



UK Sustainable Equity Strategy

Sustainability criteria

June 2024



Scope of criteria

The criteria set out in this document apply to any company investments held directly by the funds in **Ninety One UK Sustainable Equity (the 'Strategy')**.

Introduction – the overall approach

To understand the sustainability of an investment, our approach analyses the positive and negative externalities the investment creates for multiple stakeholders, including how it interacts with the environment, society and its own employees. When we refer to externalities, we define these as the costs or benefits caused by a company that are not financially incurred or received by that company. A common example being an auto manufacturer doesn't pay for a vehicle's emissions after it is sold. Where possible our approach is to quantify these effects. In particular, we want to understand how companies manage or mitigate the negative impacts they can have on society and their natural environment including any targets they have put in place.

The reason we take an externalities-based approach is because we expect them to be increasingly valued and potentially priced, starting with carbon emissions and rapidly evolving to other areas. Therefore, any decisions to include or exclude investments from the investment universe are guided by our understanding of the wider sustainability footprint these companies exhibit.

To supplement the team's individual company research, we conduct sustainability reviews across industry groups¹. The purpose of these reviews is to map the most pertinent positive and negative impacts that should be assessed for each industry group. When we compare companies within one industry group, we can build a picture of the different sustainability practices used by companies with similar products or services. This in turn allows us to define standards we expect to see at an industry level. It can also help generate meaningful engagements with companies who need to raise standards. Overall, our objective is to limit outright exclusions applied to the investment universe. We prefer to use our in-depth externality research and industry analysis to support investment decisions. This approach allows us to consider investment opportunities in companies which can adapt or improve over time.

Where we have taken a decision not to invest in a business group or sector, our assessment has concluded that, on balance, we believe the negative externalities generated by this business group or sector outweigh the positive externalities.

Firm-wide exclusions

As a firm, we do not invest in companies involved in the manufacture and production of controversial weapons.

We will not invest in companies that are directly involved in the manufacture and production of whole weapon systems and intended-use components of cluster munitions, antipersonnel landmines, and biological and chemical weapons.

Our approach to exclusions

In certain cases, we have made the decision to exclude a business group or sector based on our externalities research. These are groups of companies where we believe their long-term negative impact on the environment or on the societies they operate within are too great. These are set out below and currently include (1) tobacco and (2) coal, oil and gas.

In addition, we need to be convinced that every company passes a UN Global Compact principles test. This guides our defence-based exclusions as outlined below.

Note, this list is not exhaustive and is subject to regular reviews.

Tobacco

Tobacco consumption has been shown to have significant negative effects on public health through the burden placed on medical resources. We have debated and rejected arguments as to whether tax on tobacco contributes to the social costs. The World Health Organisation estimate only c. 10% of the world's population is covered by a tobacco tax judged to be sufficiently high (more than 75% of cigarettes' retail price). The proportion of tax in cigarette prices is also much lower in emerging markets, where 80% of the world's estimated 1.1 billion smokers live and where the tobacco companies have focused their growth efforts. Our tobacco sustainability review highlighted the high degree of uncertainty around the future viability of the tobacco business model with next generation products still in their relative infancy. If there are health implications that aren't being accounted for, tax burdens will likely increase materially over time. There is also a question as to whether heated rather than burnt tobacco products are truly minimising negative health externalities or addicting new customers to nicotine.

We will not invest in companies with more than 5% of their revenues derived from the manufacture and sale of tobacco and tobacco alternative smoking products.

On a best-efforts basis we also will not invest in companies with more than 25% of their revenues derived indirectly through the supply of dedicated equipment and services to companies directly involved in tobacco and tobacco alternative smoking products/services.

Coal, oil and gas

Climate change is the primary challenge of our generation and companies that contribute towards increasing levels of carbon dioxide emissions where alternatives are available face a clear threat - that the true cost of this pollution externality is applied to them. The demands of the Paris Agreement and government initiatives to reduce carbon emissions are increasing the demand for low carbon solutions and pushing up the price of carbon. This will make some industries, such as coal fired power generation, unviable and risks leaving investors with stranded assets.

Private and public investment in renewable technologies and the electrification drive across a range of sectors such as transport and beyond, puts the oil and gas industry at similar risk and creates a significant uncertainty around the long-term viability of their businesses. We expect further governmental as well as social pressure on these high emission industries and positive upward momentum for companies providing decarbonisation solutions. The risk case is that this transition happens more quickly, not more slowly than was currently expected in our view - a reflection of the acceleration in market perception that we have seen in the past few years.

We will not invest in companies with more than 5% of their revenues derived from thermal coal, conventional or unconventional¹ oil and gas related products, for example exploration, mining, production or refining. Additionally, we will not invest in companies increasing production of, or capacity for, thermal coal, conventional or unconventional oil and gas related products.

We will not invest in companies structurally increasing production of, or capacity for, thermal coal-based power generation. Additionally, we will only invest in power generators that dedicate the majority of their capital expenditure towards contributing activities, for example renewable power supply and electricity networks.

On a best-efforts basis we also will not invest in companies with more than 25% of their revenues derived indirectly through the supply of dedicated equipment and services to companies directly involved in thermal coal, conventional and/or unconventional oil and gas products.

¹ Unconventional Oil & Gas includes - oil sands, fracking, coal bed methane, ultra deep drilling and Arctic onshore/offshore.

Defence

The fundamental sustainability debate around the defence sector focuses on whether it threatens or protects human life, a complex and subjective topic, where ethical views matter.

Within the defence sector, this point applies in particular to weapons manufacturers and those companies supplying services and products to weapons manufacturers. Up until recently there was growing social pressure to reduce defence budgets, though these budgets have been primarily driven by fiscal considerations not moral considerations. The war in Ukraine has led to changing views in some instances, with countries such as the UK and Germany increasing their defence budgets, and within the investment industry, there has been debate as to whether defence in some circumstances could be viewed as a social good.

Bribery and corruption are two areas where the sector has fallen short historically and are therefore areas of increased focus. It's also extremely difficult to fully research who the buyers of defence products are and be sure they are not falling into the hands of buyers who would violate international treaties. It is therefore difficult to "pass" weapons manufacturers and those companies directly supplying services and products to manufacturers against the UN Global Compact principles, which is a key requirement for the Sustainable Equity strategies. As such:

We will not invest in companies with more than 5% of their revenues derived directly from the manufacture and production of conventional or civilian weapons.

On a best-efforts basis we also will not invest in companies with more than 25% of their revenues derived indirectly through the supply of dedicated equipment and services to companies directly involved in the manufacture and production of weapons.

Finally, in addition to the firm-wide exclusions of companies involved in the manufacturing and production of cluster munitions, antipersonnel landmines, biological and chemical weapons – we will also exclude companies directly involved in the manufacturing or production of inert ammunition and armour containing depleted uranium or any other industrial uranium, weapons containing white phosphorus, or nuclear weapons.

UN Global Compact principles

Our sustainability work and firmwide sustainability coverage also includes analysis of whether companies are in breach of the UN Global Compact principles, and we will not invest in any company that we believe to be in violation of the UN Global Compact principles. Our sustainability reviews highlight the high standards that we expect from all companies and we will actively engage with company management for these practices to be implemented.

We will not invest in any company that we believe to be in violation of the UN Global Compact principles.

Nuclear Power Generation

We currently see renewables as the most economic and fastest way to increase zero carbon power generation. However, we also believe that shutting down existing nuclear infrastructure early would have a significant negative impact on the progression of decarbonisation. Existing nuclear power plants offer strong decarbonisation benefits. In summary, we do not have an exclusion on nuclear power and would, for example, be comfortable to own clean utilities where nuclear is part of their generation mix. We would look for companies with nuclear power exposure to have power plants located in host countries that are signatories for non-proliferation of nuclear weapons and/or have safeguard agreements.

Other activities

Sustainability is multi-dimensional. The related opportunities and risks are evolving frequently, and we can expect other business activities will see the resilience of their cashflows challenged.

Currently we do not exclude animal testing as we note that there may be certain laws or regulations that require animal testing to be carried out as a precondition for registration of a product, and so it can make it difficult for firms that do this to distance themselves from this activity. We also do not exclude companies involved with genetically modified organisms (GMOs). However, we continually reassess these and other business activities, approaching them on a case-by-case basis and in line with our externalities-based company analysis. As such, we can expect the list of externalities-based exclusions to evolve through time.

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