

Magellan stewardship strategy – climate related risks and opportunities

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CONTENTS

OVERVIEW	3
1. ENGAGEMENT AT MAGELLAN	3
Investment Universe	3
Engagement process	4
2. APPROACH TO ASSESSING ALIGNMENT TO NET ZERO	4
3. ENGAGEMENT TARGETS and OBJECTIVES	5
Infrastructure	6
4. ESCALATION	7
5. VOTING	8
6. REPORTING	9
APPENDIX A: HIGH IMPACT MATERIAL SECTORS	10

OVERVIEW

Magellan Financial Group Limited ("MFG") and Magellan Asset Management Limited ("MAM") (together "Magellan", "we" or "our") are a signatory to the Net Zero Asset Manager ("NZAMi")¹ initiative.

The purpose of this document is to outline Magellan's stewardship (engagement and voting) relating to climate risks and opportunities for our Global Equities, Global Sustainable, Global Listed Infrastructure, Energy Transition and Core Series products.²

This strategy has been developed by senior members of the Investment Team and approved by Magellan's Risk and Compliance Committee ("RCC"), a delegate of the MAM Board.

As many countries have committed to transition their economies to Net Zero by 2050 and expectations from stakeholders, including investors, regulators and governments increase, Magellan wants to ensure that companies in our portfolios remain resilient and take advantage of opportunities. To do this, we are assessing alignment to Net Zero under the Net Zero Investment Framework ("NZIF") as part of our commitment to the NZAMi.

Asset managers that have signed the Net Zero Asset Managers' initiative have committed to develop and implement "a stewardship and engagement strategy, with a clear escalation and voting policy, that is consistent with an ambition for all assets under management to achieve Net Zero emissions by 2050 or sooner".¹

This climate stewardship strategy applies to all strategies with the exception of Australian equities (which has its own strategy) and identifies increased requirements for those strategies covered by our targets. It also describes the approach for Infrastructure's SAFE methodology (see section 3 below), a proprietary engagement framework which aligns well to the NZIF³ framework. This climate stewardship strategy has been developed with guidance from the Net Zero Stewardship Toolkit⁴.

1. ENGAGEMENT AT MAGELLAN

Magellan's long-term investment horizon gives us the opportunity to engage with companies over an extended period on issues that are important to protecting and creating shareholder value. This includes the risks and opportunities that arise from climate transition risk and physical climate risk.

Investment Universe

The Magellan investment universe excludes companies with commodity-like economics, in particular resources and basic materials, resulting in very low exposure to fossil fuels across the Global Equities, Global Sustainable and Core Series products.

Magellan's **sustainable strategies** implement a proprietary low carbon emissions overlay into portfolio construction. Globally agreed climate goals such as those defined in the 2015 Paris Agreement provide the guiding framework for the Fund.

This is incorporated by:

- Limiting the overall carbon emissions of the portfolio through a portfolio carbon emissions intensity cap, which is set having regard to globally agreed climate goals.
- Screening out companies based on their carbon emissions intensity.
- Both the above caps will be revised over time to remain in line with evolving carbon reduction goals.
- Implementing exclusions⁵ for companies with fossil fuel exposures or interests, such as companies engaged in the extraction, storage and transportation of fossil fuels.

Magellan **infrastructure strategies** have a proprietary definition of infrastructure that has underpinned the investment process since inception. This universe definition reflects the infrastructure team's assessment of the risk and reliability of the assets.

¹ NZAMi is an international group of asset managers committed to supporting the goal of net-zero greenhouse gas emissions by 2050 or sooner, and to supporting investing aligned with Net Zero emissions by this date. [Signatories – The Net Zero Asset Managers initiative](#)

² Australian Equities strategies are covered by the Airlie Funds Management Stewardship strategy.

³ <https://www.iigcc.org/resources/net-zero-investment-framework-implementation-guide>

⁴ <https://www.iigcc.org/resources/net-zero-stewardship-toolkit>

⁵ Low carbon framework exclusions for coal, oil or gas incorporate a revenue thresholds amongst other things.

Engagement process

Magellan aims to engage with portfolio companies on a broad range of Environmental, Social and Governance (“ESG”) themes identified by the Investment Team as material to those companies within our ESG risk and opportunities assessment framework. This includes climate transition and physical risks.

Engagement has two primary objectives, both of which are designed to have a positive impact on shareholder returns over time:

1. **Risk assessment, management, and opportunities:** to better understand the risks and opportunities over time. As long-term investors, we build up knowledge and insight, which we discuss during engagements. These learnings often deepen our understanding within and across industries. The output of this engagement contributes to the analyst’s assessment of the credibility of the company’s climate strategy and targets which are a key input into the assessment of alignment with Net Zero.
2. **Influence:** encouraging and supporting change to a company’s approach or the setting of climate related targets. As long-term investors, we build constructive relationships which better enable us to drive positive change at a company. The urgency with which we seek to influence usually correlates to the time horizon over which we expect the risk or opportunity to arise. However, with regards to climate transition risk and physical risk, we recognise the importance to set and report against ambitious short, medium and long term targets that are on a Paris aligned pathway to limit warming to 1.5 degrees Celsius.

As part of our commitment to NZAMi, we have identified some strategies to be managed in line with the attainment of Net Zero emissions by 2050 to determine our target. We commit to reviewing with consideration for increasing this target at least every 5 years.

For all Magellan Funds / strategies, there is a minimum requirement to assess their alignment to Net Zero using the NZIF. Companies are then prioritised for engagement based on materiality of their financed emissions and their classification of alignment to Net Zero. These companies are classified as ‘high priority’ and subject to enhanced engagement.

For Magellan Funds / strategies that are subject to our targets, companies in high impact material⁶ sectors are prioritised for engagement if they are not aligned to Net Zero. Clear engagement objectives are set with expectations of time to see progress and outcomes before escalation is considered.

2. APPROACH TO ASSESSING ALIGNMENT TO NET ZERO

The assessment of climate risk within the Magellan investment portfolios is within our framework for assessing ESG risks.

Magellan’s analysts first assess a company’s ESG risks, including climate risks, as part of our process to accept the stock onto the Investment Committee approved list. An initiation report is presented to the Investment Committee (a group of senior investment team members) that considers risks that have the potential to impact company cash flows or the discount rate applied to those cash flows. Assuming the Investment Committee deems the risks to be sufficiently manageable, the stock is included in our approved list and thereby available for inclusion in Magellan’s equity portfolios.

Magellan’s Investment Team reviews climate related targets and commitments of companies in all strategies, at least annually. This includes:

1. **Ambition:** A commitment to net-zero by 2050;
2. **Targets:** Near- and medium-term emission reduction targets with a preference for external validation;
3. **Strategy:** Alignment to reporting in accordance with the Taskforce for Climate-related Financial Disclosures (“TCFD”) and a credible strategy to achieve targets.

We consider these commitments represent prudent risk management in a transitioning economy to Net Zero.

A key input is our analyst’s view on the credibility of a company’s initiatives and climate strategy to achieve their targets. We also consider disclosure of emissions (Scope 1, 2, 3) and the progress towards targets.

Utilising both Magellan proprietary analysis and other data (including company statements, press articles, external data providers, Science Based Targets Initiative and expert networks), each company is assessed for their alignment to Net Zero. This assessment is undertaken in accordance with the NZIF⁷, with companies classified as aligned to Net Zero, aligning, committed or not aligned to Net Zero.

⁶ High Impact Material sectors are a subset of material sectors called “High Impact Sectors” defined by NZIF and GICS sub industry code – see appendix A.

⁷ <https://www.iigcc.org/resources/net-zero-investment-framework-implementation-guide>

Net Zero Asset Manager Initiative (NZAMi)

Measuring alignment using NZIF

	Net Zero Target	Interim target	Performance	Disclosure	Strategy	Capex alignment	Credibility
Achieving Net Zero	✓		✓	✓	✓		✓
Aligned: High impact	✓	✓	✓	✓	✓	✓	✓
Aligned: Low impact		✓	✓	✓			✓
Aligning		✓		✓	✓		✓
Committed	✓						✓
Not Aligned							✓

Magellan view

Source: Developed for Magellan investment process utilising the Net Zero investment Framework

Engagement with portfolio companies is important to assess the credibility of their targets and understand any technological challenges in committing to these targets.

For companies that are not aligned to Net Zero, the Investment Team will engage and encourage target setting in line with this climate strategy. If there is no progress from companies in terms of setting Net Zero aligned targets or other criteria in assessing alignment to Net Zero as defined by NZIF, staged escalation will be considered including voting and potentially divestment. This is covered in the following sections.

3. ENGAGEMENT TARGETS and OBJECTIVES

Companies will be prioritised for engagement based on Magellan's assessment of climate related risk for that sector. All companies are assessed for alignment to Net Zero then prioritised for engagement based on whether they are in a high impact material sector⁸ and according to the size of Magellan's holding across different strategies. Companies may also be prioritised based on:

- progress to date – emission reduction and progress towards targets;
- real world impacts and available technology e.g. prioritisation of transition of coal fired generation vs aviation fuel; and
- ability to influence.

For strategies that are identified as aligned to Net Zero, Magellan has set the following engagement targets for companies in high impact material sectors.⁹

- a current engagement threshold which ensures that at least 80% of financed emissions in high impact material sectors are either assessed as Net Zero, aligned with a net zero pathway, or the subject of direct or collective engagement and stewardship actions.
- by 2030, at least 90% of financed emissions in high impact material sectors are either assessed as Net Zero, aligned with a Net Zero pathway, or the subject of direct or collective engagement and stewardship actions.

If a company is not meeting the categorisation of achieving Net Zero or aligned, using the NZIF, an engagement plan is developed incorporating objectives to improve alignment with Net Zero based on NZIF. Engagement objectives will be set considering the industry, geography, business model and alignment to Net Zero.

For priority companies, engagement objectives are set which are communicated to the company and may include:

- a commitment to Net Zero emissions by the year 2050;

⁸ High Impact Material sectors are a subset of material sectors called "High Impact Sectors" defined by NZIF and GICS sub industry code – see appendix A.

- setting interim/short- and medium-term emissions reduction targets;
- external validation of emission reduction targets and the plans to achieve such targets. Magellan notes that the Science Based Target Initiative (SBTi) is its preferred standard for external validation of emission reduction targets where the methodology is available.

Additional engagement objectives may be included where it is deemed relevant by the investment team:

- improved disclosure of Scope 1, 2 and material Scope 3 emissions;
- enhanced disclosure and actions that support a credible climate strategy to meet Net Zero aligned targets. This may include specific engagement objectives regarding scenario analysis, capital allocation alignment and transition plans;
- executive remuneration linked to climate related targets;
- Board capabilities and oversight to manage climate change;
- increased transparency regarding just transition⁹ which considers workers and the community for affected industries; and
- increased transparency on climate related lobbying.

These engagement objectives are communicated to the priority companies by Magellan's Investment Team and reviewed at least annually.

Infrastructure

This section describes the current approach for Climate risks and opportunities facing companies in Magellan's Global Listed Infrastructure strategies, which aligns well to the NZIF¹⁰ framework.

Climate risks and opportunities facing companies in Magellan's Global Listed Infrastructure strategies have been assessed using our proprietary 'SAFE' Transition framework for several years.

This framework classifies portfolio constituents as 'Aligned', 'Secure', 'Transforming', or 'Vulnerable', having regard to:

- an assessment as to whether the company is favourably or unfavourably positioned in an economy that is transitioning towards net-zero greenhouse gas emissions; and
- the presence or absence of a credible emissions reduction plan.

Classification in accordance with Magellan's SAFE Transition framework drives differentiated analysis and engagement, reflecting the materiality of risks and opportunities facing portfolio companies as a result of the energy transition. 'Vulnerable' companies undergo stranded asset risk analysis, addressing the policy environment and the technical capability and cost competitiveness of substitute products or services that threaten to disrupt the company's business model.

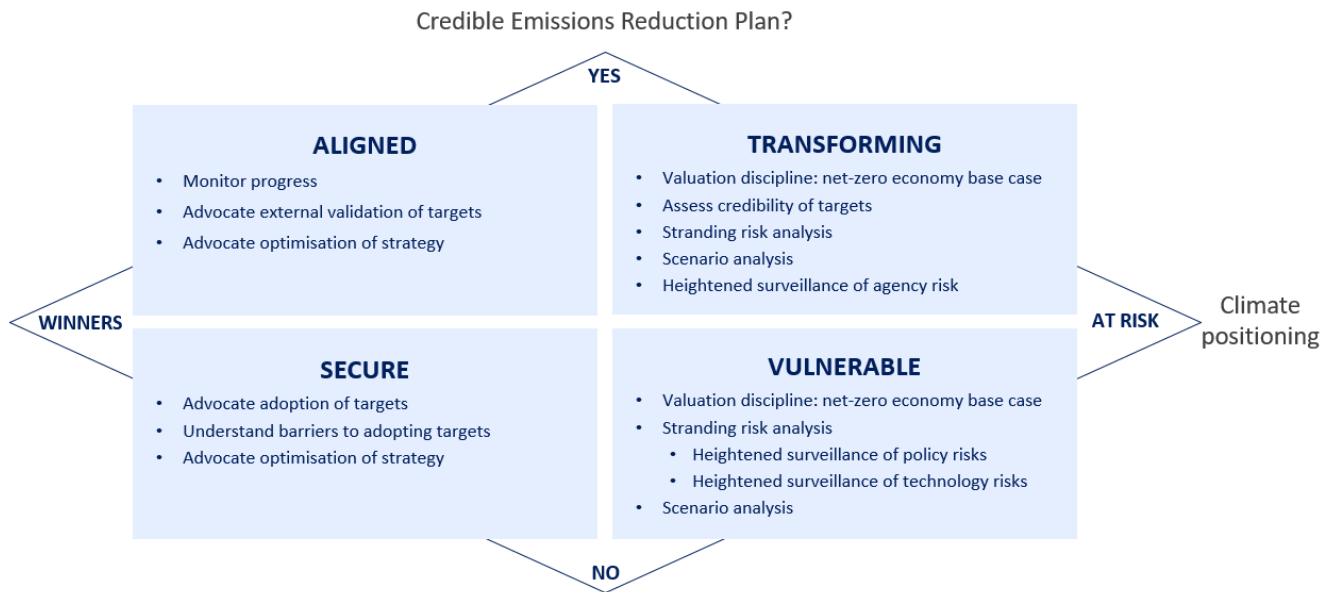
The SAFE framework will continue to be utilised within the Infrastructure process given the material risks and opportunities of the climate transition for companies in this sector. An assessment of alignment to net zero using NZIF will add to the current SAFE framework and enhance the stewardship process through the voting approach described below. The infrastructure universe is invested in some of the high impact material sectors outlined in Appendix A which are subject to a higher threshold under NZIF for assessing alignment to net zero.

⁹ International Labour Organisation: *A just transition involves maximizing the social and economic opportunities of climate action, while minimizing and carefully managing any challenges – including through effective social dialogue among all groups impacted, and respect for fundamental labour principles and rights.* <https://www.ilo.org/>

¹⁰ <https://www.iigcc.org/resources/net-zero-investment-framework-implementation-guide>

Magellan's 'SAFE' Transition Methodology

A complex transition calls for Situational Analysis, Forecasting, and Engagement



4. ESCALATION

In cases where engagement has been ongoing without reasonable progress on an issue considered to be a material climate related risk to future cashflows or valuation, the portfolio managers and ESG team will consider an escalation path that may include:



Actions will be considered on a case-by-case basis and may include, voting against directors or management proposals, for example, 'Say on Climate', or voting for climate related shareholder proposals. This is discussed in Section 5 below.

Portfolio sizing (including divestment) will be considered by the portfolio manager where the risk is deemed material to cashflows and progress has not been achieved relative to the engagement objectives. The analyst will consider the risks identified and progress when reviewing ESG scores at least annually.

5. VOTING

Magellan intends to vote in a manner that is in the best interests of its clients and that is most likely to protect and promote the long-term economic value of the companies in which Magellan invests. Engagement with companies on climate risks and opportunities, including the alignment of the company with Net Zero, is the initial focus of the stewardship strategy. Voting, as outlined below, will be utilised as a tool after engagement with the company. The company will be notified where a vote is cast against the company recommendation.

It is the responsibility of the boards of each portfolio company to manage climate risks and consider climate opportunities. Alignment with the Paris Agreement and setting climate targets are a key commitment to assess a company's preparedness for the transition to a lower carbon economy. It is important for the board of a portfolio company to not delay the transition to a lower carbon economy and take action where possible in the near term. Reporting against TCFD, external target validation with for example Science Based Targets Initiative ("**SBTi**") and links between remuneration and climate targets are highly regarded. These initiatives improve transparency and credibility of risk management.

Magellan will consider supporting shareholder proposals which encourage companies to acknowledge, consider, and report on climate risks and opportunities where current ambition, targets, strategy and disclosure are not sufficient. This may include proposals which urge companies to evolve their current approach where enhancements are warranted to improve alignment with Net Zero.

The following table outlines Magellan's climate related voting framework. Each proposal will be considered on a case-by-case basis.

Vote	Net zero policy and actions	Criteria for consideration
Director	Consider voting against Chair or director where no progress is made towards Net Zero alignment and related engagement objective.	<ul style="list-style-type: none"> • Net Zero target. • Interim targets & external accreditation. • Progress against targets. • TCFD alignment. • Actions including capital allocation alignment.
Remuneration	Consider voting against remuneration report where climate change is a material risk for the company and an engagement objective to link remuneration to climate targets has not been met in the specified timeframe.	<ul style="list-style-type: none"> • Analyst assessment of climate risk on future strategy. • Incorporation of climate targets in remuneration. • Credibility of climate strategy. • Actions including capital allocation alignment.
Mergers and Acquisitions	Consider voting against merger and acquisition related resolutions if it is detracting from alignment to Net Zero.	<ul style="list-style-type: none"> • Analyst assessment of new asset and alignment to Net Zero or ability to transition.
Say on Climate	Consider voting against management proposal where engagement objectives have not been met.	<ul style="list-style-type: none"> • Alignment to Net Zero criteria using NZIF. • Progress on climate related engagement objectives.
Shareholder proposals	Consider supporting proposals that improve alignment with Net Zero where the current ambition, targets, strategy and disclosure are not sufficient	<ul style="list-style-type: none"> • Alignment to Net Zero criteria using NZIF. • Progress on climate related engagement objectives.

6. REPORTING

As part of the commitment to Net Zero asset manager initiative, we will provide asset owner clients with information and analytics on our climate related stewardship activities. Stewardship outcomes are reported in the annual 'Stewardship Report' for each strategy available at <https://www.magellangroup.com.au/> . Progress towards NZAMi commitments and targets will be reported through CDP, PRI and in our TCFD aligned report commencing a year after setting the targets.

APPENDIX A: HIGH IMPACT MATERIAL SECTORS

High Impact material sectors are a subset of the NZIF Material sectors and included in Appendix B of the NZIF Framework.

TPI Sector	GICS Sector Name	GICS Sub Industry / Code	
Electricity utilities	Energy	Integrated Oil & Gas Electric Utilities	
	Utilities	Independent Power Producers & Energy Traders Multi-Utilities	
Oil & gas	Energy	Integrated Oil & Gas Oil & Gas Refining & Marketing Oil & Gas Exploration & Production Oil & Gas Storage & Transportation	
	Materials	Diversified Chemicals	
Oil & gas distribution	Energy	Oil & Gas Storage & Transportation Oil & Gas Exploration & Production	
	Materials	Diversified Chemicals	
Coal mining	Energy	Coal & Consumable Fuels Oil & Gas Refining & Marketing	
	Consumer discretionary	Automobile Manufacturers	
	Industrials	Industrial Conglomerates Trading Companies & Distributors	
	Materials	Diversified Metals & Mining Steel	
Autos	Consumer discretionary	Automobile Manufacturers	
Airlines	Industrials	Airlines	
Shipping	Energy	Oil & Gas Storage & Transportation	
	Industrials	Marine	
Aluminium	Materials	Aluminum Diversified Metals & Mining	
	Industrials	Trading Companies & Distributors	
Cement	Materials	Construction Materials	
Pulp & paper	Materials	Paper Packaging Paper Products	
	Materials	Steel	
Chemicals	Materials	Commodity Chemicals Diversified Chemicals Fertilizers & Agricultural Chemicals Industrial Gases Specialty Chemicals	
	Materials	Diversified Metals & Mining Copper Steel	
		Information technology	Electronic Equipment & Instruments Technology Hardware, Storage & Peripherals
		Industrials	Aerospace & Defense Construction Machinery & Heavy Trucks Heavy Electrical Equipment Electrical Components & Equipment
	Consumer discretionary	Consumer Electronics	
Materials	Construction Materials		