



# 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 do not automatically avoid companies associated with a negative theme, such as a high carbon footprint. In this example, our approach is to identify those companies at risk; understand the implications for their share price; and where appropriate and practicable support them to unlock the value in a responsible transition of resources and processes towards reducing any undesirable climate consequences from the operation of their business.



**Commonwealth Superannuation Corporation**

Any advice provided in this factsheet is general advice only and has been prepared without taking account of your personal objectives, financial situation or needs. Before acting on any such general advice, you should consider the appropriateness of the advice, having regard to your own objectives, financial situation and needs. You may wish to consult a licensed financial advisor. You should obtain a copy of the relevant Product Disclosure Statement (PDS) and consider its contents before making any decision regarding your super.

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 international 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 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 (see Case Study 6 and Case Study 7 below).
  - 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 and tobacco manufacturers.

## 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.
- 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**: this helps us to influence and achieve outcomes aligned to our members' interests.
- We focus on **value to you**: our voting decisions support issues that will provide positive financial outcomes to our members over a long investment horizon.
- We always vote in **our members' interest**: 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.

## 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 forces.
- **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.
- Only Australian fund named as one of the world's Top 25 Responsible Asset Allocators among sovereign wealth and government pensions funds around the globe<sup>1</sup>.
- Awarded the 2018 AsianInvestor Institutional Excellence Awards in the category of Governance.

### Carbon footprint:

- CSC was the first Australian superannuation fund to invite the Climate Institute to assess our carbon footprint.
- 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 31 December 2018

CSC listed equities	CSC	Benchmark	Difference
Carbon footprint*	92.5	115.7	-23.3
Coverage**	98.6%	99.2%	-0.6%

\*Carbon footprint is measured in tonnes of CO<sub>2</sub>e (Scope 1 + Scope 2) per AUD million invested (as at 31 December 2018).

\*\*Carbon emissions data is sourced from MSCI ESG Research and covers the MSCI ACWI universe of companies. For more information visit [msci.com](https://www.msci.com)

### Engagement, not dialogue, with Australian public companies:

- There is a difference between talking to companies and genuinely engaging with them. It is only after more than one-and-a-half decades of experience in reaching out to talk to corporates about their strategic governance, environmental and social risks, that we can claim to have shifted from dialogue to genuine engagement. We say this because today:
  - (i) Some investee companies are reaching out for advice, rather than simply receiving it; and
  - (ii) We have established a track record for effecting constructive change within corporates. Change that we believe will: (a) help to reduce the longer-horizon risks that our members are exposed to when investing in these businesses, and (b) increase the likelihood that the compensation we expect for bearing these risks will be delivered sustainably.

<sup>1</sup>The Bretton Woods II Leaders List: The 25 Most Responsible Asset Allocators, New America, October 2017.

## Examples of successful engagement include:

### Case Study 1: Gunns Ltd—an example of agency risk

- In 2010, we terminated the mandate with an external fund manager in order to eliminate an exposure to what we considered to be a high risk public company—Gunns Ltd;
- Gunns operated a major forestry operation in Australia. It had been heavily criticised for its logging of trees in native forests and the associated damage to wildlife;
- One of our external fund managers had a material exposure to Gunns, and through this was taking on significant governance and financial risks for our members;
- We had voted against Gunns' remuneration reports and the election of company directors;
- We had engaged with Gunns, via corporate governance research firm, Regnan,\* since 2003;
- We had also engaged directly with our external fund manager, with regards to its position in Gunns and the risks we identified in the company's poor corporate governance record;
- The external fund manager's insistence in maintaining its material exposure to Gunns was a major contributing factor in our decision to terminate the manager's mandate in late 2010 and remove our member's exposure to the risks we saw;
- Gunns went into administration in September 2012.

### Case Study 2: Woodside Petroleum—an example of active ownership

- A company that fails to engage constructively with its stakeholders can have a material impact on the viability of its resource projects;
- For this reason, we engaged with the oil and gas producer Woodside through Regnan since 2012, with the aim of better understanding the company's process for community consultation and stakeholder engagement;
- These discussions with the company revealed that stakeholder issues often contribute to decisions whether Woodside proceeds with key projects;
- After our engagement, Woodside has increased its market disclosures on the nature and importance of its stakeholder engagement and community consultation process.

### Case Study 3: Suncorp—an example of active ownership

- Regnan, on behalf of CSC, engaged with the financial services company, Suncorp, due to our concerns with the pay structure for the CEO;
- In 2011, Regnan began an investigation into the structure of the CEO's remuneration package, and encouraged the company to adopt a lower level of fixed pay and a higher at-risk component tied to business objective hurdles;
- In this way, CSC was able to influence Suncorp's deliberations prior to the appointment of a new CEO;
- When this appointment was made, the composition of the CEO's remuneration structure was better aligned with the shareholders' objectives.

### Case Study 4: Cabcharge—an example of active ownership

- Through Regnan, we engaged with taxi charge account system company, Cabcharge, because we believed Cabcharge required a succession plan for its Chairman and needed independent directors with industry skills.
- In a sustained program over six years, Regnan developed a constructive relationship with the company, which had previously been hostile to feedback from its investors. This relationship allowed our concerns to be communicated effectively to the company.
- The end result is a greater representation of independent directors on the Board, enhancements in the company's communication of its executive pay plan, and improvements in the company's social and environmental disclosures.

### Case Study 5: Study Group—an example of capitalisation on under-appreciated value in well governed assets

- We invested in the Study Group in 2006. It is a company that prepares students for life in overseas education institutions;
- Over the period from 2006 to 2010, our investment made over five times its original capital (equivalent to 56% p.a., materially higher than the ASX 200 index return of 0.7% p.a.), reflecting the company's new management structure and a focus on some successful growth initiatives;
- In 2015, Study Group enrolled 73,000 students from 145 countries, helping students to bridge academic and cultural gaps when settling in new countries;
- This highlights how a successful investment can also have a positive impact on society.

## Active ownership of private assets through controlling stakes:

### Case Study 6: 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.

### Case Study 7: Macarthur Wind Farm—largest wind farm 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 14.4% p.a. (as at December 2018, 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, providing energy for 181,000 households (estimate as at February 2019), and saves 1.5m tonnes of greenhouse gases every year;
- This highlights how a successful investment can also have a positive impact on society.

**\*Note:** CSC was a founding shareholder of Regnan, having provided seed funding and intellectual capital to start the enterprise in 2001. CSC ceased to be a shareholder in 2019, with full ownership moving to the remaining shareholder, Pental (formerly BT Investment management). For more information about CSC's decision to cease to be a shareholder please refer to our website: <https://www.csc.gov.au/Members/News/CSC-transfers-stake-in-Regnan-to-Pental/>

## Where can I get more information?



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