

RESPONSIBLE INVESTMENT REPORT

This report summarises the Fund's responsible investment activities for the year to 30 June 2018.

We take a strong, purposeful approach to integrating environmental, social and governance (ESG) considerations into investment decisions because, as stated in our Investment Beliefs, we consider them material to long-term returns. We see ESG considerations both as a source of investment opportunity and a means of managing risk.

In this report, you will find an overview of our approach to responsible investment, including a summary of our ESG integration, voting, engagement and exclusion activities for the period under review.



Our view is that ESG integration is both good for returns and for the advancement of our objective to be active owners and responsible investors. As such, we look to integrate responsible investment considerations throughout our investment process. We also acknowledge the wider beneficial impact on corporate practice, regulatory standards and the healthy functioning of capital markets from active, constructive engagement.”

MATT WHINERAY, CEO OF NZ SUPER FUND



CERTIFIED BY RIAA

OUR APPROACH TO RESPONSIBLE INVESTMENT

Our approach to Responsible Investment (RI) is governed by our Statement of Investment Policies, Standards and Procedures (SIPSP) which can be found on our public website: www.nzsuperfund.nz/publications/policies.

The SIPSP includes a specific section on RI, which states our policy, standards and procedures as they relate to responsible investment. It defines RI activities and embeds our RI Framework as the process for implementation. The RI Framework sets out in greater detail how we seek to enhance shareholder value and protect New Zealand's international reputation. It guides all of our responsible investment decision making. Our Board has overall responsibility for the SIPSP and RI Framework. Both are reviewed annually.

More specifically, the RI Framework guides our activities relating to the integration of ESG considerations into investment analysis and due diligence and into manager selection and monitoring. It guides us on how we prioritise engagement activities, execute voting and exclusion decisions and implement our Climate Change Investment Strategy.

The RI Framework also includes a commitment to positive investment, which we define as investments that provide a financial return as well as a social or environmental benefit.

The full Framework is available on our website: www.nzsuperfund.nz/documents/responsible-investment-framework.

RESPONSIBLE INVESTMENT CERTIFICATION

In September 2018 the Guardians gained Responsible Investment certification for the Fund. The Responsible Investment Certification Programme is the first of its kind in the world and is owned and managed by the Responsible Investment Association Australasia (RIAA).

The Certification Symbol signifies that the NZ Super Fund takes certain ESG or ethical considerations into account along with financial returns. To be licenced to use the Certification Symbol, the Guardians was required to meet strict operational and disclosure practices required by the Programme for the category of 'Superannuation Fund'.

The Certification Symbol is a Registered Trade Mark owned and managed by RIAA. Detailed information about RIAA, the Symbol and the Guardians' methodology and performance can be found at www.responsiblereturns.com.au, together with details about other responsible investment products certified by RIAA*.

* The Programme does not constitute financial product advice. Neither the Certification Symbol nor RIAA recommends to any person that any financial product is a suitable investment or that returns are guaranteed. Appropriate professional advice should be sought prior to making an investment decision. RIAA does not hold an Australian Financial Services Licence.

Report against the United Nations backed Principles for Responsible Investment (UNPRI)

The UNPRI is a global network of international investors that seek to implement six principles that give guidance on how to put responsible investment into practice. The UNPRI is the internationally accepted benchmark for how institutional investors should manage environmental, social and governance issues. Our responsible investment work programme is aligned closely to its principles and priorities.

Below we outline the Guardians' performance in the UNPRI's annual benchmarking process and provide a report of our 2017/18 activities against the six UNPRI principles.

UNPRI BENCHMARKING REPORT

The UNPRI supports signatories' efforts in their implementation of the Principles for Responsible Investment through an annual reporting and assessment process based on standardised indicators. Reporting is mandatory for all asset owners. Consistent with a Board approved strategic objective for the 2017/18 year, we were very pleased to receive an A+ rating from the UNPRI for overall RI governance and strategy and an A rating in the other categories in which we reported.

For the second year in a row, we gained internal assurance pre-submission of our annual response.

This year, our voting score improved from a B to an A, which reflects our move to bring voting in-house. However, our listed equity incorporation module decreased from A+ to A, as did the listed equity part of the 'Indirect' module. This was due to a greater requirement to report on voting outcomes. This is an area we have identified for improvement going forward, with the internalisation of global voting assisting this initiative.

Module	2018 level	2017 level	2016 level	Global median	NZSF score out of maximum possible
Strategy and Governance	A+	A+	A+	A	29/30
Indirect:					
– Listed Equity	A	A+	A+	B	36/39
– Fixed Income (Sovereigns/Supranationals and Agencies)	A	A	A	C	29/36
– Fixed Income (Corporate Financial)	A	nr	nr	C	29/36
– Fixed Income (Corporate Non-Financial)	A	A	A	C	29/36
– Fixed Income – Securitised	A	A	A	E	29/36
– Private Equity	nr	nr	A	–	–
Direct and Active Ownership:					
– Listed Equity – Integration	A	A+	A+	A	Screening: 13/15 Integration: 16/18
– Listed Equity – Active Ownership	A	A	A	B	27/27

nr= not reported

REPORT AGAINST THE UNPRI PRINCIPLES

01. INTEGRATION

We will incorporate ESG issues into investment analysis and decision-making processes.

ESG considerations are a component within our Risk Allocation Process (RAP) – the process by which we choose and prioritise the best investment opportunities for the Fund.

We use the RAP to rank and map our existing and potential investment opportunities by:

- attractiveness (expected return, adjusted for confidence and risk); and
- consistency with the Fund's investment style (including ESG).

We have also developed specific ESG guidelines for different investment opportunities.

MANAGER INVESTMENTS

For our external managers, responsible investment capabilities are part of our manager selection and due diligence processes. Once a manager is selected, responsible investment requirements, such as ESG integration, voting, engagement, adherence to our exclusions and reporting requirements are incorporated into our contractual arrangements with them.

We carry out regular responsible investment reviews of the Fund's external managers. Managers are rated on ESG practices and the results integrated in the overall application of our manager conviction framework (more information on our manager conviction framework is available on page 54). This influences whether we maintain, dial up or dial down the relationship.

DIRECT INVESTMENTS

ESG due diligence is a major component of our pre-investment analysis. ESG risks and opportunities are assessed, sometimes with the support of independent experts, with a view to understanding material ESG risks and forming a view of whether the company is addressing or managing them adequately. Reporting and monitoring is ongoing post-investment.

We also carry out site visits to investee companies to assess ESG risks and activities directly.

KEY ACTIVITIES FOR 2017/18:

- 2017/18 saw significant improvements in our incumbent managers putting ESG policies in place, improving RI capabilities and hiring additional RI resources. We upgraded the (internal) ESG ratings of three of our managers.
- Climate-related exclusions implemented in Emerging Markets equities mandates.
- A framework for investment professionals to incorporate climate change considerations into valuations was approved by the Investment Committee and socialised with the investment team.
- Refreshed investment management agreements with strengthened responsible investment requirements.
- Continued focus on responsible investment training and education across team, including: 12 induction training sessions and meetings with new employees, 5 staff members completed and 11 staff members enrolled in the UNPRI Academy, and one Board Education session on corporate governance practice in New Zealand.

02. ACTIVE OWNERSHIP

We will be active owners and incorporate ESG issues into our ownership policies and practices.

We are committed to being an active owner of our investments. We use our influence as a shareholder to encourage companies to manage their ESG risks. We do this by encouraging high governance standards across markets and asset classes, particularly in the New Zealand market. We exercise our voting rights globally. We monitor and engage with portfolio companies that have breached – or might breach – recognised ESG standards.

If engagement is ineffective, we may make a decision to exclude that company. In most cases, however, we believe that engagement is the best tool for encouraging companies to improve their behaviour. Exclusion is a last resort.

We take a substantial interest in the management of ESG issues with companies in which we have a significant stake.

Given engagement is so resource intensive, and our portfolio of listed stocks is so large (more than 6,000 holdings), we have employed an engagement service provider, Bank of Montreal (BMO), to engage on behalf of the Guardians, alongside the other New Zealand Crown Financial Institutions (CFIs), the Accident Compensation Corporation and the Government Superannuation Fund.

KEY ACTIVITIES FOR 2017/18:

- Internalised (brought in-house) global voting to ensure that our voting policy aligns with our corporate governance principles and that we vote consistently with each company. Previously our global managers voted on our behalf. Our new policy brings a stronger focus on Board independence, ESG disclosure, risk management, climate change resilience in investee companies, remuneration and director option schemes, auditor independence and shareholder rights (see page 62 for more information).
- Responded (both directly and as a member of the New Zealand Corporate Governance Forum) to the final stage of the New Zealand Stock Exchange Listing Rule Review.
- Active New Zealand equity managers continued to provide Annual General Meeting (AGM) voting recommendations and discussions on corporate governance. Governance issues feature more regularly in discussion with companies. Our internal team has focused on Board skills, succession plans and attending AGMs as well as company-specific social or environmental issues.
- Revised our process for measuring and reporting (internally) on engagement success.
- Reviewed climate engagement conducted by listed equity investment managers.
- Joined the ClimateAction100+ (www.climateaction100.org), a five-year initiative led by investors to engage important greenhouse gas emitters across the global economy that have significant opportunities to drive the clean energy transition and help achieve the goals of the Paris Agreement. We and other investors are calling on companies to improve governance on climate change, curb emissions and strengthen climate-related financial disclosures.

03. DISCLOSURE

We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Our integration and ownership activities are dependent on access to relevant ESG information. Therefore, we engage with investee companies and other relevant organisations to encourage disclosure on ESG and performance. We then encourage our investment professionals and managers to use this information to make more informed investment decisions.

KEY ACTIVITIES FOR 2017/18:

- Submissions on the NZX Listing Rules; the Financial Market Authority's Corporate Governance handbook; the Productivity Commission's consultation on transitioning to a low-emissions economy; and Report on a Low-Carbon Economy (see page 99 for full list).
- CEO, Chair, CIO and senior staff members spoke at national and international events on ESG related topics.
- Continued to support improved disclosure on carbon related metrics via our membership of the CDP (previously called the Carbon Disclosure Project) and other collaborations with which we are involved.

04. BEST PRACTICE 05. COLLABORATION

We will promote acceptance and implementation of the Principles within the investment industry.

We will work together to enhance our effectiveness in implementing the principles.

We participate in relevant international and local investor groups where we believe working collaboratively will help deliver better ESG outcomes. Some of these groups include:

- United Nations Principles for Responsible Investment (UNPRI);
- New Zealand Corporate Governance Forum;
- One Planet Sovereign Wealth Fund Working Group;
- CDP;
- Investor Group on Climate Change Australia/New Zealand;
- International Corporate Governance Network;
- Responsible Investment Association of Australasia (RIAA); and
- Australian Council of Superannuation Investors.

KEY ACTIVITIES FOR 2017/18:

- Completed UNPRI benchmarking assessment, achieving an A+ rating for strategy and governance and an A for all other modules (see page 59).
- Founding member of the One Planet Sovereign Wealth Fund working group, a group set up to accelerate efforts to incorporate climate change considerations into the investment decision-making process and ownership activities of sovereign wealth funds. The group has published a framework for its activities, which outlines how members will act to make meaningful progress towards the transition to a global low-carbon economy (see page 63).
- The responsible investment team presented and engaged directly with companies on ESG disclosure in New Zealand,

ran workshops on exclusions and climate change, including at the NZ Environmental Management Conference, the Pacific Climate Change conference, and on climate resilience at GRESB (Green Standards for Building & Infrastructure Managers).

- Sponsored the RIAA NZ Benchmark Report and the annual RIAA NZ Conference.
- Participated in New Zealand Crown Financial Institution (CFI) quarterly meetings on responsible investment.

06. COMMUNICATION

We will each report on our activities and progress towards implementing the principles.

We seek to be as transparent as we can, subject to commercial considerations.

ACHIEVEMENTS FOR 2017/18:

- Highly Commended in the Best RI Report by an Asset Owner – Medium & Small Funds category at the RI Reporting Awards.
- Won a Gold Award at the 2018 Australasian Reporting Awards, finalist in public sector sustainability reporting, governance reporting and report of the year categories.
- Seventh annual report against GRI criteria.

CASE STUDY

Changes to the Guardians' global voting practices

We aim to promote good corporate governance in the markets in which we invest. One lever we may use as a shareholder to help achieve this is to exercise our voting rights locally and globally across the Fund's segregated equity portfolio. This is important in maintaining oversight of directors, boards and company policies.

In 2017/18 we undertook a review of our global voting policy, practice and execution. This involved two parts:

- *Part One:* improving the influence of our voting in driving change; identification and oversight of material items; and the ability to better instruct and communicate voting intentions.
- *Part Two:* automated and traceable voting execution and reporting; overcoming voting barriers; quality and consistency of voting between markets; reducing split-voting and reducing the risk of failed votes.

Following the review, we made the decision to develop a customised internal voting policy, and return voting and execution to a proxy voting agency tasked with voting on our behalf (where previously we had relied on our investment managers). Institutional Shareholder Services (ISS) was selected to undertake this work on our behalf, effective as of April 2018.

ISS follows the Guardians' customised internal voting policy when voting on our overseas equity holdings. Our process for making voting decisions for New Zealand companies is slightly different. They are informed by the NZ Corporate Governance Forum's (www.nzcgf.org.nz/) guidelines, the recommendations of our New Zealand listed active equity managers, as well as the advice of our proxy voting agent. We instruct voting on our shares in New Zealand companies directly.

The Guardians' full global voting policy & guidelines is available to view on our website: www.nzsuperfund.nz/performance-esg-management/voting-reports.

Over 2018/19 we plan to enhance the level of information and reporting we provide about our voting activity (globally and in New Zealand) on our website.

VOTING STATISTICS 2017/18

The table below shows how we exercised our voting rights over the period under review.

	Meetings	Proposals	% For	% Against	% Abstain/DNV*
Global** H1	1,313	10,671	88	10	2
Global H2	5,314	59,355	84	12	4
New Zealand H1	55	226	92	8	0
New Zealand H2	7	25	100	0	0

* DNV = Did not vote.

** Does not include one portfolio managed by LSV. Please see <https://www.nzsuperfund.nz/performance-esg-management/voting-reports>.

H1 = 1 July - 31 December 2017

H2 = 1 January - 30 June 2018

The main resolutions that we voted against, both in New Zealand as well as globally, were those related to director elections, routine business and non-salary compensation.