

Sustainable Finance Disclosure Regulation

Sustainable Finance Disclosure Regulation

Promotion of environmental and social characteristics

The Fundsmith Sustainable Equity Sub-fund will only invest in high-quality, or 'good' companies. We identify good companies as those that can sustain a high return on the capital they employ across the entire business cycle. This good company screen analyses a variety of financial and non-financial factors that may influence a company's ability to maintain a high return on the capital they invest. As part of this screen, a business's impact on the environment and/or society, corporate strategy, and corporate governance are analysed and assessed. Companies operating in highly damaging sectors and industries would not meet our good company definition as these damaging practices limit their ability to sustain a high return on capital. We also consider the positive impacts a company may have, through innovation and product development, which informs our assessment of a business's net impact.

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 (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.

The Sub-fund also promotes environmental and social characteristics through excluding companies that generate revenue from industries/ sub-industries deemed to have an excessive net negative impact on the environment and/or society from its investable universe (IU). This includes:

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

We also use a sustainability screen which uses the information we have collected regarding companies' sustainability risks, net impact on the world, awareness of these impacts and mitigation measures to make a qualitative judgement on their sustainability. This qualitative judgement assesses whether the net impact on the world is firstly, negative, secondly, excessive, and thirdly, decreasing due to concerted action by the company. We try to assess impact, both positive and negative, in the widest possible sense. Companies we find to have an excessively net negative impact on the world and are failing to reduce it are excluded from the Sub-fund's investable universe.

This screen is informed by a variety of environmental, social and corporate governance data from third-party data providers and company reporting. We also collect qualitative data in an ESG and innovation database. This database stores sustainability information concerning all the companies in the Sub-fund's investable universe and is used to help inform our decision making regarding the impacts a company may have and the risks associated with it.

The companies that we would like to invest in are also reducing any negative E/S impacts they have and generating positive impacts by allocating capital to research and development that drives innovation in the products/ services they offer. Fundsmith measures the impact that this innovation has on E/S characteristics through improvements in the environmental metrics mentioned earlier and through qualitative measures, such as improvements to human health and welfare. Fundsmith balances this positive influence against negative impacts to make an assessment of the net impact the business has.

To measure the attainment of the promoted environmental and social characteristics promoted by this Sub-fund, we monitor a variety of quantitative and qualitative environmental and social indicators and utilise a third-party reputational risk score provided by RepRisk.

'Environmental footprint' refers to a combination of five commonly reported environmental metrics:

- Total waste generated (metric tons/£m of free cash flow [FCF])
- Hazardous waste generated (metric tons/£m of FCF)
- Water usage (m³/£m of FCF)
- Energy usage (MWh/£m FCF)
- Greenhouse gas emissions (metric tons CO₂e/£m FCF)

The Investment Manager expects the portfolio's weighted average scores across all metrics to be lower than that of the MSCI World Index for each reporting period. We also assess the principal adverse impacts (PAIs) of the Sub-fund's investments on sustainability factors to ensure no holding is causing significant harm.

Sustainable investments

The Sub-fund also commits to making a minimum proportion of sustainable investments. Sustainable investments are those which contribute towards an environmental and/or social objective without causing significant harm to any other E/S objective.

The Sub-fund's sustainable investments contribute towards a variety of E/S objectives under the definition given in Article 2(17) of the Regulation (EU) 2019/2088, the Sustainable Finance Disclosure Regulation (SFDR), through the economic 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 (SDGs) as a proxy for those objectives. Assessing companies' alignment with these Goals is done through quantitative and qualitative analysis of the contribution made by individual companies towards the underlying targets of the Goals.

Sustainability Risk Statement

Fundsmith, across all its products identifies and analyses sustainability risk (i.e. an environmental, social, or governance event or condition that, if it occurs, could potentially or actually cause a material negative impact on the value of an investment) as part of its risk management process.

Sustainability risks can represent a risk in their own right, but can also have an impact on other risks, and may contribute significantly to market risks, operational risks, liquidity risks and counterparty risks, among others. Sustainability risks can have an impact on long-term, risk adjusted returns for investors. Assessment of sustainability risks is complex and may be based on environmental, social, or governance data, which is often difficult to obtain, incomplete, estimated, out of date, or otherwise materially inaccurate. Even when identified, there can be no guarantee that this data will be correctly assessed.

The impacts of a sustainability risk occurring are numerous and vary according to a specific risk, region, or asset class. Generally, if a sustainability risk occurs for an asset, there will be a negative impact and, potentially, a loss of its value. This can in turn impact the Net Asset Value of the concerned financial product.

Fundsmith believes that the integration of this risk analysis could help to enhance long-term risk adjusted returns for investors, in accordance with the respective investment objectives and policies of our funds.

Adverse Sustainability Impacts - Entity Level

In compliance with the definition given by the SFDR, Fundsmith does not currently consider the adverse impacts of investment decisions on sustainability factors at the entity level (i.e. environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters).

We do not consider the impacts within the scope of the SFDR's definition due to the poor availability, consistency, comparability and transparency of existing ESG data, and the challenges the onerous reporting required by the Regulation poses to a small firm such as Fundsmith LLP.

However, we will consider the impacts of our investment decisions on sustainability factors, as per the definition given by the SFDR, when we feel the quality of available ESG data has improved significantly and we can produce meaningful results from principal adverse impacts reporting. Until then we will continue to consider the positive and/or negative impacts the companies we invest in may have on the environment and/or society under the criteria most relevant to our activities.