

sustainable

# investment policy

Mercer Investments (Australia) Limited  
December 2020



welcome to brighter

## Important notices.

'MERCER' is a registered trademark of Mercer (Australia) Pty Ltd ABN 32 005 315 917.

References to Mercer shall be construed to include Mercer LLC and/or its associated companies.

This contains confidential and proprietary information of Mercer and is intended for the exclusive use of the parties to whom it was provided by Mercer. Its content may not be modified, sold or otherwise provided, in whole or in part, to any other person or entity, without Mercer's prior written permission.

The findings, ratings and/or opinions expressed herein are the intellectual property of Mercer and are subject to change without notice. They are not intended to convey any guarantees as to the future performance of the investment products, asset classes or capital markets discussed. Past performance does not guarantee future results. Mercer's ratings do not constitute individualised investment advice.

Information contained herein has been obtained from a range of third party sources. While the information is believed to be reliable, Mercer has not sought to verify it independently. As such, Mercer makes no representations or warranties as to the accuracy of the information presented and takes no responsibility or liability (including for indirect, consequential or incidental damages), for any error, omission or inaccuracy in the data supplied by any third party.

This does not constitute an offer or a solicitation of an offer to buy or sell securities, commodities and/or any other financial instruments or products or constitute a solicitation on behalf of any of the investment managers, their affiliates, products or strategies that Mercer may evaluate or recommend.

For the most recent approved ratings of an investment strategy, and a fuller explanation of their meanings, contact your Mercer representative.

Conflicts of interest: For Mercer Investments conflict of interest disclosures, contact your Mercer representative or see [www.mercer.com/conflictsofinterest](http://www.mercer.com/conflictsofinterest).

Mercer universes: Mercer's universes are intended to provide collective samples of strategies that best allow for robust peer group comparisons over a chosen timeframe. Mercer does not assert that the peer groups are wholly representative of and applicable to all strategies available to investors.

Risk warnings: The value of your investments can go down as well as up, and you may not get back the amount you have invested. Investments denominated in a foreign currency will fluctuate with the value of the currency. Certain investments carry additional risks that should be considered before choosing an investment manager or making an investment decision.

This document has been prepared by Mercer Investments (Australia) Limited (MIAL) ABN 66 008 612 397, Australian Financial Services Licence #244385.

Copyright 2020 Mercer LLC. All rights reserved.

# 01/Policy Scope and Key Principles

This policy provides an overview of the principles and policies governing sustainable investment within the Mercer Funds (referred to in this policy document as 'the Funds') that have Mercer Investments (Australia) Limited (MIAL) as the Responsible Entity. MIAL is also referred to in this policy document as 'Mercer'.

MIAL is responsible for the establishment, monitoring and implementation of investment strategies for the Funds. This document outlines the process MIAL undertakes in discharging this responsibility. For Funds that are regulated superannuation funds, this policy is intended to cover the relevant requirements of the Superannuation Industry Supervision (SIS) Act and Superannuation Prudential Standard 530 (SPS 530).

This policy forms part of the investment governance framework for the Funds and should be read in that context. Please refer to this policy for Mercer's key principles and overarching approach to the following components:

1. Environmental, Social and Governance (ESG) integration
2. Sustainability themes
3. Climate change
4. Active ownership
5. Screening

**Mercer does not typically directly select investments; instead it appoints specialist investment managers. This policy sets out how Mercer will implement its investment beliefs on sustainable investment within the Funds it manages. In implementing this policy Mercer commits to clear communication of the policy and transparency in reporting on implementation activities to stakeholders.**



## Our Beliefs

Mercer believes a sustainable investment approach is more likely to create and preserve long-term investment capital and, more specifically, that:

1. ESG factors can have a material impact on long-term risk and return outcomes and these should be integrated into the investment process.
2. Taking a broader and longer-term perspective on risk, including identifying sustainability themes and trends, is likely to lead to improved risk management and new investment opportunities.
3. Climate change poses a systemic risk, and investors should consider the potential financial impacts of both the associated transition to a low-carbon economy and the physical impacts of different climate outcomes.
4. Stewardship (or active ownership) supports the realisation of long-term shareholder value by providing investors with an opportunity to enhance the value of companies and markets.

Consequently, Mercer believes that a sustainable investment approach that considers these risks and opportunities is in the best interests of our investors.

# 02/ESG Integration



Mercer expects its investment managers to assess and reflect ESG risks and opportunities in security or asset selection and portfolio construction, acknowledging that the degree of relevance or materiality varies between asset classes. Examples of ESG factors are shown below:

**Table 1. ESG Factors**

| Environmental       | Social   | Governance                                     |
|---------------------|--|--|
| Climate change      | Health and safety  | Board diversity, composition and effectiveness |
| Water               | Labour standards and modern slavery, including supply chains | Executive remuneration                         |
| Waste and pollution | Human rights and community impacts                           | Conduct, culture and ethics                    |
| Biodiversity        | Demographics / consumption                                   | Shareholder rights                             |

Mercer will evaluate the ESG policies, capabilities and practices of its investment managers as part of the manager selection and monitoring process by drawing on Mercer's ESG Ratings and associated commentary from the Mercer Manager Research team (see the Appendix for further detail). Expectations are set as ESG3 or above, where practicable and relevant to the strategy (with ESG1 being the highest rating and ESG4 being the lowest), as per the investment team's established guidance by asset class. Further, as part of the overall ESG engagement with managers, Mercer will seek to influence and encourage managers to improve their ESG integration practices where required.

# 03/Sustainability Themes



Mercer believes that including some exposure to investment managers that identify longer-term environmental and social themes and trends, and the companies delivering solutions to environmental and social challenges we face is likely to lead to improved risk management and new investment opportunities. In addition to ‘pure-play’ allocations to clean energy, water, timber or agriculture, this can include ‘broad sustainability’ allocations to companies providing sustainable goods and services in environmental matters or social areas such as health and education. Mercer’s investment manager selection and monitoring processes increasingly consider these exposures in portfolio construction decisions.

Mercer supports the United Nations Sustainable Development Goals (the SDGs) and recognises the need for investment towards achieving these goals by 2030. Mercer will utilise the SDGs for measuring impact in some of its sustainability or socially responsible labelled funds. There are different tools available for listed and unlisted equities and real assets. As the alignment and measurement tools continue to improve, we expect to evolve our approach and reporting capabilities both internally and with our investors in this area.

# 04/Climate Change

Mercer believes climate change poses a systemic risk, with financial impacts driven by two key sources of change:

1. The physical damages expected from an increase in average global temperatures
2. The associated transition to a low-carbon economy.

Each of these changes presents both risks and opportunities to investors, as outlined in Mercer's *Investing in a Time of Climate Change* reports.

Mercer considers these potential financial impacts at a diversified portfolio level, in portfolio construction within asset classes, and in investment manager selection and monitoring processes. Together with ongoing research, the potential financial impacts of climate change are included in Mercer's modelling estimates under multiple climate scenarios for physical damage and transition risk factors (as per the latest *Investing in a Time of Climate Change* report).

At the investment manager level, Mercer expects that climate change risk assessment and risk reduction are integrated within a manager's approach to ESG, along with consideration of sustainability themes and active ownership activities.

Mercer believes that limiting global average temperature increases this century to 'well below 2°C', as per the 2015 Paris Agreement, is aligned with the best economic outcome for long-term diversified investors. Mercer participates in collaborative industry engagements to support this end goal, and will seek to increasingly align portfolios with that objective where this is also consistent with meeting stated investment objectives.

Mercer's approach to climate-related financial risks and opportunities is summarised below consistent with the framework recommended in 2017 by the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD). Disclosure consistent with the TCFD recommendations is encouraged for appointed investment managers.

In summary, Mercer takes the following approach to the TCFD framework's four elements for managing climate-related financial risks:

- **Governance:** The Board and the management team have oversight of the Funds' approach to climate-related risks and opportunities. The Board oversees compliance with this policy through annual reporting from management.
- **Strategy:** Climate-related scenario analysis is undertaken as part of strategy reviews on the diversified Mercer Funds. Portfolio construction within asset classes is undertaken with a consideration of climate-related risks and opportunities under different climate scenarios.
- **Risk Management:** Consideration is given to risk reduction strategies to decarbonise the portfolio and identify new low-carbon opportunities, for example adding exposure to sustainability-themed investment managers and reviewing passively managed index exposures. In addition, Mercer participates in industry wide engagements where appropriate.
- **Targets/Metrics:** Metrics, such as carbon footprinting and transition risk indicators, are employed to review climate risk at a total portfolio level and to enable engagement with investment managers on the results.

For more information please refer to Mercer's separate *Climate Change Management Statement*.

# 05/Active Ownership

Mercer believes that stewardship, or active ownership, helps the realisation of long-term investor value of companies and markets through voting and engagement.

## Share Voting

As a shareholder of publicly listed companies, Mercer has the right to vote at shareholder meetings. Mercer regards voting its shares as important to our fiduciary responsibility.

As part of its outsourced investment model, Mercer outsources proxy voting responsibility to its listed equity investment managers and expects all shares to be voted in a manner deemed most likely to protect and enhance long-term value. Mercer carefully evaluates each manager's capability in ESG engagement and proxy voting as part of the investment manager selection process, to ensure it is representing Mercer's commitment to good governance, sustainable investment and long-term value creation.

### Taking a 'Super Vote'

At all company meetings, Mercer has the right to direct a single vote or 'Super Vote' which overrides the investment manager votes on any resolution in circumstances where Mercer believes consistency on a significant matter is in the best interest of investors. Ultimately the decision to undertake a 'Super Vote' is based on Mercer's view of the long-term interests of its investors. In determining such votes, Mercer will consult its proxy voting advisor's recommendation, its managers, and consider best practice guidelines.

### Vote Exceptions

Mercer's objective is to vote all shares in its portfolio both domestic and international with the following qualifications and exceptions.

**Share blocking markets:** there are some markets that place regulatory barriers to voting usually in the form of limitations on trading of shares if a vote is enacted. Mercer will seek to vote in these markets, however voting may be limited, and Mercer accepts that it may not vote in some or all of these markets.

**Securities lending:** Mercer operates a Securities Lending Program for the benefit of investors. Securities lending is when securities are loaned to third parties in order to earn additional investment returns.

For any identified material portfolio holdings requiring a Super Vote, Mercer will endeavour to recall the shares on loan.

In order to continue to vote across the vast majority of resolutions, Mercer will only lend a maximum of 90% of the value of its holdings in any company.

**Securities lending collateral:** Mercer's stock lending program is a fully collateralised program, managed and implemented by an external Securities Lending Agent. Collateral posted by borrowers is held by Mercer's Custodian or a sub-agent in a segregated account. Mercer would not expect to ever take receipt of these securities, or vote on them. Collateral is therefore not governed by Mercer's Sustainable Investment Policy.

**Pooled vehicles:** Mercer has some investments in pooled vehicles where the investment manager, not Mercer, has the legal right to vote the shares contained in the pooled vehicle. In these cases Mercer accepts that it cannot vote these shares, and will instead seek to monitor, and on occasion influence, voting by the investment manager.

**Power of Attorney (PoA) markets:** there are some international markets where voting can only be carried out by an individual actually attending the meeting. This usually needs to be carried out by Mercer through its custodian appointing an individual through a standing PoA for each market, who will then vote in accordance with Mercer's instructions or those of our service providers. The rules on PoAs vary by market, apply for different periods of time and have various cost implications.

Mercer will put in place PoAs for the larger markets (for example, Brazil, Argentina, Sweden and Poland) but will take a cost / benefit view on the smaller markets which employ this structure, meaning that there may be some smaller markets where Mercer will not vote shares that it may hold.

## Engagement

Engagement may be undertaken with companies via investment managers, collaborative initiatives and / or directly to enhance the long-term value of the company. Corporate engagement refers to discussions with a company, usually at Board or senior management level, with the objective of changing the behaviour of that company.

Mercer believes its appointed investment managers are typically best placed to prioritise particular engagement topics by company, however, Mercer as fiduciary also has a role to play in relation to more strategic themes and topics. Mercer has developed an Engagement Framework, which considers three main criteria – Beliefs, Materiality and Influence (BMI) and engagement priorities are expected to intersect meaningfully across the three criteria. This has helped to develop a systematic approach and key principles for considering themes and topics and agreeing portfolio-wide engagement priorities.

In most instances, corporate engagement implementation is delegated to the appointed investment managers, who are encouraged to engage with portfolio companies on material ESG issues with the aim of improving long-term risk adjusted returns and the stability of financial markets.

Mercer may also elect to participate, as appropriate, in collaborative industry engagement initiatives related to the identified engagement priorities, or other topics that are considered aligned with the best interests of investors.

In certain circumstances, Mercer may engage directly with a company on a matter deemed significant, particularly where engagement is related to proxy voting activities outlined above.

## Public policy participation

Mercer may also engage with regulators, governments and other policy makers, to recommend changes or express views regarding regulatory regimes or policy positions where this is deemed important to protect the rights, and enhance the interests, of its investors.

Public policies that Mercer may engage on are the laws or the rules set by governments and regulators which companies must observe if they desire to operate or have their shares publicly traded in that country. For example, the rules governing the disclosure of financial information to shareholders, company law governing meetings of the company and the election of directors. Some standards, such as those for accounting, are set at a global level. It is these laws, rules, and regulations that set the minimum rules for corporate behaviour and transparency.

## Disclosure

In the interests of transparency for our investors, Mercer will publish on its website its voting results for all companies voted on a six-monthly basis, within 3 calendar months of the end of the six-month period, as required by current industry standards and in line with the standard set by the Financial Services Council. Voting reports, including the use of Super Votes and any contentious or sensitive votes, will be tabled at the relevant Board meetings on a six-monthly basis.

Mercer will also make available to investors a report on its voting and engagement activity and monitoring processes on at least an annual basis.

# 06/Screening

Mercer may screen portfolios for sectors, companies, products or activities deemed to cause an unacceptable level of harm, or are guilty of severe breaches of law or commonly accepted behaviour, or deemed as not meeting the expected ESG standards under the ESG integration approach outlined, such that their viability as an ongoing investment is in question.

## United Nations Global Compact

We will screen and monitor our portfolios for high-severity breaches under the UN Global Compact (UNGC) Principles that relate to human rights, environmental and corruption issues, and as identified by the external ESG research provider Mercer appoints. In response to identified breaches, Mercer will engage with the investment managers owning those companies and seek their views on the risk, return and reputation implications as well as engagement insights on the issue.

## Exclusions

As an overarching principle, Mercer is committed to investing responsibly and prefers an integration and engagement-based approach as outlined earlier in the policy. However, there are a limited number of instances in which exclusions may be considered necessary. Exclusions should be a last resort because once divested, Mercer loses its shareholder rights and thereby the ability to influence the future behaviour of companies. Even where an exclusion may be considered necessary, Mercer may seek to use its influence to address the underlying issue of concern with companies, regulators and other standard setters such as stock exchanges or industry groups to the extent that ongoing engagement on the issue is aligned with the best interest of investors.

The reasons to exclude certain securities are likely to be a combination of a number of underlying factors that make continuing to include exposure to the securities in the investment universe untenable. These factors could include investment beliefs, risk management, expected social impact, public policy, reputation, investor expectations, ability to influence, and expected impact on portfolio returns.

## Current exclusions

The following exclusions are currently applied across all Mercer Funds as a result of decisions supported by Mercer's Investment Exclusions Framework that considers multiple risk, return and reputation criteria for assessing exclusions:

- **Controversial weapons:** Companies that manufacture whole weapons systems, or delivery platforms, or components that were developed or are significantly modified for exclusive use in cluster munitions, anti-personnel landmines, biological or chemical weapons, as well as companies involved in the production and retailing of automatic and semi-automatic civilian firearms and ammunition.
- **Tobacco companies:** Companies involved in the manufacture and/or production of tobacco products (regardless of revenue), including subsidiaries and joint ventures, as well as any other company that derives 50% or more of revenue from other tobacco related business activities such as packaging, distribution and retail of tobacco products.

Mercer also manages a number of Socially Responsible funds and investment options, to which additional exclusions apply. These additional exclusions are designed to align with the values of the investors in those funds. Examples include excluding companies involved in adult entertainment, alcohol, fossil fuels, and gambling.

## Implementation

Mercer relies on a third party provider of ESG Research in determining the individual companies to be excluded based on the decisions made under the above criteria.

Mercer will apply this framework to its direct investments, through its Investment Management Agreements with its external investment managers. Where Mercer is invested in a collective investment scheme (CIV) or fund in which its assets are pooled with those of others, it may not be able to dictate these exclusions. In these instances, Mercer will make best endeavours to implement the exclusions and will notify the investment manager of any approved exclusions and the specific definitions for those exclusions.

In selecting investment managers and CIVs, Mercer will consider the manager's ability to implement any Approved Exclusions. Compliance with the exclusions will be encouraged and monitored but cannot be guaranteed. From time to time, a manager of a CIV may exclude the product, activity or industry using a definition that is different to Mercer's definition. This is acceptable provided there is broad consistency with the Mercer definition. If a CIV is known to have material exposure to an excluded product, activity or industry, and the manager is unable or unwilling to divest these exposures, the CIV will be terminated in an orderly manner.

# 07/Policy Implementation and Governance

Key responsibilities for the maintenance and implementation of this policy are set out in the table below.

| Name of owner                  | Area of responsibility   |
|--------------------------------|--|
| MIAL                           | Approve and monitor against policy.  |
| Chief Investment Officer (CIO) | Accountable for adherence to policy and oversight of Investment Management Team. |
| Investment Management Team     | Implement against policy.  |

This policy will be reviewed at least annually, or more frequently if:

- Meaningful change is made to the sustainable investment process; or
- Relevant legislation or regulation requirements change.

Despite any provision to the contrary, management may amend this document to:

- Correct any grammatical, typographical or cross referencing errors;
- Reflect non-material changes to operational procedures;
- Reflect any non-material changes required by law, a regulator or internal/external auditors; or
- Implement any required changes flowing from a board resolution;

Provided the amendment is approved by any two members of the Pacific Leadership Team ('PLT'). All other amendments to this document must be approved by the MIAL Board.

## Application to different investment structures

Mercer's investment arrangements are a combination of separate mandates with investment managers, investments in pooled vehicles, and direct investments. Appropriate approaches are expected across these different investment arrangements.

Mercer's Investment Management Agreements for mandates will reference the Mercer Funds Sustainable Investment Policy. Where Mercer invests in pooled funds, adopting the policy ultimately relies on the investment managers incorporating ESG into their investment processes.

Pooled vehicles have their own Trustee or Responsible Entity, who must act on behalf of all unit holders collectively. Whilst the adoption of the policy in these vehicles ultimately relies on investment managers incorporating ESG into their investment processes, Mercer's Trustee retains ultimate responsibility for meeting Mercer's aspirations in regard to investing in a sustainable manner and allocating to such vehicles. Mercer may, where appropriate, seek to monitor significant ESG issues that arise within a pooled investment.

## Application to different asset classes

Mercer believes that ESG factors can be applied across asset classes including, listed equities (active and passive), sovereign and corporate bonds, property, infrastructure and unlisted assets. However, we acknowledge that the degree of relevance, or materiality, varies as does the current state of integration by strategies between asset classes. Climate change risks are applicable, to varying degrees, across all asset classes with a focus on listed equities, infrastructure, real estate and fixed income. These considerations, inform our expectations for investment managers in Mercer's selection and monitoring processes.

## Revision History

| Version | Reason for amendment  | Date approved by MIAL Board |
|---------|---|-----------------------------|
| 1.      | Inclusion of Sustainable Investment Policy within broader governance framework.   | 15 November 2017            |
| 2       | Inclusion of Exclusions into Sustainable Investment Policy  | 15 June 2018                |
| 3.      | Annual update. Incorporation of Securities Lending in the Active Ownership sections plus other minor editing.   | 21 November 2018            |
| 4.      | Annual update. Notable updates in the sustainability section to reference the SDGs, the active ownership section on proxy voting and the engagement framework, update latest exclusions definitions, together with layout improvements and other minor edits. | 21 November 2019            |
| 5.      | Annual update. Review to make the Policy more concise and principles based.   | 19 November 2020            |

# Appendix - Mercer's ESG Ratings

Mercer's ESG Ratings represent the Mercer Manager Research team's assessment of the degree to which environmental, social and corporate governance (ESG) factors are incorporated within a strategy's investment process. Four factors are considered and documented within the research commentary and an overall rating assigned, where ESG1 = highest possible rating and ESG4 = lowest possible rating. The research is stored within Mercer's Global Investment Manager Database (GIMD).

## Mercer's four factors



### Idea generation

- Efforts to identify and integrate ESG factors into active fund positions as a source of value added.
- Identification of material ESG factors - skill of team members, data sourcing.



### Implementation

- Engagement and proxy voting activities (where applicable) with investee companies.
- Does the investment horizon align with the ability to effectively implement ESG views?



### Portfolio construction

- Efforts to integrate ESG-driven views into the portfolio's construction.



### Business management

- Firm-level support for ESG integration, engagement activities and transparency.

|        |  |   |  |   |
|--------|--|---|--|---|
| Active | <b>ESG1</b><br>Leading approach to integration, where ESG is embedded in investment philosophy; strong on stewardship which is a core part of process. | <b>ESG2</b><br>Consistent and repeatable process to ESG integration (focus on risk management); well-developed evidence of stewardship. | <b>ESG3</b><br>Well-developed G integration; less consistency in E&S stewardship process is ad hoc, but indications of progress. | <b>ESG4</b><br>Little or no integration of ESG factors or stewardship into core processes and no indication of future change. |
|--------|--|---|--|---|

For passive equity ratings, the overall framework is the same, but the focus is primarily concerned with stewardship activities.

## Mercer's four factors - passive equities



### Voting & engagement

- Policy, process and prioritisation.
- Quality of engagements.



### ESG integration

- Skill set of resources.
- Effectiveness of engagement outcomes.



### Resources & implementation

- Data analysis to enhance active ownership.



### Firmwide commitment

- Collaborative initiatives and engagement with regulators and policymakers.

|         |   |  |   |   |
|---------|---|--|---|---|
| Passive | <b>ESGp1</b><br>Leaders in V&E across ESG; stewardship activities and ESG initiatives undertaken consistently at a global level; clear link between engagement & voting actions | <b>ESGp2</b><br>Strong approach to V&E across ESG topics, and initiatives at a regional level, with progress made at a global level; working towards clearer links between V&E | <b>ESGp3</b><br>Focus of V&E tends to be on governance topics only, or more regionally focused with less evidence E&S (in voting & engagement, as well as other internal ESG initiatives) | <b>ESGp4</b><br>Little or no initiatives taken on developing a global V&E capability, reactive engagements; and little progress made on other ESG initiatives |
|---------|---|--|---|---|



Mercer Investments (Australia) Limited  
ABN 66 008 612 397  
AFS Licence #244385  
Collins Square  
727 Collins Street Melbourne Vic 3000  
GPO Box 9946 Melbourne Vic 3001  
+61 3 9623 5555

welcome to brighter

© 2020 Mercer LLC. All rights reserved.

250782 - 20210125