

ESG Investment Policy

October 2017



Improving the future prosperity of Victoria

Contents

1	Document Information	3
1.1	Document Status	3
1.2	Document History	3
2	Introduction	4
3	ESG investment approach	4
3.1	Approach 1: Stewardship	4
3.2	Approach 2: ESG integration	5
3.3	Approach 3: ESG disclosure	7
3.4	Approach 4: Staying informed	7
4	Responsibilities	8
	Appendix 1 – Current exclusions	9

1 Document Information

1.1 Document Status

The current status of this document is shown below.

Original issue date	February 2009
Current approval date	April 2016
Owner	Head of ESG
Date of next review	October 2018
Board review required	No

1.2 Document History

The history of changes made to this document is shown below.

Version	Date	Summary of changes
1.0	February 2009	First issue.
2.0	November 2010	Minor amendments after CIO review.
3.0	February 2012	Annual review. Page 6 changed approval level from Board to ORMC.
3.1	February 2014	Minor amendments following review of all policies
4.0	August 2014	Annual review. Combined sections 4 and 6 and updated section 7 to reflect current practice.
5.0	April 2016	Annual review. Major amendments to reflect current practice and market norms.
6.0	October 2017	Annual review. Amendments to reflect changes in VFMC's ESG approach.

2 Introduction

VFMC is a large Australian-based investor holding investments across different asset classes and geographies. As a public authority, it is VFMC's role to provide investment and funds management services to Victorian public authorities in a commercially effective, efficient and competitive manner.

More broadly, our purpose is to improve the future prosperity of Victoria.

In achieving this purpose, VFMC invests in a diverse range of assets in Australian and international markets, utilising internal and external investment managers. The consideration of material environmental, social and governance (ESG) issues in our investment decision-making processes is a key part of fulfilling our objectives.

VFMC believes that organisations that perform better with regard to managing material ESG issues can improve risk adjusted returns by, for example, properly managing risks, anticipating regulatory action or accessing new markets. Conversely, organisations that do not take material ESG issues into consideration may deliver diminished risk adjusted returns.

VFMC considers ESG risks and opportunities alongside other investment factors in our investment decision-making processes across all asset classes in order to protect and manage investments on behalf of the Victorian Government and clients. Examples¹ of ESG risks include:

- Environmental: stranded assets in a carbon-constrained policy landscape and poor management of potential environmental risks
- Social: labour rights, community relations and workplace health and safety
- Governance: Board composition, executive remuneration and appropriate enterprise risk management.

ESG opportunities may include targeted investment in new products and services that are otherwise attractive on investment grounds and also designed to reduce or mitigate ESG risks and/or improve the ESG risk exposure of affected assets.

VFMC has adopted the following approach to applying ESG in its investment process:

1. Stewardship
2. ESG integration
3. ESG disclosure
4. Staying informed

This ESG Investment Policy covers VFMC's investments across all asset classes, and will be applied in line with VFMC's policies and investment objectives.

3 ESG investment approach

3.1 Approach 1: Stewardship

Objective

VFMC will make full use of the rights of ownership by actively exercising votes at company and fund meetings and by engaging with investee companies, fund managers and policy-makers on material issues, including climate change and other material ESG issues.

¹ This list provides examples only and does not constitute a full list of risks and opportunities that were identified by VFMC as being material to VFMC's investment portfolio.

Activities

i. Engagement

Engaging with investee companies, fund managers and policy-makers is a vital part of maintaining investor oversight and ensuring that investor views are taken into account in the governance of companies and other assets. We believe that by exercising these ownership rights and maintaining our 'seat at the table' we can help to ensure better value for the Victorian Government and our clients. Research has shown that successful company engagements can lead to excess returns².

We will engage with companies, fund managers and policy-makers on a range of material ESG issues.

Direct engagement

Where relevant and appropriate, VFMC will engage directly with:

- companies, with the aim to:
 - better understand the way a company is managing ESG issues
 - encourage companies to improve their performance in an area of material concern
 - encourage the disclosure by companies of material ESG issues and support the use of relevant analytical tools and standards
- external investment managers on:
 - their approach to integrating ESG in investment analysis
 - on how they approach their own engagement activities
 - the manager's overall ESG policies, strategies, competencies and performance

Collaborative engagement

VFMC recognises that engagement efforts may be more effective when combined with the engagement efforts of like-minded investors. This is particularly important when it comes to engaging on public policy issues, and in tackling systemic ESG issues such as climate change.

VFMC aims to participate in relevant collaborative engagement initiatives, directly or through service providers. VFMC will ensure that material ESG issues are targeted. This engagement may include:

- holding constructive dialogue with listed companies
- encouraging the disclosure of material ESG issues, including climate change risk, across different assets classes
- supporting the development of disclosure tools and standards
- participating in the development of public policy on finance sector ESG issues
- being a signatory to relevant ESG-related initiatives and statements

ii. Voting

VFMC will make use of the rights of ownership by actively exercising votes at company and fund meetings and, where appropriate, proposing resolutions at shareholder meetings. This includes voting on fund issues, constitutional changes and other material issues for unlisted funds.

For more information on VFMC's proxy voting, see our [proxy voting policy](#).

3.2 Approach 2: ESG integration

Objective

VFMC will integrate material ESG considerations into our investment decision-making processes.

² Dimson et al (2013), *Active Ownership*, London Business School, Boston College and Temple University.

Activities

i. Integrating ESG into investments

When making investment decisions it is important to focus on risks and opportunities that are material to company and asset value. VFMC will consider material ESG issues across all asset classes in the selection, management and monitoring of internally-managed and externally-managed investments.

VFMC recognises that integrating ESG is an ongoing and iterative process, and we expect to implement the ESG Investment Policy over time.

Whole of portfolio

VFMC will integrate ESG considerations into our investment portfolio by:

- assessing material ESG risks across the portfolio, including climate change risk, to understand any positive and negative impacts and identify opportunities and, where appropriate, manage the identified impacts
- monitoring state, national and international policy developments in the ESG space
- communicating VFMC's ESG Investment Policy and expectations to service providers
- where appropriate, selecting investment service providers that integrate ESG factors into their services
- monitoring the latest industry and academic research and analysis for applicability to VFMC's ongoing integration of ESG

Externally-managed investments

We will integrate ESG considerations into our externally-managed investments by:

- systematically incorporating ESG analysis into the external manager due diligence process
- formally assessing manager ESG policy, strategy, capability and performance in investment proposal documentation
- systematically monitoring the ESG performance of external managers

Internally-managed investments

We will integrate ESG considerations into our internally-managed investments by:

- systematically incorporating ESG analysis into company and corporate credit analysis
- systematically monitoring the ESG performance of companies and assets
- incorporating material ESG issues into engagement and voting activities

Exclusions

VFMC distinguishes our ESG integration approach from an approach that restricts investments according to ethical criteria. VFMC's consideration of ESG and climate change issues is investment-driven and VFMC may invest in any entity where it is lawful to do so.

Although VFMC's investment approach generally avoids exclusion, in certain circumstances after comprehensive assessment of the economic, reputation, legal and fiduciary requirements, client concerns, materiality, and risk and return issues associated with the investment, VFMC may decide to apply an exclusion. The Executive ESG Governance Committee would approve any such exclusion.

See Appendix 1 for current exclusions.

3.3 Approach 3: ESG disclosure

Objective

VFMC will actively encourage the development and use of ESG-related standards, and will disclose our own ESG activities to clients and, where relevant, other stakeholders.

Activities

VFMC believes that encouraging high quality, consistent and comparable disclosure on material ESG issues from companies and other assets is an essential element of an effective active ownership approach. VFMC and our external investment managers rely on publicly-disclosed ESG information as part of the investment analysis process.

Through our direct and collaborative engagement program, VFMC will actively encourage the development and use of ESG-related standards that are, where practicable, comparable within and across industry sectors, geographies and asset classes.

Similarly, VFMC's clients rely on clear, high quality and comparable disclosure on VFMC's approach to, and performance on, material ESG issues across the investment portfolio.

As a centralised investment management organisation, VFMC is mindful of the sensitivity of making client-specific ESG activities public. VFMC is committed to keeping our clients and stakeholders aware of our activities through:

- making our ESG-related policy documents publicly available
- publicly publishing aggregate voting statistics
- participating in the annual PRI reporting and assessment process, and making our results public
- participating and sharing our experiences in various industry ESG forums and working groups
- providing clients with:
 - reports on client-specific voting activity
 - regular ESG updates
 - presentations on ESG matters

3.4 Approach 4: Staying informed

Objective

VFMC will actively seek opportunities to expand our understanding of material ESG issues affecting the portfolio, and stay informed on emerging trends.

Activities

We will stay informed on material and emerging ESG issues by seeking to:

- maintain active membership of relevant ESG-related organisations and initiatives
- monitor various relevant investment, policy and academic journals and publications
- share relevant ESG information within and between sections of our organisation, encouraging peer-to-peer learning
- actively pursue a dialogue with VFMC's external investment managers, consultants, rating agencies and other stakeholders on ESG policy, activities and industry developments
- attend relevant industry events
- maintain and expand local, national and global networks within the ESG investment community
- where required, ensuring that key employees receive ESG training.

4 Responsibilities

This policy is approved by VFMC's Operational Risk Management Committee. Maintaining and periodically reviewing the ESG Investment Policy, and VFMC's compliance with the policy, is the responsibility of the Head of ESG.

Appendix 1 – Current exclusions

VFMC has exclusions in place for tobacco manufacturers and cluster munitions.

Tobacco exclusion

Following Management's recommendation, the VFMC Board approved divestment of tobacco stocks in segregated mandates as a means of reducing the exposure to tobacco manufacturers in VFMC client portfolios. The decision was taken on 1 December 2014 to amend the investment guidelines to exclude tobacco manufacturers as defined by MSCI in its Global Industry Classification Standard (GICS®) framework. This was fully implemented by 31 March 2015.

We retain indirect exposure to tobacco manufacturers via commingled / pooled investment structures and derivative instruments based on indices that include these companies.

Cluster munitions exclusion

VFMC has also divested from cluster munitions as required by our interpretation of the 2012 amendment to the *Criminal Code (Cwth)*, Division 72, Subdivision C.