

Responsible Investment Update  
June – December 2022

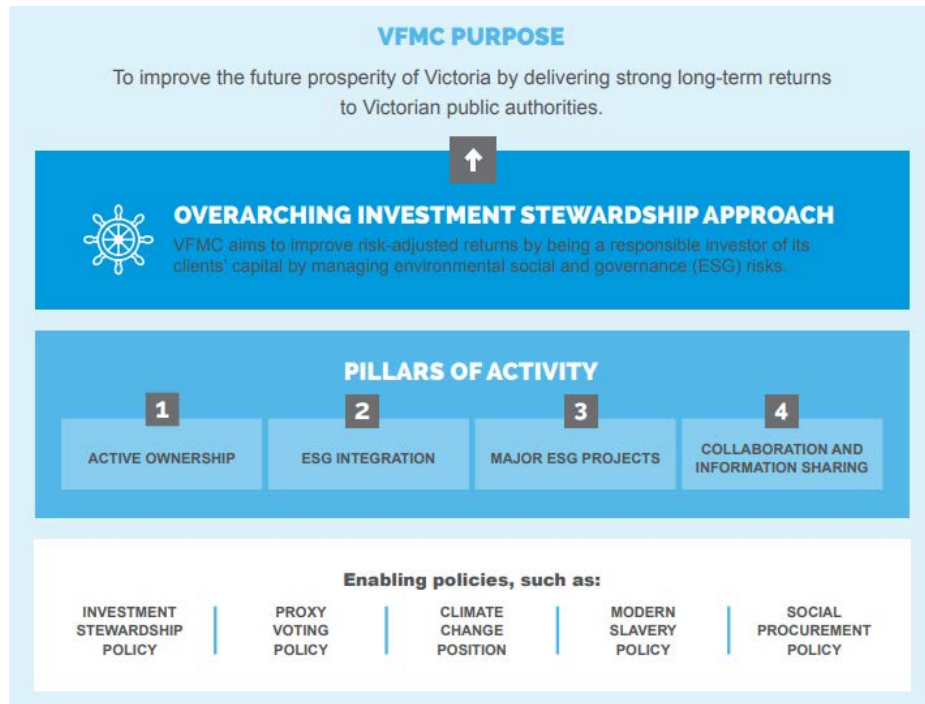


# Contents

VFMC’s Investment Stewardship approach.....	3
1. ESG issues.....	3
2. Summary of Activity.....	4
Spotlight on top three ESG engagement themes .....	7
3. Climate change.....	7
4. Governance and remuneration .....	8
6. Modern slavery, Labour Rights and Responsible Supply Chains .....	9
The Path Ahead - Focus Areas for 2H FY 2023.....	10

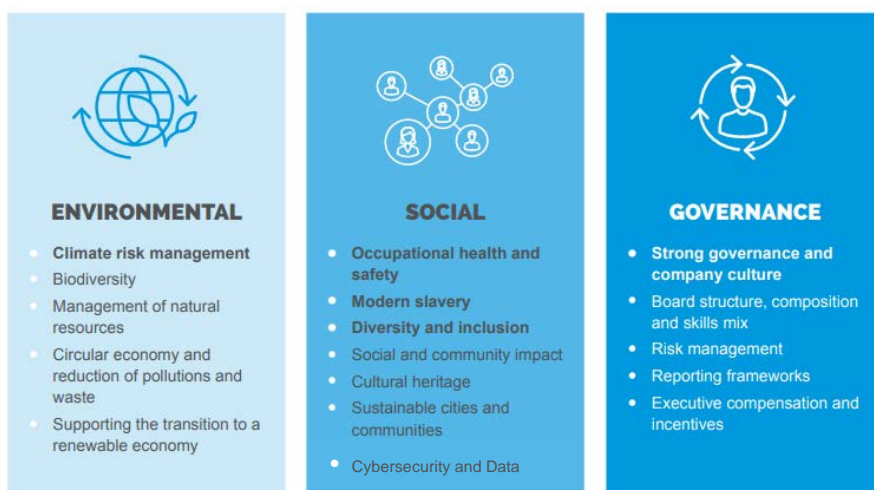
# VFMC's Investment Stewardship approach

VFMC seeks to improve risk-adjusted returns by being an active and responsible steward of its clients' capital and managing environmental, social, and governance (ESG) issues alongside other investment factors. VFMC's approach to investment stewardship supports its purpose to manage the long-term investments of Victorian State Government entities.



## 1. ESG issues

ESG factors are often interconnected in the ways in which they impact the risk, volatility, and long-term returns of investments. While ESG factors are continuously evolving to reflect market and societal norms, VFMC has focussed on the following material ESG themes are set out below.



## 2. Summary of Activity

### Active ownership

VFMC actively monitors and engages with investee companies and external fund managers across all asset classes. This active ownership enables VFMC to influence positive change in ESG practices across our portfolio and in real-world outcomes.

VFMC's active ownership activities focus on:

- Proactively engaging with investee companies on a range of ESG related matters through the year; and
- Exercising its voting rights at listed company AGMs.

#### Proactively engaging with investee companies

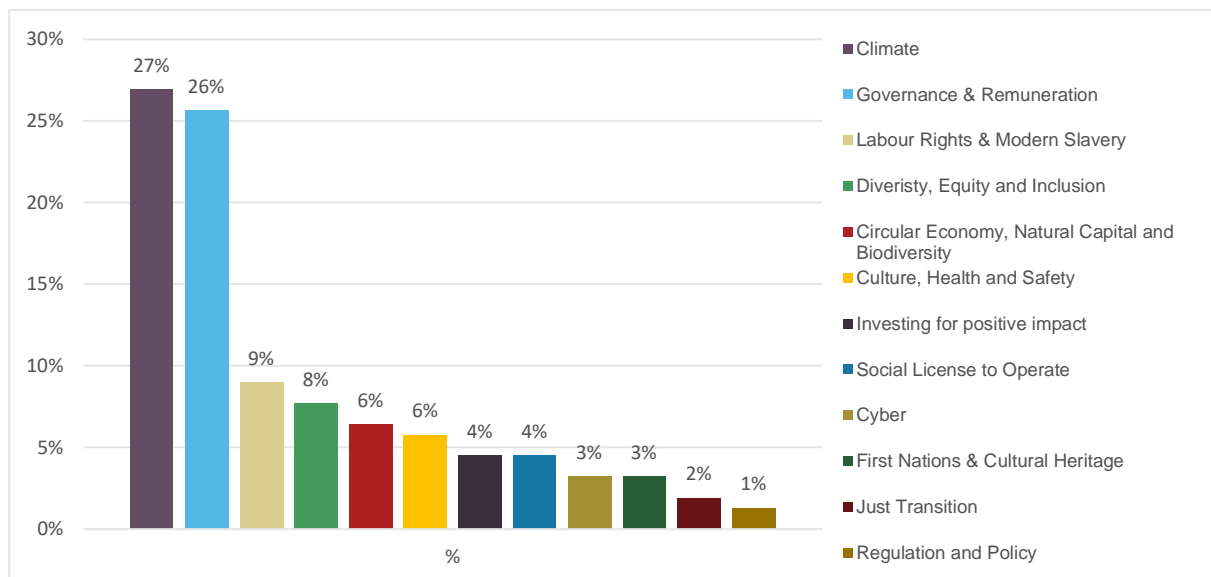
VFMC engages directly with investee companies and indirectly via fund managers on its material ESG issues and emerging ESG issues. It pays close attention to issues and opportunities that can impact the long-term sustainability of its investments.

Similarly, where VFMC looks to appoint an external fund manager, an ESG assessment is undertaken as part of the due diligence process. For example, in December 2022 VFMC conducted an assessment of Australian Small Caps Manager ahead of their appointment. The Manager was found to have a solid and rigorous approach to ESG integration, with the explicit consideration of ESG issues at a sectoral and stock level through their proprietary 12 factor ESG scoring framework.

Over 1HFY23, VFMC undertook 258 discrete ESG-related activities across all asset classes, material themes and pillars of activity. Below sets out the breakdown of activity by theme and activity. The top three engagement topics for the half were climate change, governance and remuneration, and modern slavery.

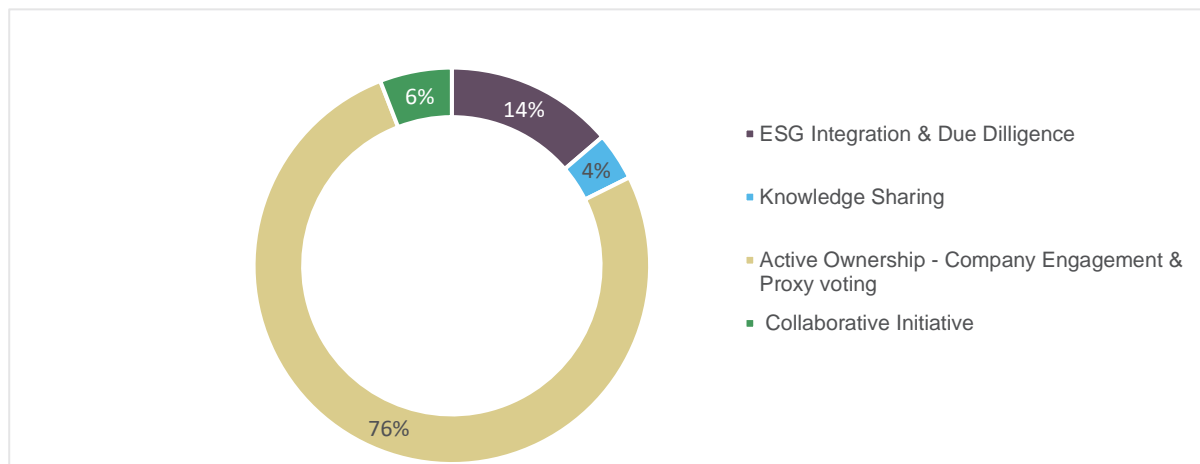
Whilst the focus of the 1HFY23 report is to highlight the key activities, which proxy voting is a large focus of during the period, the 2HFY23 report in June will provide a more detailed overview of our engagement and integration efforts and objectives achieved.

**Figure 1: ESG Thematic Breakdown**



**Figure 2: ESG Activity Breakdown**

Proxy voting, by count, had the greatest discrete allocation of our ESG activity for the 1H FY23 period as a result of the major proxy season coinciding within this period. That said, the initiatives undertaken within ESG integration and collaborative contribute the greatest by time spend and longer-term impact to the VFMC investment portfolio.



### Exercising voting rights at AGMs

As the first half of the financial year is when a large majority of VFMC's investee companies in Australia hold their AGMs, active ownership activities across company engagement and exercising proxy votes made up over 75% of the team's work over 1H FY23.

Voting at company AGMs provides investors like VFMC with a formal means to exercise ownership rights, hold the Board and company management accountable and, where appropriate, indicate dissatisfaction or concern with an issue. Contentious resolutions can be effective in influencing a company to act.

For Australian equities, VFMC votes on all companies held within the S&P/ASX 300 Index and, by exception, votes on companies that are outside of this index but held in an internal equity portfolio. 1H FY23 covers the major proxy season in Australia. For global equities, voting is conducted on its behalf by an external proxy voting service provider, CGI Glass Lewis. Where VFMC has shares of companies outside the MSCI World Index, voting is generally conducted on its behalf by external fund managers, on a case-by-case basis. Voting activity is monitored by VFMC and it maintains the authority to override these arrangements.

Key voting themes over 1H FY23 focussed on:

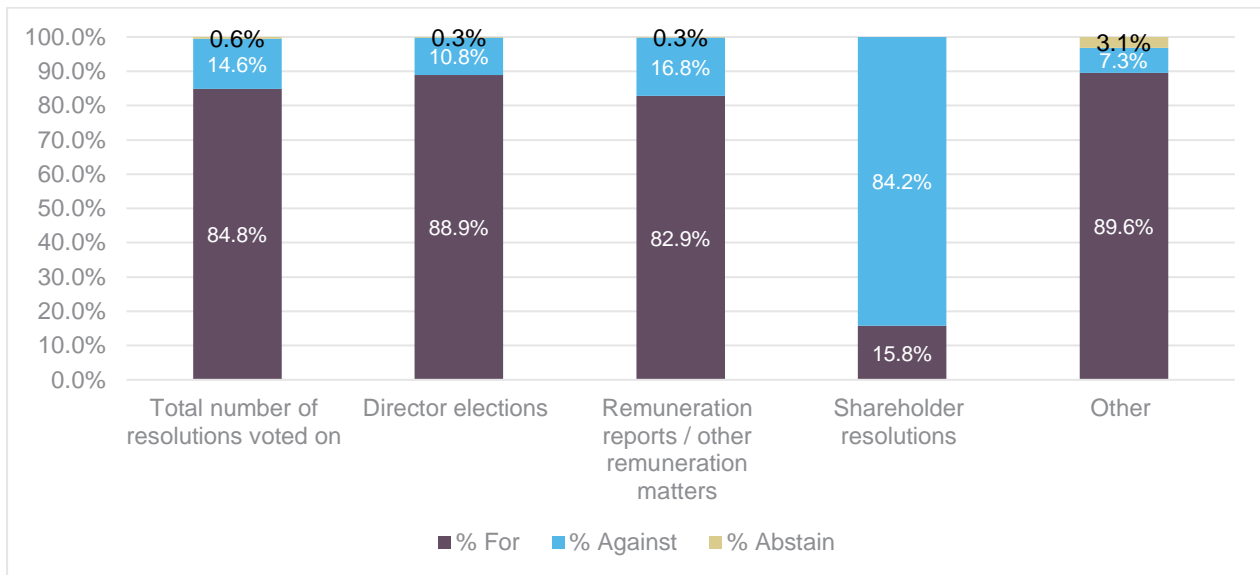
- Shareholder requisitioned resolutions (e.g., regarding climate risk management, and a just transition);
- Executive remuneration;
- Director appointments (skills, capacity, diversity, accountability); and
- Company culture (e.g., workforce wellbeing, diversity, sexual harassment, retaining talent).

In each of these areas VFMC looked at resolutions on a case by case. As an example, VFMC voted against Remuneration Reports that were deemed to be excessive and Director elections/re-elections where a Director's workload was considered to be excessive.

### Australian Proxy Voting Statistics

VFMC voted on a total of 863 Australian resolutions at 162 meetings over the 1H FY23 period. This covered 380 Director elections, 368 remuneration reports and pay-related matters, 19 shareholder resolutions, and 96 general resolutions. A summary of VFMC's voting record is set out below.

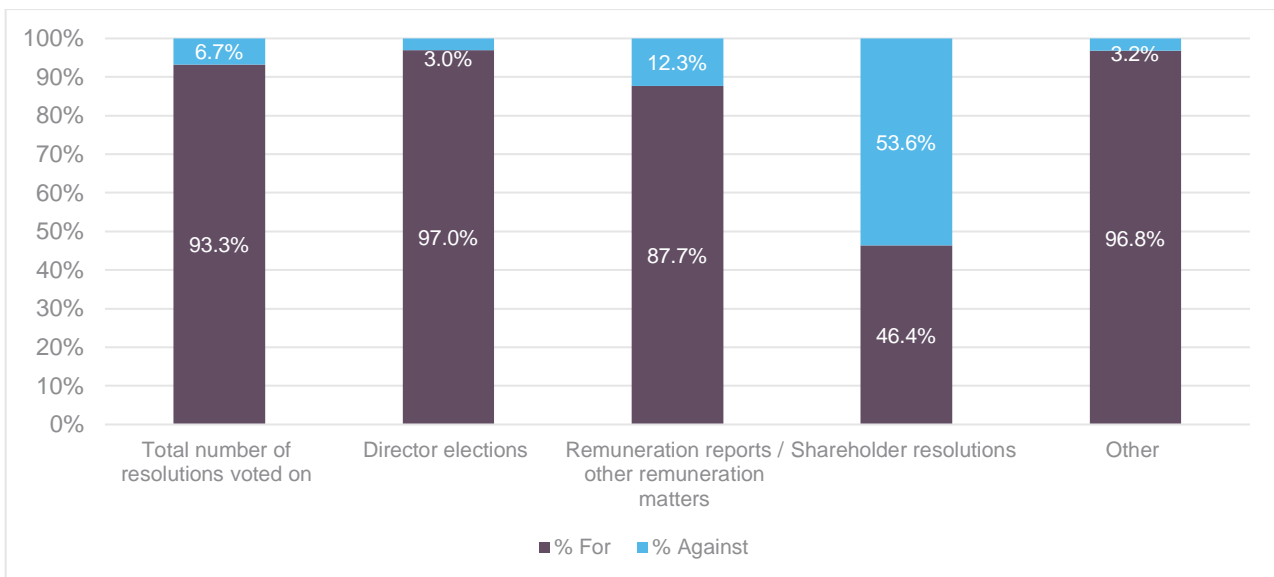
**Figure 3: 1HFY23 Proxy Voting – Australia**



**International Equities Proxy Voting Statistics**

Glass Lewis voted on VFMC’s behalf on 667 international resolutions over 1H FY23. This included 367 Director elections, 114 remuneration reports / pay related matters, 28 shareholder resolutions, and 158 general resolutions. Internationally, shareholder resolutions are much more readily deployed as levers of active ownership, in part due structural barriers for institutional engagement. International shareholder resolutions across 1H FY22 covered a broad range of issues including climate change, diversity, equity and inclusion, biodiversity, and governance. A summary of VFMC’s International voting is set out below.

**Figure 4: 1HFY23 Proxy Voting – Global ex Aus**



# Spotlight on top three ESG engagement themes

## 3. Climate change

Climate change continued to be a key focus area in 1H FY23. In Australia, eight companies included climate plan-related resolutions at their AGMs, all of which passed. Climate Transition Action Plans (CTAPs) are time-bound action plans that clearly outlines how an organization will pivot its existing assets, operations, and entire business model towards a trajectory that aligns with the latest and most ambitious climate science recommendations<sup>1</sup>. It is worth noting that CTAP resolutions are advisory only.

In assessing company CTAPs, VFMC's ask of companies is to adopt the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) risk assessment and reporting framework, align corporate strategy to the Paris Agreement and the objective of net zero emissions by 2050, undertake scenario analysis, set Paris-aligned emissions targets endorsed by external parties such as SBTi, undertake analysis of the physical risks arising for assets within its portfolio, align policy and advocacy activity and plan for just and equitable transition,

In addition to CTAP resolutions, shareholder resolutions were primarily lodged by activist organisations in relation to divestment of fossil fuel assets and the financing of new fossil fuel projects or the expansion of existing ones. After reviewing the resolutions, VFMC deemed engagement a more effective lever of active ownership given the complexity of the issues associated with the wind-down of fossil fuel assets and, accordingly, did not vote in favour of these resolutions.

Where engagement with the boards and management of investee companies on climate relates issues do not generate sufficient progress on issues, VFMC will deploy its active ownership rights to vote for specific resolutions.

VFMC is also a member of Climate Action 100+ (CA100+). CA100+ is an investor-led initiative to ensure that the necessary companies act on climate change. The initiative is made up of around 700 investors, responsible for over \$68 trillion in assets under management, and engages companies on improving climate change governance, cutting emissions, and strengthening climate-related financial disclosures. VFMC engages with investee companies as part of CA100+ and its own right.

### Case study: engaging for a better climate change outcome.

The Paris Agreement clearly outlines, limiting the increase in global temperatures has to be done within the context of "the imperatives of a just transition of the workforce and the creation of decent work and quality jobs."<sup>2</sup> As outlined in the last Responsible Investment Update, VFMC is a member of the ACSI Just Transition Working Group and in December 2022, this group delivered a research paper 'A Just Transition to a clean energy economy: Investor expectations and policy recommendations'.<sup>3</sup>

#### Origin Energy and the Just Transition

In 2022, Origin Energy announced plans for the early closure of Eraring Power Station by August 2025 which VFMC has advocated for. The announced closure also reflects the changing conditions in the National Electricity Market and the challenges posed to the economics of coal-fired power stations "by cleaner and lower cost generation, including solar, wind and batteries". Following retirement, Origin intends to use the site to install a large-scale battery. The site currently employs over 500 workers, including permanent employees and contractors and will impact the local community in Lake Macquarie, New South Wales (NSW) region, including those in nearby mines that supply the plant.

<sup>1</sup> [www.cdp.net](http://www.cdp.net)

<sup>2</sup> [https://unfccc.int/sites/default/files/english\\_paris\\_agreement.pdf](https://unfccc.int/sites/default/files/english_paris_agreement.pdf)

<sup>3</sup> <https://acsi.org.au/research-reports/a-just-transition-to-a-clean-energy-economy/>

As part of the ACSI Working Group, and as a CA100+ member, VFMC participated in a number of company engagements seeking confirmation of Origin's commitment to a Just Transition. In Origin's subsequent 2022 Climate Transition Report, Origin have committed to engage with the workforce and community and outlined a number of equitable transition principles. In addition their disclosures included a commitment to tailored transitional support for employees, continuing with current community commitments, sponsorship and donations out to 2032, and the establishment of a community fund.

#### 4. Governance and remuneration

VFMC carefully considers the election and re-election of directors. The board is the representative of shareholders and is ultimately accountable to shareholders for the company's performance. When considering the election or re-election of directors, VFMC will consider Board and/or company performance, governance practices, board composition (including gender diversity and other forms of diversity) of the board and/or committees, the capacity of individual directors given other commitments, remuneration practices and the ratio of audit to non-audit fees. VFMC is focused on improving board diversity and utilizes its engagement activities to promote the adoption diversity targets and reporting of progress towards a gender balanced board.

The Australian Corporations Act requires a listed company to submit its remuneration report to shareholders every year for a non-binding vote. Any company with an against vote on the remuneration report greater than 25 percent in two consecutive years must submit a conditional resolution to the second AGM authorising a meeting to consider the removal of all incumbent non-executive directors. This 'spill' resolution requires majority support. Among the ASX300 constituents, in 2022, 22 recorded remuneration strikes at AGMs, the lowest annual count in recent years.

VFMC encourages companies to ensure that their remuneration disclosures clearly articulate what is being paid, why and how (including timeframes). In considering a company's remuneration report, VFMC will evaluate the report as a whole. VFMC is cognisant that remuneration plans should reflect what is needed to attract, motivate and retain the right people.

In H1 FY23 VFMC voted against termination payment resolutions in excess of 12 months' salary, where they did not appear to provide any benefit shareholders and provided the board with significant discretion. VFMC also opposed a number of remunerations reports where short term incentive plans had either no performance hurdles, or hurdles that are not considered to be sufficiently challenging.

##### **Case study: the link between remuneration and safety.**

VFMC expects Short Term Incentive (STI) plans to relate to the key drivers of the business and any assessment of outperformance to correlate with increased shareholder returns. VFMC will consider the key performance indicators (KPIs) for the STI VFMC will consider the materiality of the occupational health and safety component of the bonus where there have been poor safety outcomes.

VFMC believes that reductions to annual bonuses / STIs outcomes is appropriate where a fatality has occurred in the workplace. What is opaque amongst investors is what quantum of reduction would be appropriate. In H1 FY23, the impact to STIs varied from no impact to 10% and 25% reductions. Additionally, companies may consider zero fatalities a gateway to an STI payment.

As an example, South 32 reported fatalities and, as a consequence, applied a 20% reduction in STI for the CEO and varying reductions to Key Management Personnel (KMP). In addition, the company has had fatalities in each of the past five years other than for FY2019. VFMC voted against the 2022 remuneration report after taking into consideration all relevant facts and circumstances, including the number of fatalities, the cause of such fatalities, repeat failures in safety and the number of high potential incidents.

VFMC communicated the vote and rationale to the company and will engage further on this topic.



## 5. Modern slavery, Labour Rights and Responsible Supply Chains

Actions to protect, preserve and sustain human capital value are critical to an organisation's ability to maintain sustainable operations and growth, safeguard labour rights, promote safe working environments as well as its social licence to operate.

VFMC submitted its third Modern Slavery Statement in December 2022 which sets out how VFMC identifies, manages, and addresses modern slavery risk. During the year, material progress was made to the approach to modern slavery risk identification and management, extending analysis of inherent country and industry risk factors to include two further steps to VFMC's risk assessment process:

1. systematically monitoring actual instances of modern slavery, labour and working condition controversies; and
2. assessing the quality of investee companies' modern slavery risk management and remediation efforts.

VFMC has also continued to participate in modern slavery and human rights collaboration and knowledge-sharing initiatives, including as an active member of the Investors Against Slavery and Trafficking (IAST) Company Engagement Workstream. This Workstream focuses on direct investor engagement with companies on how they can be more effective in identifying, addressing, and preventing labor exploitation risks within their operations and supply chain.

### Case Study: Engaging to increase transparency in modern slavery.

In 2021-2022, VFMC engaged with two large Australian companies that displayed elevated modern slavery risk factors and actual instances of modern slavery. One of these companies was identified as a high-risk holding in VFMC's modern slavery assessment, primarily due to the nature of the inherent risk, as well as the identified supply chain controversies.

This collaborative activity resulted in significant progress related to the following objectives:

IAST APAC Objective	Status of Progress
Increase supply chain mapping transparency	<ul style="list-style-type: none"> <li>• Company has now identified and discloses locations of its farmers in Australia and overseas.</li> <li>• Transparency on Tier 1 supply chain has improved, with partner growers specified.</li> </ul>
Develop targets and KPIs	<ul style="list-style-type: none"> <li>• Specific action plan and KPIs have been set for financial year ahead.</li> </ul>
Demonstrate actions taken and provide case studies	<ul style="list-style-type: none"> <li>• Company disclosed key initiatives in accordance with its three-year action plan.</li> <li>• Case studies demonstrate efficacy of approach.</li> <li>• Membership of industry and collaborative groups is disclosed.</li> </ul>

The Australian Government is currently reviewing the Act's effectiveness, and has committed to introduce penalties for non-compliance, which aim to hold eligible companies to account. The Review is due to deliver its final report detailing its findings and recommendation in March 2023. In line with this expected change, VFMC is planning to continually improve its approach modern slavery risk, with several actions planned for FY23, including:

- review and refresh Modern Slavery Policy in line with evolving best practice expectations and updated Modern Slavery Act;
- increase visibility of the portfolio's supply chain; and
- the systematic integration of Modern Slavery Clauses in all Investment Management Agreements (IMAs) and high-risk supply contracts.

## The Path Ahead - Focus Areas for 2H FY 2023

Looking ahead, VFMC has prioritised the following activities as key deliverables for the six months to June 2023 and will be reported on in detail, in the 2H FY2023 report.

- Progress VFMC's Climate Action Plan by:
  - completing 2022 Taskforce for Climate Related Financial Disclosure (TCFD) and assessing and reporting the climate-related risks and opportunities across the investment portfolio;
  - completing carbon foot printing of VFMC's internal bond portfolios; and
  - undertaking a gap analysis across the infrastructure and property portfolios.
- VFMC will continue to participate in several collaborative investor engagements, including:
  - Climate Action 100+, an investor-led initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change. VFMC is a joint lead investor, with a focus on Rio Tinto.
  - In 1H FY 2023 VFMC joined PRI Advance, a stewardship initiative where institutional investors work together to act on human rights and social issues. VFMC is a collaborative investor focusing on BHP. Work in this area will commence in 1H FY 2023.
- The AGM voting season has been completed, within the parameters set out in the 'Proxy Voting Policy and Application' guidelines. This itself will be reviewed and updated in 2H FY 2023.
- VFMC will also focus on several internal ESG projects:
  - Progress work with the Absolute Returns team to establish an ESG Manager Assessment Framework and develop ESG data capabilities in partnership with Institutional Limited Partner Association (ILPA) and Data Convergence Project.
  - Development of a methodology and supporting model to assess ESG risk in emerging markets.
  - Undertake ESG stock assessments on material holdings in VFMC's internally managed Australia equities portfolio.