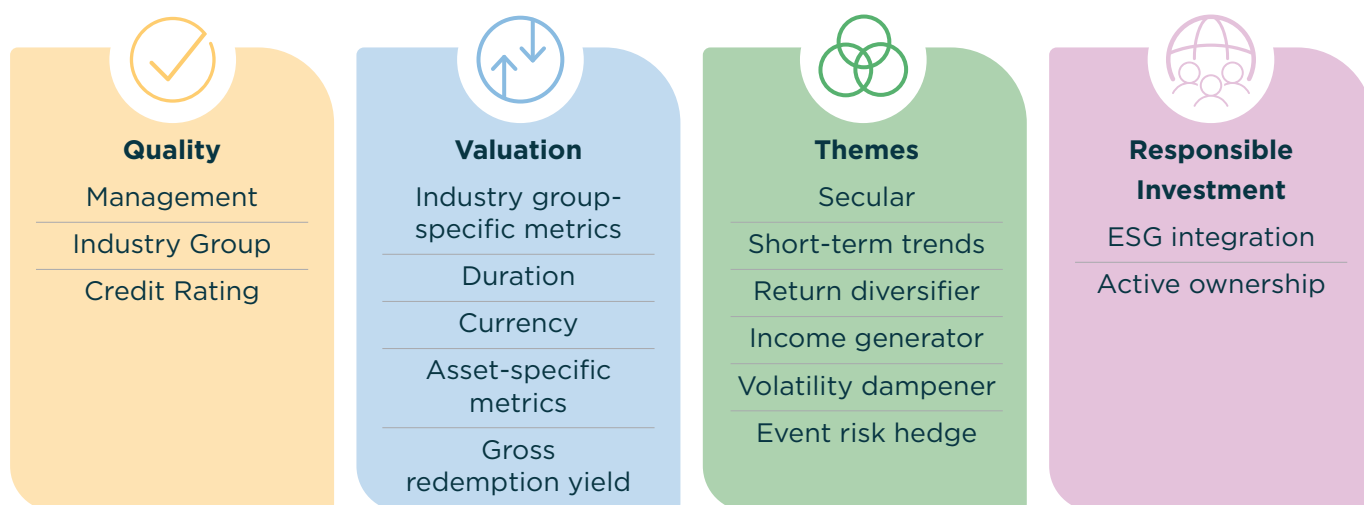


ESG integration and equities

This applies to centrally monitored holdings only. Your Investment Manager has the flexibility, within a controlled framework, to tailor your portfolio regarding asset allocation and security selection, to accommodate your investment requirements.

Quilter Cheviot invests directly in equities primarily in the UK, North American, and European markets. As part of our research process, we consider environmental, social and governance (ESG) factors. Responsible investment sits alongside the other three fundamental pillars of our equity selection process: quality, valuation, and themes.



The Responsible Investment team works closely with the Equity Research team to integrate ESG considerations into the analysis process. However, our overall approach to this is multi-faceted as it includes quantitative and qualitative analysis.

A growing number of companies manage ESG issues as part of their business-as-usual model to mitigate risk and maximise opportunity. Embracing ESG strategies may have direct and indirect positive impacts on the financial performance of a company.

- **Direct impacts** may be seen from the efficient use of material and energy resources, productivity improvements and process changes which can lead to reduced costs.
- **Indirect gains** are more difficult to measure but are important, nonetheless. These may include brand and reputational benefits of community engagement, which may in turn attract potential clients and employees and encourage increased employee and client loyalty.

Integrating ESG considerations into our investment process helps us identify and understand potential risks and opportunities, and ultimately protect, and possibly enhance, long-term investment outcomes for our clients. When we meet company management and boards, we discuss a number of issues, and as appropriate, those relating to ESG issues.

There are three key elements to integrating ESG factors into equity research:



Qualitative analysis identifying challenges and opportunities

The qualitative process aims to identify the material challenges and opportunities that a company faces from an ESG perspective. These will vary according to the industry group, the geography, and the company itself. We believe this should be considered holistically as there is no perfect company – all will have challenges from an ESG perspective to different degrees. Some will have more obvious ESG related opportunities, depending on the industry group or activity in which they operate. While this may be an attractive proposition, we are not solely reliant on ESG scoring when making investment decisions. The challenge is to understand the company’s current positioning but also where the company’s ambitions lie. This is not something you can discern from data alone and engagement plays an important role in this. The fundamentals of quality, valuations and themes cannot be overridden by a good ESG story.

Quantitative analysis through proprietary dashboards

Across Quilter Cheviot, we classify all monitored holdings across three categories: Aware, Engaged and Dedicated. For the Engaged category, our equity ESG dashboards are integral to this process. For our quantitative ESG integration approach, we incorporate material ESG factors based on the Sustainability Accounting Standards Board (SASB) framework plus additional factors which are identified in conjunction with the relevant analyst, which are determined to be relevant to the sector. Material ESG factors are sourced through various third-party data providers, annual reports, and publicly available sources on non-governmental (NGO) platforms such as CDP (formerly known as the carbon disclosure project).

By using several providers to source the data, we have data points which relate to most of SASB’s materiality factors and use these to undertake a holistic analysis through our industry group dashboards. Despite the variety of sources used, there are some areas where we do not currently have the required data. Air quality, energy management and critical incident risk management are some of the disclosure

topics where we have data gaps and there is ongoing work to address these areas. We work continually to improve data coverage and accuracy, with a focus on raw rather than aggregated data.

SASB

The SASB¹ reporting framework identifies ESG factors, which are financially material, and which have a direct impact on companies' enterprise value. There is a total of 26 factors which will have varying importance depending on the industry groups covered. For example, in the pharmaceutical and biotechnology industry, relevant disclosure topics will include access and affordability, product quality and safety, and customer welfare. This will be different to the energy industry where its main disclosure topics are greenhouse gas (GHG) emissions, employee health and safety, water, and wastewater management. As the material issues vary based on industry, we have created specific industry group dashboards to cover all industries on our monitored list.

Core and bespoke datasets

In addition to the 26 SASB factors, all dashboards have four core datasets, and some will also have additional bespoke data. The core datasets included on all dashboards provide relevant insight for all industry groups and are:

- Climate GHG reduction targets
- Governance assessment
- CEO pay to total shareholder return alignment (TSR)
- Percentage of women on boards

As an example, the climate GHG reduction target metric identifies whether companies have approved science-based targets or at least committed to setting targets and therefore are aligned with global net zero targets. We use several datasets that are specifically relevant to certain industry groups and their usage in the dashboards will again vary based on industry. A current example of this is the fossil fuel financing league table published by the Rainforest Action Network², which is only relevant to the banking industry.

Dashboard overview

The ESG industry group dashboards provide high level risk flags on consistent poor performers and highlight excellent performers on a relative basis. A company flagged as underperforming would be one where there is consistent poor performance across a material number of the SASB, core and bespoke datasets, relative to industry group peers. In contrast with this, a company flagged as outperforming is one where there is a consistent positive performance across a material number of the SASB, core and bespoke datasets, relative to their industry group peers. It is possible for a company to be flagged as performing well on some ESG factors while performing poorly on others. When a company is flagged as both leading in concerns and excellence, all factors will need to be weighed up against each other to determine which risk factors are of greater importance and we will engage with the company to determine the outcome.

Inclusion criteria for the Engaged category

The Engaged equity universe has specific exclusions as well as inclusionary criteria which are driven by the quantitative data provided through the industry group dashboards. This enables us to rank companies on a relative basis within industry groups and for inclusion within the Engaged universe. In categorising the investment universe, the quantitative data provides useful signals on out performance and under performance against ESG metrics. Where these signals are not clear we will gather more context through equity analyst discussion and company engagement. If we do not think the

¹ <https://www.sasb.org>

² **Rainforest Action Network - Fighting for People and Planet (ran.org)**

quantitative data represents true ESG performance, we will make a qualitative judgement-based decision on categorisation considering additional context. This may result in a company being included within the Engaged universe despite having a material number of underperforming quantitative data points.

We proactively engage with companies on a regular basis, and as part of the six-monthly formal review of the dashboards we will hold dialogue with companies where we require clarification of the quantitative evidence shown in the dashboards. The dashboards are refreshed on a quarterly basis and additionally we will engage with the companies within this universe on other occasions in line with our engagement framework.

We have not set a specific percentage hurdle for inclusion in the Engaged universe as industry groups will vary and we do not want to set artificial limits.

Active ownership through voting and engagement

Engagement will take different forms including collaborative, which will be alongside other investors; thematic which will focus on one of our three key themes; a more reactive approach usually around proxy season; or a 'catch up' to ensure that communication channels remain effective.

Voting and engagement is part of our investment process. This means that all decisions are made in conjunction with the relevant analyst. We use ISS as our proxy voting service provider and have set a baseline policy which ISS bases its recommendations on. We do not always follow ISS' recommendations and we believe this is the right approach to ensure we avoid a mechanistic approach to engagement and voting.

For more information, please see our **Engagement Policy** and **Voting Policy**, as well as the relevant sections of the **Responsible Investment Policy**.

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