

Ethical Investment and Stewardship Approach

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Introduction

Our Ethical Investment and Stewardship Approach is designed to explain how we implement our Ethical Investment Policy. It contains the following sections:

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Ethical investment

Overview

U Ethical pursues a values-driven, risk-adjusted approach to investing, supporting the transition to a more sustainable world. We avoid investments in activities that significantly harm ESG themes, actively promote ESG principles through our investment choices, and encourage issuers to prioritise sustainability and address climate change in their decision-making processes. We define issuers as companies, supranational banks and/or government-linked agencies.

The application of our Ethical Investment Policy varies depending on the asset class (outlined in Table 1 below). We incorporate a top-down approach that defines our investable universe by excluding issuers operating in industries or involved in business activities or practices that do not align with the Ethical Investment Policy, subject to stringent materiality thresholds.

Additionally, U Ethical targets issuers that are ESG Leaders based on their ESG Rating.



Source: MSCI ESG Research.

U Ethical's investment process integrates ESG considerations with the aim of minimising investment risk and identifying investment opportunities. Informed by our Ethical Investment Philosophy, we seek out issuers producing goods or providing services that appropriately manage their impact on society and the environment according to industry best-practice, industry standards and/or voluntary frameworks. U Ethical relies on these considerations to inform and prioritise its stewardship activities and to contribute to the collaborative investor initiatives in which it participates.

We monitor issuers on an ongoing basis through ESG alerts, broker research and media outlets. We conduct a full annual review, as well as monthly and interim reviews where necessary - for example, in the event of a significant controversy case, misconduct event or egregious business conduct.

Table 1: Application of Ethical Investment Policy by asset class

Asset class	Negative screening	ESG integration	Positive contribution	Active stewardship
Australian equities	Yes	Yes	Yes	Yes
International equities	Yes	Yes	Yes	Limited
Fixed income	Yes*	Limited	Limited	Limited
Cash, cash equivalents and term deposits	Limited	No	No	Limited

* The fossil fuel criterion does not apply to fixed income securities where the issuance is aligned with the International Capital Market Association's (ICMA) Use of Proceeds Principles for green bonds and transition finance and is externally verified by a third-party provider.

Ethical and ESG screening

Ethical analyses are integrated with the investment analysts' research notes for all new portfolio holdings. The ethical analysis section aims to demonstrate in detail how new issuers under review comply with (and do not breach) U Ethical's ethical framework. It also considers whether issuers meet or exceed operational or product-level best practice and their future prospects.

Analyses include:

- **Ethical framework analysis.** Summary across compliance, risk management and forward-looking information
- **ESG strengths.** Best ESG aspects with an indication of positive screening and material contributions to social or environmental impact and/or good climate risk management
- **ESG weaknesses.** Any business involvement or ESG practice that could or may contravene any of U Ethical's frameworks, exclusionary criteria or values, and
- **ESG controversies.** An overview of the most recent controversies

Additionally, U Ethical produces comprehensive, bespoke ESG reports for all issuers held in our portfolios, as well as those on our watchlist. These in-depth reports assess the ESG characteristic of issuers, providing valuable insights to guide responsible investment decisions. Our bespoke analysis ensures alignment with U Ethical's values and helps maintain compliance with the evolving expectations of society and our clients.

The reports cover the following key elements:

- **ESG profile.** Overall ESG score, ESG pillar scores, and key ESG themes
- **Negative screening.** Controversy and norms-based screening and exclusions
- **Positive contribution.** Alignment with sustainable impact themes
- **Key ESG metrics.** Including board gender diversity, low carbon transition scores, implied temperature rise, and carbon emissions
- **Stewardship.** Proxy voting and engagement activity

Based on this robust framework and analysis of the elements above, each issuer is assigned one of four possible outcomes:

Pass	Aligned with the Policy and contributing to a sustainable world
Neutral	Aligned with the Policy but not significantly contributing to a sustainable world
Watch list	Aligned with the Policy but there are some ESG concerns
Fail	Misaligned with the Investment Policy

U Ethical utilises MSCI ESG Research data, ISS Governance data, broker research and other market intelligence and analytics to assist with both negative screening and positive contribution. For further details on our screening criteria and materiality thresholds, please see definitions in our Ethical Investment Policy.

Negative screening

Zero tolerance negative screening

We do not invest in issuers directly deriving revenue or earnings from the following activities (see definitions in the Ethical Investment Policy):



Controversial and nuclear weapons



Tobacco production



Nuclear power generation

5% materiality for negative screening

We do not invest in issuers which exceed a materiality threshold of 5% of revenue or earnings directly from the following activities (see definitions in the Ethical Investment Policy):



Fossil fuels*



Uranium mining



Conventional weapons and civilian firearms



Predatory lending



Gambling



Adult entertainment



Animal cruelty and exploitation



Alcohol production

*Coal mining, oil and gas production, power generation and equity ownership

Business involvement screening

Business involvement screening measures issuers' direct and indirect exposures to specific products and services, quantified as percentages of total company revenue and total company ownership.

We use MSCI Business Involvement Screening (BIS) to provide another lens of analysis which captures revenue and earnings exposure for issuers covering a parent or holding company and direct company subsidiaries.

'Ownership of' involvement: this factor captures issuers that own from 20% to 49.99% of a company with involvement in the business activity listed in U Ethical's negative screening list; and

'Ownership by' involvement: this factor captures issuers that are 50% or more owned by a company with involvement.

Controversy screening

U Ethical monitors issuers who are or have been involved in controversies. We generally exclude issuers involved in very severe controversies in the last 12 months.

If more than 12 months have passed since a company or issuer had a very severe controversy, a qualitative analysis is undertaken to review the company's response and its efforts to resolve and – where required – remediate.

We also screen out issuers that fail to meet international global norms and conventions, including the UNGC, UNGP, ILO Conventions (core and broad) and OECD Guidelines for Multinational Enterprises.

Cash, cash equivalents and term deposits are only exposed to the financial services sector (predominantly banks) and given the nature of the underlying investments this limits full application of negative screening. The focus on screening for these issuers is on issuer controversies and overall ESG profiles.

ESG controversies and global norms

U Ethical monitors ethical and ESG controversies to ensure that issuers held in portfolios comply with the Ethical Investment Policy. The investment team uses a range of sources to monitor controversies. These include MSCI ESG Research alerts, ISS Governance

research, broker reports, news publications, Bloomberg, industry bodies such as RIAA, PRI, CFA and relationships with not-for-profit organisations such as the UCA Justice and International Mission Cluster (JIM), ACCR and ShareAction.

MSCI ESG controversy research

U Ethical uses MSCI ESG controversy research which categorises activity and controversy alerts using the following flags and categories:

Flags

Red: Indicates that a company has been involved in one or more recent very severe controversies

Orange: Indicates that a company has been involved in one or more serious recent controversies that are just shy of the criteria of the red flag

Yellow: Indicates that the company has been involved in significant recent controversies

Green: Indicates that the company is not involved in major recent controversies. It may have involvement in one or more less significant controversies.

	Very serious	Serious	Medium	Minimal
Extremely widespread	Very severe	Very severe	Severe	Moderate
Extensive	Very severe	Severe	Moderate	Moderate
Limited	Severe	Moderate	Minor	Minor
Low	Moderate	Moderate	Minor	Minor

Source: MSCI ESG Research Controversies and Global Norms Methodology

This categorisation helps to determine whether it is the result of underlying problems or structural failings at the issuer. The status of a controversy case reflects whether it is concluded, ongoing or a historical concern and is used to understand the timeline and progress of events.

U Ethical generally excludes companies that have red flags when analysing issuers for initial investment and would take appropriate action where portfolio issuers are flagged for new controversies.

U Ethical also applies a norms-based screening process to identify issuers involved in ESG controversies that may suggest misalignment with internationally recognised global norms and conventions.

The screening is guided by four key global norms and conventions, which are:

- The Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises
- The Ten Principles of the United Nations Global Compact (UNGC)
- The International Labour Organization's (ILO) Fundamental Conventions and ILO Declaration on Fundamental Principles and Rights at Work
- The United Nations Guiding Principles on Business and Human Rights (UNGPR)

ESG integration

U Ethical's investment process integrates ESG considerations with the aim of both minimising investment risk exposure and identifying investment opportunities. U Ethical conducts qualitative and quantitative ESG analysis across all new holdings prior to investment. ESG factors vary according to industry and issuer. U Ethical monitors issuer controversies and overall ESG profiles on an ongoing basis.

As part of that process, U Ethical applies an in-house ESG score for equities that includes climate risk and transition, overall ESG profile and positive alignment to sustainable impact themes.

This ESG score may affect portfolio weightings and the prioritisation of stewardship activities.

Positive contribution

We seek to invest in issuers that align with our Ethical Investment Philosophy through positive contribution. For equities, this information constitutes a part of our overall ESG score for issuers.

For Australian and international equities, we utilise the MSCI ESG Sustainable Impact Metrics (SIM) framework for an initial screen. This assesses product and services revenue alignment to the United Nations Sustainable Development Goals (UN SDGs) across six Environment Impact and seven Social Impact categories where relevant.

All 17 SDGs are assessed in the product alignment analysis from Strongly Aligned to Strongly Misaligned. This is followed by an internal review and investment team discussion. We also screen for issuers that indirectly support SIM categories across the value chain and are aligned to longer-term investment themes (see Figure 1 below).

For fixed income securities, we seek to include Green, Social, Sustainability and sustainability-linked (GSS) bonds and loans that target identifiable environmental, social or sustainability impact from the issuance and use of proceeds. However, any allocation to these securities is subject to other portfolio construction, investment performance and risk management criteria. Positive contribution is not relevant for cash, cash equivalents and term deposits.

Figure 1: MSCI Sustainable Impact Metrics Taxonomy

Pillar	Environmental impact		Social impact	
	Climate change	Natural capital	Basic needs	Empowerment
Themes	Alternative energy	Sustainable water	Nutrition	Education
Categories	Energy efficiency	Pollution prevention and control	Major disease treatments	SME finance
	Green building	Sustainable agriculture	Sanitation	Connectivity
			Affordable Real Estate	

Source: MSCI ESG Research, MSCI ESG Business Involvement Screening Research, Global Sanctions, and Sustainable Impact Metrics Methodology Summary Guide for Corporate Issuers, October 2022.

Stewardship

Approach to stewardship

As an ethical and responsible investor, we hold the issuers in which we invest to high standards. Beyond screening and evaluating potential new investments, our stringent investment process also applies to existing portfolio issuers. Stewardship takes place through a direct engagement, collaborative industry initiatives and advocacy.



Direct engagements: Individually communicating with issuers and issuers in our investment portfolios



Collaborative engagements: Working with industry peers for greater leverage and a unified voice, targeting portfolio issuers (as well as some outside our portfolios) and critical themes for responsible investors



Advocacy initiatives: Individually and collectively addressing systemic risks by influencing decisions within political, economic and social institutions

Through this stewardship approach, U Ethical seeks appropriate and continuous disclosures on ESG matters. We also encourage issuers not only to improve on general governance best practice and operational profile, but also to seek a greater ambition to deliver social and environmental outcomes, drive innovation and become, or continue to be, an industry leader.

For specific controversy cases, we engage with management to ensure that they are taking immediate and appropriate action, including remediation and process improvements to pre-empt future cases from occurring. Ongoing dialogues and collaborations contribute to long-term outcomes: financially as a result of good governance, and for society by reducing or pre-empting social and environmental impacts.

In order to ensure our active stewardship is focused, we refer to a series of themes that guide our priorities for engagement activities. These themes are segmented into core and secondary considerations (Figure 2).

Figure 2: Themes for engagement activities

Environmental stewardship	Climate change risk	Human rights & global norms (Modern Slavery)	Corporate sourcing governance & behaviour	Social responsibility
<ul style="list-style-type: none"> ● ESG profile improvement ● Animal welfare 	<ul style="list-style-type: none"> ● Task Force on Climate-Related Financial Disclosure (TCFD) Reporting ● Paris-aligned climate scenario roadmaps 	<ul style="list-style-type: none"> ● Labour management ● Controversial sourcing ● Reconciliation Action Plan (RAP) ● First Nations peoples' rights (cultural heritage) 	<ul style="list-style-type: none"> ● Gender diversity ● Remuneration ● Corporate behaviour 	<ul style="list-style-type: none"> ● Community relations ● Responsible sourcing / dematerialisation ● Gambling
<ul style="list-style-type: none"> ● Core considerations ● Secondary considerations 				



Engagement prioritisation process

U Ethical's investment decision-making process enables us to prioritise engagements that aim to improve general ESG performance. These are also based on thematic areas identified by the investment team.

The focus of engagement is on Australian equity holdings where U Ethical's access to company management is greatest. However, there is a large overlap with cash, cash equivalent, term deposit and fixed income issuers. Ownership of cash and fixed income instruments can therefore enhance our leverage for engagement and advocacy with some issuers. We pursue stewardship for other issuers and international equity holdings where severe controversies need to be addressed or where we seek an overall improvement in their ESG profile.

A prioritised approach means that engagement does not cover all portfolio issuers and issuers.

The following steps are taken:

1. Consider involvements* in business activities that might be in breach of our Ethical Investment Policy. We will consider issuers' corporate structures and equity involvements as part of that process. We prioritise issuers with poor ESG profiles and performance and/or ESG-related controversies of a severe (orange flag) or very severe (red flag) nature.
2. Analyse industry specific, financially material ESG issues as prioritised by our internal ESG research, MSCI ESG Research's ESG Rating model and other available research.
3. Select engagement themes in line with focus areas outlined in the previous section.
4. Choose the type (direct, collaborative or advocacy) and the medium (letter, email or meeting) of engagement.
5. Reference the internal engagement guidelines for key ethical considerations relevant to the industries in which we invest. This document provides guidance for critical questions that the investment team may need to address to maintain compliance with our Ethical Investment Policy criteria.

The investment team typically engages with management after their interim and full year results. Ethical and ESG considerations relating to stewardship are discussed daily or on an ad hoc basis by the investment team. ESG analyses and voting records are reported quarterly to U Ethical's investment committee, and the main ethical, ESG or proxy voting concerns are discussed with U Ethical's independent Ethical Advisory Panel at its meetings, which are generally scheduled quarterly.

Direct engagements

Direct engagements provide opportunities at the highest corporate level to discuss the ESG performance of a company and to encourage further improvement and disclosures.

All communication is addressed to either the company secretary, head of investor relations (IR) or general counsel and augmented by regular or on-going communication with IR and senior executives at the company.

Collaborative engagements

In cases where we realise we cannot affect change as an individual investor, we encourage or join collaborative endeavours. In some instances when third parties aligned with our values and ethical investment philosophy approach us for support, we engage collaboratively.

Collaborations with both internal stakeholders and external peers across non-government organisations and industry associations help to achieve positive outcomes over the medium to long term.

Internally, U Ethical works closely with the social justice experts from UCA's Justice and International Mission (JIM) Cluster on matters of human rights locally and globally.

Externally, existing collaborations include the following organisations and respective campaigns and/or working groups:

- Responsible Investment Association Australasia (RIAA)
 - RIAA's Human Rights Working Group
 - RIAA's Nature Working Group
- United Nations Principles for Responsible Investment (UNPRI)
 - UNPRI's Tax Reference Group
 - UNPRI's Global Policy Reference Group (GPRG)
- The Investor Group on Climate Change (IGCC)
- ClimateAction 100+
- Investors Against Slavery and Trafficking (IAST)
- B Lab Australia & New Zealand
- Banking and Finance Oath Limited (signed by individual team members)

Advocacy initiatives

U Ethical has historically played a strong advocacy role in influencing policymakers and political representatives within the commonwealth government through UCA's JIM Cluster. The JIM Cluster meets regularly with policymakers and acts as expert witness in parliamentary inquiries. U Ethical provides varying degrees of support to the key thematic areas of JIM's advocacy work. These themes have included:

- Protecting people on temporary visas from family violence,
- Climate Justice Action
- Online safety and curbing online child sexual exploitation, and
- Online gambling advertising reform

We vigorously pursue our ethical values and objectives within the constraints of our scale and resources. While naturally concerned about the range of ethical issues that are prevalent at any point in time, we elect to focus our attention on those areas with most direct alignment to issuer and portfolio risks and opportunities, and where we believe our efforts will be best rewarded in achieving the desired outcomes.



Stewardship through voting

When our research uncovers issuers held in our portfolios that have subsequently become involved in unacceptable activities or practices, our preference is firstly to initiate a process of direct engagement as a means of advocating and encouraging remediation and/or change consistent with evolving stakeholder expectations.

If engagement yields an unsatisfactory response, we will vote against at least one of the following (in descending order):

1. The chair of the board
2. The chair of the nominations committee
3. A member of the nominations committee or the longest serving director seeking re-election

Proxy voting

Actively exercising our proxy vote is an integral part of U Ethical's stewardship and signals the intent of our ethical investment philosophy.

Before voting against a resolution at a company's annual general meeting, we strive to speak or meet with the company's management to raise our concerns.

When portfolio issuers are involved in controversy cases of a certain severity, we also seek first to have a conversation with the company's management and to follow up with formal correspondence and future meetings.

Shareholder resolutions

Following a review of each shareholder proposal, and in line with our Ethical Investment Policy, we review and support shareholder proposals of an environmental or social nature.

We vote on all shareholder resolutions, considering each on a case-by-case basis in relation to our ethical investment philosophy. Where votes are cast against management, U Ethical may discuss with the company why the decision was made.

Climate change-related proposals against corporate boards have recently grown in importance. Aligned with climate science, we look for three key dimensions of decarbonisation targets: comprehensiveness, robustness, ambition and feasibility.



Public disclosure

Our annual voting records and statistics, including voting rationales, are disclosed on our website.

Tracking and monitoring

All communication and engagement with issuers - letters, company meetings, ethical and ESG-related questions raised on earnings calls or dedicated calls or at meetings - are recorded on Proxy Exchange, the online platform of our governance service provider, ISS.

These activities are reviewed and reported quarterly or biannually to monitor and evaluate the outcomes of U Ethical's engagement work. Engagement and advocacy statistics and overviews are included in the following materials:

- Investment committee papers and reports
- Quarterly newsletter to clients
- Client presentations, and
- U Ethical's website

For details on the outcomes of engagement in these areas, please refer to our most recent Stewardship Report.

Glossary and links

ACCR	Australasian Centre for Corporate Responsibility
ACSI	Australian Council of Superannuation Investors
CDP	Carbon Disclosure Project
CFA	Chartered Financial Analyst
ESG	Environmental, Social, Governance
FSC	Forestry Stewardship Council
GICS	Global Industry Classification Standard
GBCA	Green Building Council of Australia
GRESB	Global Real Estate Sustainability Benchmark
GRI	Global Reporting Initiative
ILO	International Labour Organization
ISO	International Organization for Standardization
ISS	Institutional Shareholder Services
OECD	Organisation for Economic Co-operation and Development
PRI	United Nations Principles for Responsible Investment
RIAA	Responsible Investment Association of Australasia
SDGs	United Nations Sustainable Development Goals
TCFD	Task Force on Climate-Related Financial Disclosures
UCA	Uniting Church in Australia
UNGC	United Nations Global Compact
UNGP	United Nations Guiding Principles on Business and Human Rights

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