Mercer

welcome to brighter

Annual sustainable investment report

2021
Highlights

Mercer Australia
Published July 2022

About Mercer

Mercer is a global leader in redefining the world of work, reshaping retirement and investment outcomes, and unlocking real health and wellbeing. A business of Marsh McLennan, Mercer's approximately 25,000 colleagues are based in 43 countries and the firm operates in 130 countries. Our purpose is to make a difference in people's lives, and in Australia we do this by providing specialist services including superannuation services, trustee services, investment services and workforce consulting and products.

About this report

This report summarises the sustainable investment activity for calendar year 2021, for the Mercer Funds, our suite of managed investment schemes, and the Mercer-managed investment options within Mercer Super.

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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, and more specifically, that:

- Environmental, social and 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
- 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 2021 highlights

Welcome to our Annual Sustainable Investment Report, reflecting on 2021.

It was another significant year with the global pandemic continuing to impact society and markets. The pandemic reinforced the importance of future proofing portfolios in the face of systemic risks, such as climate change, and we saw an accelerated uptake of ESG by investors and companies alike. As long-term proponents of sustainable investing, we are encouraged to see this and remain committed to lead via industry thought leadership as well as the activity within our portfolios.

During 2021, we delivered on our policy and portfolio implementation commitments, whilst strengthening our position on climate change by announcing a net-zero by 2050 target for investments managed by Mercer with an expectation to reduce emissions by 45% from 2020 baseline levels by 2030[1].

The importance of social factors ('S' of ESG) emerged as a key trend during the pandemic and this received much focus in our engagements with investment managers as well as investee companies. For instance, we initiated tracking diversity statistics of our appointed investment managers. Data capture on ESG metrics is an integral first step to be able to engage effectively and influence positive change. We also published our inaugural Investment Approach to Modern Slavery document that outlines our framework for assessing modern slavery risk within our portfolios.

Finally, we were very pleased to be recognised externally as a sustainable investment leader throughout the course of the year as is captured in the table below.

[1] Defined as absolute carbon emissions, per $M of FUM and Scope 1&2 for the Mercer Funds in aggregate and for each diversified fund

A key highlights summary is as follows:

Highlights	In 2021, Mercer achieved the following...
Greater transparency	• Launched our inaugural Annual Sustainable Investment Report. • Disclosed portfolio holdings publicly on our website. • Updated our Task Force on Climate-Related Financial Disclosures (TCFD) aligned Investment Approach to Climate Change document.
Net-zero climate transition commitment	• Announced our commitment to net-zero by 2050 across all our Australian portfolios, with an expectation to reduce emissions by 45% by 2030, and implementation now actively underway.
Modern slavery risk management and disclosure increased	• Published our inaugural business-wide Modern Slavery Statement and a supplementary Investment Approach to Modern Slavery document.
ESG Engagement with appointed managers strengthened	• Launched a new manager ESG engagement tracker to capture ESG engagements with investment managers across asset classes as well as ESG topics. Conducted 52 manager ESG engagements during 2021. • Leveraged Mercer's global scale ($US388bn assets under management as at 31 March 2022) to engage with investment managers collectively on ESG via a single global ESG annual manager survey instead of the previous regional surveys. The survey covers all key ESG engagement priorities - climate change, modern slavery, diversity and inclusion, UN Global Compact.
External recognition from Rainmaker and RIAA for Mercer as an industry leader	• Achieved recognition for Mercer Super as a Top 20 ESG Super Fund by 2021 Rainmaker Study and as a leading super fund by Responsible Investment Association Australasia (RIAA). • Achieved recognition for Mercer Australia as a responsible investment leader in RIAA's 2021 benchmark report.

If you have any further questions or comments please get in touch with your local consultant or sustainable investment contact. We look forward to partnering with all our investors in the year ahead.

Kylie Willment
Chief Investment Officer
Pacific

Komal Jalan
Sustainable Investment Leader
Pacific

Policy and governance

Mercer's Sustainable Investment Policy was reviewed and updated in November 2021 to capture our evolving approach to sustainable investment.

Key updates to the policy included aligning policy wording to key implementation developments during the year, notably in the areas of active ownership, climate change, modern slavery and UN Global Compact (UNGC).

The Mercer boards[2] responsible for our investments, in 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 continued to meet quarterly in 2021 to share ideas and collaborate on best practice in sustainable investment. The committee includes representation from Mercer's investment management and consulting teams in the Pacific, Europe and North America.

[2] 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.

Our industry ratings and thought leadership

Industry ratings and recognition

We actively participate in external industry surveys to monitor the effectiveness of our sustainable investment implementation program.

Mercer is a signatory to the Principles of Responsible Investment (PRI), the global peak body for responsible investment. The results for the 2021 PRI assessment are due in Q3 2022. In 2020, PRI awarded Mercer its highest possible rating of A+ for Strategy & Governance, as well as an A rating for all asset classes.

During 2021, Mercer Australia was awarded the following accolades:

- Mercer Australia recognised as a Responsible Investment Leader in the Investment Manager category, RIAA Benchmark Report.
- Mercer Superannuation (Australia) Limited recognised as a Leading Responsible Investment Super Fund, RIAA Responsible Investment Super Study.
- Mercer Super Trust recognised as a Top 20 ESG super fund by Rainmaker's ESG Superannuation Taxonomy Study.

These results acknowledge our commitment to sustainable investing.

ESG thought leadership

Progressing thought leadership is a key priority for Mercer globally, and we continued to publish papers on pressing topics throughout 2021. Examples of recent papers are:

- "Zero places to hide"[6], released shortly after the 6th IPCC Assessment Report (AR6), called upon investors to act with urgency and at scale to respond to the climate challenge. We stressed that net-zero is crucial, net-zero is possible, and that net-zero needs action now.
- "Biodiversity on the brink"[7] provided a high-level introduction to biodiversity for investors with a call to turn their attention to tackling global biodiversity loss, which is already affecting food security, livelihoods, health and quality of life worldwide.
- "Raising your impact ambition"[8] presented the case for impact investment to institutional investors, connecting the pursuit of risk-adjusted returns with the delivery of positive real-world outcomes. It explored the often cited US$12 trillion global growth opportunity investment universe associated with delivering on the UN Sustainable Development Goals.

Sustainable investment portfolio implementation summary

Mercer's sustainable investment implementation framework spans across four key areas of activity and a summary of metrics and progress under each is as follows:

Integration

Include ESG factors in investment decisions

- **Engagement with external investment managers**
  - **52** engagements between Mercer and our external investment managers (at least one per week) during 2021 and tracked topics of focus
  - **71** strategy level responses to annual survey across key topics
- **Mercer ESG Ratings**
  - **2.1** average rating overall (rating scale is ESG1-4 with 1 being the highest and 4 lowest; overall < ESG3, which is positive)
  - **100%** of the single sector funds assessed are the same or better than 2020
  - **87%** of funds assessed are better than Universe*
- **Climate Change**
  - **Net zero** implementation and tracking underway
  - Portfolio climate risk assessments based on the new proprietary Analytics for Climate Transition (ACT) Tool
  - All key asset classes at an aggregate level had weighted average carbon intensity below the benchmark
- **Diversity, equity and inclusion**
  - **89%** of our investment managers have a firm-wide DEI policy
  - **24%** of our investment managers' decision makers identify as non-male

* Mercer's Global Investment Manager Database and relative asset class universe

Active Owership

Be active owners through voting and engagement

- **Voting**
  - **99%** of meetings voted, globally, including Australia
  - **13%** of meetings with at least 1 vote Against, Withhold or Abstain
  - **11%** of votes Against management recommendations
  - **3** Supervotes used
- Continued to implement **direct corporate engagement** program for Top 20 ASX listed holdings based on materiality
- Continued involvement with a number of **collaborative engagement initiatives** and launched a new framework to assess and monitor the value derived from these

Sustainable investment portfolio implementation summary (continued)

Investment

Allocate to sustainability solutions

- Continued to focus on **sustainability themed allocations** within the sustainability labelled funds and investment options
- **Direct Property portfolio**
  - **50% (5)** Strategies have a NABERS* energy rating of 4.9 or more based on the underlying assets
  - **All managers** have net zero carbon targets by 2030 (or earlier)
- **Direct Infrastructure portfolio**
  - **23%** renewables exposure

* National Australian Built Environment Rating System

Screening

Screen for products or activities deemed to be irresponsible or causing harm

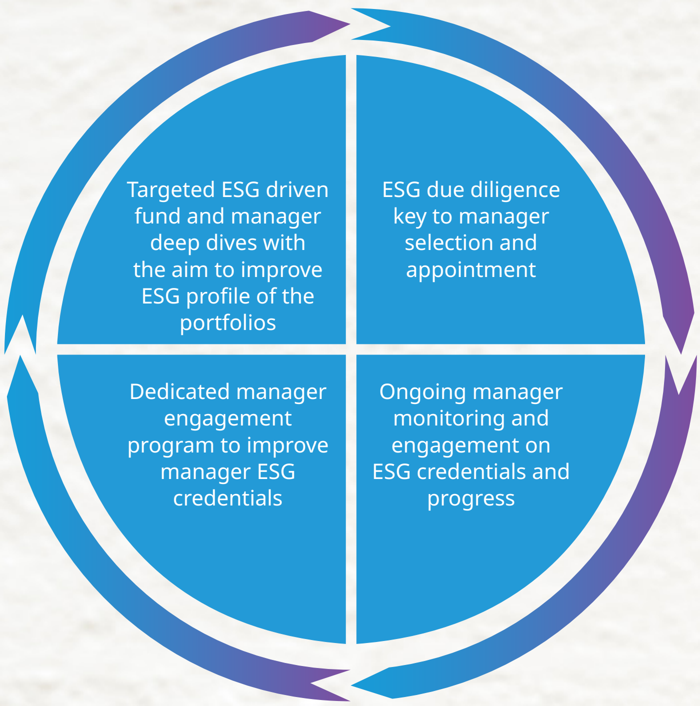
- **Exclusions**
  - Continued to monitor and ensure compliance with our fund-wide (tobacco and controversial weapons) exclusion commitments
- **UN Global Compact (UNGC)**
  - Continue to screen for UNGC red flag incidents in the portfolio
  - Two companies make up approximately 80% by weight of our UNGC exposure and we participated in engagement with one of those
  - All managers were surveyed on their UNGC practices
- **Modern Slavery**
  - Identified no modern slavery red flag holdings in the portfolio
  - Updated our country and industry risk assessment and reporting across portfolios

1. ESG integration

Our investment management team considers manager ESG ratings prior to appointment and on an ongoing basis, and actively seeks to appoint better ESG rated strategies that fit the required investment criteria for the solution.

The team also actively engages with investment managers on improving their ESG integration processes, from carbon emission reductions to improved diversity representation on the team.

Portfolio ESG Integration



Mercer has a dedicated Manager ESG Rating Research team that assesses the extent to which ESG factors are incorporated into a strategy's investment decisions across the following four pillars:

Mercer's four factor framework

Idea generation

- Efforts to identify and integrate ESG factors into active fund positions as a source of added value.
- Identification of material ESG factors - skill of team members, data sourcing.

Portfolio construction

- Efforts to integrate ESG driven views into the portfolio's construction.

Implementation

- Engagement and proxy voting activities (where applicable).
- Investment horizon aligns with ability to effectively implement ESG views.

Business management

- Firm-level support for ESG integration, engagement activities and transparency.

Mercer's four ESG ratings

ESG1

ESG integrated into investment philosophy; **active ownership a core part of process.**

ESG2

Consistent and repeatable process to ESG integration (focus on risk management); **strong evidence of active ownership.**

ESG3

Ad-hoc process to ESG integration and active ownership, but **indications of progress.**

ESG4

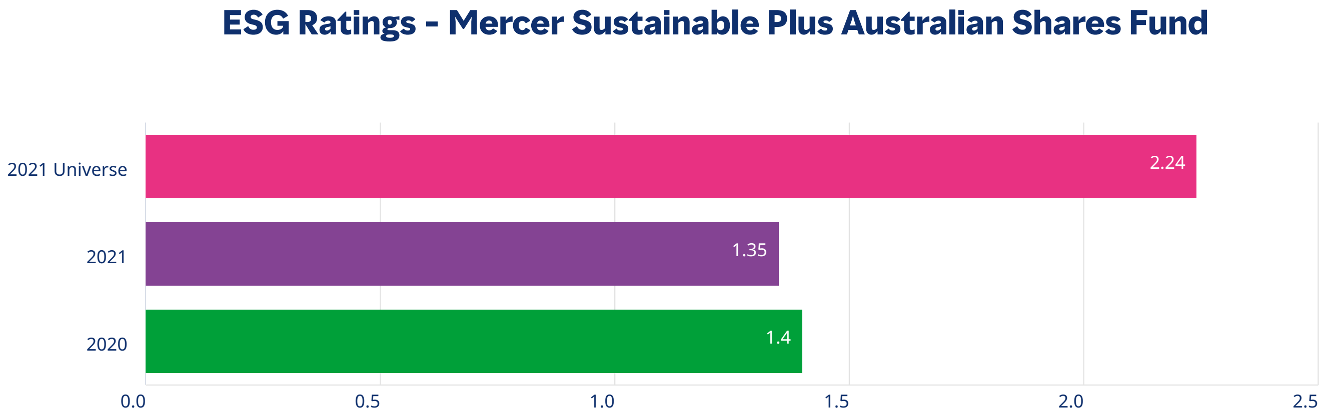
Little or no integration of ESG factors or active ownership into core processes and **no indication of future change.**

These "top down" internal ESG ratings along with externally sourced "bottom up" ESG metrics are key to Mercer's assessment and ongoing monitoring of investment managers.

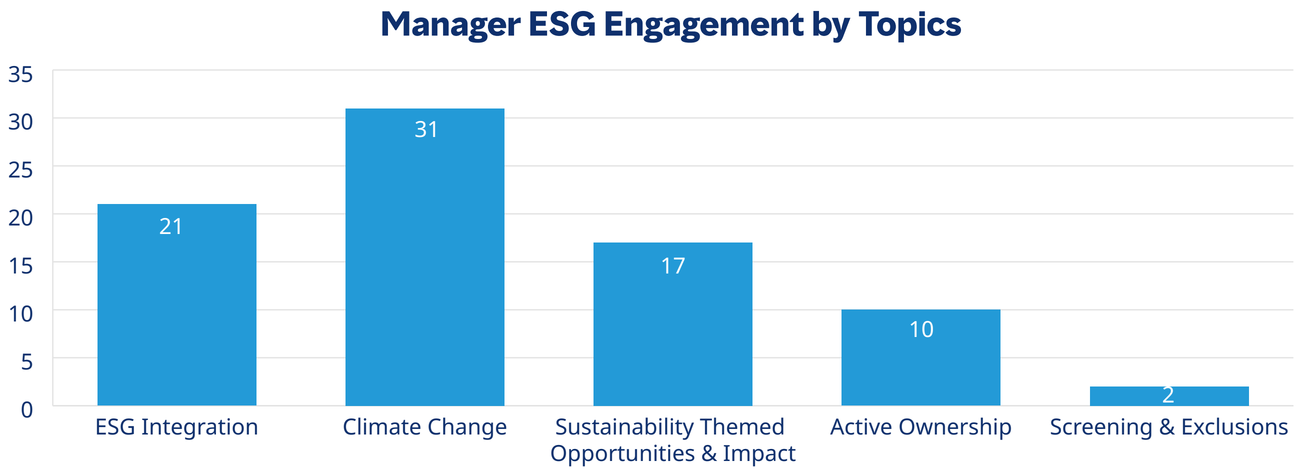
In 2021, for a universe of 30 Mercer portfolios across equities, fixed income, property, infrastructure and listed alternatives, we noted the following summary results for the Mercer ESG Ratings:

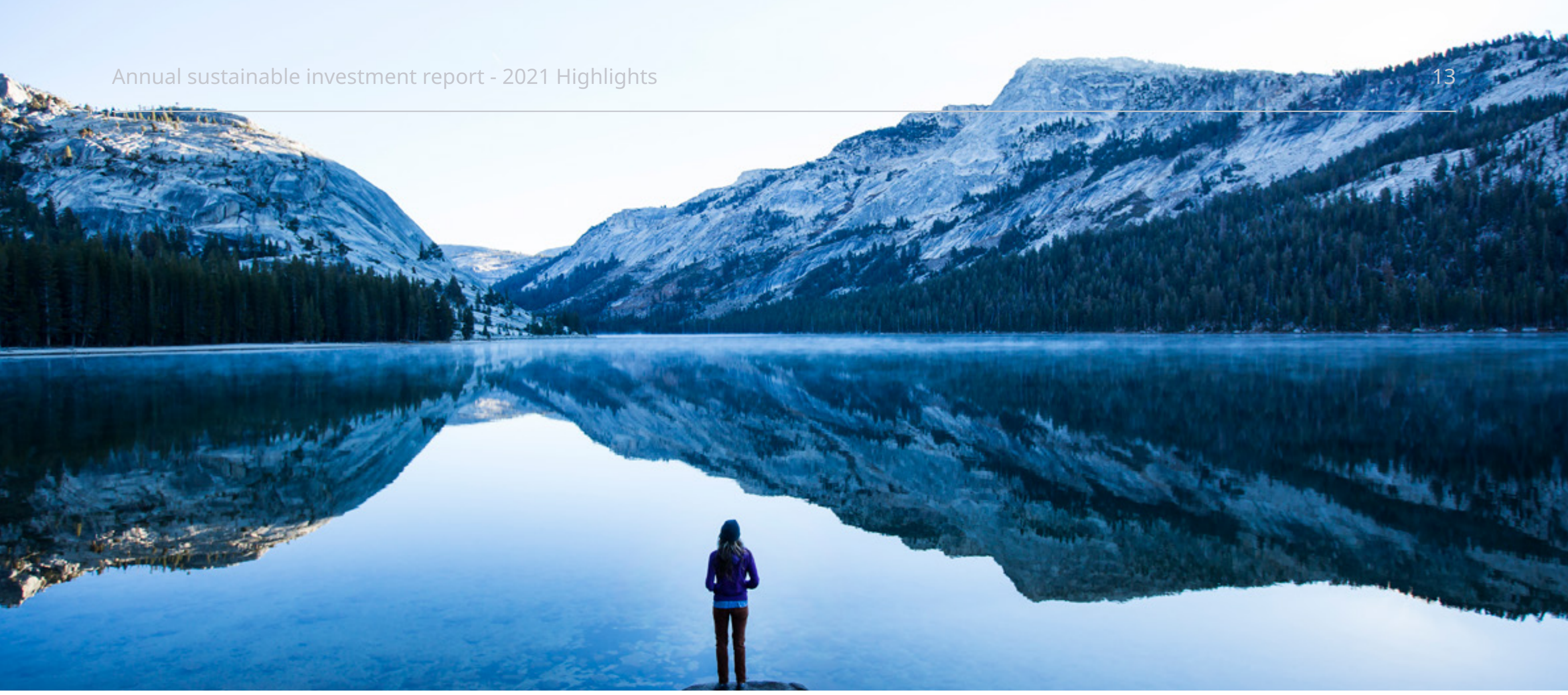
- 100% of the portfolios either improved or were at par with the previous year's ESG rating.
- 87% performed better than or at par vs the universe (of comparative strategies).
  - For the 13% that had an ESG rating lower than the universe, we note that in one case the universe had recently improved, and in three cases the universe was not directly comparable with the portfolio.

An example is shown below for Mercer Sustainable Plus Australian Shares portfolio



Further, we now track our ESG engagements with investment managers across ESG topics. In 2021, Mercer's investment management team conducted a total of 52 ESG engagements across new and existing managers, as well as a range of ESG topics.





Climate change

Mercer believes climate change poses a systemic risk, with financial impacts driven by two key sources of change:

1. The physical damages expected from an increase in average global temperatures, and
2. The associated transition to a low-carbon economy.

Each of these changes presents both risks and opportunities to investors.

These potential financial impacts are taken into account at a diversified portfolio level, in portfolio construction within asset classes, and in investment manager selection and monitoring processes.

Mercer's approach is consistent with the framework recommended by the Financial Stability Board's Task Force on Climate-Related Financial Disclosures (TCFD) and can be read in detail in the Investment Approach to Climate Change document. Disclosure consistent with the TCFD recommendations is encouraged for appointed investment managers.

Our climate transition framework

Mercer has adopted a spectrum approach that aims to assess transition risk and capacity across portfolios using our Analytics for Climate Transition (ACT) tool.

Manage 'Grey' Risks
High carbon intensity,
Low transition capacity

Steward the 'In-between'
Varying carbon intensity
and transition prospects

Target 'Green' Solutions
Low carbon intensity,
high transition capacity

2020 **2030** **2050**

1. Calculate the baseline

2. Analyse portfolio possibilities

3. Set measureable goals

4. Implement the plan

Integration
- Incorporate analysis into strategy and portfolio decisions
- Optimise SAA and seek asset class alignment
- Monitor market pricing*

Active Ownership
- Engage with appointed investment managers and companies and utilise voting rights to influence disclosure and practices aligned with 2030 and 2050 ambitions, including via collaborative initiatives

Investment
- Allocate to low-carbon / sustainability themed solutions
- Monitor technology developments and pricing*

Screening
- Screen to monitor high-carbon exposures with low transition capacity

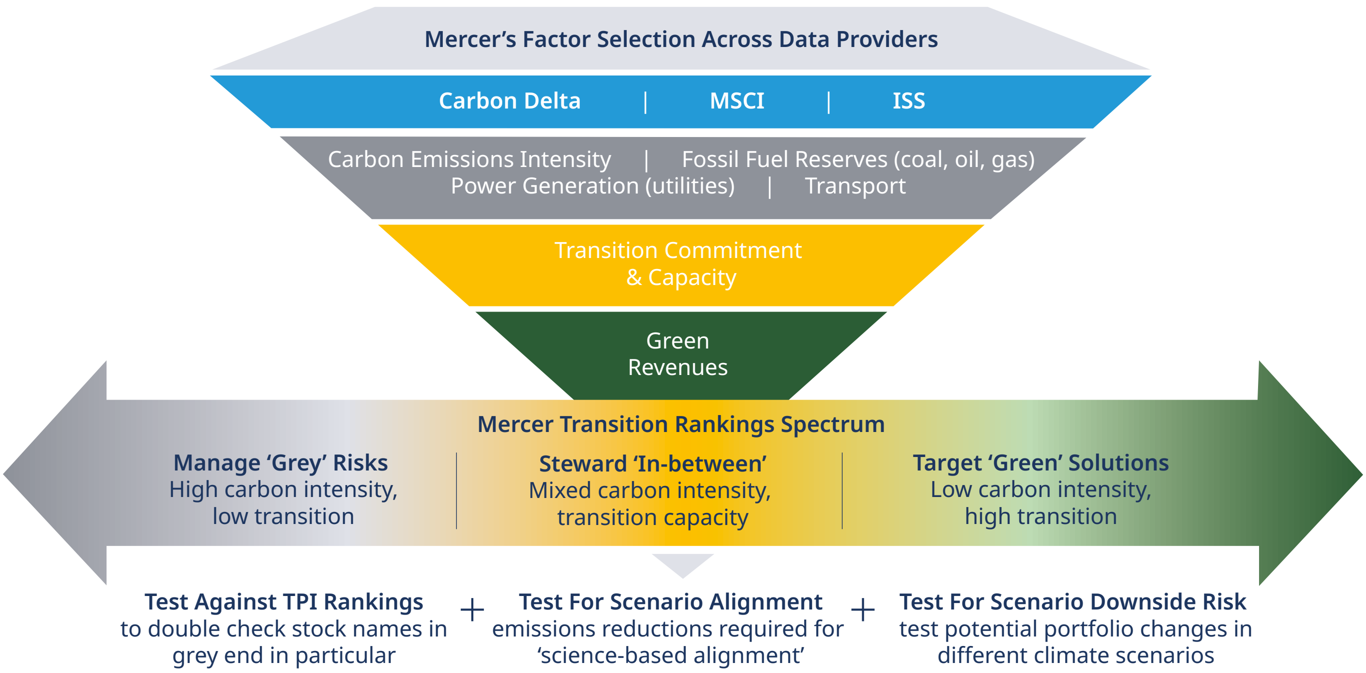
Report and disclose consistent with the TCFD framework

*'Decarbonisation at the Right Price' (DARP) is a term used to describe this market aware approach to transition objectives

Climate metrics and measurement

Weighted Average Carbon Intensity (WACI) is the most widely used metric to assess carbon risk for portfolios and make comparisons across assets, and is also recommended by the TCFD. We analyse and report on the WACI of our portfolios and include this metric alongside risk and return metrics within our quarterly reports.

The investment management team considers a wide range of climate metrics when assessing portfolio climate risk. In addition to our climate scenario modelling work, our proprietary Analytics for Climate Transition ("ACT") tool considers 15 different metrics including transition risk, policy risk, UN Sustainable Development Goals ("SDG") alignment and potential emissions from reserves (see figure below). This tool is also used to assess holdings-level exposure to stranded asset risk in the transitionary environment we are entering.

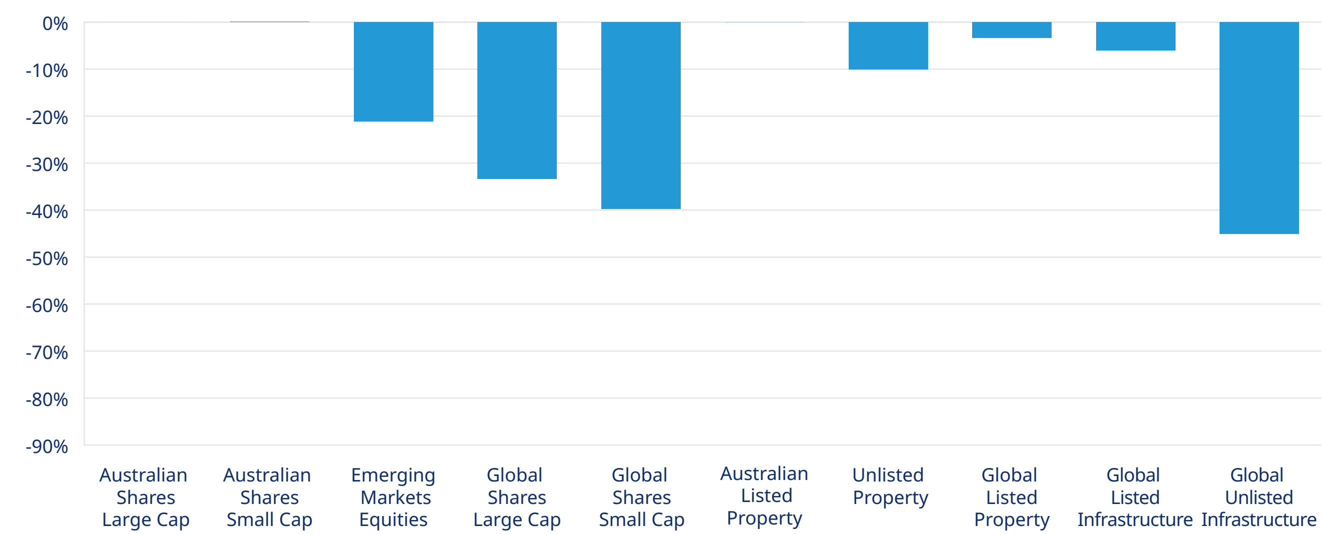


Our 2021 climate measurement results

WACI vs Benchmark

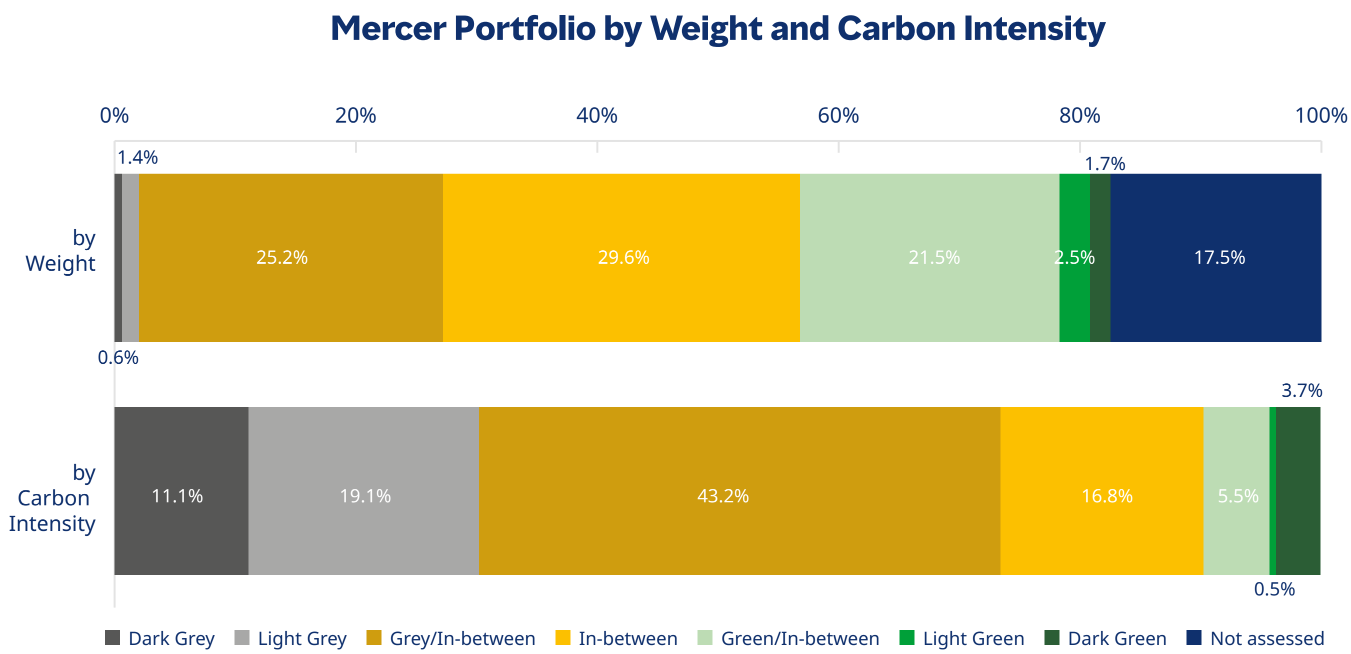
As at December 2021, all asset classes at an aggregate level had WACI equal to or lower than the benchmark as can be seen in the figure below.

WACI Relative to Benchmark



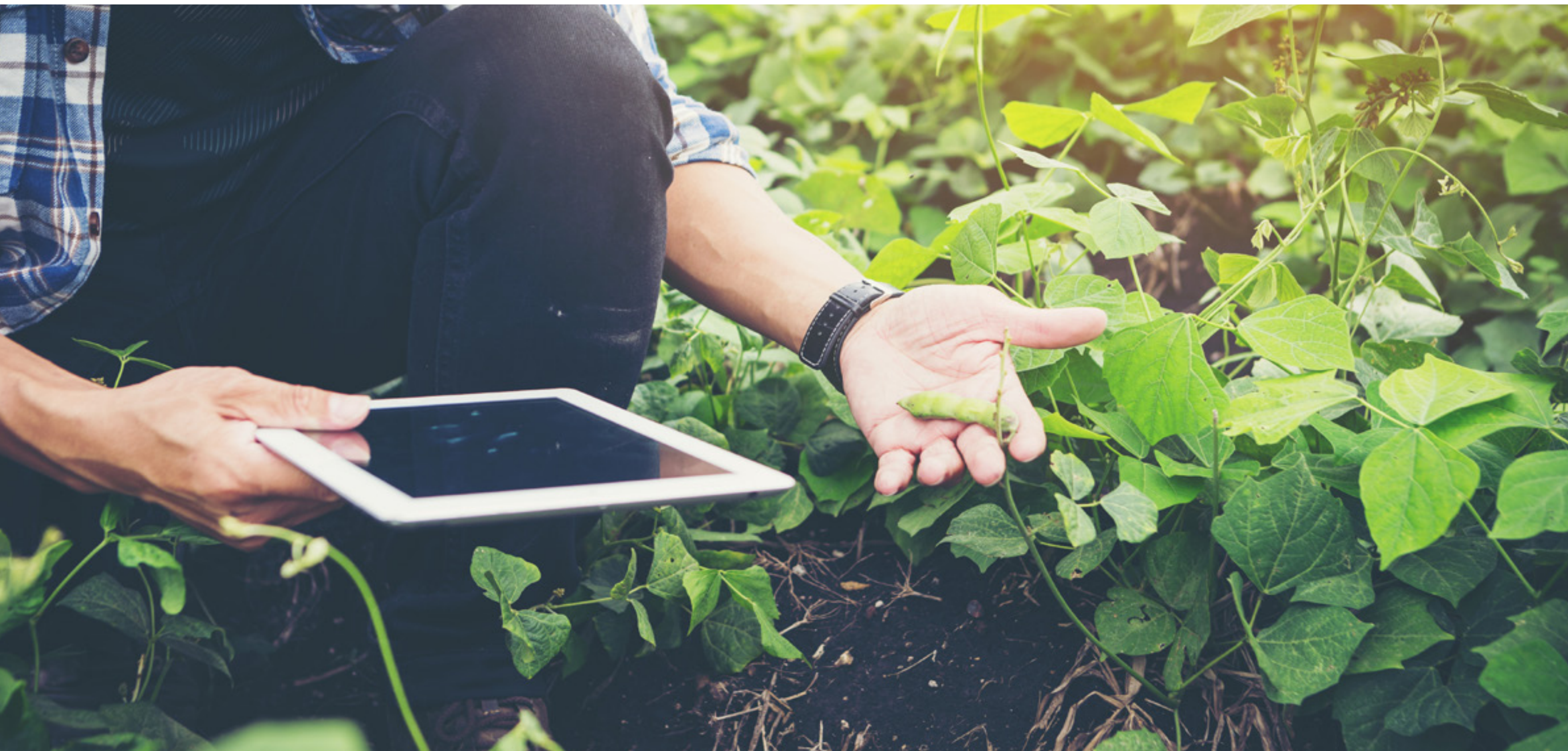
Source: Mercer, with underlying data from MSCI ESG Research
Note: composite benchmarks were used to allow asset class level reporting

Climate transition portfolio assessment based on Mercer ACT tool



The Grey high carbon intensity, low transition capacity	**The In-between** varying carbon intensity and transition prospects	**The Green** low carbon intensity, high transaition capacity

As can be seen in the figure above, a 2% portfolio exposure by weight to "dark grey" and "light grey" assets amounts to 30% of total portfolio WACI. These carbon intensive exposures are monitored regularly so we can manage and engage in line with Mercer's climate transition framework. A further breakdown by asset class reveals that emerging market equities as well as listed and unlisted infrastructure were the greatest contributors to the grey assets, whilst global equities, listed property and unlisted infrastructure contributed the greatest to green assets. It must be noted that this analysis covers approximately 83% of the total portfolio as sufficient data is not available for asset classes such as alternatives and private equity.



Modern slavery

Mercer is against slavery in all forms and strives in all its activities to respect human rights across its businesses. Mercer is committed to assessing and addressing modern slavery risks in its investment processes, and ensuring its appointed investment managers and investee companies do the same.

The diagram below outlines the components of Mercer's modern slavery program and the activities that have been undertaken.

Assessing and understanding modern slavery

- Dedicated modern slavery risk assessment
- Training and education
- Research

Addressing modern slavery

- Beliefs, policy and process
- Integration
- Active ownership
- Screening

Monitoring reporting and disclosure

- Annual monitoring
- Internal and external reporting

1. Our approach to assessing and seeking to mitigate the risk of modern slavery within our portfolios is outlined in our Investment Approach to Modern Slavery document, and our annual business-wide Modern Slavery Statement. In 2021, we conducted a total portfolio modern slavery risk assessment that resulted in dedicated manager engagements during the second half of the year where country and sector exposures indicated high potential risk. The asset class thematic risk assessment and holdings-level country and industry risk assessments identified risk hotspots in few asset classes, such as emerging market equities and bonds.
2. Some of the highest risk country and sector exposures identified in the emerging market shares portfolio included, India and China.
3. There were **no companies** in our portfolio that met the Controversy flag assessment for modern slavery (i.e. 'red flags').

Further, modern slavery has been a key thematic in our 2021 Manager ESG Survey. Key findings from manager responses for Australian portfolios include:

- **66%** of manager strategies have undertaken a human rights or labour practices risk assessment.
- **66%** have also put policies in place and undertaken training of colleagues, and **51%** have been engaging with investee companies.

Manager engagement and industry collaboration are a key part of our ability to influence positive change. We look forward to collaborating further with in the investment community to understand the role of investors in combatting human rights abuses.

Timothy Stamp, Principal, Sustainable Investment Consulting and Co-Chair of the Modern Slavery Working Group for Marsh McLennan, Pacific

2. Active ownership

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

Proxy voting

Mercer outsources proxy voting responsibility to its listed share investment managers and expects all shares to be voted in a timely manner and in a manner deemed most likely to protect and enhance long-term value. Each investment manager's capability in ESG engagement and proxy voting is carefully evaluated as part of the investment manager selection process, to ensure it is representing Mercer's commitment to good governance, sustainable investment and long-term value creation. Mercer accepts that managers may have detailed knowledge of both the governance and the operations of the investee companies and has therefore enabled managers to vote based on their own proxy-voting execution policy.

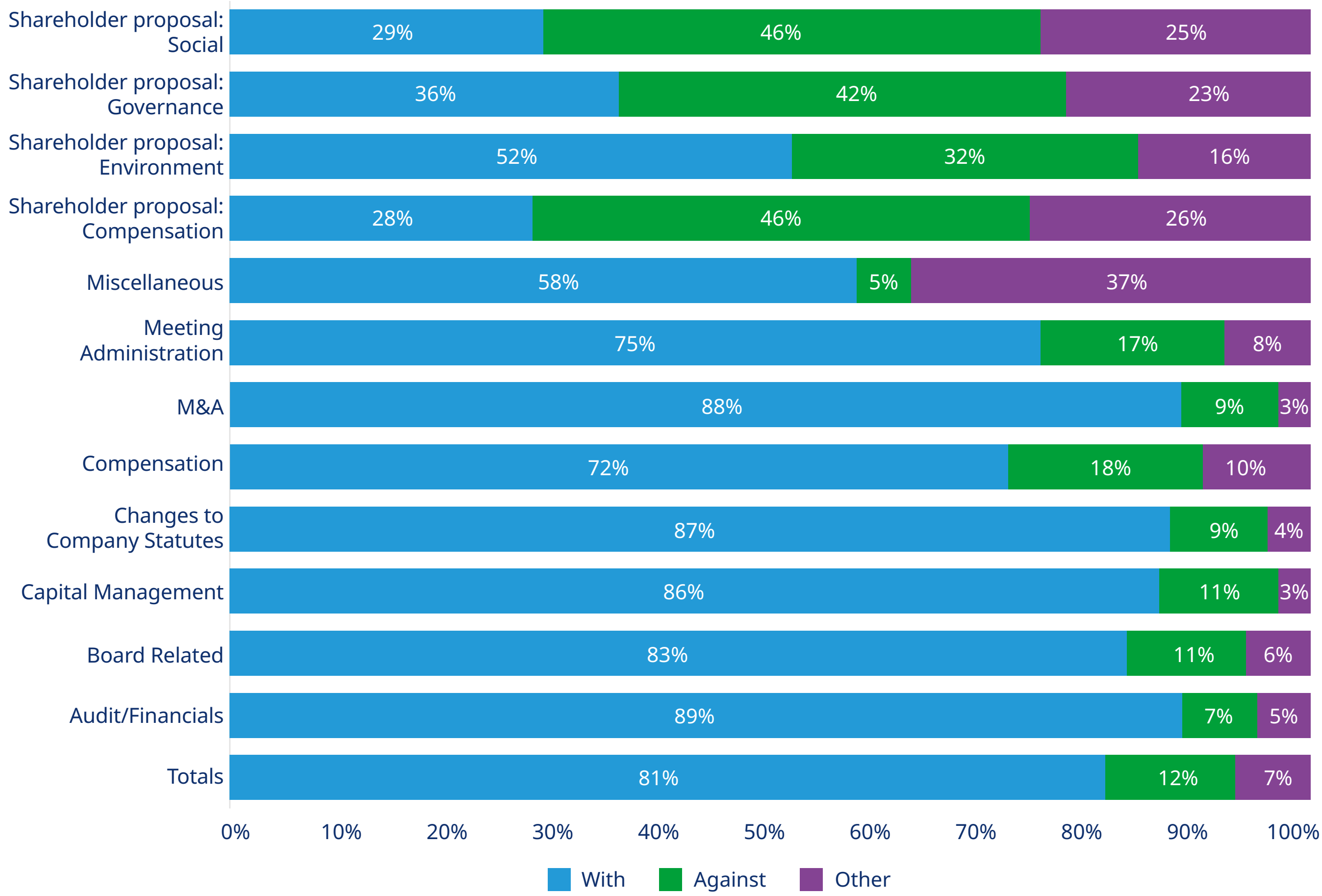
While proxy voting is typically outsourced to investment managers and may sometimes lead to mixed votes, Mercer retains the right to direct a 'Super Vote' which overrides the investment manager's votes on any resolution in circumstances where Mercer believes consistency on a significant matter is in the best interest of investors.

Below summarises the CY 2021 proxy voting activity for the Mercer Funds in Australia, for both our domestic and global equities holdings.

Number of meetings voted	3892
Number of Australian meetings voted	375 (99%)
Number of ballots voted	5787
Number of proposals voted	42,178
Proposals voted against management recommendation	11%
Meetings with at least one vote against, withhold or abstain	13%
Number of super votes used	3

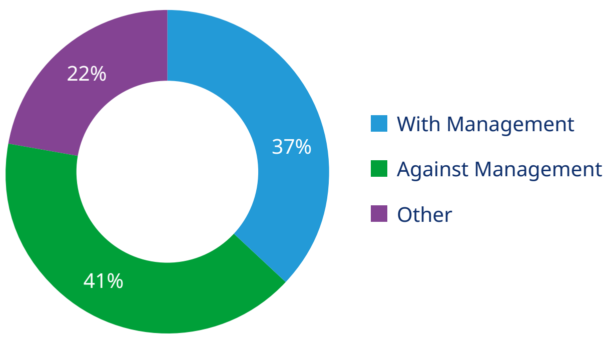
The charts below provide further insight into proposal topics broken down by with/against management votes.

Proposal Categories - Votes Versus Management

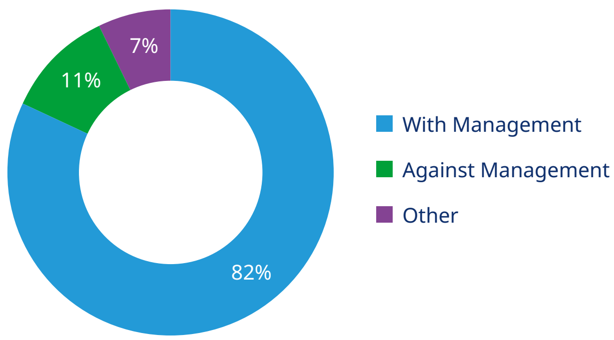


SHP: shareholder proposal.

Shareholder Proposals



Management Proposals



Mercer also makes available its voting activities via a Proxy Voting Search site, updated every six months, within a month of 30 June and 31 December.

Super vote summary

There were three company meetings where a super vote was used in 2021 – QBE Insurance Group, Rio Tinto Limited and Goodman Group, as summarised below.

Company Name: QBE Insurance Group (ASX: QBE)

Key issue for voting consideration: Shareholder proposal regarding climate change

Mercer super vote position: In line with the company management

Voting principle and issue summary: Climate change is a key engagement priority at Mercer in line with our commitment to net zero. Mercer expects companies to meaningfully disclose their climate risk assessments in line with the recommendations of the task force on climate related financial disclosure (TCFD).

In the case of QBE, we noted the recent progress made by the company to commit and disclose its climate action plan. The company has committed to net zero emissions by 2050 for its investment portfolio and more specifically has outlined its approach to managing oil and gas exposure risk for its underwriting portfolio in its publicly disclosed environmental and social risk framework.

As such, we supported voting in line with company management on shareholder proposal through our super vote at the company's 2021 AGM.

Company Name: Rio Tinto Limited (ASX: RIO)

Key issue for voting consideration: Remuneration proposal

Mercer super vote position: Not in line with the company management

Voting principle and issue summary: Mercer expects executive remuneration to be aligned and commensurate with long-term stakeholder value creation.

Our key concern in reviewing Rio's 2021 remuneration report related to the size of the unvested equity awards for the former CEO Jean Sebastien Jacques in light of the Juukan Gorge incident. As such, we used our super vote to vote Against the company's remuneration proposal.

The company subsequently recorded a remuneration strike at its AGM revealing widespread investor discontent on the issue.

Company Name: Goodman Group (ASX: GMG)

Key issue for voting consideration: Remuneration proposal

Mercer super vote position: Not in line with the company management

Voting principle and issue summary: Mercer expects executive remuneration to be aligned and commensurate with long-term stakeholder value creation.

At GMG's 2021 AGM, Mercer closely reviewed the remuneration proposals and used a super vote to vote Against three executive equity grant resolutions. Our key concern with the executive equity grants was the unjustified increase in pay quantum.

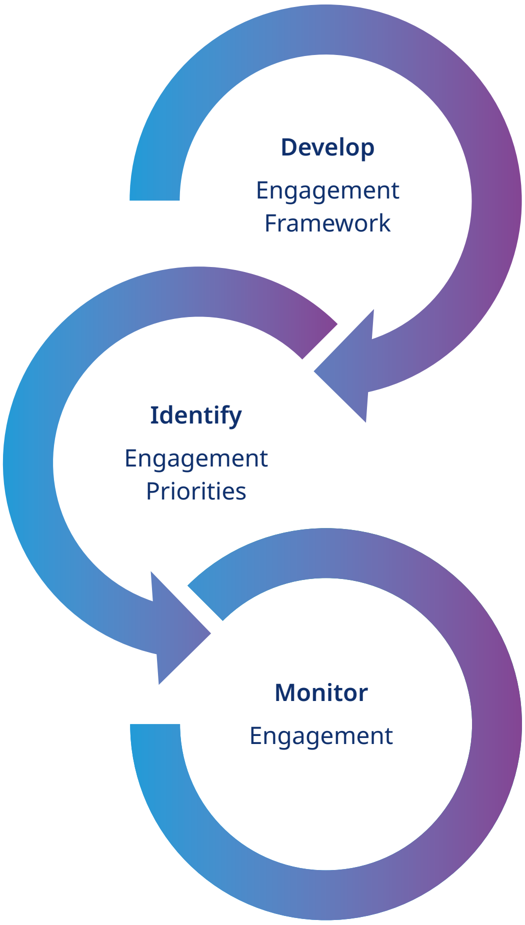
The company subsequently recorded a remuneration strike at its AGM revealing widespread investor discontent on the issue.

Engagement

We believe our appointed investment managers are typically best placed to prioritise particular engagement topics by company, and this is an expected part of an external investment manager's active ownership approach. However, Mercer may also conduct engagement activities with companies directly, or through involvement in collaborative initiatives, where we believe engagement by us is in the best interests of our investors.

To inform our engagement activities, Mercer has developed an Engagement Framework, which considers three main criteria – Beliefs, Materiality and Influence (BMI). Our engagement priorities are expected to intersect meaningfully across the three criteria in order to determine portfolio-wide engagement priorities.

Engagement Framework



- Considers three main criteria – Beliefs, Materiality and Influence (BMI)
- Used to develop a systematic approach for considering themes and topics and agreeing portfolio-wide engagement priorities.

- Priority topics for our engagement with external investment managers are Climate Change, Human Rights & Labour Practices, and Diversity, Equity & Inclusion.

Progress since last year:

- **Annual survey** undertaken with managers on their engagement approach together with their views on priority themes, this year conducted on a **global scale for the first time**.
- Survey results are used to populate **newly developed Engagement Dashboards** which will help guide our portfolio managers' engagement activity with managers on their stewardship approaches with the view to **positively influence** these over time.
- **Engagement Trackers** have been implemented this year to better capture, monitor and communicate our ongoing engagement activity, both at manager level and underlying company level.

Mercer Direct Corporate Engagement Case Study

In 2021, Mercer participated in engagement with BHP Limited pursuant to our commitment to UN Global Compact:

BHP

Company Name: BHP Group Limited (ASX: BHP)

Key issue covered in corporate engagement: Tailings Management

BHP features on the UNGC screening list in regards the issues outstanding from the 2015 Samarco Fundao dam incident.

From our engagement, we note the improvements made by the company over the years to address Tailing Storage Facility failure risk. The company now has an aspiration to achieve zero harm from tailings. In FY2021, the company created a permanent Tailings Excellence team dedicated to embedding leading practice within the organisation.

Manager ESG engagement survey

Mercer's now global ESG engagement survey for all managers appointed by us was distributed in December, with more than 180 managers covering over 200 unique manager strategies responding. In Australia there were 71 manager strategy level responses across asset classes.

This annual ESG survey is key to our manager ESG engagement program as it provides useful qualitative input to annual progress made by managers on key sustainable investment themes.

Overall, 100% of responses indicated the organisation has a sustainable investment or equivalent policy.

In regards to active ownership, survey responses revealed that:

- Goal oriented meetings with company management are the primary approach to engagement, followed by collaborative engagement and proxy voting strategies.
- In Australia, 46% of our external appointed manager strategies were engaging with policymakers.
- Where engagements have been stalling, Australian managers indicated their use of the following escalation mechanisms :54% escalated via voting, 48% undertook collaborative engagement, 44% exited the holding, and 13% did not escalate (please note that investment managers may use more than one escalation mechanism, hence these percentages will sum up to more than 100%).

In regards to diversity, equity and inclusion, survey responses revealed that:

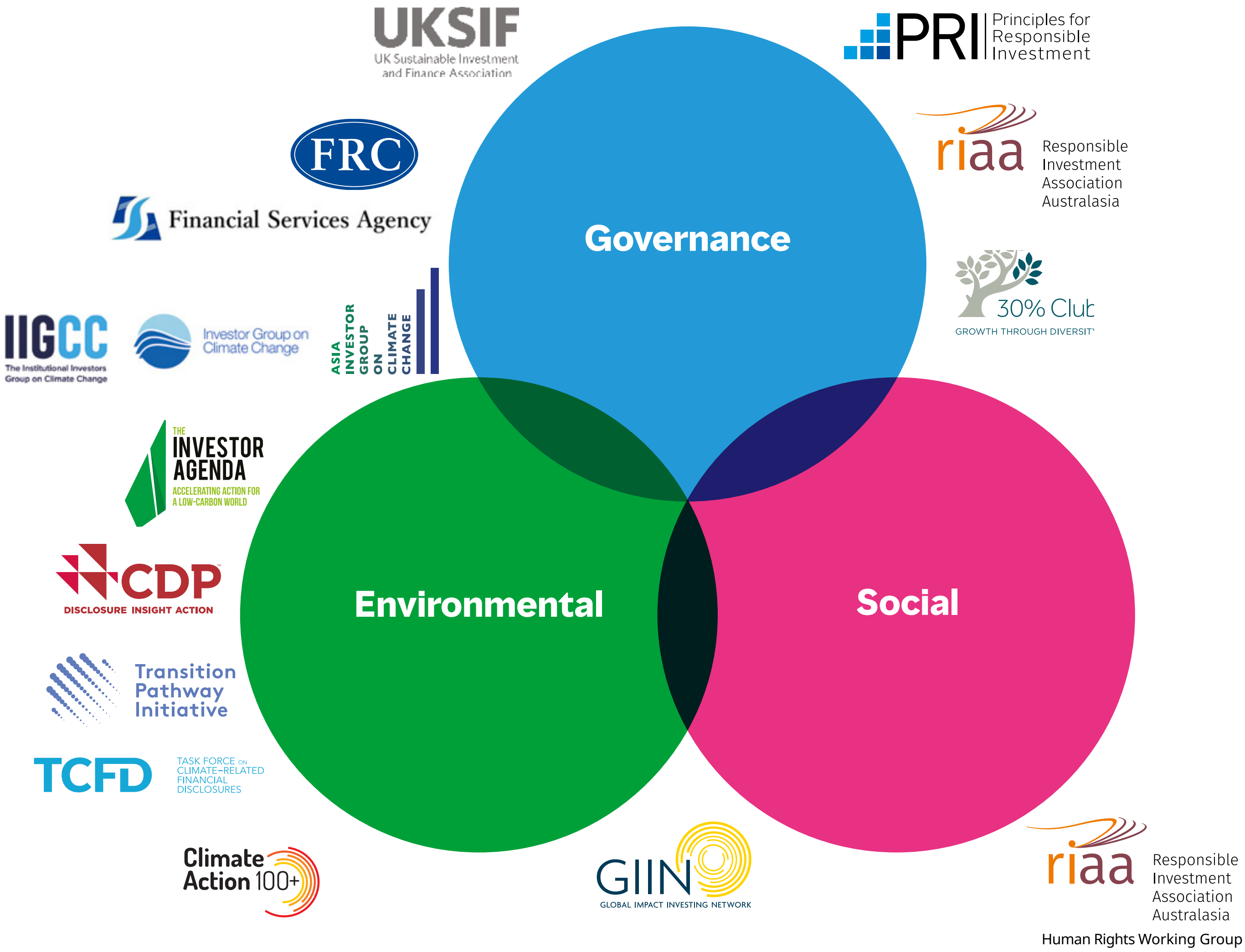
- **92%** are tracking gender diversity metrics and **72%** are tracking ethnic diversity for their own organisation, including diversity of key decision makers in investment teams around **24%** of key decision makers on average are non-male. We expect this to improve beyond at least 30% over the coming years.

Capturing diversity statistics for our investment managers is key to influencing positive progress on diversity within our investment value chain.

Jillian Reid, Partner, Global Solutions Leader, Sustainable Investment

Collaborative Engagements

Mercer also participates in a number of initiatives where we collaborate with other investors for greater impact. Our global collaborative initiatives for 2021 can be summarised as follows.



3. Sustainability -themed investments

Mercer believes that including exposure to external investment managers that identify longer-term environmental and social themes and the companies delivering solutions to environmental and social challenges is likely to lead to improved risk management and new investment opportunities.

The actively managed Mercer Sustainable Plus International/ Global Shares portfolio and the Sustainable Plus Australian Shares portfolio aim to not only deliver financial returns, but also to give investors exposure to sustainability themed investments with active ownership as key to their investment process and strategy.

Below are examples of ASX-listed company exposures within Sustainable Plus Australian Shares portfolio that also deliver positive social and/or environmental outcomes in enabling the sustainable development goals (SDGs):

Calix

- Calix has a number of businesses that are focused on improving sustainability outcomes globally. These include technology piloted by European cement companies to separate carbon dioxide from the cement production process to be used or stored. It is also developing next-generation Lithium battery technology and has patented a zero-emissions iron and steel production process.

Lifestyle Communities

- Lifestyle Communities is a business for purpose. Its mission is to enable working, semi-retired and retired people to maintain independence, build social connections and feel content to downsize at an affordable price – a differentiated model to the stock standard retirement village.
- The company is responsible for owning and operating these residential communities for Australians over 50 (SDG9 and SDG11). The focus is on health and wellness, providing facilities such as club houses, pools, gardens and outdoor recreation that homeowners can enjoy and socialise over. The mental and physical developments from such participation are key to a strong, happy and healthy aging population (SDG3).

Further, for the Mercer Sustainable Plus International/Global Shares portfolio, the following thematic return drivers were identified and targeted in 2021.

Renewable & Alternative Energy
Solar, wind, wave, biofuels, and geothermal technology

Pollution Control
Pollution control solutions and environmental testing

Water Infrastructure and Technologies
Irrigation, storage, treatment, drainage and flood protection

Sustainable Consumer Goods
Meeting shifting consumer demands in sourcing and technology

Energy Efficiency
Storage plus power network, industry, building, and transport efficiency

Waste Management and Technologies
Recycling processing, hazardous and general waste management

Health and Social Services
Positive impacts for social development and addressing poverty or aging populations

Responsible Finance
Supporting role for real economy

Below are some examples of company holdings in the Sustainable Plus International Shares Fund:

xylem

Xylem's innovative water management solutions contribute to energy and water efficiency.

Xylem's core offerings, including smart metering devices, network software, advanced data analytics and water infrastructure, delivering significant cost savings and environmental benefits.

Interesting stories:

- Xylem have i**nstalled more than 80 million smart meters**, serving millions of end customers in 150 countries.
- On average, 2-14% energy savings are achieved per device. That stacks up to a lot of efficiencies!
- You might have seen **Xylem's name displayed at Manchester City matches. Xylem work with Manchester City on projects such as building water towers in communities around the world without access to clean water.**

grameenphone

Grameenphone provides telecommunications products and services in Bangladesh.

Interesting stories:

- Grameenphone reaches 99% of this largely rural country through its inventive "Village Phone" program, which has **earned numerous awards for its social and economic impact** across local communities.
- Approximately **72.7 million individuals benefit from internet access**, aiding economic and social empowerment from internet connectivity.
- **Provides women with jobs selling data and voice services** in communities that would otherwise lack internet access.

LAUREATE EDUCATION INC

Education service provider offering vocational training and job placement for primarily low-income students.

Interesting stories:

- They **serve 875,000 students** with approximately 75% of students are from emerging markets.
- Graduates of the company's top schools and universities **achieve a 31% average starting salary premium.**

Laureate Education contributes to the improved quality of life from education and reduced inequalities.

Source: external investment manager reports

In addition to the above sustainability-labelled listed share allocations, we have included case studies from our unlisted/direct portfolios and their exposure to sustainability themes.

Mercer Global Unlisted Infrastructure

Around one-fifth (23%) of our Unlisted Infrastructure portfolio consists of renewable energy assets. These include the following co-investments:

- Wind and solar energy business Finerge (managed by Igneo Infrastructure Partners – formerly named First Sentier Investors) is one of the largest in Portugal and generates 2,384 GWh of green energy, which saves 1,312 ktons of carbon emissions (ktCO2e) annually.
- Energy-from-waste asset Viridor (managed by KKR) is the UK's second largest waste processing and recycling business. It delivers a carbon benefit of 650 ktCO2e compared to equivalent landfill operations. Energy generated powers the equivalent of 500,000 homes per year.

Mercer Australian Direct Property Portfolio

The Mercer Australian Direct Property portfolio has considerable allocations to assets with strong sustainability credentials, as highlighted below:

- The Fund has an 85% average Global Real Estate Sustainability Benchmark (GRESB) rating, compared to the industry average of 73%.
- All investment managers have net-zero carbon targets by 2030 (or earlier), two underlying funds are already carbon neutral.
- The portfolio has allocations to several green office funds, including an Investa strategy with an average 5.2-star NABERS (National Australia Built Environment Rating System) Energy rating.
- All investment managers have modern slavery statements and reconciliation action plans.

4. Screening

Mercer may screen portfolios for sectors, companies, products or activities deemed to cause an unacceptable level of harm, guilty of severe breaches of law or commonly accepted behaviour, or deemed as not meeting the expected ESG standards under the ESG integration approach outlined, to the extent their viability as an ongoing investment is in question.

United Nations Global Compact (UNGC)

Mercer screens and monitors listed portfolios for high-severity incidents under the UNGC principles that relate to human rights, labour, environmental and corruption issues, as identified by appointed external ESG research provider, ISS. We expect external investment managers to engage with companies to resolve the UNGC-related issues identified through the screening process and report engagement progress.

Our annual global ESG survey of external investment managers specifically covers questions on UNGC. For the 2021 survey, the key results for Australian strategy responses were as follows:

48%

UNGC is covered specifically in ESG or related policy

76%

Actively monitor for UNGC breaches

Looking forward in 2022

We hope you enjoyed this report.

We are proud of the progress we have made and believe there is still much to be done, particularly to achieve real world outcomes through our individual portfolio contributions as well as collectively as an industry. Sustainability can be a key enabler to building resilient portfolios in the face of disruptive macroeconomic global scenarios. As fiduciaries of long-term capital, we take this seriously.

Early 2022 saw financial markets disrupted by a major geopolitical event with the Russia Ukraine war. We were extremely saddened to see the devastating humanitarian impact for the millions of people affected in the region. Our response has been to divest any existing exposure to Russian securities as market conditions allow as well as prohibit any new investment in Russian securities.

As the world changes and society looks to those with power, capital and influence to act positively to address this change, we are committed to achieving meaningful influence across our investment value chain and report the positive outcomes to you. Social capital and human capital, with the most important factors including human rights, diversity and inclusion, and modern slavery assessments are key areas of focus along with implementing net-zero across our portfolios for 2022.

We will continue to review and improve our sustainable investment practices and collaborate with other industry leaders to help drive the industry forward. We look forward to updating you on our progress again and welcome any feedback on what you would like to see more of in the 2022 report. Please contact your Mercer representative with any feedback or reach out with any questions at contact.australia@mercer.com.

Glossary

- **Active Ownership:** Mercer's approach to active ownership, or stewardship, includes proxy voting and engagement activities. These provide investors with an opportunity to enhance the value of companies and markets in a manner more consistent with long-term investor timeframes.
- **Carbon Intensity:** Total amount of greenhouse gas emissions normalised by a common denominator across companies such as revenue, with the most common one being the Weighted Average Carbon Intensity (WACI). This allows for comparison across companies, and in the case of an investment portfolio, for comparison across funds and benchmarks. The usual measurement includes carbon dioxide, methane, and other greenhouse gases and is often expressed as carbon dioxide equivalent (CO_2e).
- **Engagement:** An element of active ownership. Typically refers to discussions between an investor and a company, usually at the Board or senior management level, with the objective of changing a particular aspect of that company. May also refer to engagement between a fund-of-fund investor and external investment managers or policy advocacy with governments.
- **ESG:** Factors related to Environmental, Social, and Governance issues, such as those outlined below from Mercer's Sustainable Investment Policy:

Environmental	Social	Governance
Climate change	Health and Safety	Board diversity, composition and effectiveness
Water	Labour standard and modern slavery, including in supply chains	Executive remuneration
Waste and pollution	Human rights and community impacts	Conduct, culture and ethics
Biodiversity	Demographics / consumption	Shareholder rights

- **ESG Integration:** An approach to sustainable investing. Refers to the inclusion of ESG factors throughout an investment process with a focus on the potential financial impacts. Associated with Mercer's ESG ratings, which evaluates the extent to which ESG factors are integrated within an investment manager's approach.
- **Modern Slavery:** Modern slavery is an umbrella term covering a wide range of exploitative practices. Mercer's approach to defining modern slavery is aligned with the Australian Modern Slavery Act 2018 (Cth), which identifies eight exploitative practices with reference to the Criminal Code: Trafficking in persons; Slavery; Servitude; Forced labour; Forced marriage; Debt bondage; The worst forms of child labour; Deceptive recruiting for labour or services.
- **Net-Zero:** Net-zero carbon dioxide (CO_2) emissions are achieved when anthropogenic CO_2 emissions are balanced globally by anthropogenic CO_2 removals over a specified period. The term "net-zero" is typically associated with the 2050 date or earlier, as this is aligned with the scientific recommendations to achieve a 1.5°C scenario. Scientific conclusions are that for a 50-67% chance of achieving a 1.5°C scenario: a 45% emissions reduction is required from 2010 levels to 2030 and the net zero target year is ~2050. This now sets an 'end point' to work back from and establish trajectories to achieve the necessary emissions reductions and invest in the carbon removal technologies to 'net off' the residual.
- **Proxy Voting:** A proxy vote refers to the ballot cast on resolutions at company Annual General Meetings by entities on behalf of the actual shareholders, typically external investment managers on behalf of the ultimate investor. Particular attention may be paid to shareholder proposals, which must meet a certain level of support among shareholders in order to be brought to management and are often associated with ESG topics. Votes against management indicate that shareholders disagree with a position being adopted.

- **Scenario Analysis:** Scenario analysis is a common tool used in portfolio modelling to build on back-testing with historical data to project forward what may eventuate under different scenarios. The process involves “what-if” thinking and requires estimated inputs and assumptions. Climate scenario analysis translates scientific input to investment-related estimations. Many models estimate the physical and transition impacts to an investment portfolio based on different warming increases and time horizons.
- **Sustainability-themed investments:** These manager strategies typically identify longer-term environmental and social themes and the companies delivering solutions to environmental and social challenges. In addition to ‘pure-play’ allocations such as clean energy, water, timber or agriculture, this can include ‘broad sustainability’ allocations to companies providing sustainable goods and services in environmental matters or social areas such as health and education. The UN Sustainable Development Goals (SDGs) are typically referenced as part of these allocations.
- **Task Force on Climate-Related Financial Disclosures (TCFD):** The TCFD was established by the Financial Stability Board to provide recommendations to investors and corporations for more effective climate-related disclosures in order to facilitate a better understanding of the overall financial system’s exposure to climate-related risks. The 11 recommendations cover four areas: governance, strategy, risk management, and metrics and targets.
- **UN Global Compact (UNGC):** UNGC is a non-binding, voluntary initiative based on business commitments to implement international law principles. The pact is principles-based, and covers 10 areas including human rights, labour, environment, and anti-corruption. It is currently the largest corporate sustainability initiative with over 13,000 participants from over 170 countries.

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