

Sustainable investment report

Mercer Australia
2020 Highlights



welcome to brighter

About Mercer

Mercer is one of the world's leading firms for superannuation, investments, health and human resource consulting and products. Our organisation's purpose is creating better lives; we do this by making a difference in the health, wealth and careers of millions of Australians. Supported by our global team of 23,000 colleagues, we help our clients challenge conventional thinking to create solutions that drive long-term value for members and make a difference in the lives of millions of people every day. Locally, Mercer Australia a team of approximately 2,200 colleagues based in eight offices across Australia.

Contents

Our sustainable investment philosophy	2
Reflecting on 2020	2
Policy and governance	3
Industry recognition and thought leadership	4
Sustainable investment activity summary	5
1. ESG Integration	6
2. Active ownership	10
3. Sustainability themed investing	13
4. Screening	14
Looking forward	15

Our sustainable investment philosophy

At Mercer, sustainability is one of our key investment beliefs. We believe a sustainable investment approach is more likely to create and preserve long-term investment capital. Specifically:

- Environmental, social and corporate governance (ESG) factors can have a material impact on long-term risk and return outcomes and these should be integrated into the investment process;
- Taking a broader and longer-term perspective on risk, including identifying sustainability themes and trends, is likely to lead to improved risk management and new investment opportunities;
- Climate change poses a systemic risk, and investors should consider the potential financial impacts of both the associated transition to a low-carbon economy and the physical impacts of different climate outcomes; and
- Stewardship (or active ownership) supports the realisation of long-term shareholder value by providing investors with an opportunity to enhance the value of companies and markets.

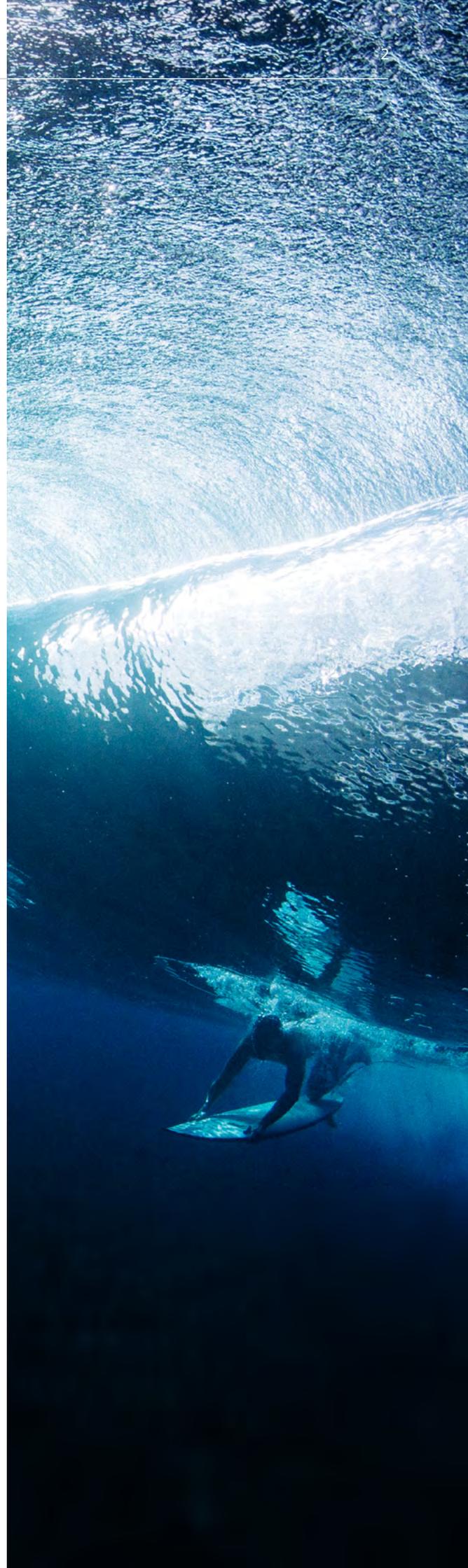
Consequently, we believe that a sustainable investment approach that considers these risks and opportunities is in the best interests of all investors.

Reflecting on 2020

2020 was a year like no other. COVID-19 provided the impetus for companies to put ESG factors front and centre, as they seek to rebuild their businesses - and the economy - sustainably.

The crisis provided fresh evidence that companies with a deeper understanding of their risks and opportunities can better adapt to known issues and prepare for new ones as they emerge.

Meanwhile ESG funds, with a focus on integration and sustainability themes, delivered strong performance relative to their traditional equivalents in 2020.



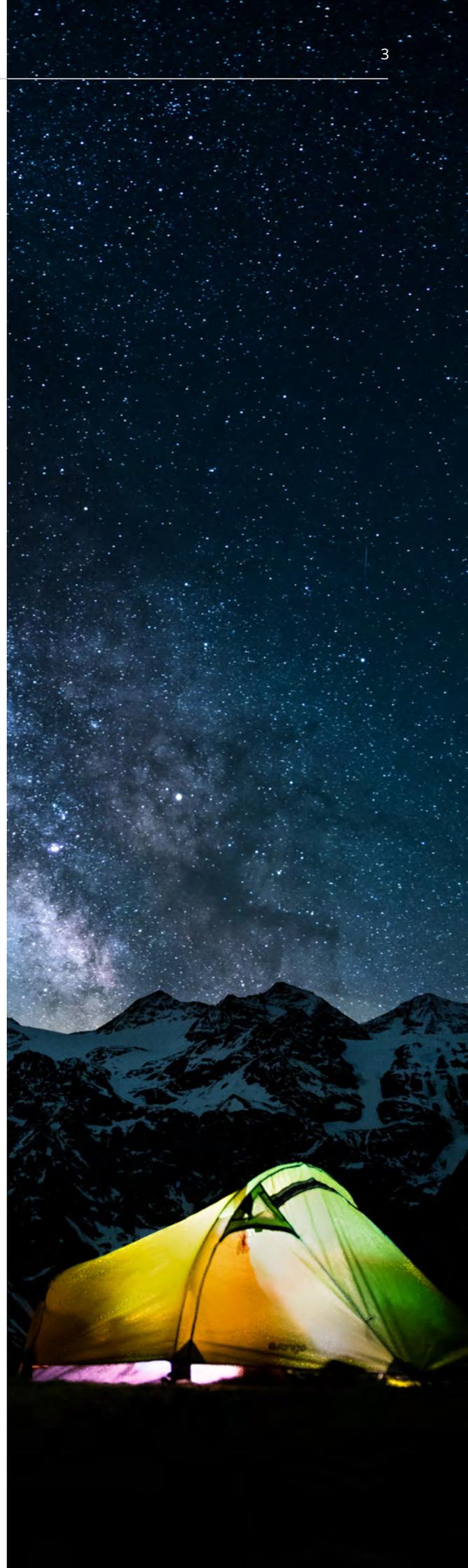
Policy and governance

Mercer's [Sustainable Investment Policy](#) was reviewed and updated in the first half of 2020 to capture our evolving approach to sustainable investment. Key updates to the policy included our strengthened approach to voting and engagement (active ownership), and the monitoring of United Nations Global Compact (UNGC) breaches.

The boards for Mercer Funds¹ in Australia review sustainable investment updates on a regular basis across a range of topics ensuring oversight and focus on sustainable investment.

Mercer's Global ESG Integration committee - co-chaired by Mercer Pacific's Chief Investment Officer (CIO), Kylie Willment - continued to meet quarterly in 2020 to share ideas on best practice to enhance our processes and consistency across various regions. The committee includes representation from Mercer investment and consulting teams in Pacific, Europe and North America.

¹ The Mercer Funds, Responsible Entity and Trustee, Mercer Investments (Australia) Limited (MIAL) ABN 66 008 612 397, Australian Financial Services License #244385, and the Mercer Super Trust, Registered Superannuation entity licensee, Mercer Superannuation (Australia) Limited (MSAL) ABN 79 004 717 533, Australian Financial Services License #235907, 727 Collins Street Melbourne VIC 3000.



Industry recognition and thought leadership

Industry recognition

We actively participate in global industry reporting projects to monitor the success of our Sustainable Investment Program. The Principles for Responsible Investment (PRI), the global industry peak body for responsible investment, awarded Mercer its highest possible rating of A+ for Strategy & Governance, as well as an A rating for all asset classes².

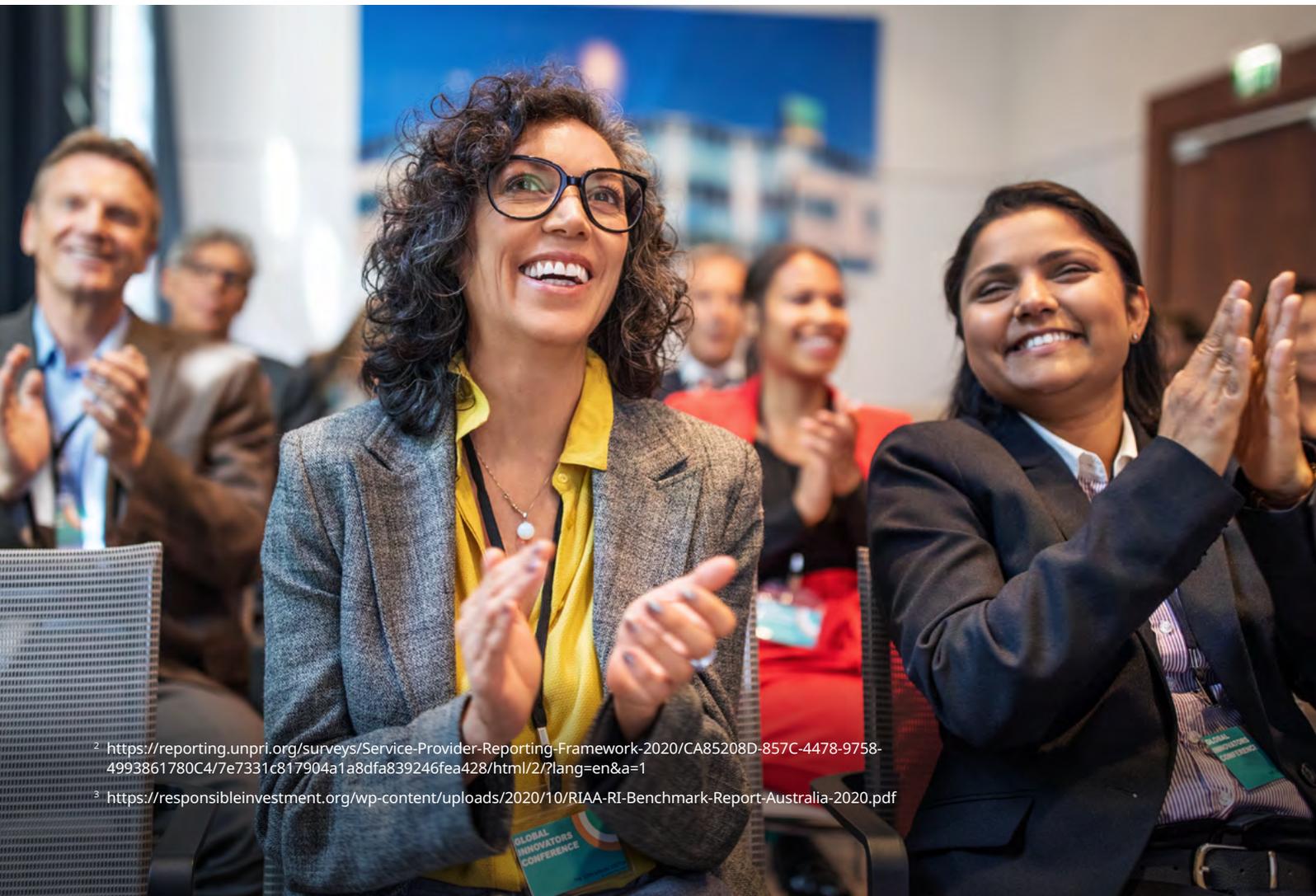
Mercer is also a member of the Responsible Investment Association Australasia (RIAA). The 2020 RIAA Benchmark Report³ recognised Mercer Australia as a Responsible Investment Leader.

Thought leadership

Progressing thought leadership continues to be a key priority for Mercer, globally.

We published a report in collaboration with the World Economic Forum titled '[Transformational Investment: Converting Global Systemic Risks into Sustainable Returns](#)'. This report addresses some of the long-term, global systemic risks facing our economy, society and the planet. It suggests opportunities for the institutional investment community to bring positive change, while pursuing attractive risk-adjusted investment returns.

Mercer also launched a new climate transition advice framework and [Analytics for Climate Transition \(ACT\) tool](#). It enables investors to assess and rank emissions intensity, transition capacity and green revenues exposures; prioritise risks and opportunities; and set targets and metrics for reducing emissions over time.



² <https://reporting.unpri.org/surveys/Service-Provider-Reporting-Framework-2020/CA85208D-857C-4478-9758-4993861780C4/7e7331c817904a1a8dfa839246fea428/html/2/?lang=en&a=1>

³ <https://responsibleinvestment.org/wp-content/uploads/2020/10/RIAA-RI-Benchmark-Report-Australia-2020.pdf>

Sustainable investment activity summary

During the year we continued to strengthen our focus on sustainable investment through key activities, including:



ESG Integration

We continued to target improvements in the ESG ratings of our investment managers and sustainability themed exposures in our portfolios. For instance, 17% of our unlisted infrastructure portfolio is in sustainability themed assets like renewable energy and water.



Voting

We redesigned our Proxy Voting program and closely linked it with engagement based on our view of the long-term interests of investors.



Engagement

We initiated a portfolio-wide engagement program for ESG priorities including but not limited to climate change, modern slavery, and diversity and inclusion.



Climate Change

We actioned our commitment to climate change by undertaking an in-depth portfolio analysis for climate transition.



Modern Slavery

Our Modern Slavery Working Group are continuing to develop a Modern Slavery Statement, which will reinforce our commitment to taking meaningful steps to ensure our investments and business are not contaminated with human exploitation.



Our Sustainable Investment Pathway has four key implementation pillars:

1. ESG integration
2. Active ownership
3. Sustainability themed investing
4. Screening

1. ESG integration

Our belief is that ESG factors can have a material impact on long-term risk and return outcomes. Mercer does not typically select investments directly. Rather, we combine specialist investment managers into portfolios. We expect our investment managers to assess and reflect ESG risks and opportunities in security or asset selection and portfolio construction, acknowledging that the degree of relevance or materiality varies between asset classes.

Selection and monitoring processes for potential and appointed investment managers is informed by Mercer's ESG Ratings and associated commentary from the Manager Research team. These ratings represent the Mercer Manager Research team's assessment of the degree to which ESG factors are incorporated within a strategy's investment process. The research is stored within Mercer's Global Investment Manager Database (GIMD).

During 2020, we continued to monitor the ESG ratings of the underlying investment managers within our funds and options. Mercer's Investment Management team performs an annual deep dive into the funds and manager ESG capabilities versus their comparative peer group universe. These reviews provide an additional input into investment decision-making and inform our regular discussions with managers.

This year's ESG ratings review covered 22 funds across equities, fixed income, listed property, infrastructure and liquid alternatives. As at December 2020, 45.5% (10/22) of funds had a higher ESG rating and 40.1% (9/22) of funds had an ESG rating in line with their comparative peer group universe. Year-on-year, 36.4% (8/22) saw their ESG ratings improve and 54.5% (12/22) remained in-line with their universe.



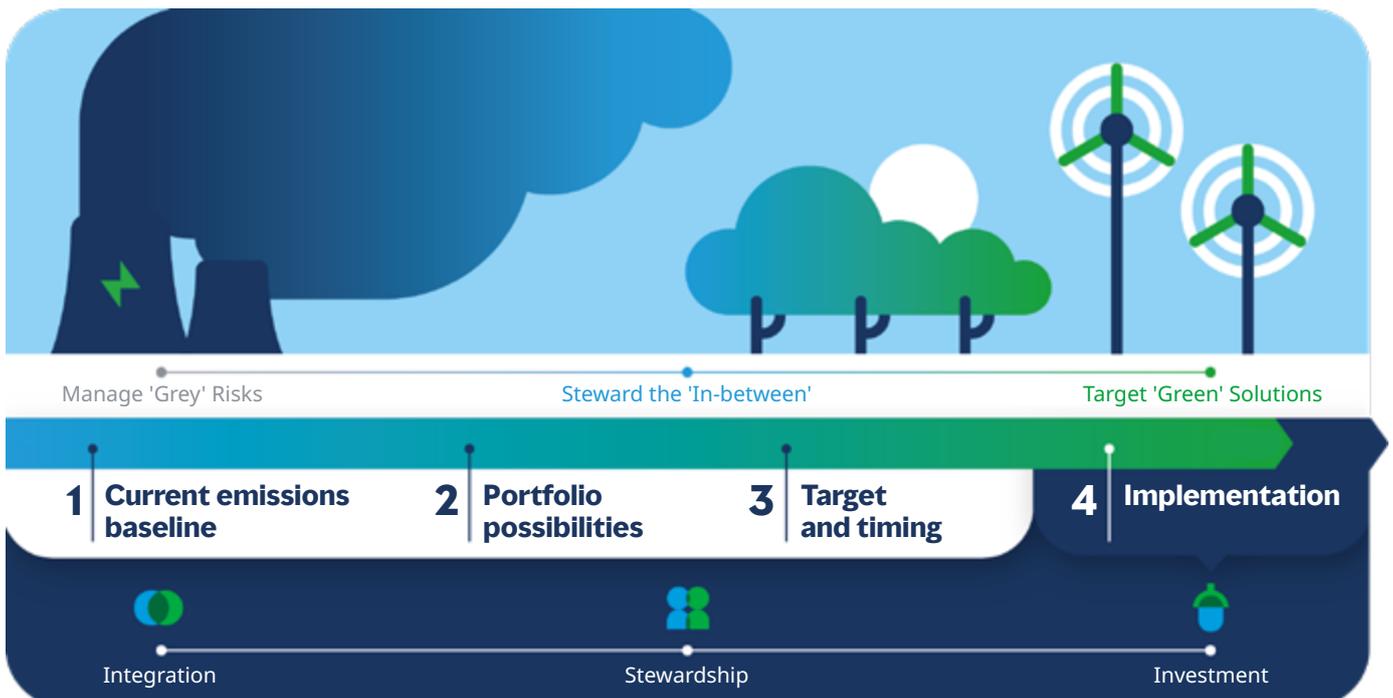


Climate change integration

In 2020 we used Mercer’s new ACT tool to perform an in-depth portfolio analysis for climate transition risk, building on our existing climate change scenario modelling and fund stress-testing capability.

The ACT tool draws on multiple data providers and metrics to assess portfolios across a spectrum from grey to green investments. ‘Grey’ assets are those that generate high emissions and have limited capacity for transition. ‘Green’ assets are those with low emissions, including the solutions to the net-zero transition.

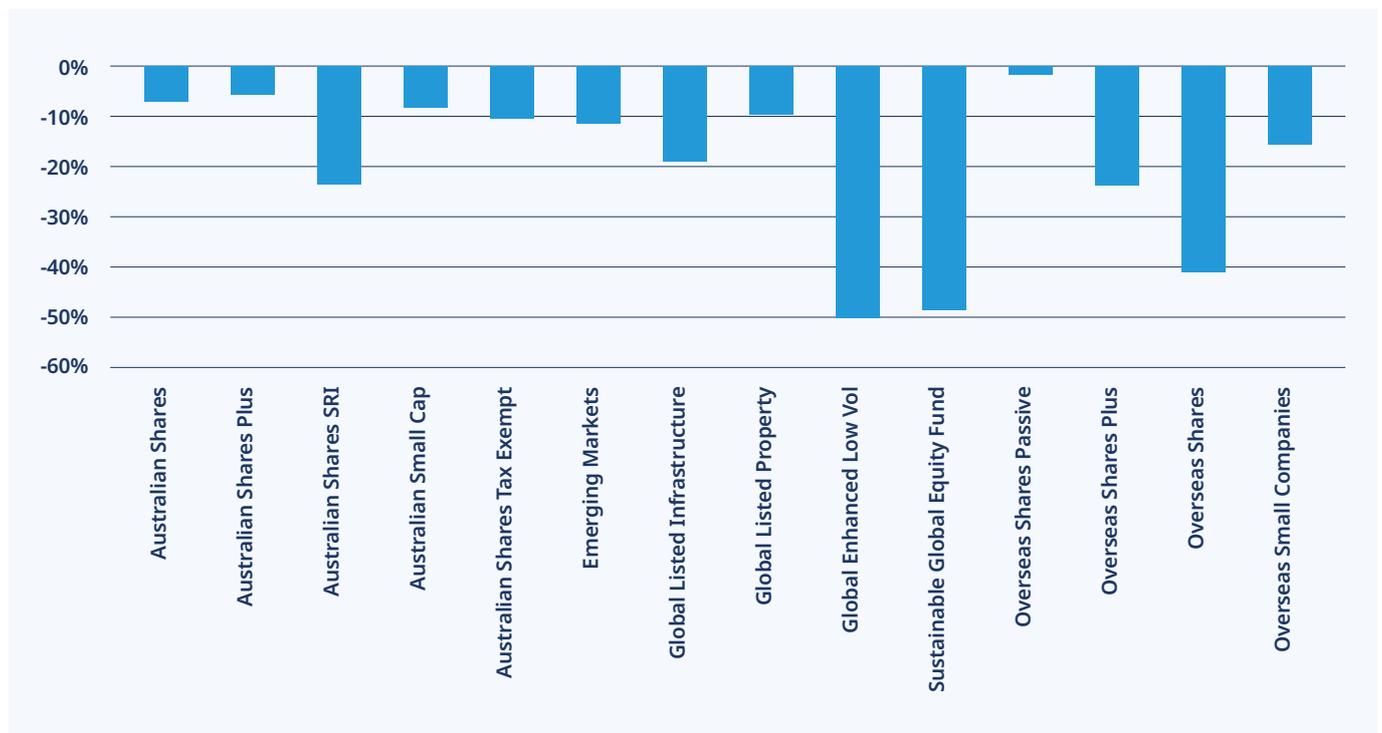
The results will help us assess where emissions reductions could come from, compare different strategies, engage with investment managers and plan for portfolio changes to reduce emissions. Over time, the goal is to reduce the greys, grow the greens and steward the assets that are ‘in-between’.





As at December 2020, all our listed equity funds had a Weighted Average Carbon Intensity (WACI) less than their respective benchmarks⁴ (see figure below).

WACI Relative to Benchmark



Further, our climate change management disclosure is captured in our Climate Change Management Statement, in line with the Task Force on Climate-related Financial Disclosures (TCFD) framework.

⁴ Australian Shares, Australian Shares Plus, Socially Responsible Australian Shares and Australian Shares Tax Exempt benchmarked to S&P/ASX 300 Accumulation Index; Australian Shares Small Cap benchmarked to S&P/ASX Small Ordinaries Accumulation; Emerging Markets benchmarked to MSCI Emerging Markets; Global Listed Infrastructure benchmarked to FTSE Global Core Infrastructure 50/50 (AUD Net Hedged); Global Listed Property benchmarked to FTSE EPRA/NAREIT Developed Index (AUD Hedged); Global Enhanced Low Vol benchmarked to MSCI World Minimum Volatility Index \$A optimised in \$A unhedged; Sustainable Global Equity benchmarked to MSCI World (NRD) Index in A\$; Overseas Shares, Overseas Shares Passive and Overseas Shares Plus benchmarked to MSCI World ex Australia; Overseas Small Companies benchmarked to MSCI World Small Cap Index.

Modern slavery integration

Modern Slavery has always been captured under the 'social' component of ESG considerations, but in 2020 we developed an explicit approach consistent with the Modern Slavery Act 2018 (Cth) (MSA) requirements. Under these requirements, we leverage the frameworks and approaches in the UN Guiding Principles on Business and Human Rights (UNGPs).

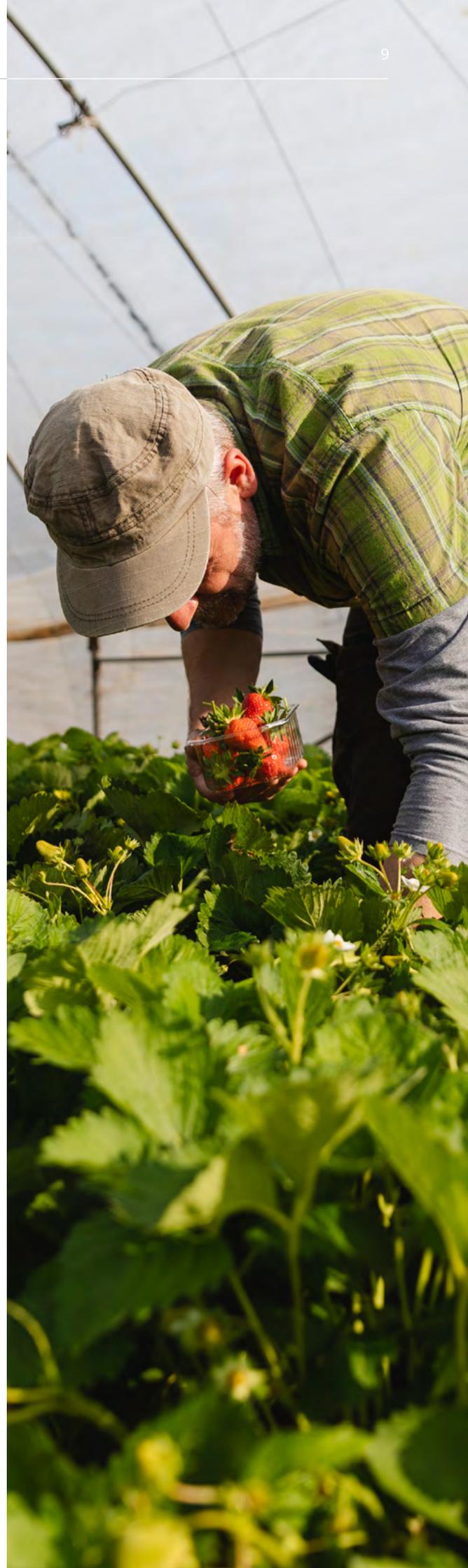
Mercer has a firm-wide, cross functional working group on Modern Slavery and a dedicated investments Modern Slavery Program (summary approach in chart below).

Modern Slavery Program



Our Modern Slavery Program centres on a robust risk assessment and seeks to identify high risk areas through country and industry exposure assessments within portfolios.

The program builds on our collaborative work in co-authoring an investor toolkit on human rights in 2018, as part of the RIAA Human Rights Working Group. This toolkit includes a number of practical engagement points that remain valid in a post-COVID world. Ultimately working towards de-risking company supply chains, the program targets win-win solutions that benefit workers, companies, and investors alike.



2. Active ownership

We believe that active ownership, is one of the most powerful mechanisms to effect meaningful and lasting change. It's an opportunity to enhance the value of companies and markets through voting and engagement.

Proxy voting

Below summarises the 2020 proxy voting activity for the Mercer Funds in Australia, for both our domestic and global equities holdings.

Number of meetings voted	3532
Number of Australian meetings voted	343
Number of ballots voted	7921
Number of proposals voted	40,055
Proposals voted against management recommendation	10%
Meetings with at least one vote against, withhold or abstain	7%
Number of Super Votes used	3

At all company meetings, Mercer has the right to direct a single vote or 'Super Vote' which overrides the investment manager votes on any resolution in circumstances where Mercer believes consistency on a significant matter is in the best interest of investors.

Super Votes 2020

QBE Insurance

At QBE's 2020 Annual General Meeting (AGM), Mercer used a super vote to vote in line with company management i.e. 'Against' two shareholder proposals asking the company to (a) disclose short, medium and long-term targets to reduce investment and underwriting exposure to oil and gas assets in line with the Paris Agreement; and (b) develop a policy which guarantees QBE does not invest in, insure or advocate for any projects or works that could result in negative impacts occurring within the boundaries of a World Heritage or Ramsar property, respectively.

Mercer's proxy advisor recommended voting in line with company management i.e. 'Against' the two shareholder proposals. Majority of our investment managers had voting positions supporting company management i.e. 'Against' the shareholder proposals.

Mercer closely reviewed the company's response to shareholder proposals, as well as views presented by our proxy advisor and investment managers. The company had committed to publishing in their 2020 Annual Report its short, medium and long-term targets - in line with Paris Agreement - for managing climate risk within the underwriting and investment portfolios. Given this commitment as well as further disclosures made by the company, we concluded that the additional value created from supporting these shareholder proposals wasn't compelling enough. As such, we supported company management and voted 'Against' the shareholder proposals.

Later in 2020, QBE announced its net zero by 2050 target in line with the Paris Agreement goals, which we welcome as a positive development.

BHP Group Limited

At BHP's 2020 AGM, Mercer used a super vote to vote in line with company management i.e. 'Against' shareholder proposal relating to climate lobbying by industry associations.

Mercer's proxy advisor, and majority of the appointed investment managers holding the stock, recommended voting in line with company management i.e. 'Against' the shareholder proposal.

Mercer engaged with BHP ahead of its AGM and was advised that BHP had done a major review of its governance around industry associations. In August, BHP released a new industry association's expectations policy stating that it will work with its lobby groups to establish standards relating to climate advocacy as well as monitor for alignment with BHP's own positions. BHP has also detailed new Global Climate Policy Standards that serve as a direction on the company's expectations of its industry associations lobbying on climate policy.

National Australia Bank Limited

At NAB's 2020 AGM, Mercer used a super vote to vote in line with company management i.e. 'Against' shareholder proposal relating to climate lobbying by industry associations.

Mercer's proxy advisor, and majority of the appointed investment managers holding the stock, recommended voting in line with company management i.e. 'Against' the shareholder proposal.

Mercer engaged with NAB ahead of its AGM and reviewed the company's approach to key themes such as climate change and modern slavery.

We noted several positive steps undertaken by the company to address risks and concerns relating to climate, including assessment and disclosure of fossil fuel related activities as well as signing up to collaborative initiatives. For instance, NAB now expects its exposure to thermal coal mining to be effectively zero by 2030; and, NAB will not finance new thermal coal mining projects. Further, at the time of the company's AGM, NAB was the only Australian bank to have signed up to the Collective Commitment to Climate Action ("CCCA") which requires the Company, within three years of signing up, to set and publish sector-specific, scenario-based targets for portfolio alignment.



Corporate Engagements

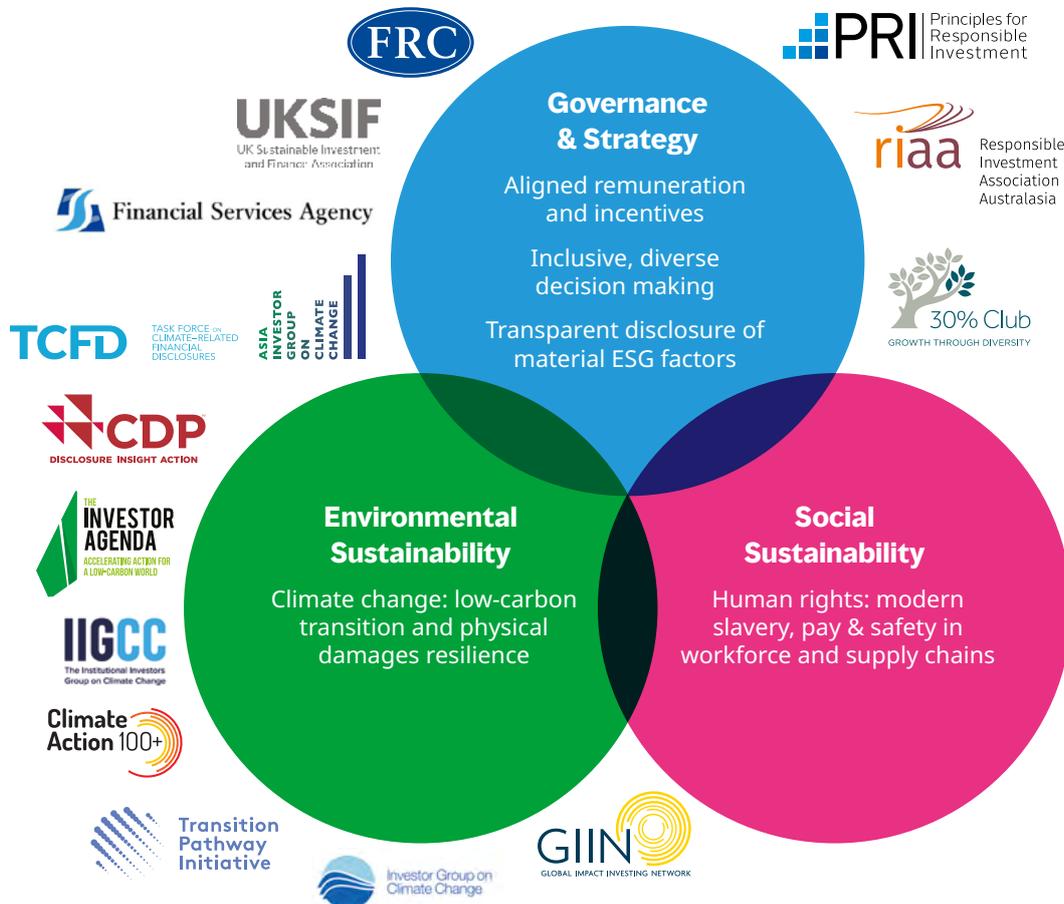
In 2020, Mercer directly engaged with a number of ASX-listed companies within our Top 20 equity holdings, across a range of issues such as board structure, executive remuneration, strategy and governance, climate change and indigenous rights. This was in addition to the direct corporate engagements that our appointed managers regularly do on our behalf. Engagements with companies typically involve more than one issue and are in addition to any discussions surrounding voting matters.

Case Example: Rio Tinto Limited

Mercer directly engaged with the company during the year to predominantly address indigenous rights - in response to the Juukan Gorge incident - and climate change. Specifically we note that the Juukan Gorge incident has been a catalyst for increased awareness of social risks related to mining. In our view, balancing profitability and the social licence to operate is key to long term value creation. We welcome the several changes at the company's board and senior management level taking accountability of the incident as well as its recently updated approach aimed at strengthening cultural heritage management in partnership with Traditional Owners. We also note Rio Tinto's progress on climate change disclosure and risk management, in particular the setting of measurable scope 3 emissions reduction goals in early 2021. The discussions with the company comprehensively cover each of the environmental, social and governance themes captured within in our engagement priorities and so we will closely monitor company management with respect to ESG factors going forward.

Collaborative Engagements

Mercer also participates in a number of initiatives where we collaborate with other investors for greater impact. Our key engagement priority themes and collaborative initiatives for 2020 can be summarised as follows:



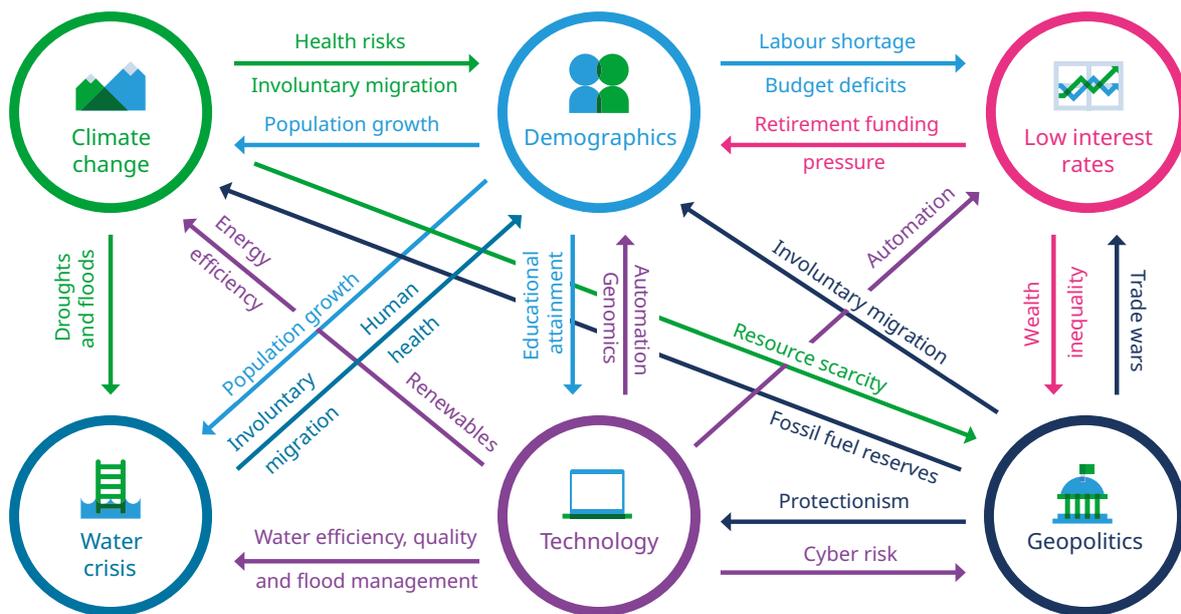
3. Sustainability themed investing

We believe that including some exposure to investment managers and companies that deliver solutions to ESG challenges can lead to improved risk management and new investment opportunities. Mercer’s investment manager selection and monitoring processes considers these exposures in our portfolio construction decisions.

In *Transformational Investing: Converting Global Systemic Risks into Sustainable Returns*, Mercer in collaboration with the World Economic Forum presented a tested pathway for long-term investors to convert systemic risk uncertainty into sustainable investment opportunities. It also establishes a governance framework designed to help the investment community address six key global systemic risks identified as most relevant to long-term investors (see Figure below).

The findings argue that the investment community has the collective power to bring positive change while still pursuing attractive risk-adjusted returns.

Global systemic risks most relevant to long-term investors



In 2020 we continued to focus on sustainability themed exposures in our portfolios:



17% of our unlisted infrastructure portfolio is invested in sustainability themed assets like renewable energy and water.



Our Socially Responsible Global Equity Fund is 73% weighted to investment managers with a focus on sustainable thematic and/or impact investing.



Our 2020 Strategic Asset Allocation review approved increases to sustainable equities, to be implemented in 2021.

4. Screening

Mercer may screen portfolios for sectors, companies, products or activities if:

- they are deemed to cause an unacceptable level of harm;
- they are guilty of severe breaches of law or commonly accepted behaviour;
- they fail to meet the expected ESG standards under the ESG integration approach outlined; and
- their viability as an ongoing investment is in question.

As an overarching principle, Mercer prefers an integration and engagement-based approach. However, there are a limited number of instances in which exclusions may be considered necessary. Exclusions should be a last resort because once divested, Mercer loses its shareholder rights and thereby the ability to influence the future behaviour of companies.

The reasons to exclude certain securities are likely to be a combination of a number of underlying factors that make continuing to include exposure to the securities in the investment universe untenable. These factors could include investment beliefs, risk management, expected social impact, public policy, reputation, investor expectations, ability to influence, and expected impact on portfolio returns.

Mercer also manages a number of Socially Responsible funds and investment options, to which additional exclusions apply. Examples include excluding companies involved in adult entertainment, alcohol, fossil fuels, and gambling from these options. These exclusions are in addition to our whole of fund exclusions relating to tobacco and controversial weapons and are designed to align with the values of the investors in those funds.

We also screen and monitor our portfolios for high severity breaches under the UN Global Compact (UNGC) Principles that relate to human rights, environmental and corruption issues, and as identified by Mercer's appointed external ESG research provider. In response to identified breaches, Mercer will engage with the investment managers owning those companies and seek their views on the risk, return and reputation implications as well as engagement insights on the issue. If the company has not rectified the breach within a reasonable timeframe, Mercer may decide to test the topic within the Exclusions Framework and take further action as a result.



Looking forward

We look to the future with sustainability in mind.

Client preferences for sustainability within mainstream investing are shifting, and evidence shows that we can invest for a sustainable future while not sacrificing on returns. It has been a busy and exciting year and, with a number of developments in the pipeline, we look forward to further strengthening our approach in the year ahead.

We're focused on strengthening our commitment to investing in a time of climate change. Our 2020 climate transition risk analysis culminated in Mercer Australia announcing its commitment to achieve net zero absolute portfolio carbon emissions by 2050 for Mercer Funds and Mercer Super Trust investment options. This is a milestone moment – one that we believe will be good for the portfolios and good for society.

Diversity and inclusion is also high on our priority list for 2021 and we aim to achieve meaningful influence across our investment value chain. Growing research shows that diverse teams may lead to better decision making and less unconscious bias in the investment community.

We will also be updating our Climate Change Management Statement, along with a new Modern Slavery Investments Position Statement.

There is much to consider, and we looking forward to continuing on this sustainable investment journey with our clients, members, and the wider industry in 2021 and beyond.



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Certain investments carry additional risks that should be considered before choosing an investment manager or making an investment decision.

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