Australian Government
Commonwealth Superannuation Corporation

03/21

Stewardship:

Sustainability through an investment lens

WE INVEST RESPONSIBLY: By integrating, into our investment process, consideration of not just direct asset and corporate risks, but also the indirect risks that arise from their interactions with the world in which they must operate.

I. The way we think about investment risk is integrated and long-term

What type of risks do we consider?

- **Risks** include traditional tangible financial risks, such as those directly impacting on a company's market share and operating profits, but also non-traditional risks. These non-traditional risks can be less tangible in the short term, but have the potential to significantly affect the long-term viability and competitive success of business franchises over the longer horizons relevant to you. These risks include, but are not limited to, the environmental (E), social (S) and governance (G) consequences of, and influences on, corporate operations and strategy—often referred to as 'ESG factors'.

Our Philosophy

- We believe that the most **successful** companies are those that consider all potential, strategic influences on the long-term sustainability of their business, not just the short-term operational drivers of current profitability.
- We attempt to work with, rather than be in conflict with, the companies in which your superannuation savings are invested.
- **We are focused on genuine sustainable impact, rather than simplistic divestment.** There are many facets to managing ESG risks because they are interdependent. We believe incremental, consistent changes are more effective in supporting robust and smooth transitions to a more sustainable future.

We focus on value and achieving sustainable financial outcomes for customers. Over time, this should also achieve positive externalities as we consider long term risks holistically.

Commonwealth Superannuation Corporation

Commonwealth Superannuation Corporation (CSC) ABN: 48 882 817 243, AFSL: 238069, RSEL: L0001397

Defence Force Retirement and Death Benefits Scheme ABN: 39 798 362 763

Australian Defence Force Superannuation ABN: 90 302 247 344 RSE: R1077063

Commonwealth Superannuation Scheme ABN: 19 415 776 361 RSE: R1004649

Public Sector Superannuation accumulation plan ABN: 65 127 917 725 RSE: R1004601

Military Superannuation and Benefits Scheme ABN: 50 925 523 120 RSE: R1000306

Australian Defence Force Cover ABN: 64 250 674 722

Public Sector Superannuation Scheme ABN: 74 172 177 893 RSE: R1004595

1922 Scheme
DFRB Scheme
PNG Scheme
DFSPB
CSC retirement income

II. How do we do this?

- **Investment option design:** our three diversified options are designed to suit the different phases of a typical member's working and retirement lifecycle.
- **Investment governance:** our intentional organisational design, processes and investment delegations framework support nimble, robust and efficiently-implemented investment decision making.
- **Capital allocation:** we look for opportunities to invest in high quality assets at prices lower than their long-term fundamental or intrinsic value.
- **Benchmark choice:** we determine the right mix of different risk factors and use this to create a benchmark for your portfolio. We then evaluate investment opportunities against this low-cost benchmark.
- **Incentives:** aligned to members' typical objectives for retirement income provision.
- **Identification and management of non-traditional financial risks through active ownership:**
  - We identify all the factors that are expected to influence the sustainability of the value of any large investments of our super funds, including analysing the extent to which the company itself, and the market in general, is aware of these factors.
  - Where appropriate, we may take control positions to exert influence over the strategic management of private assets. Examples of this include the Macarthur Wind Farm in Victoria and the office tower at 101 Collins Street in Melbourne.
  - We aim to have genuine proactive engagement with the Australian public companies in which your super savings are materially invested, to support strategies that can sustain their profitability into the future.
  - As a last resort, we may choose not to invest in assets when we consider our active ownership practices cannot work sufficiently to reduce the associated risks to long-term viability of the business. Examples of this in the past have included cluster munitions, tobacco manufacturers and undiversified companies that derive 70% or more of their revenue from thermal coal production/extraction.

We look for opportunities to invest in high-quality assets at lower prices.

Over the last 5 years, CSC has more than doubled its investments in renewable energy initiatives, e.g. windfarms.

III. We ensure that our super funds are active owners of the companies your super savings are invested in

What is active ownership?

- Being an active owner means that CSC, on behalf of our members, proactively engages with the management and boards of the Australian public companies in which your superannuation is significantly invested. We do this to support those companies to take decisions that are aligned with our members' best, long-term interests.

Why do we do this?

- Because we believe it will have a positive long-term impact on the reliability of your superannuation savings.

How do we do this?

- We work to understand the strategic challenges faced by our larger public company investments and the best practices that can be identified across their peer groups around the world.
- Where appropriate we proactively engage with the management teams and Boards of these companies to support them to consider the long-term influences on, and consequences of, their business operations—not just those that are visible today.[1]
- We value the ability to constructively communicate with companies before risks arise, to try to prevent these risks having a negative impact on your superannuation.
- We encourage these companies to build their capacity for strategic decision making that is aligned to the long-term interests of our members.
- We vote on all **shareholder resolutions and always vote in our members' interest**: this helps us to influence and achieve outcomes aligned to our members' interests. A proposal from a company may be in the interests of company management but not the members of our funds. We always vote in a way that supports our members' long-term best interests.
- We focus on **value to you**: our voting decisions are aimed at supporting issues that will provide positive financial outcomes to our members over a long investment horizon.

[1] Through our specialist investment managers or directly.

What do we expect of our public companies?

- **Transparent reporting of all risks:** risks that the business might face not just in the immediate future, but over longer time horizons—including the consequences of their business activities on the environment and the way they treat their labour force.
- **Independent and highly skilled company boards:** containing people with the right mix of skills for the business and a diversity of perspectives.
- **Well-defined strategy:** that considers longer term risks and opportunities, and can be implemented effectively.
- **Appropriate pay structures:** that align staff rewards with business outcomes that are relevant to you, as one of our members.
- **Equal treatment of all shareholders:** we will resist any attempt to curtail the shareholder rights acquired through the investment of your super.

IV. Measuring our stewardship performance and your portfolio's footprint on the world

Global recognition of capability:

- Recipient of the United Nations' Principles of Responsible Investing Royal Award for excellence in sustainability in October 2003—an inaugural citation developed by the United Nations Environment Programme Finance Initiatives (UNEP FI) and the Royal Awards for Sustainability, recognising CSC's (then CSS/PSS) innovative and impactful consideration of ESG factors.
- A top 20% ranking globally in both the biennial 2017 and 2019 Bretton Woods II Most Responsible Asset Allocators Initiative (RAAI).[2]
- Awarded the 2018 AsianInvestor Institutional Excellence Awards in the category of Governance, in 2019, the category of Investment Innovation and in 2020, the categories of ESG engagement and COVID response.

Managing climate investment risk:

- CSC was the first Australian superannuation fund to invite the Climate Institute to assess our carbon footprint.
- We manage climate investment risk in three main ways by: investing in renewable energy opportunities, supporting robust transitions away from coal, and improving our net portfolio carbon footprint over time.
- At CSC, we want to achieve net zero carbon emissions as quickly as possible, ensuring that transitions into new renewable energy systems are sustainable, robust and fair as we phase out old energy sources. However the reality is, all climate action involves tradeoffs because resources are scarce. There may be intended and unintended consequences, e.g.
    1. Current technology is more energy efficient but consumes more water or creates more waste.
    2. More capital may need to be invested to improve the energy storage/battery capacity to enable more wind and solar renewable projects to be profitable.
    3. Growing populations and less developed countries still need access to affordable and sustainable energy source to avoid poverty/lift standards of living/supply basic needs.
- We publicly support the global best practice Taskforce for Climate-related Financial Disclosures (TCFD), committing to increased transparency and disclosure of climate related financial risks and encouraging our investment managers and service providers to do the same. The ultimate aim of increased transparency is to make markets more efficient, and economies more stable and resilient. Details can be found on: **csc.gov.au/-/media/Files/Multibrand/Factsheets/Your-super-and-climate-change.pdf**
- We are a signatory to the Montreal Carbon Pledge, which is supported by the Principles for Responsible Investment. It aims to increase investor awareness, understanding and management of climate change-related impacts, risks and opportunities. Under the pledge, we commit to measuring and disclosing, on at least an annual basis, the carbon footprint of our public market equities portfolio.

CSC's public market equities carbon footprint at 30 June 2020

CSC listed equities	CSC	Benchmark	Difference
Carbon footprint*	75	91	-16

* Source: MSCI: Carbon footprint is measured in tonnes of C02e (Scope 1 + Scope 2) per AUD million invested.

[2] Bretton Woods II New America RAAI, April 2019

V. Case studies of our stewardship

At CSC, we are proud to invest in opportunities that generate income for members in retirement, as well as contribute positively towards a more sustainable environment and better governed society.

Here are some examples that are aligned with the United Nations' Sustainable Development Goals (SDGs) framework.

Aimmune Peanut Allergy Therapy

CSC supports innovative health organisations through its private equity investments. One of the types of company we invest in specialises in life sciences. One of these investments is an organisation called Aimmune Therapeutics, which performs expert research in the field of oral immunotherapy (OIT).

OIT is a way of helping patients with food allergies become desensitised to allergens, reducing the frequency and severity of reactions. This is achieved by a lengthy process where the patient builds up their immunity by ingesting tiny quantities of the allergen.

Aimmune Therapeutics' research priority has been to help patients struggling with peanut allergies, and in February 2020, their groundbreaking work was approved by the Food and Drug Administration in the United States. This made it the first approved therapy for any form of food allergy.

By seeking out responsible investments and championing businesses from the beginning, CSC has supported a life-changing discovery, and one which will contribute to SDG 3: Good health and well-being.

Supporting the COVID frontline

We invest in private healthcare companies that are providing a range of critical healthcare services to support the pandemic frontline such as clinics, pathology, aged care and pharmaceuticals. One of these companies is running a clinical trial for a potential COVID-19 vaccine.

This investment also contributes to SDG 3: Good health and well-being.

Miya Water

Miya Water has generated positive *environmental* and *social* externalities. Miya manages the water distribution and sanitation assets that serve more than 600,000 people in 250,000 households in the Oporto region of Portugal.

In addition, Miya's consulting business has designed and implemented more than 150 projects, including the improvement of dozens of utilities globally, including North America, Latin America, Africa, Asia and the Caribbean to reduce physical and commercial losses.

Miya's expertise in water efficiency projects has facilitated increased water accessibility for people living in countries and communities around the world. For example, in Manila, Philippines, Miya's water management solutions have help to connect more than 2.5 million people to the water distribution system.

This investment contributes to SDG 6: Clean water and sanitation.

GEMS Education

Our investment in GEMS Education, the world's largest K-12 schools group, has generated positive social externalities globally, as well as created financial value for customers. GEMS educates more than 155,000 students across 80+ schools located in the UAE, Saudi Arabia and Europe.

In addition to school operations, GEMS also provides transportation and other support services including: uniforms, catering and after-school activities. GEMS Education aspires that for every child enrolled at a GEMS school, they impact the lives of 100 underprivileged children.

GEM's first mover advantage in Saudi Arabia also contributes to gender equality, with an equal 49/51 girls/boys ratio at school.

GEMS Education contributes to the global development of the education sector through the Varkey Foundation (named after the founder and Chairman of GEMS Education). The Varkey Foundation focuses on improving standards of education for underprivileged children. Initiatives include: teachers and school leaders training; teacher prizes and grants for education related initiatives.

Our investment in GEMS contributes to SDG 4: Quality education and SDG 5: Gender equality.

Active ownership of private assets through controlling stakes:

CDC – infrastructure of the future

The capabilities that CSC offers our superannuation customers is the unique combination of our scale and agility. Our portfolio construction is designed to recognise and move early into new investment opportunities before others crowd in. We "*hunt where others are not (yet)*" to secure strong growth with confidence.

For example, we were the first Australian superannuation fund to recognise that data centres would be a critical form of infrastructure for a technology-driven future. We followed through with a significant pioneering investment in Canberra Data Centres (CDC) in 2016, which has grown customer savings as CDC increased in value by 40% per annum over the past 3 years.

CDC was strongly positioned to benefit from the trend we spotted towards centralisation of data storage in efficient, purpose-built centres. This reflects the calibre of CDC's management team and their capability to leverage and grow their specialised knowledge and servicing-quality in the Canberra market.

We pro-actively sourced this investment from within our high-quality-investment manager network, rather than wait for the marketplace to eventually recognise the value of this strategy.

In December 2019 we completed a partial (50%) sale of our interest in CDC to lock in material gains for our members. We continue to remain a major shareholder of this business, because we continue to believe in its capacity for further growth both geographically and via expanding partnerships with other large commercial data operators.

CDC also uses a closed loop water-cooling system, to reduce water used for cooling by at least 50,000 litres per day, contributing to SDG 9: Infrastructure and SDG 11: Sustainable cities and communities.

CSC Direct Property (office) portfolio

Our average NABERS* energy rating is about 4.4 stars (with no building having a star rating below 4.0).

Over the time that CSC has held these investments, we have improved the NABERS energy ratings of our major directly-held properties. This contributes to SDG 7: Affordable and Clean energy.

*NABERS - the National Australian Built Environment Rating System, is used to measure a building's energy efficiency, carbon emissions, as well as the water consumed, the waste produced and compare it to similar buildings.

Innovative local water and electricity utility business

Our infrastructure investment in this multi-utility business provides sustainable water and energy services to over 400 communities in NSW and Queensland.

It contributes to the conservation of precious resources – water and energy renewables by proactively addressing the increasing disruption in the provision of essential services.
This investment is an opportunity to help efficiently manage the essential resource needs of new communities and contributes to SDG 6: Clean water and sanitation and SDG 11: Sustainable cities and communities.

The business integrates intelligent water and energy solutions with traditional supply sources to improve economic and sustainability outcomes for customers.

For example, the business currently operates eight state-of-the-art local water centres, including the world's largest in-ground residential water centre. Its core water utility service includes drinking water, recycled water, and wastewater services. Residential water customers use up to 70% less drinking water than average through the use of localised water recycling infrastructure for use on gardens and lawns, for washing down equipment outdoors, for toilet flushing, clothes washing and air cooling. As recycled water is not subject to water restrictions, this gives communities secure water supply all year round.

Its energy services include investments in energy efficient infrastructure and demand management technologies such as smart meters and embedded generation and storage. In many cases, it also provides bespoke thermal networks which use a centralised plant to provide communal heating and cooling to residents in an energy and cost-efficient manner.

Office Tower, 101 Collins St Melbourne—solar energy

- CSC, on behalf of our members, is the sole owner of this building;
- 101 Collins St was the first premium-grade office tower in the Melbourne CBD to have installed solar power, which saves 67 tonnes of greenhouse gas emissions each year. This has enhanced the capital value of the building, thereby boosting your returns;
- The building has historically generated strong inflation–linked cashflows and significant capital appreciation. This investment contributes to SDG 7: Affordable and clean energy.

Macarthur Wind Farm— one of the largest wind farms in Southern Hemisphere

- The wind farm has been operational since 2013;
- We acquired a 50% ownership in the farm in September 2015, with an expected return of 10% p.a. (pre-fees) based on the contracted payments to be received from the investment;
- In the period of CSC ownership, it has generated a return of 14% p.a. (as at December 2020, on a gross return basis) for our members. Members should note that investments can go up and down and past performance is not a reliable indicator of future performance;
- The wind farm is one of the largest in the southern hemisphere. In 2020, our 50% share of Macarthur's generation has avoided the need to produce c.540,000 tonnes of CO2 equivalent if that generation was provided by a brown coal fired generator.
- This highlights how a successful investment can also have a positive impact on society. This investment contributes to SDG 7: Affordable and clean energy and SDG 13: Climate action.

Where can I get more information?

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