

# Investment Stewardship Policy

March 2023



Improving the future prosperity of Victoria

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# 1 Introduction

## 1.1 Purpose

Victorian Funds Management Corporation (VFMC) manages funds for the State of Victoria and related Victorian public authorities. VFMC provides these services in line with its obligations under the *Victorian Funds Management Corporation Act 1994* (VFMC Act) and the Centralised Investment Model (CIM).

In delivering investment returns consistent with the long-term objectives and risk appetite of the State and clients, VFMC’s investment activities include being a responsible investment steward. This means that we seek to holistically look after our clients’ assets over the long-term, in a responsible manner.

The purpose of this policy is to set out, at a high level, VFMC’s approach to investment stewardship.

It is VFMC’s belief that investment stewardship activities:

1. Are consistent with client and wider community expectations of a leading asset manager
2. Optimise our ability to deliver sustainable long-term returns for our clients
3. Assist in managing investment risk and identifying opportunities

VFMC’s approach to investment stewardship focuses on improving risk and returns by managing environmental, social and governance (ESG) risks alongside other investment factors. We believe integrating ESG factors into our decision-making process is essential to our role as responsible stewards of capital, and clients’ long-term returns. VFMC does this though on four key areas of work:

- a. Active ownership
- b. ESG integration
- c. Undertaking major ESG projects
- d. Collaboration

The field of investment stewardship is broad and encompasses diverse areas of consideration. As such, it is intended that this policy has broad application. Notwithstanding, VFMC has a longstanding and ongoing focus on several priority themes. As an investor, VFMC prioritises ESG themes based on investment materiality and fulfilling VFMC’s fiduciary obligations as a responsible investor whilst supporting social change towards an inclusive, fair and ‘just’ economy (whereby due consideration is given to support impacted workers, communities and stakeholders).

Priority theme	Overview
<b>Strong Governance and Company Culture</b>	Promote good corporate governance and business practice to support long-term shareholder value and alignment with VFMC’s role as an investee stakeholder
<b>Climate Risk Management</b>	Seek to manage the portfolio risks associated with climate change but also actively support and benefit from the transition to a low carbon economy.
<b>Work and Labour standards, including modern slavery and human rights</b>	Understand how VFMC's portfolio companies' value chains impact on human and labor rights, and prevent, mitigate and account for negative impacts / externalities
<b>Occupational health and safety</b>	Promote physically and psychologically safe working environments to support engaged workforces and sustainable operations in investee companies

<b>Diversity and Inclusion</b>	Progress diversity, equity and inclusion within investee companies to positively affect decision-making, levels of employee engagement, reputation amongst stakeholders, innovation and improved financial performance.
<b>Cultural Heritage</b>	Promote the merits of effective recognition, protection, and conservation of First Nations cultural heritage to ensure corporations retain their social license to operate and mitigate risks from business disruption.
<b>Cyber Security and Data Governance</b>	Promote enterprise-wide cyber resilience, user privacy and responsible data/platform management in line with social expectations.

## 1.2 Objectives

The objective of this policy is to articulate VFMC’s high-level approach to investment stewardship and ensure that VFMC maintains a contemporary approach.

## 1.3 Scope

This policy covers VFMC’s investments across all asset classes (both internally and externally managed) and all jurisdictions.

## 1.4 Framework

The Policy was developed with reference to peer and industry practice regarding investment stewardship.

## 2 Policy principles – investment stewardship

VFMC's approach to investment stewardship, irrespective of topic or theme, centers around the following key areas of work:

- a. Active ownership
- b. ESG integration
- c. Major ESG projects
- d. Industry collaboration.

Our general approach to each of these is described in more detail below.

### 2.1 Active ownership

As a large investor and steward of our clients' capital, we are bestowed with ownership rights that we seek to use in a responsible manner. Accordingly, as part of our approach to investment stewardship we seek to be an active owner. We do this by:

- Proactively engaging with investee companies and external fund managers on a range of ESG related matters
- Exercising our proxy votes at listed company and unlisted fund meetings

Actively engaging and voting ensures that we maintain a strong focus on the corporate governance and broader ESG practices in place at the companies in which we invest our clients' money. It also provides us with the ability to influence and drive positive change in the practices of investee companies.

#### Engagement

VFMC runs a multi-year engagement program whereby we engage directly and indirectly with investee companies regarding a broad range of ESG related matters and monitor and track progress against these over time. The focus of our ESG related engagement includes influencing positive change and continuous improvement in corporate practices and elevating and encouraging proactive management of ESG risks as they relate to VFMC as a shareholder.

In addition to directly engaging with investee companies, VFMC is a member of the Australian Council of Superannuation Investors (ACSI). ACSI engages with listed companies in a collective manner on behalf of its members regarding ESG related matters.

VFMC's external fund managers also engage with investee companies and we periodically discuss corporate engagement activities with our fund managers. This provides us with a means by which to share knowledge and enhance our understanding of the issues at hand. It also allows us to test the active ownership capabilities of our external fund managers.

## Voting

VFMC actively exercises its voting rights at listed company and unlisted fund meetings. In doing so, VFMC adopts a rigorous approach to evaluating the resolutions before it and does not automatically follow proxy voting advice. In determining how to vote VFMC considers:

- Principles of good corporate governance
- Proxy voting research
- External manager analysis
- VFMC's equity analysts' views
- Engagement with the company
- Commercial considerations

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

## Escalation

VFMC implements a time bound and evidence-based program to track progress in response to our engagement efforts across all sectors, with an escalation strategy in place for situations where engagement has not achieved our intended outcomes. Escalation actions include broader advocacy, exercising proxy votes to signal dissatisfaction on resolutions, supporting shareholder resolutions and voting against company directors. In certain and limited circumstances, VFMC may consider exclusion as final recourse, as detailed in our approach to exclusions.

## 2.2 ESG integration

Central to being a responsible investor and active steward of capital, is seeking to ensure that ESG factors are systematically integrated into the investment management process, in a pragmatic manner. Considering ESG issues as part of the investment management process provides investors with another lens through which to view, assess and understand investee companies and investment managers. At VFMC, when integrating ESG into the investment management and decision making processes (both internally and externally managed), we:

- Seek to comprehensively assess (and manage) material ESG risks across and within the portfolio through the incorporation of ESG into investment processes.
- Include ESG as part of the pre-investment due diligence process
- Seek to monitor:
  - How external managers are considering ESG
  - The ESG performance of companies and assets

As part of integrating ESG into VFMC's 'whole of portfolio' approach to investing, we also monitor:

- ESG based macro-economic thematics impacting markets (i.e.. Inequality, food security, climate change etc)
- State, national and international regulatory and policy developments in the ESG field
- The latest industry and academic research and analysis regarding investment stewardship and ESG integration
- New and emerging ESG related investment products and approaches

## Exclusions

VFMC primarily seeks to manage ESG risks through its active ownership investment approach and generally avoids exclusion. Any decision to divest is not taken lightly and exclusions are only considered (and put in place) where it is believed that there is no other option by which to manage or ameliorate the risks. In this regard, it is noted that VFMC excludes thermal coal mining, tobacco and cluster munitions. VFMC has a formal process in place to guide its decision-making regarding exclusions. See Appendix 1 for current exclusions.

## ESG Working Group

VFMC has established a multi-disciplinary ESG Working Group to further integrate ESG within our investment activities. The working group includes representatives from all investment classes and brings together experience across internal and external investment management functions. Group members share, discuss, and evaluate market insights to gain a holistic view of ESG risk and opportunities across VFMC, to enhance ESG investment decision making, risk and returns.

## 2.3 Major ESG Projects

To ensure a robust approach to investment stewardship that continues to evolve and develop, VFMC implements its work streams across a range of important ESG projects to support its investment stewardship activities. These projects are organised across ESG themes and Asset Class initiatives with the objective of ensuring that VFMC:

- Continues to develop its understanding of key issues and risks
- Proactively manages ESG risk
- Complies with relevant regulatory requirements.
- Conducts its activities in accordance with industry guidance and best practice standards.
- Develops analytical data to support ongoing evolution of ESG measurement

Examples of these projects include our Taskforce for Climate Related Disclosure (TCFD) and Modern Slavery Statement.

## 2.4 Industry Collaboration

A key part of being a responsible investment steward is collaborating with other investors to influence change across the market, at a systemic level. This is because the collective influence of investors is often greater than what can be achieved by any individual investor. It is also an efficient way in which to work, particularly given that investment stewardship and ESG activities are expansive in nature, encompassing all asset classes, many geographies, and a diverse range of issues.

In collaborating and working with others, we are conscious of the fact that in the field of ESG there are many collaborations and that VFMC cannot feasibly participate in them all. In deciding whether to participate, we consider a range of factors, including:

- Whether the collaborative initiative is directionally aligned with VFMC's approach to investment stewardship
- Client expectations and priorities
- Consideration of Victorian Government policy over the longer term
- The ability of the initiative to drive meaningful practical change

Related to our collaborative activities, we also seek to share information with our clients, peers, and key industry groups. The sharing of collective knowledge strengthens the industry as a whole and ensures that we garner learnings from others.



## 3 Document Information

### 3.1 Document Status

Original issue date	February 2009
Current approval date	March 2023
Document category	Board level policy
Annual attestation required	No
Policy induction session required	No

### 3.2 Document Review and Approval

Policy role	VFMC role	Minimum review frequency	Last review date	Next review date
Owner	Head of Investment Stewardship	Annually	February 2023	February 2024
Approver 1 (ELT member)	CIO	Annually	March 2023	March 2024
Approver 2 (Management committee)	ORMC / EIC	Every two years	March 2023	March 2025
Approver 3 (Board committee)	ARCC	Every two years	June 2023	June 2025
Approver 4 (Board)	Board	Every two years	June 2023	June 2025

### 3.3 Document History

Version	Date	Summary of changes
1	2009	First issue – ESG Investment Policy.
2 - 8	2010 - 2019	Annual review, minor amendments, including change from Board approval to ORMC approval in February 2012.
9	2021	The policy has been re-written and updated to reflect VFMC's broader approach to investment stewardship. Renamed to Investment Stewardship Policy.
10	2022	Annual review, minor amendments including consistent terminology for exclusions and inclusion of impact investments.
11	2023	The policy has been re-written and updated to reflect VFMC's evolving approach to investment stewardship following a strategic review in 2022.

## Appendix 1 – Current exclusions

VFMC has the following exclusions in place.

<b>Exclusion</b>	<b>Definition</b>	<b>Methodology</b>
Tobacco	VFMC excludes investments in companies involved in the manufacturing of tobacco products as defined by MSCI in its Global Industry Classification Standard (GICS®) framework.	Securities of companies engaging in manufacturing tobacco products will be identified for exclusion using the “tobacco” GICS industry classification: 302030
Cluster munitions	VFMC excludes investments in companies associated with the production of cluster munitions as required by our interpretation of the 2012 amendment to the Criminal Code (Cth), Division 72, Subdivision C.	Exclusion is based on MSCI assessment and where there is strong evidence that a company manufactures: <ul style="list-style-type: none"> <li>a) components that were developed or are significantly modified for exclusive use in cluster munitions</li> <li>b) cluster munition whole weapons systems</li> </ul>
Thermal Coal	VFMC excludes investments in companies primarily involved in the production and mining of thermal coal as defined by MSCI in its Global Industry Classification Standard (GICS®) framework	Companies will be identified for exclusion using the “coal and consumable fuels” GICS sub-industry classification: 10102050 . Within this GICS classification, VFMC will use a revenue assessment to exclude companies primarily involved in the production and mining of thermal coal, related products and other consumable fuels related to the generation of energy.