portfolios and incorporate these risks into relative value pricing considerations. The following diagram shows our view of ESG's impact on our credit issuers:

Impacts on credit

- Will a company's future revenue be weakened or become less predictable as a result of ESG risks?
- Will its costs structurally increase as a result of mitigating such risks?

- Does a company need to sustain an increased level of capital expenditure in order to mitigate these risks?
- How will such risks affect a company's working capital needs?

- Will these risks substantially increase the company's cost of funding?
- Will the company be able to access equity and debt funding in the long run?

- Will these risks change our collateral value? Will they introduce contingent liabilities?
- Will elevated risks reduce the estimated useful life of assets? Will decommissioning costs and or remediation costs increase?

Proprietary thematic ESG research

At PAMA we utilise both external and internal ESG research sources. External ESG research is provided by specialist firms including MSCI ESG Research, Moody's ESG Solutions (formerly V.E), RepRisk, proxy advisors and other sources. Internal research resources include our Equities and Credit teams and our Responsible Investment team.

Over 2021 we produced internal research on a number of ESG themes including:

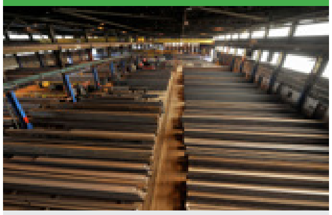
Transition to net zero economy

Analysis of risks and opportunities to our investment universe from the transition to net zero carbon emissions, including a scoring framework for listed companies.

Waste

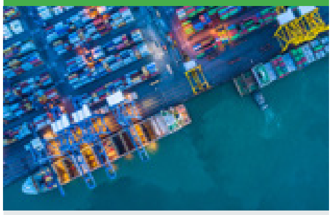
Fundamentals of the waste management industry, trends in waste generation and recovery, as well as the opportunities and challenges ahead for the sector.

Steel in a low carbon world



Carbon reduction in steel globally & implications for the Australian steel sector.

Supply chain and inflation emissions



Understanding disruptions and further potential for impacts to global supply chain networks through inflation of raw materials, transportation costs, labour and fuel.

ESG Strategies and Product

In addition to integrating ESG across PAMA products, we also offer dedicated ethical equities, credit and multi-asset investment strategies. These strategies have more explicit ethical objectives and are designed for clients who want to align their investments with their values. These strategies include:

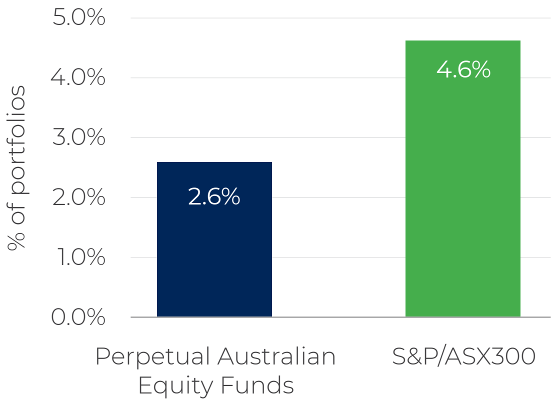
- **Perpetual Ethical SRI Fund** – aims to provide long-term capital growth and regular income through investment in quality shares of ethical and socially responsible companies.
- **Perpetual Ethical SRI Credit Fund** – aims to provide regular income and consistent returns by investing in a diverse range of income generating, ethical and socially responsible assets.
- **Perpetual ESG Real Return Fund** – a multi-asset fund that aims to achieve its return objective while minimising risk through a diverse range of ethical and socially responsible assets.
- **Trillium ESG Global Equity Fund** and the **Trillium Global Sustainable Opportunities Fund** are managed separately by the Trillium investment team and are available as unit trusts in Australia.

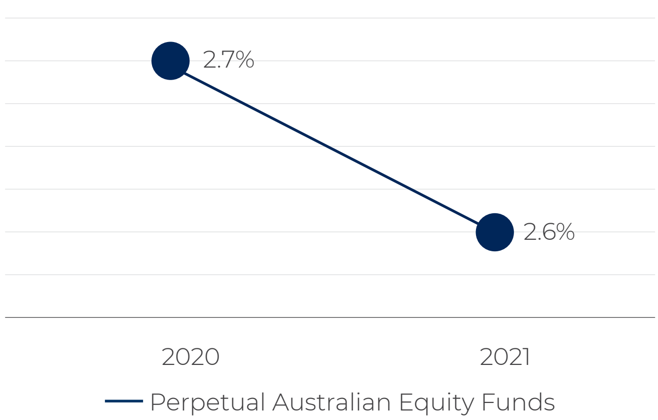
Climate risk

Over the year, we continued to increase our focus on assessing the risk and opportunities arising from climate change across our portfolios. While our equity strategies shown below do not have specific climate-related objectives, the information below compares the exposure of our fund strategies and equity assets under management to high greenhouse gas (GHG) emissions-intensive sectors, versus the market benchmark (S&P/ASX 300 Index). Our Australian equity portfolios have on average nearly half the exposure to high carbon emissions intensive sectors than the S&P/ASX 300 Index.

GHG Emissions Intensive Sectors[3]	Passive Index (S&P/ASX300) Portfolio*	Perpetual Australian Share Fund	Perpetual Industrial Share Fund	Perpetual Concentrated Equity Fund	Perpetual SHARE-PLUS Long-Short Fund	Perpetual Pure Equity Alpha Fund	Perpetual Ethical SRI Fund
% Exposure of key portfolios versus S&P/ASX 300 Index – 31 December 2021							
Coal & Consumable Fuels	0.6%	–	–	–	2.8%	1.6%	–
Integrated Oil & Gas	–	–	–	–	–	–	–
Oil & Gas Equipment & Services	0.2%	–	–	–	–	–	–
Oil & Gas Exploration & Production	2.1%	4.2%	–	3.8%	–	2.6%	–
Oil & Gas Refining & Marketing	0.4%	2.3%	–	2.5%	–	1.3%	–
Electric Utilities	0.6%	–	–	–	1.0%	–	–
Gas Utilities	0.5%	–	–	–	-0.3%	-0.3%	–
Multi-Utilities	0.2%	–	–	–	–	–	–
Total carbon-related assets	**4.6%**	**6.5%**	**–**	**6.3%**	**3.5%**	**5.2%**	**–**

Total carbon-related assets





* Source: Perpetual, MSCI ESG Research

ESG integration examples

Australian Equities case studies

ESG Theme(s):

Climate change

Investment team: Australian Equities
Integration details: The climate change and stranded asset risk facing this diversified resource company has significantly reduced following the divestment of its oil assets from its portfolio. This will result in a significant reduction in emissions and therefore material progress towards the company's goal of a 30% operational emissions reduction by 2030 and to be net zero by 2050.

ESG Theme(s):

Climate change

Investment team: Australian Equities
Integration details: Our negative view and consequent decision not to own this transport company has been reinforced by recent actions by the company which have increased their long term ESG risk. In particular a recent acquisition, while not only very expensive and increases balance sheet risks, has increased the company's revenue exposure to thermal coal – a commodity with a problematic future in a carbon-constrained world. In the near term this will also increase the company's social licence scrutiny.

ESG Theme(s):

Sustainability

Human capital management

Investment team: Australian Equities
Integration details: A leading approach to sustainability is a factor in our positive view on this property company. The higher environmental performance of their office portfolio provides downside protection as the cyclical (and potentially structural) challenges arising from COVID impact office markets. Buildings that are rated higher for their energy efficiency will fare much better than less efficient buildings of inferior grade through a market downturn. Sustainability performance is also crucial to customers who are looking for high quality buildings that are energy and water efficient to manage their own environmental footprints. A safe, diverse and engaged workforce is also increasingly important – this company's safety performance has been excellent, employee engagement has improved and absenteeism has continued on a downward trend.

ESG Theme(s):

Corporate governance

Investment team: Australian Equities
Integration details: This gambling company has been held in our portfolios for a significant period due to our view that the market was significantly undervaluing its assets, and should this persist then the company could be subject to M&A interest (an investment thesis which has subsequently transpired). In our view this undervaluation was significant compensation for the governance risks that existed, while we engaged with the company, often assertively, to address these issues. Unfortunately media revelations uncovering governance issues that were more extensive than first thought emerged, causing action by regulators against the company and other negative impacts on shareholders. This has accelerated governance improvements at the company, however it is clear we underestimated the initial governance risks present at the company. It is positive for our investors that the original investment thesis is now playing out, but we look to learn from these cases to improve our forward looking ESG risk assessments.

Credit and Fixed Income case studies

ESG Theme(s):

Corporate governance

Investment team: Credit and Fixed Income

Integration details: This financial services company was fined for false and misleading marketing of a credit product due to ASIC identifying a lack of disclosure around the product's potential risk of capital loss and illiquidity. After investigating the incident we deemed it an isolated event and did not expect this will have any meaningful impact on this company's structured products which we invest in. In essence the products were mislabelled and the relevant disclaimers covering the above issues did not go far enough. There has been no financial impact on any of the fund investors. All historic liquidity requests have been satisfied. ASIC also made no allegations in the proceedings that, when the company engaged in the contravening conduct, it deliberately or intentionally set out to mislead consumers. The company has cooperated and made changes to its marketing materials in an effort to resolve the issues raised by ASIC. The presiding justice noted "The agreed facts show a very high level of cooperation with ASIC on the part of [The company] and demonstrate a commendable attitude toward legal compliance".

ESG Theme(s):

Corporate governance

Social licence to operate

Investment team: Credit and Fixed Income

Integration details: In recent years, this financial services company has been subject to numerous revelations of unethical behaviour involving customers. This has included charging fees for financial advice they never received, charging deceased customers and dragging its heels in awarding compensation. As a result, we increased our ESG Risk Score from Medium to High for the company and removed them from our list of approved securities, due to severe concerns over its corporate governance and the resultant reputational damage, financial impact and ongoing business implications.

ESG engagement and advocacy

- **PAMA has a long track record as an active shareholder in the Australian market**
- **Company engagement is an integral part of how we invest – we do not outsource it**
- **We engage based on our client interests first and foremost**
- **We maximise our influence by engaging for all our portfolios and not on a fund-by-fund basis**
- **Unsuccessful engagements can be escalated through a variety of means**
- **We also engage and advocate on ESG issues with government and collaboratively**

Our policy is that investment managers should use their influence as an asset manager in order to achieve better investment outcomes over the long term.

ESG shareholder engagement

Due to our significant presence in the Australian equities market and our philosophy as an active shareholder, PAMA has achieved positive engagement outcomes for our investors over a long period.

Rather than trying to change every company, or target every issue, we focus our engagement efforts on quality companies where we have, or are considering, a financial interest. Where it is in the interest of our clients for us to engage, we seek an open and positive dialogue with the companies in which our portfolios invest. From time to time Perpetual may intervene when there are significant concerns about a company's publicly available strategy, performance, management, remuneration, governance or approach to other ESG issues.

We seek to be constructive in all our engagements and have a uniform goal – to improve investment outcomes for all shareholders.

Engagement is therefore not a separate activity, but an integral part of our approach to investing. Consistent with our approach to ESG and other investment considerations, engagement priorities are driven by investment materiality. If we believe that an issue is material, and that as a shareholder we are able to positively influence how a company is addressing this issue, then we will engage.

This is why engagement activities are conducted by the investment team – the same team that makes investment decisions – and is not outsourced. Engagement, like proxy voting, is an important tool for an active investor, to be utilised to the fullest extent to achieve the best results for our clients. We believe this integrated approach adds weight to our engagement efforts – companies are more likely to change if this message is communicated directly by the individuals who decide which companies we will invest in and how we will vote.

Rather than engaging and voting differently on a fund-by-fund basis, we pool our total assets under management invested with each company to maximise our influence.

If a satisfactory outcome on concerns raised cannot be achieved through active dialogue with a company, we may choose to escalate the matter. To this end our investment managers can utilise a number of forums and actions to exercise their influence, including:

- meetings with management;
- expressing concerns through the company's advisers;
- meeting with the Chairman, senior independent director or with all independent directors;
- voting against or abstaining from voting on management resolutions at shareholder's meetings;
- engaging in active public intervention (use of a public forum to drive change); and/or
- full or partial divestment.

Engagement with companies will always be conducted in accordance with the Corporations Act 2001 and, in particular, in compliance with the insider trading provisions of the Corporations Act 2001.

We also engage with regulators and Government on relevant ESG issues.

ESG bondholder engagement

The Credit and Fixed Income team also engage on ESG issues with issuers where they feel they may have influence over a material issue. They have also commenced engaging with credit rating agencies (see page 17 for examples).

ESG collaborative engagement

The Responsible Investment Team joined as a member of the Responsible Investment Association Australasia's Nature Working Group and Leader's Subgroups, collaborating to address nature-related financial risks and expand opportunities in Australia and Aotearoa New Zealand. Participation in the Leader's Subgroup seeks to build awareness and education for investors, companies and fellow RIAA members to engage and understand some of the key international nature-related developments such as the Taskforce on Nature-related Financial Disclosures (TNFD).

ESG engagement examples

Australian Equities case studies

ESG Theme(s):

Climate change

Investment team: Australian Equities
Engagement details: This resource company faces a number of challenges and opportunities in terms of climate change going forward. In terms of direct company emissions, we are strong advocates of having a demonstrable pathway on emissions reductions rather than platitudes and targets that do not have a realistic chance of being achieved. Given the size of the organisation and the breadth of countries it operates in, we believe that the company is well positioned to both reduce its own emissions through renewables and new technologies, but also be a key enabler of reducing global emissions through the commodities it produces, particularly copper and nickel. Although iron ore and coking coal products go into steel production that accounts for ~12% of global emissions, steel itself is also an important commodity enabling emissions reductions elsewhere.

ESG Theme(s):

Human capital management

Investment team: Australian Equities
Engagement details: We believe that this financial company has very strong prospects however one area of ESG concern that emerged as part of the ESG Workbook process was human capital, in particular employee engagement. On areas of culture and engagement, the company failed to meet threshold requirements embedded in executive bonus outcomes. We raised this issue with the company as this could be a precursor to operational risk. We noted the Chairman's comments that the company was working hard on the issue and we will continue to monitor the situation going forward.

ESG Theme(s):

Human capital management

Governance

Investment team: Australian Equities
Engagement details: We engaged with this consumer products company on a number of ESG issues that arose as a result of our ESG Workbook integration process. This engagement centred on the key material issues including labour management, board expertise and board motivation (director shareholdings). The company was grateful and receptive to these interactions and we look forward to seeing progress on these fronts in the near future.

ESG Theme(s):

Sustainability

Board Composition

Investment team: Australian Equities
Engagement details: A positive attribute of this logistics company we identified is its leading approach to sustainability and ESG issues. On managing material risk areas including raw material sourcing and labour management the company rates in the top quartile versus peers. However our ESG Workbook process identified one key area of concern which we believe warranted further engagement. A lack of director shareholdings ('skin in the game') raises board motivation risks and is of particular concern currently in this case with the company facing some important capital allocation decisions, especially whether to invest in a whole new product line, which we believe carries significant financial risk to shareholders (which directors do not share). We have firmly put forward our view that this issue needs to be addressed.

ESG Theme(s):

Board Composition

Executive Remuneration

Investment team: Australian Equities
Engagement details: This insurance company has been a perennial underperformer due in no small part in our view to poor Board decision-making. Our ESG Workbook process also identified a lack of industry expertise and high groupthink risk. We believe a thorough refreshment of the Board, including the Chair, will be required to improve the situation and ultimately unlock the value in the business that the market does not currently recognise. In our engagement we have initially made the case for insurance underwriting and general insurance industry experience to be the key determinant for the next Board member. In terms of executive remuneration, we voiced our concerns about bonus outcomes for the prior year as well as attempting to influence upcoming design changes, due in part to the requirement to become BEAR (Banking Executive Accountability Regime) compliant. We are in favour of re-weighting variable pay from short to longer-term KPIs and retaining objective measurable objectives over subjective measures that are more opaque and more open to board discretion.

ESG Theme(s):

Board renewal and commitment

Investment team: Australian Equities
Engagement details: The board of this agriculture company has attracted criticism for being stretched in terms of workload and adequacy. We have communicated to the board that the Board renewal process needs to be expedited. One new appointment recently was a positive however we need to see further progress – the Chair has confirmed the company is in an active recruitment process for two appointments and individual workload issues will be addressed.

ESG Theme(s):

Board motivation

Investment team: Australian Equities
Engagement details: This small consumer goods company has related party arrangements with directors, potentially impacting their independence. While we have supported these arrangements in the near term because we believe the properties the agreements are subject to are important to the success of the company, the terms of these arrangements (rents above independent estimates and what appear to be non-arm's length or favourable terms) are disappointing and not sustainable. This has led to an engagement with the company to encourage them to find a solution.

ESG Theme(s):

Executive remuneration

Investment team: Australian Equities
Engagement details: We engaged with this property company regarding executives long term incentives (LTIs). In our view the LTI vesting metrics were not appropriate in that no operating metric was included. The Chair confirmed to us that the company would be reverting to both an operating and shareholder return metric for LTIs in FY22.

Credit and Fixed Income case studies

ESG Theme(s):

Sustainability

Modern Slavery

Investment team: Credit and Fixed Income

Engagement details: We expressed our concerns about the lack of ambition relating to one of the sustainability-linked targets when this large diversified industrial company launched its inaugural sustainability-linked bond. We also advocated that the company should link the sustainability target to how it manages modern slavery risks going forward. Furthermore we asked management to disclose more audits across the entire supply chain, to ensure they are not simply passing their modern slavery obligations onto their direct suppliers. Management has subsequently indicated that they will be publishing more audits on other suppliers further up the supply chain, rather than just tier 1 suppliers.

ESG Theme(s):

ESG Disclosure

Investment team: Credit and Fixed Income

Engagement details: Following its inaugural credit transaction, this electricity distribution company does not publish its annual reports to non-participating debt investors following the success of its inaugural credit transaction. We actively advocated for better disclosure by expressing our concern to the management and sell-side brokers and warned the company that we would cease research coverage unless the company made its annual reports available to all potential investors. Following our advocacy, the company started publishing its annual reports to all potential debt investors including non-participating investors.

ESG Theme(s):

Corporate Governance

Investment team: Credit and Fixed Income

Engagement details: Breaches of anti-crime requirements have emerged at this bank following recent inquiries and the Financial Services Royal Commission. We were of the view that an elevated corporate governance risk required heightened scrutiny and surveillance, exacerbated by under-investment by the bank in the risk function and IT infrastructure. As well as reducing our exposure, we expressed our concerns to the company and advocated for greater investment in these areas. We believe the combination of direct engagement and portfolio positioning sent a strong message to management. We have also discussed these concerns with the rating agencies and advocated for these corporate governance risks to play a greater part in their rating methodologies.

Proxy voting

- **Like engagement, voting is a valuable tool for an active investor like PAMA and is not outsourced**
- **We will support resolutions that are in our clients' best interests**
- **We consider a company Board's effectiveness holistically, rather than box-ticking**
- **Individual company directors should be held to account for poor company stewardship**
- **Quality company management produces better outcomes for shareholders but is not always easy to find – executive remuneration is important in attracting and retaining good management**
- **It is important for shareholders to voice their concerns at AGM time where remuneration structures or outcomes are excessive or otherwise misaligned with shareholder interests**
- **We assess shareholder resolutions through the same process as company resolutions – we consider carefully what is good for shareholders and therefore our clients**

Proxy voting

We exercise our voting rights over all shares we own where possible, carefully considering our vote to ensure it is made in our clients' best interests – supporting resolutions that will maximise shareholder value.

While we use research from proxy advice firms to help inform our views, we will always vote independently and sometimes differently to their recommendations, and those of company management, if we feel it is necessary to achieve our clients' goals. We take a pragmatic approach to voting based on our deep knowledge of individual companies and their management and Boards, gained in some cases over many years as a shareholder, rather than a rigid one-size-fits-all approach.

Much like our engagement approach, we view proxy voting as a valuable tool for us as an active investor and do not outsource it. All meeting resolutions[4] are considered by the relevant equity analyst and by the Head of Responsible Investment. Voting recommendations are put to the Head of Australian Equities for a final decision. This is then consistently applied across our entire shareholding[5] in the relevant company to maximise the power of our vote.

Voting case studies

ESG	Theme	Theme Detail	Management Recommendation	Vote Decision	Vote Rationale
G	Board Related	Election of Directors	For	Against	This director chaired the Board Remuneration Committee and was therefore accountable for arranging executive retention payments which were in our view unnecessary and excessive and sent the wrong message to other senior management. We believe this decision by the Board exposes a potential weakness in governance. Subsequently the CFO resigned to join a competitor, proving the payments were ineffective in any case. It was for these reasons we also voted against the company's remuneration report (see below).

ESG	Theme	Theme Detail	Management Recommendation	Vote Decision	Vote Rationale
G	Board Related	Election of Directors	For	For	The independence of this director was brought into question due to the receipt of consultancy fees however we believe his value to the business outweighs this issue and we have engaged with the company that this issue needs to be addressed.
G	Board Related	Election of Directors	For	For	This family-run company displayed a failure of governance and oversight however given the family's majority ownership position and the fact that we believe this director had limited accountability for the prior issues we believe it was appropriate to support his reelection.
G	Board Related	Election of Directors	For	For	This board is frequently targeted for a lack of independence given the founder retains significant involvement. However we believe the deep industry experience, knowledge of the business and strong track record in creating shareholder value warrants continued support from shareholders.
G	Board Related	Election of Directors	For	Against	This long serving director and chairman has presided over a number of issues and has a poor track record on hiring/firing of CEOs. Business strategy, structure of executive remuneration and shareholdings at board level have all been issues in recent years.
G	Board Related	Election of Directors	For	Against	Lack of industry experience, poor capital allocation, poor handling of a strategic review demonstrate an inability to unlock shareholder value.
G	Board Related	Election of Directors	For	Against	Dissatisfaction with the fact the board elected to pay a partial bonus during FY21, despite management falling short on strategy and lack of controls over inventory. Lack of progress on board renewal.
G	Board Related	Related Party Transactions	For	For	Approval for these related party transactions was controversial – however the properties subject to the related party leases are in our view critical to the success of the company however the terms (rents above independent estimates and what appear to be non-arms length/favourable terms) are disappointing, leading to engagement with the company to find a solution.

ESG	Theme	Theme Detail	Management Recommendation	Vote Decision	Vote Rationale
G	Changes to Company Statutes	Amend Articles, Constitution, Bylaws – Bundled	For	Against	We voted against the amendments to the constitution for virtual AGMs consistent with the internal view that in-person AGMs are important – the risk is the company will have too much discretion to hold virtual-only AGMs without a reasonable justification, thereby reducing shareholders rights.
G	Compensation	Remuneration Report (Retrospective)	For	Against	Executive retention payments were arranged which were in our view unnecessary and excessive and sent the wrong message to other senior management. We believe this decision by the Board exposes a potential weakness in governance. Subsequently the CFO resigned to join a competitor, proving the payments were ineffective in any case. For these reasons we also voted against the re election of the chair of the remuneration committee (see above).
G	Compensation	Remuneration Report (Retrospective)	For	For	We were of the view that criticisms of management remuneration being excessive in a difficult year for shareholders were misplaced – in our view management did a very good job in an extraordinarily difficult year.
G	Compensation	Remuneration Report (Retrospective)	For	Against	In this case, we believed board discretion to reduce executive bonus and long-term incentive outcomes below formulaic levels was warranted but not applied. Shareholders in this company have suffered due to management missteps including customer remediation and operational issues.
G	Compensation	Remuneration Report (Retrospective)	For	Against	Annual incentive outcomes, especially for the new CEO, appeared disproportionate in the context of the company's poor FY21 performance. The CEO received 97% of maximum bonus while operating profit fell nearly 18% and guidance for FY22 was underwhelming.
G	Compensation	Remuneration Report (Retrospective)	For	Against	We are unhappy with the share issuance over recent years which, given the weakness in the share price, meaning the dilution is even worse for long-standing shareholders. Management seem to focus on net operational cash expenditure and ignore share based payments, which is a concern.

ESG	Theme	Theme Detail	Management Recommendation	Vote Decision	Vote Rationale
G	Compensation	Remuneration Report (Retrospective)	For	Against	Despite engaging with the Chairman to reflect our disappointment around the Board composition and lack of engagement with shareholders in the process of forming the board for this newly demerged company, we did not have confidence that the Board renewal before the next AGM will meet our expectations. On top of this, we remain disappointed with the decision of the prior Board to raise equity last year at a depressed valuation. We do not believe the raise was necessary nor the Board took appropriate steps to explore alternate options. To reflect our disappointment and the permanent dilution we have had as a result we are also voting against the equity grant to the CEO.
G	Compensation	Remuneration Report (Retrospective)	For	Against	Annual incentive outcomes for FY21 appear disproportionately high given the negative shareholder experience and stated performance against the company's own performance targets, especially in relation to financial and customer metrics.
G	Compensation	Stock Option Grants	For	Against	Despite our engagement on this issue the company continue to set vesting hurdles which are too low, hence it is more a retention rather than performance incentive.
G	Compensation	Stock Option Grants	For	Against	This company was amongst the most severely impacted by the economic consequences of COVID-19. We believe senior management have done a good job given the circumstances, and as such we were supportive of a one-off retention grant in 2020 to reflect their performance, forgone long-term incentives due to factors outside management's control, and the need for management stability during a difficult time. However a one-off retention grant should be exactly that – a one-off – and therefore we have voted against this additional retention grant.
G	Compensation	Stock Option Grants	For	Against	Insufficiently challenging vesting hurdles.
G	Compensation	Stock Option Grants	For	Against	We voted against issue of performance rights to the CEO to reflect our disappointment in the operational performance of the business under his tenure.

ESG	Theme	Theme Detail	Management Recommendation	Vote Decision	Vote Rationale
G	Compensation	Stock Option Grants	For	Against	Options appear excessive, will result in material dilution. Non executive directors are being granted management like options as well, which is not ideal.
G	SHP*: Governance	SHP Regarding Facilitation of Shareholder Proposals	Against	Against	Changing the company's constitution to permit non-binding 'opinion' type shareholder resolutions. We agree with most proxy advisors that this would not be a positive governance development. It's not clear shareholders need this additional right and it can open the floodgates to many resolutions, from any shareholder with an opinion on any issue, irrelevant to, or even against, shareholders' interests. It distracts the Board and muddies the waters about board accountability.
E	Environment	Management Proposal Regarding ESG Issues (Approval of Climate Transition Action Plan)	For	For	We had some concerns about the adequacy of the company's emissions reductions targets however we think it positive that the company is putting forward an initial 'Say on Climate' resolution and the company's approach to this issue ranks above peers.
E	SHP: Environment	SHP Regarding Climate Lobbying	For	For	On its face we are not normally receptive to (non-binding) shareholder resolutions that are focused on a third party (in this case an industry association) and that dictate how a company should be run. However this proposal (that the company strengthen its review of industry associations to ensure that it identifies areas of inconsistency with the Paris Agreement) warranted support as it gained Board endorsement due to the fact it already largely reflects company practise.
E	SHP: Environment	SHP Regarding Report/Action on Climate Change	Against	Against	This resolution dictated how the company should be run and it was not clear this additional climate reporting is necessary for shareholders. Unworkable in practise. It advocated a strategy where the company should preference broader climate change goals over preservation of shareholder value, for example not selling problematic assets.

*Shareholder proposal

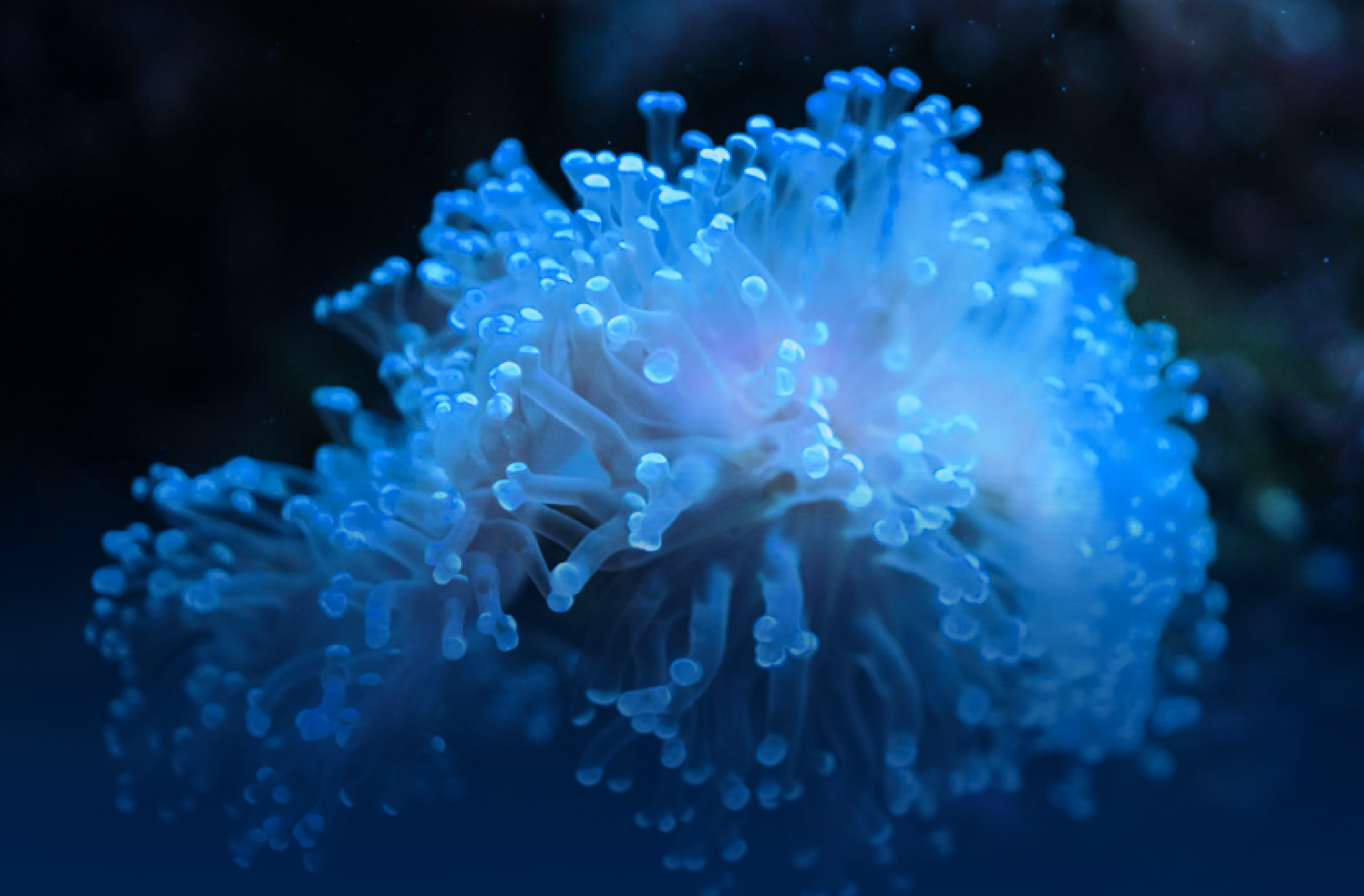
PAMA Responsible Investment team

Richard Morris
Head of Responsible Investments
richard.morris@perpetual.com.au

Harry Agnew
Responsible Investment Analyst
harry.agnew@perpetual.com.au

Footnotes

1 Except for certain quantitative and niche portfolios.
2 We also consider opportunities of an ESG nature in the course of our normal investment analysis. See ESG Case Studies for more information.
3 Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures, TCFD, June 2017 https://assets.bbhub.io/company/sites/60/2020/10/FINAL-TCFD-Annex-Amended-121517.pdf
4 Except for certain quantitative and other portfolios.
5 Except for certain segregated mandates where the client has elected to make the voting decision.



Find out more

Advisor Services 1800 062 725

Investor Services 1800 022 033

Email Investments@perpetual.com.au

www.perpetual.com.au

Perpetual