

# Our Ethical SRI Credit screening process

Perpetual employs a rigorous investment process in managing our suite of Credit and Fixed Income strategies. The Perpetual Ethical SRI Credit strategy employs this same disciplined process, but with additional Ethical, SRI and sovereign screens, to ensure that all investments held in the Fund match investors' personal social, environmental and ethical preferences more closely.



## Overview

Ethical and socially responsible investment (SRI) research requires specialist skills. Work in this field is aimed at evaluating the issuer's performance on a range of environmental, social and governance (ESG) and ethical criteria.

To be included in the investment universe for the Perpetual Ethical SRI Credit Fund, issuers must meet Perpetual's initial credit investment criteria (quality filters) in addition to passing the Ethical SRI Credit screening process.

**The Perpetual Ethical SRI Credit strategy has three exclusion screens, including:**

- an exclusion for involvement in certain industries, and
- a performance screen based on an evaluation of an issuer's overall sustainability performance on SRI criteria, and
- where applicable, a separate screening process for non-corporate (sovereign) issuers.

Perpetual has a dedicated Responsible Investments team, which oversees the screening process and may draw on internal and other supplementary research to determine the issuer's suitability for inclusion in the Fund. Screening criteria may change over time to account for emerging issues.

When assessing corporate issuers that are listed on equity exchanges (for example, the ASX), Perpetual utilises external research, provided by V.E (formerly Vigeo EIRIS), a leading global provider of ESG research.

V.E's research methodology covers 330 ESG indicators and has been developed over their 30-year history. V.E's research coverage extends to more than 7,800 listed companies.<sup>1</sup>

When assessing unlisted corporate issuers, Perpetual utilises a range of publicly available sources and research, and the media.

Additionally, the team may draw on external ESG research from RepRisk, a global research provider covering a broad range of environmental, social and governance issues.

<sup>1</sup> For more information regarding V.E's research solutions and methodologies, please visit: <https://vigeo-eiris.com/solutions-investors/>.

## The screening process

Issuers that have met Perpetual's broad quality investment criteria are then assessed on a range of ESG and ethical issues to determine their suitability for inclusion in the Ethical SRI Credit universe and portfolio.

The screening process for the Ethical SRI strategy for corporate issuers is a combination of ethical screening and an SRI performance screening process. This combined approach allows exclusions based on specific unethical activities while also identifying the performance of issuers on a broader range of SRI factors.

The SRI performance screening process includes a positive scoring element, which allows issuers demonstrating ESG leadership to be rewarded in the analysis. This provides a wider scope for differentiation of issuers from a socially responsible perspective and is likely to become increasingly important as issuers and counterparties respond positively to greater investor awareness of ethical and social issues.

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A separate screening process for non-corporate (sovereign) issuers applies in the Ethical SRI Credit Strategy.

### Stage 1: Ethical screening

Stage one of the Ethical SRI Credit screening process aims to exclude those issuers that are significantly engaged in the production or distribution of products and services determined to be ethically unacceptable to the manager's clients<sup>2</sup>. These criteria are relatively objective and rely, where possible, on a quantitative assessment of revenue generated by the products and services. This means the Fund does not invest in issuers that derive a material proportion (5% or more), and in some circumstances 0%, of their revenue from the manufacture or sale of generally ethically unacceptable products and services<sup>3</sup>.

This step therefore deals with the type of industry the issuer operates in and the products and/or services that the issuer produces and/or sells.

The exclusion criteria are currently based on the following activities:

- ▶ alcohol
- ▶ gambling
- ▶ tobacco<sup>3</sup>
- ▶ uranium and nuclear
- ▶ armaments (including weapons<sup>3</sup>)
- ▶ fossil fuels (upstream)
- ▶ genetic engineering
- ▶ pornography
- ▶ animal cruelty (cosmetic testing)

### Stage 2: SRI screening

The SRI screen is the second screening stage, where issuers are scored on a broad range of environmental, social and governance issues.

This evaluates how an issuer's business practices impact on society and the environment. Issuers can receive negative scores for poor behaviour, such as a poor approach to human rights, the environment or supply chain. They can also receive positive scores for worthwhile activities such as the use of renewable energy, positive employee policies or charity commitment. We believe this approach allows us to be more innovative in where we can add value for investors as it identifies issuers that have responded positively to SRI or ESG issues.

Based on our policies, Perpetual allocates scores for performance in these areas using negative and positive scores. If the issuer's net total score is negative, the issuer fails the SRI screen and is therefore excluded from the Fund's investment universe.

The negative and positive scoring issues are outlined on the following page.

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<sup>2</sup> This includes affiliate companies whereby the company holds over 50% of voting rights in a subsidiary company and 20%-50% of the voting right in an associate company.

<sup>3</sup> For involvement in the production of tobacco, tobacco-based products and the development and production of controversial weapons a 0% revenue threshold is applied.

## Table 1: SRI filter – scoring elements

Issuers are scored (positively or negatively) on their approach to or involvement in the SRI issues shown in the following table. Issues are not scored uniformly but instead on the severity of the issue involved.

Environmental	Social	Governance
		
Environmental risk	Human capital	Conduct/ethics approach
Environmental policy & strategy	Human rights	Fines and other sanctions
Environmental results	Supply chain	Bribery, fraud
Renewable energy use	Community	Class actions
Product impacts	Animal rights	Other corporate misconduct
E-positive products & services	Product impacts	
Chemicals of concern	GMO	

Issuers with a negative total score fail this filter

### Stage 3: sovereign screening

Bonds directly or indirectly issued by sovereigns (governments) that exhibit unethical or other practices, inconsistent with the values of the Fund's investors, fail this screen and are therefore excluded from consideration from investment. The following indicators are used to assess these practices.

Any sovereigns scoring poorly will fail the screen:

- RepRisk ESG Country Index – reflects history of negative ESG incidents, criticism and controversies of companies and projects in each country, indicating reputational risk related to ESG/business conduct.

Incidents cover 28 ESG issues, covering key international standards.

- World Bank Worldwide Governance Indicators (WGI) – assess six dimensions of sovereign governance: voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, control of corruption.
- Transparency International Corruption Perceptions Index (CPI) – perceptions by business people and country experts of the level of public sector corruption. The most widely used indicator of corruption worldwide.

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