

Socially Responsible Investment Option

August 2023



This document describes the investment approach for the Socially Responsible Investment (SRI) option (the SRI option) managed by Funds SA. It sets out the criteria that Funds SA applies when looking at new investments and how investment in certain assets are avoided.

Socially responsible considerations are core to the SRI option's investment approach. In this context, socially responsible investing means targeting investments that contribute to the betterment of society such as education, healthcare, and climate change solutions. At the same time, where possible, avoiding investments that have the potential to cause or contribute to social harm such as tobacco, alcohol, gambling, fossil fuels, weapons, nuclear power, and adult entertainment.

The purpose of the SRI option is to deliver investment returns while employing an investment approach consistent with the SRI criteria that are discussed below. In doing so, the SRI option has a financial-based investment objective. It strives to achieve this through its strategic asset allocation, while ensuring the characteristics of the underlying investments are in line with the option's SRI criteria.

The investment objective and the strategic asset allocation of the SRI option are detailed in the tables below.

Investment objective

Funds SA investment option	Target return % p.a.	Investment time horizon	Standard Risk Measure	Number of negative annual returns likely over any 20-year period
Socially Responsible	CPI + 3.0%	10+ years	High	4 to less than 6

Note: The Standard Risk Measure is based on industry guidance that allows members to compare investment options based on the expected number of negative annual returns over any 20-year period. The Standard Risk Measure is not a complete assessment of all forms of investment risk. For example, it does not detail what the size of a negative return could be or the potential for a positive return to be less than a member may require to meet their objectives. Members should still ensure they are comfortable with the risks and potential losses associated with their chosen investment option.

Strategic asset allocation for the SRI option

Asset class	%	Range %
Australian Equities	28	15-40
International Equities	31	20-45
Private Markets	3	0-15
Property	14	0-25
Infrastructure	4	0-15
Fixed Interest	17	0-40
Cash	3	0-20
Growth Assets	70	55-85

Investment approach

Funds SA has responsibility for setting and implementing the investment option's SRI criteria. The SRI option invests with external Investment Managers that are tasked with meeting the SRI Criteria set by Funds SA. The particular SRI Criteria that Funds SA sets varies between Asset Classes and Investment Managers. There will also be times where the investment option invests in pooled funds alongside other investors where Funds SA cannot prescribe the SRI Criteria. In these cases, the aim is to select funds that remain consistent with the purpose of the SRI option.

The 'SRI Criteria' is a combination of:

1. investment exclusions,
2. targeting SRI investments, and/or
3. inclusion of a best-in-class ESG approach.







Each is discussed below.





1. Investment exclusions



The SRI option seeks to avoid companies that have the potential to cause or contribute to social harm. It excludes industries or companies that engage in certain business activities from its universe of possible investments, making them uninvestable for this investment option.

Revenue and product involvement (i.e., manufacturing, supply, and distribution) thresholds apply in some cases so that companies with multiple business activities are not excluded for very low involvement. However, Funds SA maintains low revenue thresholds so these activities can generally be avoided. The investment exclusions do not apply to derivatives that may have an indirect exposure to these types of companies.

Investment exclusions applied to the Australian and International Listed Equities portfolio only

	<p>Tobacco</p> <p>All companies classified as a producer of tobacco products.</p> <p>All companies deriving 5% or more aggregate revenue from production, distribution, retail, supply (and licensing in International equities) of tobacco-related products.</p>		<p>Gambling</p> <p>All companies deriving 5% or more revenue from ownership or operation of gambling-related business activities.</p> <p>All companies deriving 15% or more aggregate revenue from gambling-related business activities.</p>
	<p>Alcohol</p> <p>In Australian equities, all companies classified as a "Producer". All companies deriving 5% or more aggregate revenue from the production, distribution, retail and supply of alcohol-related products.</p> <p>In International equities, all companies deriving 5% or more revenue from the production of alcohol-related products. All companies deriving 15% or more aggregate revenue from the production, distribution, retail and supply of alcohol-related products.</p>		<p>Nuclear Power</p> <p>All companies generating 5% or more of their total electricity from nuclear power in a given year. All companies that have 5% or more of installed capacity attributed to nuclear sources in a given fiscal year. All companies deriving 15% or more aggregate revenue from nuclear power activities.</p> <p>Additionally, for Australian equities, all companies that have any tie to the nuclear power industry</p>
	<p>Controversial Weapons</p> <p>All companies with any tie to Controversial Weapons (cluster munitions, landmines, depleted uranium weapons, biological/chemical weapons, blinding lasers, nondetectable fragments and incendiary weapons), as defined by the methodology of the MSCI Global Ex-Controversial</p>		<p>Fossil Fuels</p> <p><i>Australian equities:</i></p> <p>All companies excluded by the application of the MSCI Global ex Fossil Fuels Indexes methodology. All companies with evidence of owning fossil fuel reserves regardless of their industry, including companies that own less than 50% of a reserves field. All companies that derive</p>

	<p>Weapons Indexes available at https://www.msci.com/index-methodology.</p> <p>Conventional Weapons</p> <p>All companies deriving 5% or more revenue from the production of conventional weapons (and components in International equities). All companies deriving 15% or more aggregate revenue from weapons systems, components, and support systems and services.</p> <p>Civilian Firearms</p> <p>All companies classified as a "Producer" of firearms and small arms ammunitions for civilian markets. The exclusion does not include companies that cater to the military, government, and law enforcement markets.</p> <p>In Australian equities, all companies deriving 5% or more revenue from the distribution (wholesale or retail) of firearms or small arms ammunition intended for civilian use. In International equities, all companies deriving 5% or more aggregate revenue from the production and distribution (wholesale or retail) of firearms or small arms ammunition intended for civilian use.</p> <p>Nuclear Weapons</p> <p>All companies that manufacture nuclear warheads and/or whole nuclear missiles. All companies that manufacture components that were developed or are significantly modified for exclusive use in nuclear weapons (warheads and missiles). All companies that manufacture or assemble delivery platforms that were developed or significantly modified for the exclusive delivery of nuclear weapons. All companies that provide auxiliary services related to nuclear weapons. All companies that manufacture components that were not developed or not significantly modified for exclusive use in nuclear weapons (warheads and missiles) but can be used in nuclear weapons. All companies that manufacture or assemble delivery platforms that were not developed or not significantly modified for the exclusive delivery of nuclear weapons but have the capability to deliver nuclear weapons. All companies that manufacture components for nuclear-exclusive delivery platforms.</p>		<p>a part of their revenue (either reported or estimated), from oil and gas related activities, including distribution / retail, equipment and services, extraction and production, petrochemicals, pipelines and transportation and refining but excluding biofuel production and sales and trading activities. All companies that derive a part of their revenue (either reported or estimated) from the mining of thermal coal (including lignite, bituminous, anthracite and steam coal) and its sale to external parties.</p> <p><i>International equities:</i></p> <p>All companies with evidence of owning proven & probable coal reserves and/or proven oil and natural gas reserves used for energy purposes, as defined by the methodology of the MSCI Global Ex Fossil Fuels Indexes available at https://www.msci.com/index-methodology. All companies deriving any revenue (either reported or estimated) from thermal coal mining or unconventional oil and gas extraction. Thermal Coal Mining: Revenue from the mining of thermal coal (including lignite, bituminous, anthracite and steam coal) and its sale to external parties. It does not cover revenue from metallurgical coal; coal mined for internal power generation (e.g. in the case of vertically integrated power producers); intra-company sales of mined thermal coal; and revenue from coal trading. Unconventional Oil & Gas Extraction: Revenue from oil sands, oil shale (kerogen-rich deposits), shale gas, shale oil, coal seam gas, and coal bed methane. It does not cover all types of conventional oil and gas production including Arctic onshore/offshore, deep water, shallow water and other onshore/offshore. All companies deriving 5% or more revenue (either reported or estimated) from thermal coal-based power generation.</p>
	<p>Adult Entertainment</p> <p>All companies deriving 5% or more revenue from the production of adult entertainment materials. All companies deriving 15% or more aggregate revenue from the production, distribution and retail of adult entertainment materials.</p>		<p>Nutrition & Health</p> <p>All companies with a "Opportunities in Nutrition and Health score" greater than 2 (i.e. 3rd and 4th quartile). Companies that are classified within the "Household * Personal Products" Industry group are exempted from exclusion due to this screen.</p> <p>All companies in the Soft Drinks sub-industry as per the Global Industry Classification Standard.</p>
	<p>Genetically Modified Organisms (GMO)</p> <p>All companies deriving 5% or more revenue from activities like genetically modifying plants, such as seeds and crops, and other organisms intended for agricultural use or human consumption.</p>		<p>Animal Welfare</p> <p><i>Australian equities only:</i></p> <p>All companies that are involved in commercial animal husbandry for the purpose of food production, including breeding, raising, and slaughtering pork, veal, poultry, and beef, as well as dairy and egg farm operators. All companies that conduct animal testing for non-pharmaceutical products such as cosmetic, personal care, and household cleaning products.</p>

	<p>Controversies Scores are used to identify those companies that are involved in serious and very serious controversies involving the environmental, social, or governance impact of their operations and/or products and services.</p> <p>In Australian equities, companies are required to have an MSCI ESG Controversies Score of 2 or above to be eligible for inclusion (see our Best in Class approach for more information). Companies that are assessed as being involved in human rights controversies (those with a score less than 5) by the MSCI ESG Controversies score concerning the following key performance issues are excluded:</p> <ul style="list-style-type: none"> • Human Rights Abuses • Support for Controversial Regimes • Freedom of Expression & Censorship • Impact on Local Communities <p>In International equities companies are required to have an MSCI ESG Controversies Score of 4 or above to be eligible for inclusion.</p>		<p>ESG Ratings are used to identify companies that have demonstrated an ability to manage their Environmental, Social and Governance (ESG) risks and opportunities. Companies are required to have an MSCI ESG Rating of 'A' or above to be eligible for inclusion.</p>
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Source: MSCI

2. Targeting socially responsible investments

In addition to avoiding companies operating in areas of negative social impact, the SRI option is focused on investments that contribute to solving large issues such as climate change, healthcare, education, and the provision of community and social infrastructure. Whilst we have not adopted a formal scale for measuring the social contribution of these assets, we align our investments with generally recognised socially responsible investing and environmental, social, and governance principles determined through our membership of industry bodies including the United Nations-supported Principles for Responsible Investment (UN PRI) and other sources. Some examples of the types of investments that Funds SA targets in the SRI option are:

- Infrastructure investments that support key community and social needs as well as renewable energy. This includes schools, TAFE, hospitals, correctional facilities, water treatment plants, and other social infrastructure sectors as well as wind and solar farms.
- Private Equity investments that are focused on businesses that generate a clear and measurable positive social and/or environmental impact across one or more of the following key impact themes: climate action, inclusive growth, and healthcare. This includes businesses providing healthcare for elderly and low-income populations, digital learning solutions, environmental regeneration, and mobile banking solutions in developing countries.

3. Inclusion of a best-in-class Environmental, Social, Governance (ESG) approach

a. Selecting fund managers

The SRI option takes a best-in-class ESG approach in the selection of its investment managers and its investments.

Funds SA identifies investment managers that have deep expertise in understanding ESG criteria and can demonstrate its application into investment decisions. Funds SA surveys the ESG practices of its Investment Managers when completing initial due diligence and on an ongoing periodic basis to ensure that ESG processes are being maintained, as well as incorporating ESG considerations into routine monitoring activities.

b. Equities: Best-in-Class ESG approach

Within the SRI option's listed equities portfolio, the best in-class ESG approach means prioritising investment in companies that are at the top of their sector according to external ESG ratings provided by MSCI ESG Ratings LLC. The ESG ratings are on a 7-point scale from 'AAA' (leader) to 'CCC' (laggard).

In both the Australian and International equities portfolio, companies must have an ESG rating of 'A' or above to be eligible for investment. Two additional rules apply to the international equities portfolio:

- when building the portfolio, companies with the best ESG ratings ('AAA' and 'AA') are prioritised when filling the target weights in each sector before investing in 'A' rated companies; and
- we recognise that even leading companies can be impacted by changes in ESG expectations. At each review, companies already in the portfolio must maintain an ESG rating of 'BB' or above to remain in the SRI option.

Socially responsible investment criteria for each asset class

The SRI option invests in a diversified asset class mix. Due to the different types of assets in each asset class, the SRI Criteria is applied in different ways. For example, investment exclusions focused on the business activities of a company may not apply to Cash and Property investments. Funds SA is better able to implement investment exclusions in listed asset classes such as Listed Equities. The way in which the SRI Criteria is applied to each asset class is shown below.

Listed Equities

- Focus on best in class companies with high ESG rating
- Investment exclusions
- Best in class ESG approach to selecting Investment Managers

Property

- Focus on environmental sustainability
- High performance building ratings
- Best in class ESG approach to selecting Investment Managers

Infrastructure

- Focus on renewable energy (e.g. windfarms and solar)
- Focus on community Infrastructure (e.g. hospitals, schools)
- Investment exclusions
- Best in class ESG approach to selecting Investment Managers

Private Markets

- Positive impact companies
- Focus on climate action & solutions, healthcare and inclusive growth
- Investment exclusions
- Best in class ESG approach to selecting Investment Managers

Fixed Interest

- Investment exclusions
- Best in class ESG approach to selecting Investment Managers

Cash

- Best in class ESG approach to selecting Investment Managers

Investment stewardship

Investment stewardship is the responsible oversight and management of investments. It is an important component of Funds SA's approach to responsible investment and focuses on Funds SA's responsibility to take actions that protect and create long-term value for its clients. Funds SA does this through various means including proxy voting, engagement, and class actions.

- Proxy voting & engagement: Funds SA directly exercises the voting rights of certain Australian securities. In determining which securities Funds SA will directly exercise its voting rights over, it employs a materiality approach that focuses on both financial materiality (i.e., our largest holdings) and degrees of influence (i.e., the percentage ownership of ordinary shares of a company owned) in the companies in which it invests. Funds SA's guiding principle is to vote in the best financial interest of its clients.

The power to exercise proxies on Funds SA's behalf with respect to the remaining securities, both in Australia and internationally, is delegated to the relevant investment manager. Funds SA expects its investment managers to be active in exercising their right to vote on matters that come before them as part of their proxy voting programmes in relation to the companies in which Funds SA is invested.

Funds SA may have opportunities to drive stewardship activities both independently and in collaboration with investment managers. While Funds SA does not usually engage directly with companies, it may undertake collaborative engagements where appropriate.

- Class actions: Funds SA has a class actions program. Participation in class actions is assessed on a case-by-case basis.

Funds SA Disclaimer

Please note that the information presented in this report is as at 1 August 2023. Allocations or the composition of particular asset classes and other investment information may change from time to time.

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