Perpetual Investments

OUR ETHICAL SRI SCREENING PROCESS

Perpetual's Ethical SRI strategy uses the same investment process as the broad Australian equities strategies. However, there is an additional screening process undertaken to develop the investable universe for this strategy, and it requires specialist research.

OVERVIEW

Ethical and socially responsible investment (SRI) research requires specialist skills. Work in this field is aimed at evaluating a company's performance on a range of environmental, social, governance (ESG) and ethical criteria which have been traditionally regarded as unrelated to a company's financial performance.

We utilise research from an external specialist to analyse the ESG practices of companies listed on the Australian market and overseas exchanges. After examining a number of SRI research providers, we chose CAER as our dedicated external specialist, based on their depth of research and quality of systems and resources.

Perpetual's Ethical SRI strategy has two screens, including:

- an immediate exclusion for involvement in certain industries through the implementation of a 5% revenue materiality threshold; and
- a performance screen based on an evaluation of companies' overall sustainability performance on SRI criteria.

The Manager, Responsible Investment oversees the process and may draw on internal and other supplementary research to ensure rigorous company screening. Screening criteria may change over time to account for emerging issues.

WHO IS CAER?

- Established in January 2000, CAER is an independent organisation offering research services on a broad range of ethical, environmental, social and governance criteria.
- CAER is the Australian research partner of Vigeo EIRIS (Experts in Responsible Investment Solutions), a provider of global ESG research and the EGP software platform to a range of clients around the world. Vigeo EIRIS was established in London in 1983.
- CAER uses Vigeo EIRIS's research methodology which covers over 300 ESG indicators and has been developed over Vigeo EIRIS' 30-year history.

Combined, CAER and Vigeo EIRIS research over 4,000 listed companies.

- Both CAER and Vigeo EIRIS have achieved certification under independent quality standards involving Responsible Investing (RI) research.
- CAER/Vigeo EIRIS draw on a range of sources for company information including: company public documents (e.g. annual reports, sustainability reporting), engagement with companies, independent and reliable sources (e.g. relevant regulatory data and non-governmental organisations [NGOs]) and the media.

- The CAER/Vigeo EIRIS methodology begins with a top-down sector analysis with sectors profiled in terms of impact. Company performance is assessed in terms of policy, performance and reporting.
- CAER/Vigeo EIRIS also provide business revenue data on issues of concern to ethical investors, such as human rights, tobacco, alcohol and genetically modified organisms.
- Companies are assessed annually (or more regularly should a significant issue occur) on a rolling cycle. The screens for the fund are updated monthly.

DIFFERENTIATION IS LIKELY TO BECOME INCREASINGLY IMPORTANT AS COMPANIES RESPOND POSITIVELY TO GREATER INVESTOR AWARENESS OF ETHICAL AND SOCIAL ISSUES.

THE SCREENING PROCESS

Companies that have met the broad Perpetual quality investment criteria are assessed on a range of additional ESG and ethical issues to determine their suitability for inclusion in the Ethical SRI portfolio.

The screening process for the Ethical SRI strategy is a combination of exclusions and an SRI performance screening process. This combined approach allows exclusions based on specific activities while also identifying the performance of companies on a broader range of factors.

The SRI scoring system includes a positive element in the performance screening process, which allows companies demonstrating ESG leadership to be rewarded in the analysis. This provides a wider scope for differentiation of companies from a socially responsible perspective, and is likely to become increasingly important as companies respond positively to greater investor awareness of ethical and social issues.

STAGE 1: ETHICAL EXCLUSION

Stage one of the Ethical SRI screening process aims to exclude those companies that are significantly engaged in the production or sale of products and services determined to be ethically unacceptable to the manager's clients. These criteria are relatively objective and rely, where possible, on a quantitative assessment of revenue generated by the products and services. Where the proportion of a company's revenue from such activities exceeds 5% of total revenue, the company will be excluded from consideration for investment.

This step therefore deals with the type of industry the company operates in and the products and/or services that the company produces and/or sells.

The exclusion criteria are currently based on the following activities:

- **alcohol**
- **gambling**
- **tobacco**
- **uranium and nuclear**
- **armaments (including weapons)**
- **fossil fuels (upstream)**
- **genetic engineering**
- **pornography**
- **animal cruelty (cosmetic testing)**

STAGE 2: SRI SCREENING

Stage two of the screening process is aimed at evaluating how a company's business practices impact on society and the environment.

The SRI screen scores companies on a broader range of ESG issues.

Companies can receive negative scores for poor behaviours, such as a poor approach to human rights or supply chain, or approach to the environment, as well as positive scores for worthwhile activities such as the use of renewable energy, positive employee policies or charity commitment. Corporate governance issues are also considered, including ethics and corporate misconduct. We believe this approach allows us to be more innovative in where we can add value for investors as it identifies companies that have responded positively to social and ethical issues.

Based on our policies, Perpetual allocates company scores for performance in these areas using negative and positive scores. If the net total score is negative, the company fails the SRI screen and is therefore excluded from the Fund's investment universe.

The negative and positive scoring issues are outlined on the following page.

OVERRIDES

In very limited circumstances, results may be overridden by Perpetual either to exclude a company that has passed or to allow a company that has failed the screens.

To prevent conflicts of interests, the portfolio manager is not involved in the override process.

TABLE 1: SRI SCREEN – SCORING

Companies are scored (positively or negatively) on their approach to or involvement in the SRI issues shown in the following table. Issues are not scored uniformly but instead on the severity of the issue involved.

ENVIRONMENTAL

SRI ISSUE	SCORE
Environmental impact/commitment lacking	↓
Environmental pollution	↓
Timber (unsustainable)	↓
Chemicals of concern	↓
Environmental performance improvement	↑
Product stewardship commitment	↑
Renewable energy	↑
Environmental solutions	↑

SOCIAL

SRI ISSUE	SCORE
Obesity	↓
Fur	↓
Genetically modified (GM) food	↓ ↑
Supply chain labour standards	↓ ↑
Employee track record & approach	↓ ↑
Human rights track record & approach	↓ ↑
Indigenous rights	↓ ↑
Charitable work and donations	↑

GOVERNANCE

SRI ISSUE	SCORE
Anti-competitive behaviour	↓
Regulatory fines	↓
Bribery news	↓
Governance news	↓
Other corporate misconduct news	↓
Code of ethics	↓ ↑
Employee share ownership	↑

MORE INFORMATION

Adviser Services 1800 062 725
Investor Services 1800 022 033
Email investments@perpetual.com.au
www.perpetual.com.au

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