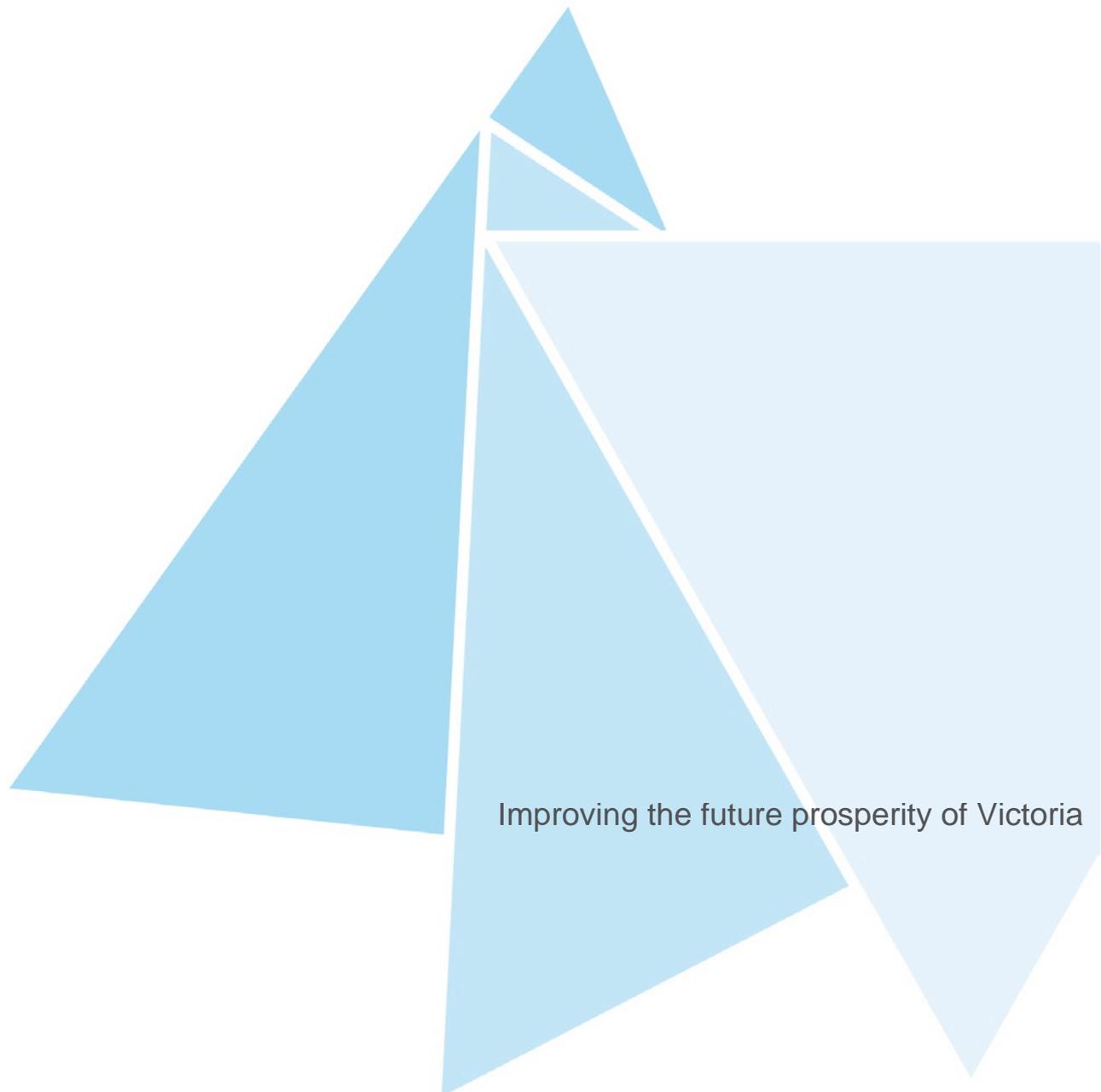


Responsible Investment Update

July – December 2021 (1H FY 2022)



Improving the future prosperity of Victoria

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2 Responsible Investment Snapshot – 1H FY2022

This Responsible Investment Update provides an overview of how VFMC has approached investment stewardship and managed environmental, social and governance (ESG) issues for the six months ending 31 December 2021 (1H FY 2022).

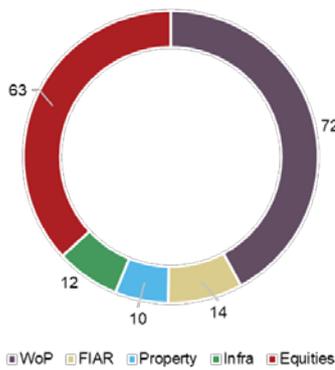
171

In 1H FY22, the Investment Stewardship team has undertaken **171 discrete ESG engagements** across all asset classes

13

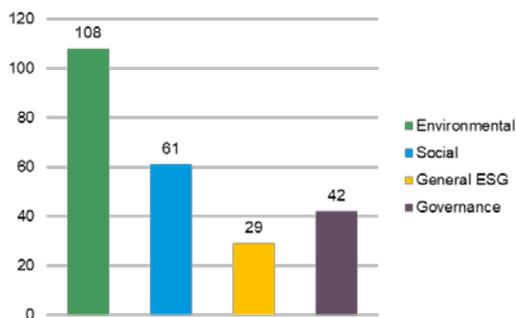
In 1H FY22, the Investment Stewardship team undertook ESG related due diligence on all 13 Investment Power Delegations (IPDs) brought to the Total Risk Allocation Committee (TRAC).

Figure 1: # of FY22 ESG Engagements by Asset Class



The Investment Stewardship team works alongside the asset class teams in an integrated manner, considering ESG issues in selecting, managing, and monitoring our investments. Equities had the highest number of dedicated ESG engagements, primarily due to the number of holdings in the asset class and our ability to access the underlying companies for engagement.

Figure 2: # of Engagements that Discussed E, S and G themes



Category	Count of Engagements that Include these Topics
Climate	56
Biodiversity	7
Energy efficiency	8
Transition to Net Zero	29
Waste	8
Social Licence to Operate	10
Modern Slavery	15
OH&S	5
Diversity and Inclusion	5
Gender Diversity	5
First Nations	10
Social impact	11
ESG Thematic investing	14
Investing for impact	15
Regulatory risk	7
Remuneration	16
Governance	16
ESG Approach / Processes	3

3 Approach to Investment Stewardship

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

Our purpose

Improving the future prosperity of Victoria

Overarching Investment Stewardship Approach

*We aim to improve risk-adjusted returns by being a responsible steward of our clients' capital and managing **material ESG issues** alongside other investment factors.*

Pillars of Activity

1. Active Ownership

2. ESG Integration

3. Major ESG projects

4. Collaboration and information sharing

Enabling Policies

Investment Stewardship Policy

Proxy Voting Policy

Climate Change Position Statement

Modern Slavery Policy

Exclusions Policy

VFMC applies 'decision useful' priority ESG themes to investment portfolios and major pillars of activity. These themes are outlined in Figure 1 below, with priority themes bolded.

Figure 1: Examples of ESG Themes



UN Sustainable Development Goals

The UN Sustainable Development Goals (UNSDGs) provide an important framework for global action to end poverty and protect the environment across multi-lateral agencies, government, civil society, investors, and business. VFMC considers the relevant UNSDGs as one of a number inputs into what we do (our products and services) and how we do it (our culture and operations). Table 1 aligns our ESG priority themes to related UNSDGs.

Table 1: Current ESG Priority Themes Mapped to UNSDGs

Priority ESG themes	Related SDGs
Strong Governance and Company Culture	SDG 16 - <i>Peace, justice, and strong institutions</i>
Climate Risk Management	SDG 7 – <i>Affordable and clean energy</i> SDG 11 – <i>Sustainable cities and communities</i> SDG 12 – <i>Responsible consumption and production</i> SDG 13 – <i>Climate action</i> SDG 14 – <i>Life below the water</i> SDG 15 – <i>Life on land</i>
Work and Labour standards, including modern slavery and human rights	SDG 8 – <i>Decent work and economic growth</i> SDG 10 – <i>Reduce inequality</i>
Occupational health and safety	SDG 3 – <i>Good health and wellbeing</i>
Diversity and Inclusion	SDG 5 – <i>Gender equity</i>

Industry Collaborations

To maintain our robust approach to ESG risk, VFMC regularly collaborates and shares knowledge with peer investors and other industry participants. We also work with investment managers, investee companies and other institutional investors through investor-led initiatives to integrate, capture and monitor the positive social, environmental and governance impacts of investments.



4 Spotlight on Priority ESG Themes

Strong Governance and Company Culture

As a responsible owner, VFMC considers governance issues like transparency, board structure, director remuneration, company culture and conduct when making investment decisions.

We have recently formalised our activities related to corporate culture through the development of a new consideration framework. This framework helps us better understand and monitor investee companies' culture through activities including:

- Evaluating company policies and procedure e.g., Diversity & Inclusion Policies, Remuneration, Workplace Health and Safety, Code of Conduct and Whistleblower Policies;
- Monitoring human-capital related controversies e.g., incidents of sexual harassment, bullying, industrial relations disputes and underpayments, through direct engagement and market tools (Weekly Controversy Alert);
- Engaging with key stakeholders to discuss relevant themes such as staff wellbeing, remuneration structures, short and long term incentives linked to people metrics; and
- Assessing company disclosure on human capital metrics (disaggregated where possible).

Case study: Preventing and addressing sexual harassment



ACSI (of which VFMC is a member) recently commissioned the Australian Human Rights Commission to undertake research into sexual harassment at ASX200 companies. The research outlined the state of sexual harassment reporting in Australia's largest companies and provided recommendations to support the prevention and appropriate management of sexual harassment in the workplace - including a specific recommendation for institutional investors to '*Seek information on investee entities systems and processes to prevent and address sexual harassment*'.

The research shows publicly-disclosed information about sexual harassment can be deceptive and active engagement is needed to ensure a comprehensive understanding of the prevention and management systems in place. For example, higher instances of reporting, disclosure and remediation of sexual harassment may indicate the maturity of the governance frameworks supporting good corporate culture.

As part of our ESG processes, VFMC assesses both publicly available information and information sought directly from investee companies on their approach to addressing sexual harassment.

Proxy Voting

Voting at company Annual General Meetings (AGMs) provides investors like VFMC with a formal means to exercise ownership rights, hold company management accountable and potentially send a signal on any issues at hand. Contentious issues can arise for resolutions being voted on, and companies can be encouraged to respond if/where strong investor support is not received. Key areas of contention over 1H FY 2022 focussed on:

- Shareholder requisitioned resolutions (e.g., regarding climate risk management and human rights);
- Executive remuneration;
- Director appointments (skills, capacity, diversity, accountability); and

- Managing human capital (e.g., workforce wellbeing, retaining talent, remuneration).

VFMC's proxy voting statistics for the 2021 AGM season are available at vfmc.vic.gov.au

Climate Risk

As the impacts of climate change continue to amplify, investors globally are viewing their portfolios through a climate risk lens, and considering how best to position portfolios to:

1. Manage the impact of climate risk and economic decarbonisation on portfolios; and
2. Safeguard their capital from increased risk of exposure to stranded assets.

In light of this, it is important that VFMC seeks to protect its portfolio from the potential investment implications of a decarbonising economy, including:

- Impairment charges due to assets exposed to transition risks;
- Increased financing costs for capital raising due to increased climate-related credit risks;
- Damage and business interruption due to extreme weather events;
- Increased risk and reduced return forecast assumptions for asset classes; and
- Impact to investee profit and loss from increased costs due to carbon prices.

Given climate risk is multi-dimensional and extends across multiple time periods, VFMC adopts a management approach that utilises levers at a company, whole-of-portfolio and systemic market-wide level. We assess top-down portfolio implications, as well as undertaking climate risk and opportunity assessment from a bottom-up perspective through the pre-investment due diligence and approval process.

In late 2020, VFMC partnered with an analytics and insights provider) to conduct a portfolio-wide climate risk assessment to support VFMC's second internal Task Force on Climate Related Financial Disclosures (TCFD) report to assess the investment portfolios exposure to physical and transition related climate risks. The learnings in the analysis, targeted company engagement in addition to our move towards a portfolio exclusion of thermal coal miners and coal powered generation will assist VFMC in mitigating growing climate-based market risks.

Supporting the transition to Net Zero

VFMC is committed to supporting economy-wide decarbonisation and the reduction of real-world greenhouse gas emissions. We have pledged to achieve net zero emissions by 2050 and are currently developing and implementing a 'roadmap to net zero' in line with the [COP-26 Just Transition Declaration](#).

In addition to monitoring climate risk, VFMC also supports climate-positive investments which provide strong financial returns and also help drive the economy's transition towards net-zero emissions. This applies across all asset classes, from renewable infrastructure to sustainability-linked loans.

We are also continuing to pursue investment opportunities that benefit from climate-related structural trends driving the reduction of greenhouse gas emissions. This includes clean power, resource efficiency, sustainable nutrition, biodiversity, clean transport and the rise of the circular economy.

Case study: Investing to support waste minimisation



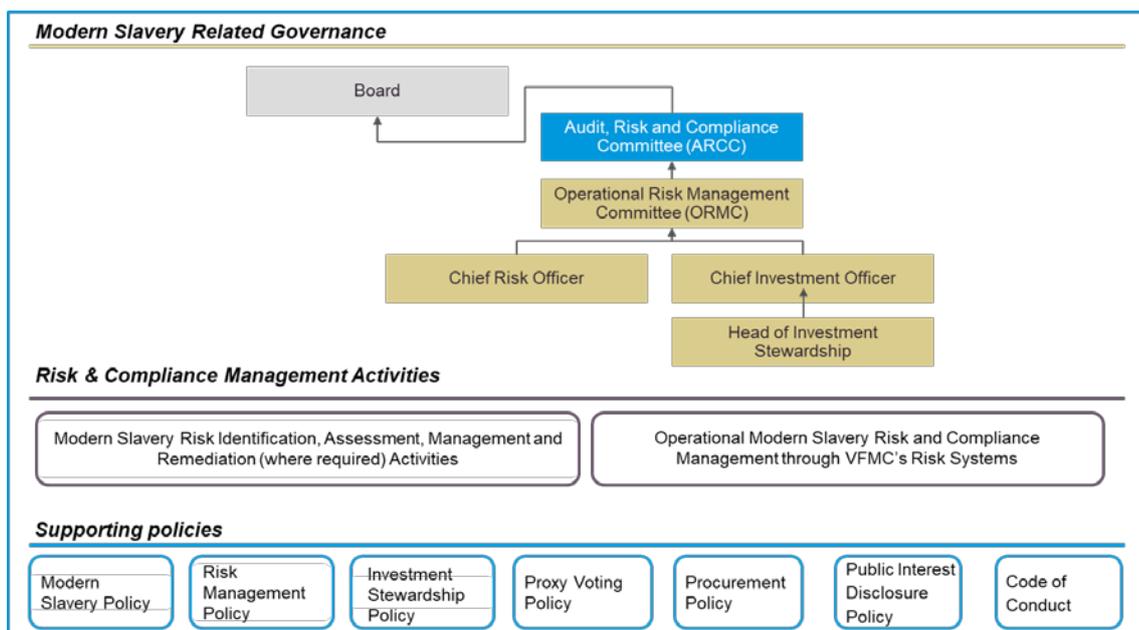
Waste minimisation and the circular economy is an emerging sustainable investment trend that is vital to achieving a net zero economy. Shifting to renewable energy sources will only address just over half the global greenhouse emissions cuts required to achieve the Paris Agreement’s goal of limiting global warming to 1.5 degrees; the remaining half will be achieved by eliminating waste and pollution, and shifting to reused, repaired or remanufactured products and materials.

VFMC’s ongoing engagement is designed to help focus the investment market on the circular economy outcomes and ESG-related tailwinds inherent in the business.

Modern Slavery

VFMC recently completed its second submission of the Modern Slavery Statement. As part of this process, we have improved our governance frameworks that support the identification and reporting of Modern Slavery risk and developed a proprietary risk assessment model for our operations and supply chains.

Figure 2: VFMC Modern Slavery Governance Structure



We also undertook comprehensive Modern Slavery risk management and compliance activities with our people, partners and internal and external investment managers, such as:

- Including modern slavery considerations in procurement and legal due diligence processes;
- Including modern slavery considerations in pre-investment due diligence processes;
- Engaging with investee companies to drive the identification and remediation of modern slavery;
- Participating in modern slavery and human rights collaborative initiatives, such as the Investors Against Slavery and Trafficking (IAST) initiative;
- Voting in support of human-rights related shareholder resolutions, where appropriate and relevant; and
- Contributing to industry knowledge sharing through a UNPRI Infrastructure Advisory Committee case study highlighting our [modern slavery risk assessment approach for our external managers](#).

Occupational Health & Safety

VFMC seeks to promote good governance and business practices that uphold workers' rights and provide safe working environments. Given the ongoing Occupational Health & Safety (OH&S) challenges faced by organisations due to COVID-19, much of our recent engagement focussed on how companies were supporting the physical health and safety and mental wellbeing of their people.

Examples of OH&S engagement include:

- VFMC recommended the inclusion of health and safety metrics such as Lost time injury frequency rate (LTIFR) or fatalities as gateway metrics within the incentive plans of a listed company. This is now being considered in the development of the FY2022 Remuneration Frameworks.
- In partnership with its International Equities manager and UNPRI, VFMC co-signed a letter requesting a European Airline to publicly and formally recognise employees' rights to form and join unions and commit to non-discrimination based on union membership. This follows recent whistleblower concerns around pilot fatigue and flight safety, which have highlighted the benefit of unions in supporting workplace dialogues, fair working conditions and safe and productive workplaces.

Diversity and Inclusion

VFMC actively supports the business case for diversity in the workplace at an organisational level. We have been proactive in addressing gender balance within VFMC through our Gender Equality Action Plan, our investment approach and our participation in 40:40 vision, an investor-led initiative that aims to see women fill 40% of executive roles in ASX200 listed companies by 2030.

We advocate for structural change by encouraging ASX200 companies to set medium and long-term targets for their executive leadership teams; make their plan public to employees, shareholders, investors and the business community; report annually on how they are tracking against targets; and pledge to achieve gender balance by 2030.

Some specific examples of VFMC's engagement and active ownership activities to promote diversity include:



Governance

Consider diversity in board appointments and voted against all-male boards.



Investments

Engaged Social Housing Bond provider to understand frameworks for measurement of positive social outcomes for women.



Collaboration

Active member of Vision 40:40 and undertook engagement with companies to achieve 40% female representation on boards and executive ranks.



Engagement

Met with company boards, fund managers and researchers to discuss their Diversity and Inclusion programs and policies.

Cultural Heritage

VFMC is committed to upholding the rights and safeguarding cultural heritage assets of First Nations peoples through principled and constructive engagement. During H1 FY22, we sought to broaden our engagement with companies, particularly in the mining, oil and gas sector, on their frameworks for consultation and constructive engagement with First Nations peoples. Activities included:

- Participation in the ACSI working group and review of ACSI's Policy on Company Engagement with First Nations People

- Collaboration with industry peers in reviewing an ASX 200 miners' relationship with First Nations communities
- Seeking insights from First Nations leaders, policy and legal experts on the newly legislated Western Australia Cultural Heritage Bill.

5 Driving ESG Integration

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 and ESG risk-adjusted returns.

Key activities of the ESG Working Group



Continuous ESG Improvement

Keeping pace with ESG change requires an ongoing commitment to evolving ESG tools and processes, training, collaboration and knowledge-sharing. Recent highlights include:

- The development of a Sustainable Bond Assessment Framework utilising International Capital Market Association (ICMA) principles, to ensure consistent and robust evaluation of new sustainable bond issuances.
- Investment in a sustainable Asian leaders equities fund due to its strong investment credentials, integrated ESG scoring framework and approach to climate risk mitigation, including a negative screen for the mining of thermal coal.
- Continued membership of the Global Real Estate Sustainability Benchmark (GRESB), to support ESG performance monitoring and drive continuous improvement in our Property and Infrastructure portfolios. In 2021, VFMC's property portfolio achieved an overall GRESB score of 84, compared to the GRESB average of 73. VFMC's infrastructure portfolio achieved an overall GRESB score of 85, compared to the GRESB average of 77.

- The appointment of two external research, data, and analytics providers to improve our ability to conduct ESG-specific portfolio analytics and scenario analysis, as well as undertake iterative climate and broader ESG risk assessments. This capability complements our existing ESG activities to enable more robust and timelier ESG integration.

Roadmap to Net Zero

VFMC is committed to supporting economy-wide decarbonisation and the reduction of real-world greenhouse gas emissions. To that end, we will seek to transition our investment portfolio towards carbon neutrality with a focus on reducing real world emissions.

We have pledged to achieve net zero emissions by 2050 and intend to develop a ‘roadmap to net zero’ to guide this transition in the half year ahead. In line with the [COP-26 Just Transition Declaration](#), we aim to support the conditions for a just transition where our investments can deliver green and inclusive economic growth to meet the challenge of decarbonising our economies, in line with limiting the global average temperature increase to 1.5°C above pre-industrial levels.

