Fundsmith
Sustainable Equity Fund | SICAV

Sustainability-related disclosure

Fundsmith
Buy good companies
Don't overpay
Do nothing

Fundsmith SICAV – Fundsmith Sustainable Equity Sub-fund

Summary

The Fundsmith Sustainable Equity Sub-fund (the "Sub-Fund") promotes environmental and social characteristics but does not have a sustainable investment as its objective. The Sub-fund will make a minimum proportion of sustainable investments.

The Sub-fund invests in high quality businesses that have a low exposure to sustainability-related risks as a result of their high quality and also have strong environmental and social performance. These characteristics are promoted by measuring The Sub-fund's holdings against five environmental metrics:

- Total waste generated
- Hazardous waste generated
- Water usage
- Energy consumption
- Greenhouse gas emissions

The Investment Manager uses exclusions, environmental, social and governance analysis and active ownership as part of the investment strategy to ensure these characteristics are met and maintained. At least 80% of the Sub-fund's assets are aligned with the promoted environmental and social characteristics. At least 70% of the Sub-fund's assets are allocated towards sustainable investments, being investments in companies that comply with the Investment Manager's good governance and do no significant harm assessments and evidence a positive contribution towards at least one of the United Nations' Sustainable Development Goals ("SDGs").

Through proprietary due diligence, research, engagement and external data sources, such as Bloomberg, the Investment Manager sources the most recent available data per holding and monitors this on an ongoing basis. Where data is not available, the Investment Manager carries out an internal estimation to calculate an approximation for the specific holding, based on sector, scale and size of the holding.

All of the Sub-fund's investee companies are monitored with respect to their principal adverse impacts ("PAIs") on sustainability factors.

The Sub-fund does not use a specific index designated as a reference benchmark for the purpose of attaining its environmental/ social characteristics.

No sustainable investment objective

This financial product promotes environmental or social characteristics, but does not have as its objective sustainable investment. The Sub-fund does however commit to making a minimum proportion of sustainable investments, as defined in Article 2(17) of Regulation (EU) 2019/2088 , the Sustainable Finance Disclosure Regulation ("SFDR").

The Investment Manager ensures that the Sub-fund's sustainable investments do no significant harm to any environmental or social objective. The Investment Manager achieves this through assessing investees' performance under all 14 of the mandatory principal adverse impact indicators given in Table 1 of Annex I of Commission Delegated Regulation (EU) 2022/1288 and three additional principal adverse impact indicators covering greenhouse gas emissions, water use and energy sources, taken from Table 2 of that Annex I. These indicators include assessing the compliance of investee companies with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights.

Environmental or social characteristics of the financial product

The environmental and social characteristics promoted by this Sub-fund are derived from its investments in high quality business with good governance practices. These businesses have low exposure to sustainability risks as a result of their high quality. The Sub-fund's underlying investments form a portfolio with a significantly lower environmental footprint, measured by the total waste generated, hazardous waste generated, water usage, energy consumption, and greenhouse gas emissions, compared to the average company, represented by the weighted average of the MSCI World Index for the chosen metrics.

These characteristics are achieved using binding exclusions during the creation of the Sub-fund's investible universe ("IU") and through assessing the principal adverse impacts of the Sub-fund's underlying investments.

The Sub-fund also promotes environmental and social characteristics through excluding companies that generate greater than 5% of their revenue from the following industries/ sub-industries:

- Aerospace & Defence,
- Brewers, Distillers & Vintners,
- Casinos & Gaming,
- Gas Utilities,
- Electric Utilities,
- Metals & Mining,
- Oil, Gas & Consumable Fuels,
- Pornography, and
- Tobacco.

[1]https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32019R2088
[2]https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_.2022.196.01.0001.01.ENG&toc=OJ%3AL%3A2022%3A196%3ATOC

The above industries/ sub-industries are excluded as the Investment Manager believes they have an unsustainable impact on the environment and/or society. This judgement is made by the Investment Manager on a case-by-case basis, focusing on factors material to a company's operations.

The Sub-fund's underlying investments also reduce the negative E/S impacts they have and generate positive impacts through allocating capital to research and development to drive innovation in the products/ services they offer. The Investment Manager measures the impact that this innovation has on E/S characteristics through improvements in the environmental metrics mentioned earlier and through other qualitative measures, such as improvements to human health and welfare.

Sustainable Investments

The Sub-fund commits to making a minimum proportion of sustainable investments. The Sub-fund intends to contribute towards a variety of environmental or social objectives under the definition given in Article 2(17) of the SFDR, through the activities of its underlying investments. The Investment Manager has chosen to assess companies' alignment with the E/S objectives defined by the SFDR through using the United Nation's 17 Sustainable Development Goals[3] as a proxy for those objectives.

Investment strategy

Strategy

The Fundsmith Sustainable Equity Sub-fund operates a long term, buy and hold investment strategy, only investing in publicly listed, large market capitalisation (>$15bn) companies. The Sub-fund's underlying investments are selected from an investible universe of approximately 65 companies, all of which have been subject to detailed research and analysis by the Investment Manager's research team before admission to the Sub-fund's investible universe. A concentrated portfolio comprising of between 20 to 30 high-quality businesses is created from this investable universe.

The Fundsmith Sustainable Equity Sub-fund follows the approach laid out in the Investment Manager's Responsible Investment Policy, which describes the approach taken towards investment and how the promoted environmental and social characteristics are attained.

[3] https://sdgs.un.org/goals

This Includes:

Exclusions

Exclusions are applied during the construction of the portfolio's universe of investible companies. These exclusions are applied to prevent investment in companies with any exposure to controversial weapons or controversial jurisdictions, including those subjected to UN Security Council Sanctions and a 'Call to Action' by the Financial Action Task Force.

In addition to the above, this Sub-fund uses two exclusionary screens during the creation of its investible universe. The first is a sector and revenue-based screen used to remove companies profiting from activities in sectors that the Investment Manager deems to be unsuitable for a 'sustainable' fund. These are listed in the 'Environmental or social characteristics of the financial product?' section of this annex.

The second screen is based upon a judgment of a company's net impact on the environment and society. This includes an assessment of the negative and positive effects a company has on the environment and society, utilising quantitative and qualitative data and a third-party reputational risk assessment. These factors are used in combination to create an objective as possible judgement on a business's net impact. A company deemed to have an excessive net negative impact, assessed using the various environmental and social metrics and indicators used by the investment manager and comparing this to similar companies and the wider investible universe, is excluded from the Sub-fund's investible universe. This decision is subject to the approval by the Investment Manager's Stewardship & Sustainability Committee. Excessive is defined within the specific context of each individual company and the judgement is based upon factors that are material to the business and its operations. These exclusions are re-assessed on at least an annual basis.

ESG Integration

As well as forming a component of the Sub-fund's second exclusionary screen, environmental, social and governance ("ESG") factors are integrated into the wider investment process. The Investment Manager assesses a business's ability to manage their E/S impact and the resulting risks, as well as taking advantage of opportunities, as part of the assessment of a company's ability to sustain a high return on invested capital over the long term. A component of this assessment is the reduction of negative impacts and the generation of positive impacts through innovation in the products/services companies offer, such as healthier food and drink options, health care products that address global health issues, and more environmentally sustainable products to mitigate their contribution to climate change. Portfolio companies are monitored continually with all new and material information/ data integrated into the Investment Manager's ongoing assessment of the business.

Active Ownership

Should the Investment Manager find a company's quality of governance or financial, environmental, or social performance to be of concern, for example a deterioration of the metrics used to measure the attainment of the E/S impact, the Investment Manager's engagement and escalation processes (including proxy voting) will be used to attempt to address the issue and encourage a long-term approach towards their capital allocation.

Good Governance

The investment strategy also analyses the good governance practices of investee companies. This can be in the form of independent checks and balances on management's actions by the board of directors and anything else that influences the decision-making and incentive structure within the organisation. This includes relatively easy areas to assess, such as policies towards forced and child labour within the business's supply chain, workplace safety and employee satisfaction, the percent of non-executive independent directors on the company's board and nomination committee, the independence of the board, the remuneration structure of executives at the company and tax compliance. It also includes an assessment of areas of the company that are harder to objectively measure, such as the culture at the company and how that incentivises employees to act appropriately.

Proportion of investments

A minimum of 80% of the Sub-fund's assets are aligned with its promoted E/S characteristics. The Sub-fund also commits to allocating at least 70% of its assets towards sustainable investments. 10% of the Sub-fund's assets may be investments that meet the promoted E/S characteristics but do not meet the criteria set to qualify as a sustainable investment.

The Investment Manager aims to always be fully invested in equities, but a small proportion of cash is held within the Sub-fund for liquidity purposes. There may also be investments that do not currently meet all the E/S characteristics that the Sub-fund is promoting, or do not produce the necessary data to report their performance regarding these characteristics. These companies are included as the Investment Manager believes that active ownership activities will encourage the company to publish the necessary data or will generate meaningful improvement within the area they trail the Sub-fund's other investments. Cash held by the Sub-fund and investments failing to meet the promoted E/S characteristics account for 20% of the Sub-fund's assets. The actual percentage may vary over time. The Sub-fund only invests in listed equity to have direct exposure to investee entities.

Monitoring of environmental or social characteristics

The Investment Manager uses five sustainability indicators, updated on a quarterly basis, to monitor the environmental characteristics promoted by the Sub-fund. These are:

- Total waste generated
- Hazardous waste generated
- Water usage
- Energy consumption
- Greenhouse gas emissions

The Investment manager monitors all 14 of the mandatory principal adverse impact (PAI) indicators for the Sub-fund. These cover greenhouse gas emissions, biodiversity, water, waste, and social and employee matters. Additionally, the Investment Manager monitors the Sub-fund's performance against three further PAI indicators, including assessments of underlying investments with or without carbon emission reduction initiatives, non-renewable energy assessments, and the presence of a water management policy. The Sub-fund's performance in respect of these indicators is assessed at the end of each quarter of the calendar year.

Methodologies for environmental or social characteristics

At least 80% of the Sub-fund's assets must be invested in companies that outperform the average company across each of the five selected sustainability indicators. By outperform, the Investment Manager intends to maintain the Sub-fund's weighted average intensity for each metric below that of the weighted average intensity for the MSCI World Index.

The weighted average free cash flow (FCF) for the portfolio and index is calculated by multiplying each of the constituent companies' free cash flow (€m) by their respective weightings and summing the result for all constituents. The same method is used to calculate the weighted average total waste (metric tons), hazardous waste (metric tons), water usage (m3), energy (MWh), and greenhouse gas emissions (CO2e) for both the Sub-fund and Index. The weighted average environmental indicators are divided by the weighted average FCF to produce an intensity-based metric, representing the average company for the Sub-fund's portfolio and the Index.

Sustainable Investments

The SFDR defines a sustainable investment as an investment in an economic activity that contributes to an environmental or social objective, provided that the investment does not significantly harm any environmental or social objective and that the investee companies follow good governance practices.

To qualify as a sustainable investment for the Sub-fund, a company must pass the Investment Manager's good governance test, relating to the four areas specified by the SFDR: sound management structures, employee relations, remuneration and tax compliance. Companies must also pass the do no significant harm test, relating to environmental, social, human rights, anticorruption and antibribery matters, represented by the principal adverse impact indicators discussed in the previous section.

The company must make a positive contribution to at least one of the United Nations' Sustainable Development Goals (SDGs) and their underlying targets. The assessment is made using a pass-fail approach based on both qualitative and quantitative analysis of a business's activities. The Sub-fund commits to allocating at least 70% of its assets towards sustainable investments.

[4] https://www.un.org/en/climatechange/paris-agreement

[5] https://sciencebasedtargets.org/

[6] https://www.cdp.net/en

Every company is assessed against SDG 5 (Gender Equality) and SDG 13 (Climate Action). Companies are tested for a positive contribution to gender equality through their board and executive suite composition. Corporates are judged to make a positive contribution to the climate through having a greenhouse gas emissions reduction target in line with the 2015 Paris Agreement[4] approved by the Science Based Targets initiative[5]. Companies must also have submitted a response to the CDP's[6] Climate Change questionnaire. Companies can make a positive contribution by generating at least 20% of their revenues from activities aligned with Sustainable Development Goals and their underlying targets.

Data sourcing and processing

Data Sourcing

The Investment Manager sources data from Bloomberg to calculate both the Sub-fund and Index's characteristics. Environmental data is for the most recent available per holding and is updated on a rolling basis. The free cash flow data used reflects the most recently reported numbers. Environmental and financial data for MSCI World Index constituents is also sourced from Bloomberg. MSCI provides data for the constituents and weightings of the MSCI World Index.

Data Quality and Processing

Data sourced from Bloomberg is checked manually for outliers and metric consistency. Should inconsistencies be found the Investment Manager fills gaps and corrects data using internal research. Sources such as company reports, CDP questionnaires and engagement are used.

The proportion of data estimated varies between the metrics used for key indicators selected. Where data is not available for a portfolio holding, an internal estimation engine is used to calculate an approximation for the business. The estimation is based on similar companies operating within the same industry and scaled to the assets of the business.

Limitations to methodologies and data

The main limitation faced is the varying availability, consistency and quality of sustainability-related information across the metrics tracked. Environmental metrics also rely on data which is backward-looking and does not account for forward-looking information on a company's approach to managing the metrics the Investment Manager tracks. Where such issues exist, the Investment Manager uses further research to fill any data gaps and, when necessary, engagement support improvement in the data published by investees to ensure that the environmental or social characteristics promoted by the Sub-Fund are met.

Due diligence

Company due diligence is an integrated part of the Sub-fund's investment process, executed by the Research team during their initial assessment of a company and continued throughout the period the investment is held.

Much of the data used in the Investment Manager's company analysis is subjected to external due diligence. For example, company reports and accounts are audited by a third-party before publication and carbon emissions data collected from the CDP allows the Investment Manager to see the proportion of company emissions that have been verified by a third party. The Investment Manager also collects carbon emission reduction plans from the Science Based Targets initiative, which works with companies to ensure that the commitments made are accurate and achievable.

Engagement policies

The Investment Manager's approach to engagement is detailed in the Investment Manager's Responsible Investment Policy. The Investment Manager's approach comes directly from their desire to be a long-term shareholder in the businesses the Sub-fund invests in. When the Investment Manager engages with investee companies, the priority is to support changes and/or investment that promotes their long-term, sustainable growth and equally to oppose activities focused on maximising short-term profits. The decision to engage with a company is made on a case-by-case basis, prompted by a variety of internal and external factors but will always be focused on issues that are material to the business's activities and long-term success.

Designated reference benchmark

The Sub-fund does not use a specific index designated as a reference benchmark for the purpose of attaining its environmental/ social characteristics. It uses the MSCI World Index as a tool for comparison.