Responsible Investment Annual Review 2017/2018

CSF Pty Limited has paid substantial attention to Responsible Investment (RI) since the early part of the 2000s decade.

In this review, we cover the main developments in the RI field at CSF Pty Limited (CSF) during the 2017/18 financial year. This includes question-and-answer ‘spotlights’ on service providers or collaborative organisations related to our RI effort and a general introduction to background material about our approach to RI. You can find the *Responsible Investment Annual Review 2016/17*, our *Responsible Investment Policy* and *Climate Change Policy*, and more information on our RI approach on our website.

This review covers eight major areas:

1. Introduction to Responsible Investment
2. Integration of ESG factors
3. Active ownership
4. Collaboration
5. Sustainability themed investment
6. Climate change
7. Divestment/negative screening
8. Our PositiveIMPACT investment option

We intend to provide an annual update on key developments in the RI field at CSF. We welcome input on the sorts of issues which our members would like to see covered, so please contact us with ideas or suggestions.

December 2018

1. Introduction to Responsible Investment (RI)

What does Responsible Investment mean to us?

Put simply, we believe the appropriate application of RI practices to our investment portfolio will enhance financial outcomes for our members over the long term.

There is a natural tendency for financial market participants to focus excessively on issues which are easily measurable and which will manifest themselves in earnings statements over short term periods. However superannuation is a long term commitment for our members, so when managing our portfolio we do what we can to ensure that issues of that nature receive appropriate attention. Many of these issues are of an environmental, social, or governance nature, and the acronym 'ESG' has come into common usage through the financial industry.

We note in our *Responsible Investment Policy* that we are more inclined to pursue investments which will contribute towards enhancing the environmental or social amenity of the world in which our members live, and into which they will retire. In addition, our heritage brings with it an expectation that our operations will be conducted in a responsible and ethical manner.

We do not compromise investment performance in pursuit of specific ethical or environmental agendas under the RI/ESG banner. All investments being considered for inclusion in our portfolio must meet standard risk/return criteria. RI is not an attempt to strike a balance between financial and non-financial (i.e. ESG) goals, nor to sacrifice the former for the latter. Furthermore, we are acutely aware that any costs we incur regarding investment, reduce the net returns to our members.

Many organisations and initiatives with stated goals of advancing RI in one way or another have developed over the last decade. We do not participate in all such initiatives and in particular we avoid activities which don't have reasonable prospects for improving long-term outcomes for members. We maintain a budget for spending on memberships, service providers, and initiatives which we support under the RI banner.

Overview

Our RI activities have four main components:

1. We **integrate Environmental, Social and Governance (ESG)** issues into our day to day investment decision-making process through how we select, review and engage with our external investment managers.
2. We **behave as an 'active owner'** of the companies that we invest in by engaging with companies on a range of ESG issues and through exercising our right to vote at company meetings.
3. We **collaborate with other investors and industry groups** to address systemic, industry-wide RI/ESG issues that are best addressed through joining forces with others.
4. We **invest in sustainability-themed opportunities** where they meet our usual risk/return investment criteria, and at the same time generate a positive social and/or environmental impact.

Many members may not be familiar with terms such as ESG integration, engagement, and collaboration, so to provide greater insight into these terms and how we apply them, we provide Spotlights on each area in following sections:

- Section 2: Integration of ESG factors
- Section 3: Active Ownership
- Section 4: Collaboration

2. Integration of ESG factors

As the majority of our investments are externally managed, the main focus of our ESG integration effort entails:

- assessing the extent to which our existing and potential external managers embrace RI thinking and incorporate it into their investment decisions
- encouraging our managers to enhance their performance in this area over time.

Our panel of investment managers contains firms with widely differing investment approaches. This enhances the overall diversification of our portfolio. Integration of ESG information into decisions does not fit equally well with all of the managers' processes. In particular, we have some managers with processes which can be described as quantitative or rules-based and which hold virtually every stock in the market. These investment managers do not employ fundamental analysts to meet with company management, undertake independent assessments of business strategy, etc. Accordingly, they are able to offer lower fees and this allows us to keep the overall fees which our members face at a reasonable level.

ESG integration fits more neatly within processes of managers which use fundamental, bottom-up analysis to identify a small subset of companies which they expect to perform well, generally assessed with a medium to long term time horizon. One such manager in our portfolio is Generation Investment Management (Generation). Generation is based in London and commenced managing portfolios for external investors in 2005. CSF invested in the firm's global equity strategy in 2008.

Generation is widely seen as a poster-child for the ESG integration/RI movement globally. Furthermore, the performance of its global equity strategy has been outstanding, ranking towards the very top of literally hundreds of managers offering global equity strategies over the period since the firm's inception. When Generation was first established, many sceptics argued that consideration of ESG issues had little role to play in delivering favourable investment outcomes. Whilst such views are aired less frequently these days, Generation's results suggest that they were ill-founded at the time and remain so.

Please refer to the following question-and-answer 'spotlight' on service provider Generation Investment Management for an understanding of our RI thinking, and the benefits of strong integration of ESG analysis into investment decision making.

Q&A

CSF: We at CSF have been invested with Generation for quite a few years and find ourselves to be aligned with your firm's unique philosophy. Generation has been mentioned in various communications with our members and your strategy forms part of our recently introduced PositiveIMPACT option, as well as our longer established, 'mainstream' options. Nonetheless, our members have never heard from Generation directly. Could you give us a brief overview of the Generation 'story'?

Generation: Generation was founded in 2004 by seven partners, the most well-known of whom are our Chairman Al Gore (former US Vice-president) and Senior Partner David Blood (former CEO of Goldman Sachs Asset Management).

When Generation was founded, few investment managers were integrating sustainability into an investment process, and many believed that sustainability and investment returns were mutually exclusive. Generation's mission was to prove the business case for sustainable investing as a way to deliver long term value. The founders fundamentally believed that best practice investing was to take a long-term approach, and that the short termism prevalent in capital markets was detrimental to economies, value creation, wider society and the environment.

Our Global Equity strategy has now been running since 2005, but we would not be here today without the support of our early clients, including CSF who we have been working with since 2008. We feel extremely fortunate that these investors were prepared to join us when we had only a short track record, based on a shared vision and philosophy.

CSF: Over the 13 years since you commenced managing portfolios, performance has been outstanding. There are of course many vagaries in investment performance. But are you able to give us some thoughts on the key drivers of that terrific outcome – is it the investment culture you've been able to create? Is it the quality of the individuals in the team? Is it because you look at issues that others ignore, and therefore avoid errors which they make? Or have you just been in the right place at the right time? And maybe had a bit of luck?

Generation: Probably a combination of all of the above! Although, over the last 13 years, we have been driven by the conviction that integrating sustainability within a rigorous investment process would lead us to identify sources of value not seen by others, and would ultimately be a better way to invest over the long term; it was never (purely) about values. Certainly, such a mission driven culture is also invaluable when it comes to attracting and retaining talented individuals and we believe this is partly why the team has seen very little turnover.

Applying our approach has not meant we have always got it right. But over time it has also helped us to avoid some investment pitfalls, such as those related to stranded carbon assets, debt-fuelled booms and even regulatory pressure and consumer response to the obesity epidemic.

We should also note that we are not the only ones to recognise the benefits of our approach. Over the years we have welcomed increasing awareness of ESG issues among the investment community. However, what we have learnt is that ESG integration is extremely difficult. Sustainability and ESG analysis require trade-offs. The issues are also becoming increasingly complex, as many solutions face some degree of unintended consequences. (For example; social media - is it good or bad?). Evaluating trade-offs is an exercise in navigating grey areas requiring judgement, compromise, practical experience and a constant grounding in the clarity of first principles. We hope that our combination of people, a consistent and disciplined investment process, and mission orientation, will enable us to continue to deliver value to our clients in the future.

CSF: You appear to have kept the business itself relatively simple and sought to retain a boutique feel – just the three investment strategies, focused only on institutional clients, no outside ownership etc. What has been the thinking here?

Generation: We have stayed true to Generation's original business plan in remaining a boutique firm. More than ever, we believe in the importance of remaining this way - not only in terms of strategy focus, but also team size and client relationships, which are all critical components of our culture. We have discovered that the best way to outperform the market is to stay research focused and concentrated in our stock selection. We aspire to develop our knowledge and expertise rather than expand and diversify. We also look at the universe of equity managers and observe that the very best are boutiques.

CSF: You have closed the global equity strategy to new clients at a relatively low level. Indeed, you have been very careful about accepting new cashflows from existing clients. Again, what is the thinking behind these decisions?

Generation: We closed our global equity fund in 2010 because we held the view that if we allowed the fund to get too large, the likelihood of not delivering investment results to our clients would increase. We were also mindful of the risks of putting asset gathering ahead of performance; our performance fee is deliberately designed to align us with our clients. We do accept new inflows, but only to the extent that we have corresponding outflows.

CSF: A little while ago, you were arguing that we at or near a tipping point in the transition to a more sustainable world/economy. This sounds very encouraging. Is that still your thinking?

Generation: Absolutely, and we now refer to it as the Sustainability Revolution. Our experience has continued to intensify our belief that we are approaching a systemic, secular, multi-decade transition to a sustainable economy. This transition is being driven by a combination of factors: global population growth, increased pollution, resource constraints and the climate crisis. Technological innovation and consumer demand are accelerating the transition. We believe that the Sustainability Revolution has the magnitude of the Industrial Revolution and the speed of the Digital Revolution. The imperative to use new digital tools to achieve much higher levels of efficiency is sweeping the world. Last year we launched our inaugural Sustainability Trends Report to document the early indicators across all areas of the economy that we are observing, including the progress in electrification across the transport ecosystem, the downward cost-curves of renewable energy sources, investment and availability of technology innovations, and consumer preference shifts.

CSF: Specifically, how do you view the outlook regarding the climate change challenge?

Generation: The climate change challenge remains significant, and requires action across all stakeholders at national and international levels, with business alone being insufficient to provide all the solutions. However, while the Sustainability Revolution is at an early stage, we feel extremely optimistic about the pace of change. We also see vast opportunity, and our private equity strategy seeks to invest exclusively in disruptive business models that provide solutions to climate change and other sustainability challenges. ⟶

CSF: What are the key themes reflected in your portfolios currently?

Generation: In terms of themes, it is easier to call out areas that our process leads us away from. While unconstrained in principle, sectors such as Oil & Gas and Tobacco are not present in our portfolio as they are fundamentally misaligned with our world view in creating significant unpriced externalities. Instead, what you will see is a focus on quality businesses run by management teams for the long term, providing products or services consistent with the type of society we aspire to live in.

We continue to monitor the progress of other managers across asset classes with respect to their integration of ESG factors into decision making. We note that there has been steady progress, both in terms of actual practices of managers, and in the way that they document and communicate them.

3. Active ownership

Engagement

Engagement involves participating in a dialogue with investee companies with a view to improving their standards of behaviour on various dimensions, often of an ESG nature. We see engagement as one way to reduce the risk and/or increase the return generated from an investment in a company.

We see engagement as a very important part of our overall RI effort. In 2003 we became early supporters of Regnan, who are now widely regarded as Australia's leading, dedicated specialist in ESG engagement. We also utilise a global engagement service, Bank of Montreal's Responsible Engagement Overlay. As we understand it, we are one of the few funds in Australia with such a long commitment to engagement, covering both domestic and global markets.

In a nutshell, our engagement service providers:

- Review our portfolio, along with those of other clients, to identify cases where the nature of the investee company's operations or their behaviours in managing their operations expose the company concerned to risks which may not be currently recognised in markets. Generally, the focus is on risks of an environmental, governance, or social nature, as such issues have not traditionally been the focus for mainstream investment managers.
- Develop and execute a plan to engage with the companies concerned to effect change in the operations or behaviours of those companies. The engagement is typically undertaken away from the public limelight as this is more likely to facilitate an open and productive dialogue and result in the desired change.
- Report to us and other clients on the outcomes of their engagement.
- In addition, from time-to-time, they undertake advocacy related to relevant areas of public policy, regulation, or disclosure standards.

As mentioned in our 2016/17 report, engagement is a painstaking activity and it will never be possible to know with certainty how companies would have behaved in the absence of the engagement from/with shareholders. Furthermore, there is a classic free-rider problem because all shareholders benefit from engagement activity, not just those who pay for it. Nevertheless, we believe that there is clear evidence that engagement has, over time, resulted in substantial behavioural changes by many companies across a wide range of industries.

The following question-and-answer 'spotlight' focuses on the work of our engagement service provider Regnan.

Q&A

CSF: We at CSF have long been supporters of engagement and see our relationship with Regnan as a key component of our overall RI effort. In our formal RI documents we list Regnan, amongst others, as a service provider and the firm has been mentioned in various other communications with our members. Nonetheless, our members have never heard from Regnan directly. Could you give us a brief overview of the Regnan 'story'?

Regnan: Regnan has a rich history that dates back to the mid-1990s. In short it's a story of institutional investors coming together after realising there was an information gap in the market. They wanted to know more about Australian companies and the long term risks they faced so they could make better investment decisions to benefit their members and customers.

While predecessor organisations existed for years beforehand, Regnan was officially launched in 2007 thanks to the leadership of several super funds and fund managers, keen to be so-called 'responsible investors'. CSF was a founding client and supporter of this unique initiative: a new service to directly engage with top Australian companies to improve their performance across a range of issues, particularly long term risks to the sustainability of their business. Our founding supporters believed that real change in company behaviour could be effected through a reasoned dialogue between company management and shareholders on these issues which, at that stage at least, were not the primary focus of traditional participants in financial markets.

Today these are often called ESG issues (standing for environmental, social, and governance issues) and investors and companies alike are paying more attention to them. For each ASX200 company, Regnan assesses the material ESG risks to that business and then work with or engage with the company to ensure that those risks are managed and disclosed. This is done on behalf of funds such as CSF who invest members' retirement savings for the long term, and see these issues as important factors in ensuring better returns for members.

CSF: So could you give us a feel for the scale and focus of your work?

Regnan: Regnan has a small but highly experienced team of 11. They have deep experience and knowledge across a diverse range of ESG issues as well as a deep knowledge of the companies the fund invests in. Among our team, we have staff qualified in environmental sciences, accounting, finance, law, economics and development studies, with backgrounds in banking and financial regulation, through to academia and professional services.

As for our targeted engagement program, it starts with research. We look at every company in the ASX200 and score them across a range of ESG criteria (such as their exposure to and management of evolving climate change regulations, workplace health and safety risks, and community relations). Every company is different, even those within the same sector, and so we're sure to look at the unique risks (and opportunities) each company faces. Also, our research only considers what is material to a company – that is, the issues we see as likely to impact underlying value and thus returns.

This in-house research then informs the engagement program, helping us to identify areas of concern and where our activity may have the most impact. We set desired changes we'd like to see in companies, sometimes across a whole industry if the issue is systemic, before we seek a meeting.

In approaching companies, we aim to be constructive rather than confrontational. We believe that building relationships and establishing a dialogue centred on feedback is key to effective engagement. It also helps that the companies we're speaking with know that rigorous research is behind us – they can see we understand their business and their operating environment, making them more open to what we have to say.

Each meeting is carefully planned, with areas we'd like to discuss and objectives set in advance. We conduct many meetings so the subject area can vary a lot, so it helps having assigned analysts who develop deep knowledge of each company. Meetings may involve, for example, talking to a utility company about how they're managing the transition to a low carbon economy, or a retailer about labour risks in their supply chain, or making sure executive pay is designed in a way that won't create adverse outcomes such as encouraging staff to act against customer or shareholder interests. Whatever the subject, we make sure it's relevant to protect value for members.

CSF: How has the engagement environment evolved over the years? Are companies becoming generally receptive to your input? Or is the attitude still a bit antagonistic?

Regnan: We have definitely seen the engagement environment evolve over the years, especially at board level. A decade ago when we would meet with a company chair or directors, they were surprised at the topics we were raising – topics no one had ever asked them about before. In the early days, it was crucial to say we were meeting with them on behalf of the likes of CSF and that these funds believed such issues can impact company value.

Slowly but surely there have been developments that have raised the profile of ESG and responsible investment, and companies are not only more willing to talk to these issues, but they realise there is strong interest from large investors like super funds to hear more about them. We're seeing more companies taking a leadership position in actively managing these risks as well as better communicating how they're doing this.

One of the biggest changes has happened around climate change. After the Paris Agreement and a climate-focused task force being established by the G20's Financial Stability Board in 2015, companies are a lot more willing to discuss climate risk and the impacts it might have on their business. Once upon a time, if you'd raised climate change with companies, you may have been labelled a 'greenie' or activist. Today, it's rare for a company to display an antagonistic attitude when we raise concerns about climate change and how they're adapting to it. The reality is that many are already starting to see its impacts on their business – from extreme weather events disrupting operations more frequently, to changes in the markets for their products, to consistently higher temperatures affecting livestock health and crop yields.

CSF: In the industry, divestment (or negative screening) and engagement are sometimes seen as being competing solutions to the same problem. This is a very superficial characterisation of very complex issues of course. It's pretty obvious where Regnan stands on the broad divestment vs engagement issue, but could you give us a quick overview of your thinking?

Regnan: The investment tools which you're talking about – negative screening and divestment – are at one end of the responsible investment equation and in this context mostly involve decisions made on values-based or ethical grounds. This often has the outcome of limiting the number of companies you invest in. A decision to limit your investment universe will reflect a tolerance level for certain business activities being crossed. For instance, an investor may consider the amount of revenue a company generates from fossil fuels which are contributing to anthropogenic climate change, or whether a company manufactures weapons to be sold to non-state actors (i.e. an individual or organisation that has significant political influence, but it not allied to any particular country or state) or if a business derives a certain amount of revenue from machines associated with problem gambling (i.e. 'pokies'). Whatever the threshold may be for divestment or screening, it is usually dictated by a fund's investment frameworks and policies. Sometimes these will include specific guidance around where and when values or ethics come into decision making.

In our view, it is more important as a fiduciary, particularly in relation to the ASX200, to influence rather than divest. We believe targeted and well executed engagement is the most effective means to encourage companies to change for the better. Holding shares in a company gives you a seat at the table. And if you're a super fund, your voice is significant – companies are a lot more likely to listen. Through Regnan, CSF joins other long term investors, giving even more weight to its voice in engagement.

Of course, for many responsible investors, their approach needs to factor in some ethical considerations in addition to the factors which will impact long term value and returns. While divesting a company's shares for an ethical reason may send a message to the company, it can still be a one off signal and then it can be harder to affect change. Divestment should be a very last resort if you're confident a company can't or won't change. Sustained engagement with a company provides ongoing opportunity for funds to reinforce and build upon messages which seek change. While the door's open, it may also provide greater scope for an investor with ethical concerns to also raise these with a given company. In our view, being an active investor and undertaking engagement is a win-win.

CSF: For very good reasons, Regnan avoids talking publicly about specific engagement exercises. But could you give us an overview of some of the key themes driving your work currently?

Regnan: As we've discussed, climate change is a key focus area – it is already a material risk for a third of the ASX200. It's something we've discussed with companies since our inception, but the recent developments we mentioned before have provided added momentum on this topic. It's helped us to get companies to look beyond their own emissions and to consider broader issues such as physical risks to their own infrastructure, as well as infrastructure they rely on from a changing climate. Having the right people and skills in the business for a low carbon future, and being able to adapt to a tightening regulatory landscape is also important. To know companies are staying on top of these risks, disclosures and public reports are important, so encouraging more reporting also forms part of our engagement.

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry has put the spotlight on conduct and corporate culture in recent months. This has been a longstanding theme in our work and we have seen some improvement in boards understanding their role in setting and driving culture. However, the increased scrutiny by regulators and the community alike has ensured that conduct culture has been an area of heightened activity in the past year. Our own research has shown that on average a poor conduct culture leads to lower returns – unethical not just illegal behaviour costs.

Another of our key engagement themes is what we call 'strategic human capital management'. That is, the way people's knowledge, skills and abilities are organised to achieve strong company performance. Rapid technological change (including artificial intelligence) and intensifying competition in a globalised world are reshaping modern business, requiring new company responses. While it's always been important, managing people in light of these changes is now critical to a business's success. Since few companies are immune to these forces, it's a topic we raise in many of our meetings to help companies not only survive but thrive in this period of intense change.

CSF: As mentioned above, we see engagement generally, and specifically the work which you at Regnan undertake, as being a very important part of our overall Responsible Investment effort. And we pay you a material fee for this work. How do you see your responsibility to us and our members? And how should we hold you accountable?

Regnan: Regnan's vision is "a financial system that genuinely serves society". Our company purpose is "to contribute to sustainable value in investments and a robust financial ecosystem, through best practice stewardship". It is this vision and purpose which guides our activities across research, engagement and advisory, and helps us to remain focused on why we do what we do: to serve the individuals who have entrusted their savings to the financial system. We are proud to be part of the responsible investment infrastructure that supports fund members, including those of CSF.

Much like we ask for accountability from companies, we offer it to those who have selected us to engage on their behalf. We provide regular reports to CSF management, detailing the meetings we've had, the topics discussed, and the objectives pursued. We measure the impact of our work, requiring robust evidence of change against our set objectives (such as through public reporting) and confirmation at senior levels before our change objectives are considered achieved and are, at least in part, due to our efforts. While we can't share too much specific detail on our engagements, in the interest of accountability, each year we prepare a public report on our ESG engagement and advocacy activity. We outline how many meetings we held, the topics discussed and progress on objectives, in addition to sharing case studies and advocacy highlights. We'd welcome all CSF members reading our public reports and following the work we undertake on their behalf!

In many cases, ESG engagement relates to broad themes which are ongoing in nature and have relevance for a number of companies in the market. The issues and behaviours involved don't generally have a quick or simple resolution, so the key themes are expected to carry over from one year to the next. In that context, the key engagement issues or themes focused on during 2017/18 are listed below together with some historical context where relevant:

In Australia

- Climate change - this has been a key engagement theme for many years; indeed, virtually since our engagement effort commenced. Naturally, the companies involved and the particular areas of focus have evolved over the years with changes in the policy environment and the business mix of the companies.
- Water – an issue which is associated with climate change and has been prominent for a number of years.
- Human capital and conduct culture – Regnan have had 'conduct culture' (i.e. the organisational culture which shapes risk taking and ethical conduct) as a key theme over the last 2-3 years.
- ESG disclosure – engagement has become increasingly focused on the UN Development Program's Sustainable Development Goals and the Financial Stability Board's Task Force on Climate-Related Financial Disclosures.
- Board diversity – although more can be done, considerable progress has been made on gender diversity, but other aspects of diversity remain relevant to some companies.
- Remuneration – this issue remains relevant, although the so called 'Two Strikes' policy appears to have had a positive influence over recent years.

Globally

- Climate change – adherence to reporting standards and reassessment of business strategies.
- Other environmental issues – the impact of plastic disposal on ocean health.
- A range of corporate governance issues – these varied across countries, but Board independence and remuneration were common themes. In the US, work was undertaken on company response to shareholder resolutions which had received majority support.
- Access to medicine and drug pricing.
- Labour standards in supply chains.

Voting

Voting at company meetings is also an important part of active ownership. There is strong evidence that where shareholders show an active interest in the management of the companies in which they invest, the companies are more likely to act in the interests of those shareholders.

As has been our practice for a number of years, we voted on all resolutions put before General Meetings of the companies in which we invest directly in Australia, except for the stocks contained in one micro-cap mandate where the voting activity is delegated to the external manager. We make our voting decisions based on advice received from ACSI and from our external investment managers.

In the following table, we provide a summary of our voting record in 2017, together with a comparison with our voting in the previous three years.

	Management recommendations 2017	CSF votes 2017	CSF votes (2014-2016) (%)
For	1618	1529 (89.2%)	90.0
Against	48	161 (9.4%)	8.3
Abstain/ Do not vote	0	26 (1.4%)	1.7
None (or Other)*	50	0	0
Total Votes	1716	1716	

* The "no management recommendation" is usually the case for remuneration or grant proposals for non-executive directors, and for remuneration reports in some companies.

We voted against proposals put up for General Meetings on about 9% of resolutions, broadly in line with the pattern of recent years. A full record of our voting is available on our website at csf.com.au/governance.

Key points arising from company AGM's through 2017 were:

- Increasing scrutiny over Director performance, resulting in higher 'No' votes for the re-election of Directors in cases where company performance is judged to have been poor. The issue of Director accountability came into particular focus in May 2018 at the Royal Commission into Misconduct in the Banking, Superannuation, and Financial Services Industry.
- Only six so-called strikes against company remuneration policies, the lowest number since the 'Two Strikes' system commenced in 2011. A 'strike' occurs when 25% or more of shareholders vote against a company's Remuneration Report at the AGM. If a second strike occurs at the following AGM, there is an automatic vote on whether all Directors should face an election regarding their appointment to the Board (i.e. a vote on whether to "spill" the Board).
- A sharp reduction in the number of companies with no female Directors, continuing the trend towards greater Board diversity apparent over recent years.
- An increase in the number of shareholder resolutions, with climate change being a key driver.
- A further gradual increase in the level of voter turnout. Across the ASX200, voter turnout has reached an average of 67%, up from around 52% a decade ago.

4. Collaboration

Collaboration has been an important part of our RI endeavours for many years.

The following question and answer 'spotlight' focuses on providing a greater understanding of the Investors Group on Climate Change (IGCC), and the relevance of collaboration more generally. More information on the various collaborative initiatives in which we are involved is provided in our *Responsible Investment Policy*.

Q&A

CSF: At CSF, we've focused on climate change as a key long term issue for our members for a number of years and our involvement with the Investors Group on Climate Change (IGCC) has been an important part of our overall effort in the area. But we've never really given our members any background on IGCC specifically. Tell us about how and why the IGCC was initially set up.

IGCC: The initiative really arose back in the early 2000s. There was a need for long term investors to have a coordinated voice in the area of climate change. A peak body called the Institutional Investors Group on Climate Change (IIGCC) had been established in the UK shortly before that, and we were able to use that body as our blueprint.

CSF: How does IGCC operate?

IGCC: We have about 70 members, mostly either investment managers or superannuation funds like CSF, drawn mainly from Australia but with a small number from New Zealand. The members pay annual fees and this supports a small secretariat.

CSF: And what are the key areas of IGCC's work?

IGCC: We focus mainly on advocacy and education. We think that climate change is of fundamental importance for our economy, for civil society, and for investment markets. And many of the parties involved in the debate have timeframes and agendas which are inconsistent with the long term perspective, which institutional investors rightly hold on behalf of their members. We recognise that the transition to a low carbon future will be a decades long process, but seek to ensure that the transition occurs in a rational manner, so that we as institutional investors can play our part by allocating the required capital. So: we meet with politicians of all persuasions and their advisers to put our position; we prepare submissions to government enquiries; we comment privately and through press releases and the like on relevant policy developments. We have for many years co-operated and shared ideas with like-minded counterparts in Europe, the USA, and Asia. In 2013, the relationship between the various regional groups was formalised with the establishment of the Global Investor Coalition on Climate Change. The work now has a global component, and the IGCC has been asked to present the investors' views at various international fora, including at COP 21 in Paris in late 2015. This was the meeting at which the current global policy framework was agreed. In addition, there's an educational component to our work. IGCC is a forum through which members can share ideas. In this way, we try to assist our members and others in developing their own policies and approaches to the climate change issue.

CSF: How do you see the state of play in the climate change policy area?

IGCC: When you look back over the last couple of decades, things could have progressed much more smoothly than they have, both in Australia and globally. There have been fits and starts in policy, some progress but lots of frustration and setbacks. Of course, in the meantime, there have been tremendous advances in technology, not only in renewable energy but in a broad range of areas relevant to the transition to a more sustainable world. Further, the science behind climate change has stood the test of time, and the physical impacts of the changing climate have become more evident. The important thing is not to be deterred by the frustrations and setbacks. We must hang in there and do what we can to promote a smooth and efficient transition to a more sustainable future.

CSF: How does your work with IGCC dovetail with CSF's broader effort in climate change and Responsible Investment generally?

IGCC: Climate change is a massive issue. It touches on many parts of our investment portfolio. And there is no silver bullet solution to the challenges which the issue presents. Accordingly, where CSF are investing for the long term on behalf of members, it is important that we address it on a number of fronts. We think that what we do in the areas of integration, in active ownership and in sustainability-themed investment are all important. And so is collaboration.

5. Sustainability-themed investment

In our *Responsible Investment Policy*, we state our preparedness to undertake investments which will contribute to the social and environmental amenity of the world in which our members live, and into which they will eventually retire. Any investments which we make with a sustainability theme must, however, meet standard risk/return criteria. We don't have a specific target for sustainability-themed investments, as we believe that adopting such a target could lead us into investments which do not satisfy normal investment criteria, just to meet the target.

Nevertheless, we have a number of strategies in our portfolio which have a sustainability theme. In the following table, we list the assets in our portfolio where:

- There is a clear sustainability angle to the strategy concerned, and the manager is a global leader in integrating sustainability into its decision-making, or
- The underlying assets generate renewable energy and therefore have inherent sustainability benefits. In some cases, the renewable energy assets form part of diversified infrastructure portfolios. In others, the strategy is invested solely in renewables.

Manager/strategy	Amount invested[1] ($m)	Percent of total assets (%)	Total commitment where applicable[2] ($m)
Global Equities			
Generation Investment Management	351.8	3.7	N/A
Stewart Investors	296.4	3.1	N/A
Property[3]			
APPF Commercial	53.1	0.6	N/A
APPF Retail	62.0	0.7	N/A
APPF Industrial	104.0	1.1	N/A
GPT Office	74.6	0.8	N/A
Global Credit			
Generation Investment Management	12.4	0.1	60.0
Renewables and other environmental			
Windfarms, peaking gas and water treatment within Infrastructure Capital Group funds	75.0	0.8	N/A
Wind, solar and waste-to-energy within Macquarie Asia Infrastructure Fund	49.0	0.5	50.0
Lighthouse Solar Fund	69.9	0.7	90.0
Global Renewable Energy and Energy Efficiency Fund	43.1	0.5	60.0
Quinbrook Low Carbon Power Fund	131.8	1.4	135.0
Copenhagen Infrastructure III	3.1	0.0	80.0
All			
TOTAL	1,326.2	14.0	N/A

1. Value of the investment at 30 June 2018.
2. With some unlisted funds, we provide a commitment up front. This committed amount is then drawn down progressively through an investment period as underlying investments are made. Through the life of the fund, we receive distributions of income and capital gains or losses. In this column, we show the original committed amount, converted to Australian dollars at the time of commitment. It differs from the amount shown in the first column and can be higher or lower depending on where the fund is in its lifecycle. For the Macquarie Asia Infrastructure Fund (MAIF), the figure shown in both the first and third columns is based on the renewables share of total assets as at 30 June 2018.
3. We have only included in this table our investment in property vehicles which achieved very high rankings in the latest GRESB report.

We included a similar table in our *Responsible Investment Annual Review 2016/17.* There is one new entry in the table this year, being Copenhagen Infrastructure Partners Fund III. Copenhagen Infrastructure Partners (CIP) was established in 2011 by a small group of executives who had previously worked together at a Danish utility company, with the support of a large Danish pension fund. The CIP team has substantial experience in successfully developing a number of large scale renewable energy projects, particularly offshore wind projects in northern Europe. Fund III will invest in a range of renewable energy technologies, expected to be largely onshore and offshore wind and solar, but possibly with smaller allocations to geothermal and bioenergy. All investors in CIP's first two funds are located in Scandinavia. We are pleased to be the manager's first Australian client.

Other differences in the table are due to changes in market valuations, contributions/drawdowns, or repayments of capital and increases to commitments made in previous years. The total invested across these strategies has risen from 11.8% (as at June 2017) to 14% (as at June 2018) of total assets. The main contributor to the increase has been a rapid drawdown on our commitment to the Quinbrook Low Carbon Power Fund, combined with an increase in the size of that commitment.

6. Climate change

Climate change is reflected across our integration efforts, our active ownership activities, our priorities for collaborating with others, and through our investments in sustainability-themed opportunities. Since the commencement of our focused RI program in the early part of the 2000s, climate change has been the single biggest underlying issue. Over the last year, the most obvious aspect of our climate change response was our commitment to invest an additional $157 million into renewable energy (see section 5: Sustainability-themed investment).

More detail on our thinking on this issue is provided in our Climate Change Policy which has been approved by the Board and is overseen by the Investment Committee.

In our *Responsible Investment Annual Review 2016/17*, we mentioned our commitment to the Montreal Pledge which we signed in 2015. Pursuant to this pledge, we have now measured and reported the carbon emissions of our listed equity portfolio on three occasions, at annual intervals. The measurement was undertaken on each occasion by an organisation called Trucost, which is an acknowledged expert in the field. Our fourth report on carbon emissions will be released towards the end of 2018.

As stated in our *Climate Change Policy*, over time we would like to see a reduction in the carbon emissions from our listed equity portfolio. So far, this has been observed in our global portfolio, but not the domestic one. Given this outcome, we sought further advice in respect of the major emitters across both portfolios. The findings were that by and large the companies concerned are aware of the issues and working to address them, although with varying degrees of urgency and sophistication. Our engagement overlay managers continue to work with these companies.

7. Our PositiveIMPACT option

As stated in our *Responsible Investment Annual Review 2016/17*, we recognise that some of our members prefer to have their super investment concentrated in assets where there is a clear and tangible impact. For this reason, we introduced our PositiveIMPACT investment option in November 2017.

We believe that the activities which we undertake under the RI banner are comprehensive and appropriate given the circumstances under which we operate, and are driven by a desire to enhance long-term investment returns for members. Furthermore, because we have embraced RI over many years, we have a number of strategies in our portfolio where there is a clear and tangible social or environmental impact.

- Our PositiveIMPACT option is built from the subset of our total portfolio where: the investment managers are global leaders in the integration of sustainability into investment decision-making, and/or
- the underlying assets have clear environmental and/or social benefits.

A number of the strategies included in this new option are mentioned in section 5 of this Review: Sustainability-themed investment.

More information on our PositiveIMPACT option is contained in our *Product Disclosure Statement* (PDS) and/or *Investment guide* (available at on our website).

Contact us

Call 03 9648 4700
9am to 5pm AEST/AEDT
Monday to Friday

Post

PO Box 333
Collins Street West VIC 8007

Head Office

Level 1, 535 Bourke Street
Melbourne VIC 3000

Brisbane, Cairns, Canberra, Darwin,
Geelong, Hobart, Melbourne,
Perth, Ringwood, Sydney.

csf.com.au

CSF012 181218