What is Allan Gray's approach to responsible investing?

Sustainability is embedded in how we invest on behalf of our clients, operate our business and interact with society. We have always considered environmental, social and governance (ESG) factors as part of our investment process. We believe this holistic approach can improve investment returns, risk management and our ability to assist our clients to act as responsible owners. In other words, it protects our clients' interests as long-term investors.

Our approach

The essence of our approach has not changed since the firm was established in 1973. The below commentary, written more than 20 years ago by our then-chief investment officer (CIO), attests to our history of responsible stewardship.

> *"Allan Gray's relationship of trust with its clients and its investment ethics require not only that we make buy and sell decisions with our clients' best interests at heart, but also that we encourage our clients to exercise their rights as shareholders in favour of sound corporate governance. In our opinion, the key components to sound corporate governance are: effective disclosure, which enables investors to make informed decisions; accountability of those entrusted with running the business for their actions, both management to the board and the board to shareholders; and aligning the interests of managers and shareholders so that managers' incentives are designed to reward them for creating value for shareholders."*
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> ***Allan Gray Quarterly Commentary, Q4, 2003***

While ESG integration has always been part of our DNA, we strive for annual improvements. These include efforts to enhance the quality of our ESG research, engagements and proxy voting processes; to refine our client-related disclosures; and to participate constructively in industry, regulatory and policymaking initiatives.

We aim to do what we believe is right. This does not mean taking a binary view on whether investments are "good" or "bad" and making related portfolio inclusions or exclusions. We recognise that, unfortunately, there are often trade-offs that need to be weighed up between environmental, social, governance and economic considerations. For example, tackling climate change is a critical global priority, but in a developing country such as South Africa, the need to address socioeconomic issues, such as unemployment and inequality, is equally important in pursuit of a sustainable economy. We seek to evaluate these factors in a holistic and balanced manner.

Our ESG research process

Our ESG research is conducted in-house and integrated into our investment analysis across all asset classes and geographies. Investment analysts are responsible for researching ESG issues relating to the instruments they cover and highlighting these in their research reports. Our valuations also take account of possible ESG tailwinds and opportunities. Material ESG risks or opportunities are factored into company valuations. For equities, earnings or cashflows are adjusted if the risk is quantifiable, or the valuation multiple of the company or division is adjusted if the risk or opportunity is significant but uncertain. For bonds, we look to compensate for higher risk in the spread. The team scrutinises, challenges and debates investment theses during team meetings where reports are reviewed.

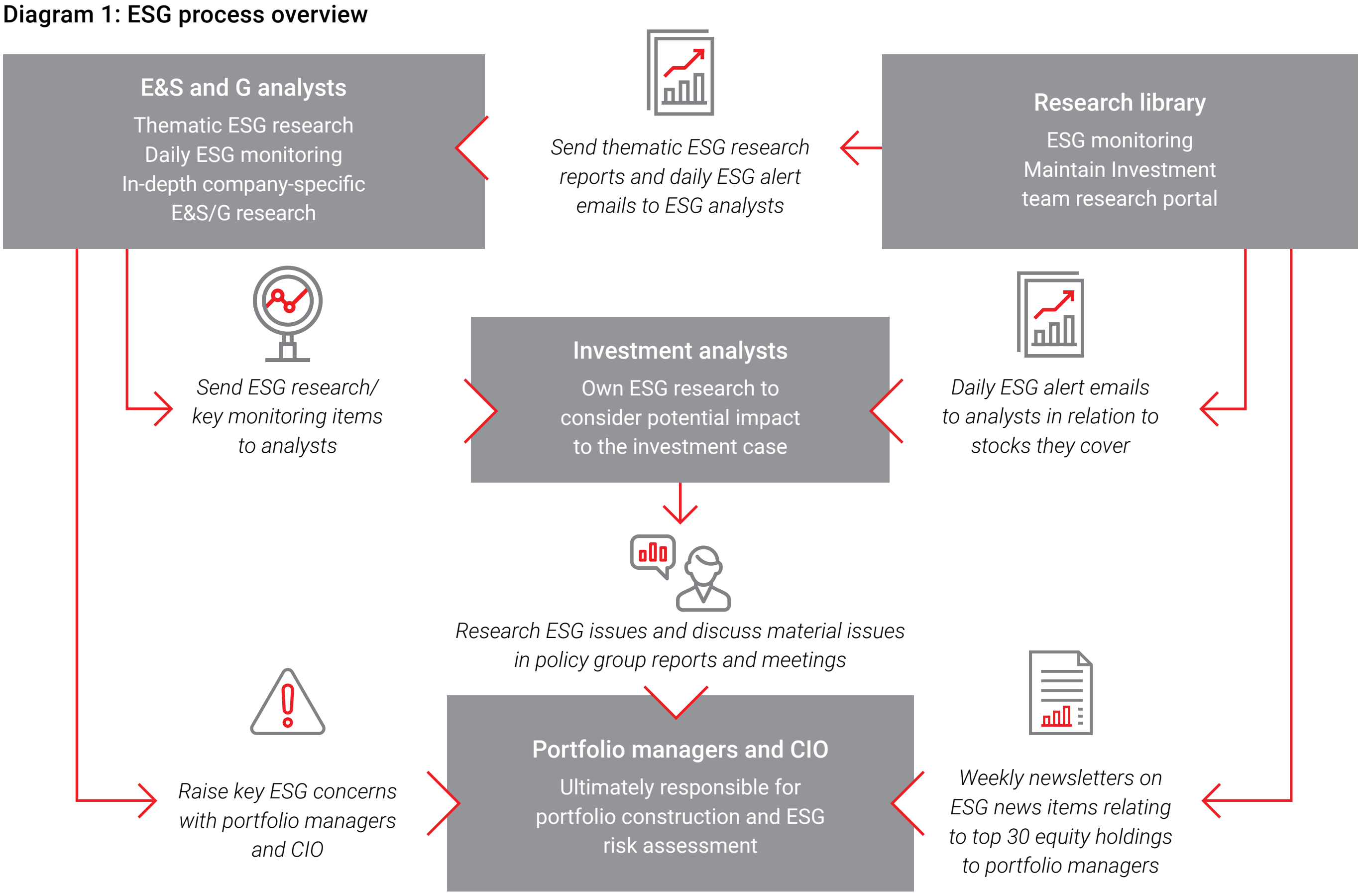
We distinguish between 1) our ESG risk rating system and 2) our broader internal risk ratings – or "star ratings" – which reflect our assessment of the complete risk profile of an investment. The respective purposes of these two sets of ratings are explained in our Ratings FAQ, under "The role of ratings in the investment process".

If a portfolio manager decides to buy a share, accountability for the incorporation of sustainability considerations falls on that portfolio manager.

Our CIO may veto investments by other portfolio managers in cases where he determines that the company's business practices are unethical. While we use a multiple portfolio manager system, where portfolio managers each manage a slice of the broader portfolio, and view it as key to our success, we believe it is necessary to have an additional level of oversight through the CIO's ethical veto. The Allan Gray board holds the CIO accountable, including for his use of (or decision not to exercise) this veto.

We continue to monitor ESG factors once we are invested. This is crucial because ESG issues are dynamic. The Investment team includes a governance analyst and two environmental and social analysts, who perform additional monitoring, in-depth research into identified risk areas and thematic ESG research. Additionally, our research library monitors company-specific ESG news and shares relevant news items with the team. **Diagram 1** captures our day-to-day ESG processes and reporting flows.

Diagram 1: ESG process overview



Active ownership

Good stewardship of our clients' capital also requires active ownership, which we effect through engagement with companies and by making voting recommendations – or by submitting proxy votes where authorised – on resolutions tabled at shareholder meetings.

We engage frequently and meaningfully with both company boards and management teams. We do not use external proxy advisers and prefer to form our voting recommendations independently. We think critically about the resolutions at hand and make a point of engaging with boards ahead of time if we have concerns. We publish our voting recommendations, together with the outcome of the shareholders' vote on each relevant resolution, on our website quarterly in arrears.

We acknowledge that we are invested in companies that have negative environmental or social externalities, and we focus on understanding how they aim to reduce their impact. Investing in "ESG improvers" makes investment sense, as better ESG credentials are likely to be rewarded by the market if they signify a stronger or more responsible business. We believe in holding management teams and boards to account on their strategy and execution.

In addition to company engagements, we actively partake in industry initiatives that promote sound corporate governance and sustainable business practices.

We keep the following factors in mind in our approach to ESG:

CLIENT CENTRICITY	Our core objective is to build long-term wealth for our clients. It is therefore crucial to serve as responsible stewards of our clients' assets by safeguarding their interests as investors. We aim to generate the best possible risk-adjusted returns for our clients, as responsibly as possible.
INDEPENDENT MINDEDNESS	Allan Gray has always followed a contrarian investment approach and we strongly encourage and value independent thinking. Our approach to responsible investing is no different. We may not always do what is popular, but we consider it far more important to be authentic.
INTEGRITY	In a world where accusations of "greenwashing" abound, we try to be as clear as possible about our ESG commitments and honest about the limits of what we can achieve.
PRAGMATISM	We live in an imperfect world where there are often trade-offs involved in decision-making. We try to be realistic and pragmatic about these and make decisions that are in society's best interests. We recognise that not everyone will agree with our decisions and that, as with stock picking, at times we may get things wrong. In such cases, we endeavour to learn from our mistakes and remain open to changing our views as more information comes to light.

Our responsible investment policies provide more detail on how we consider sustainability in the investment process and how we approach ownership responsibilities on behalf of our clients. Clients may also refer to our position statement on climate change to understand our thinking around the role we can play to support the transition to a lower-carbon economy.

Fixed income stewardship

Bondholders and shareholders broadly share the same ESG concerns, but bondholders do not benefit from the same powers of ownership conferred on shareholders; for example, they cannot vote to remove directors. Therefore, our engagement approach when it comes to fixed income differs from that of our equity holdings.

We typically engage with debt issuers' management during debt investor roadshows, which frequently occur after financial results are published or before an issuer intends to come to market with a new instrument.

In South Africa, we aim to play a constructive role by engaging with government on key matters through various channels, for example, through the Association for Savings and Investment South Africa (ASISA), or through direct engagement with policymakers on ESG-related matters such as the fiscus, corporate governance and the environment.

In the case of corporates and parastatals, where we may be a more significant lender, we may request meetings with key management or write to boards when specific issues arise. Most of the corporates in our fixed income investment universe are listed entities, which allows us to draw on our equity research process in assessing the creditworthiness of issuers.

Stewardship in frontier markets and the rest of Africa

The principles underlying our approach to stewardship also apply to investments in other African countries and frontier markets. However, our approach may be adjusted to reflect the complexities introduced by investing in less developed markets.

Weighing up ESG considerations in these markets can be challenging, as disclosures are generally more limited than for JSE-listed companies. Furthermore, developing markets typically feature systemic ESG challenges which, in turn, have implications for companies' operating conditions. Governance risk often includes heightened political risk at a macro level: Even companies exercising good corporate governance remain vulnerable.

In terms of making voting recommendations, we cover all resolutions tabled by those companies to which our funds have material exposure.

In the case of fixed interest instruments issued by governments, our ability to influence policymakers in Africa outside of South Africa is limited by the small size of a typical position in relation to the market capitalisation of the total debt in issue. Given our limited ability to bring about change using this method, our approach for these issuers focuses on research over direct engagement.

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