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climate change policy

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1. Purpose

The purpose of this Policy is to formally outline HESTA's principles and commitments in relation to the incorporation of climate change considerations into investment processes and decision-making.

2. Scope

This Climate Change Policy applies to all HESTA's investments including:

- all classes, including Australian and international shares, property, unlisted and listed infrastructure, private equity, alternatives, global bonds and timber
- all types, including direct, mandated and pooled
- all styles, including active and passive, and
- all geographic locations.

The way in which HESTA incorporates climate change considerations into investment processes and decision-making will differ depending on these investment characteristics.

3. Policy Context

This Policy will be applied in a manner consistent with other HESTA investment, strategic or operational policies and processes, including HESTA's Investment Policy.

This policy should be read in conjunction with HESTA's Responsible Investment Policy and Active Ownership Policy.

4. Definitions

Climate Change: refers to the observed increases in global average air and ocean temperature caused by human produced carbon emissions which has resulted in other impacts such as widespread melting of snow and ice, rising global sea levels and changes to atmospheric and ocean circulation. Further impacts include changes in rainfall and wind patterns and extreme weather events such as fires and floods, storms and storm surges.

Climate Change risks: refer to risks facing underlying companies that arise as a result of climate change including consequential changes to:

- the physical environment resulting in rising sea levels, extreme weather events such as fires and floods, storms and storm surges, etc (i.e. physical risks)
- government policy and legislation resulting in increased costs of compliance (mitigation, taxes or permit, disclosure) and increased input costs (i.e. carbon risks) and
- the market, such as reduced demand for goods and services that contribute to, or become less desirable or necessary in, a future impacted by climate change and rising temperatures e.g. coal,

heaters in geographic locations becoming warmer (i.e. market risks). The potential financial impact on asset valuations from reduced demand for fossil fuels has become known as “stranded assets”.

Direct risks from climate change, including property damage and business interruptions, will impose additional costs on companies, as they will need to adapt to, manage and mitigate these risks.

Climate Change opportunities: refer to opportunities facing underlying companies that arise as a result of climate change including consequential changes to:

- the physical environment
- government policy and legislation resulting in increased energy efficiency of production processes, early adoption of new technologies, greater access to finance for low emissions projects, and
- the market, such as increased demand for goods and services that address climate change or become more necessary or desirable in a future impacted by climate change e.g. low emissions technologies, design of resilient infrastructure and property etc.

Stranded assets: refers to assets involved in the exploitation of a fossil fuel resource that, due to reduced demand, will no longer be exploited and will thus have no, or little, value. Stranded assets can include fossil fuel exploration rights, production facilities and the infrastructure required to transport the fossil fuel to customers, such as rail and port facilities, as well as coal-fired power stations, property or infrastructure or other assets at risk of seawater inundation

5. Climate Change Policy Principles

The Climate Change Policy is grounded in HESTA’s key investment objective which is to continue to deliver sustainable, ambitious long-term returns for members. HESTA believes that climate change has the potential to translate into both risks and opportunities for investments across asset classes that need to be managed, or may be captured.

These climate change risks and opportunities have the potential to impact investment risks and returns and as such, considering these issues alongside traditional financial and business risk factors in making investment decisions can improve long-term risk-adjusted returns to members.

In this way, HESTA sees the incorporation of climate change considerations into the investment processes and decision making as entirely consistent with HESTA’s fiduciary duty to act in the best interests of fund members. In fact, HESTA believes that the proper management and mitigation of climate change risks or the capitalisation of climate change opportunities will deliver superior returns over the long-term and that failure to manage and mitigate climate change risks or capture climate change opportunities constitutes a risk that must be taken into account in investment decisions.

Being a ‘universal’ owner and long-term investor (please see HESTA’s Responsible Investment Policy for definitions) HESTA regards consideration of climate change issues in investment processes and decision-making as being of even greater importance in serving the interests of our members. HESTA believes that this approach will have the ancillary benefit of contributing to improved environmental and social outcomes, which will in turn:

- contribute to a stronger economy, which is a prerequisite for delivering the best risk-adjusted returns for members
- improve the overall retirement outcome for members, as their retirement outcome will not only be affected by the financial returns received, but by the state of the environment and the society into which they retire
- A further benefit of incorporating ESG issues into investment processes and decision-making is the increased alignment with HESTA member interests.

As a universal and long-term owner, HESTA does not support an exclusion or divestment approach to investments in response to absolute or relative high exposure to climate change risks. This approach is explained in more detail in the Responsible Investment Policy. Exceptions to this approach are outlined under 7. Climate Change Policy Implementation below.

6. Climate Change Policy Objectives

HESTA's Climate Change Policy objectives are to:

- protect the Fund from fossil fuel and other assets that the Trustee considers have the highest risk of becoming stranded assets
- ensure that relevant climate change risks and opportunities are incorporated in investment processes and decision-making for investments made on behalf of HESTA, in that they are fully reflected in the valuation of any investment
- encourage improved policy, legislation and standards to reduce the risks and stimulate the opportunities associated with climate change
- encourage improved governance, management and disclosure of climate change related matters by underlying companies, and
- raise awareness and increase understanding of the actual and potential climate change risks and opportunities and their relevance to investments across the investment industry. The Trustee believes the thermal coal restriction approach in this Policy will assist to raise awareness in companies considering investing in thermal coal assets.

7. Climate Change Policy Implementation

HESTA will implement this Climate Change Policy consistent with the implementation of the broader HESTA Responsible Investment Policy. As such HESTA will incorporate climate change issues into investment processes and decision making including:

- seeking to understand the impact of relevant climate change risks and opportunities in HESTA's portfolio and within each of the major asset classes
- considering climate change risks and opportunities in the structure of the portfolio
- considering climate change in the selection of external investment managers appointed to manage HESTA's investments – and incorporating climate change into the Investment Management Agreements HESTA has with these external managers
- being an active owner by engaging with companies to improve their governance, management and disclosure of climate change related matters
- being active in public policy in relation to climate change related matters that are material or have the potential to be material in terms of the economic interests of our members – either directly or via likeminded organisations, and
- collaborating with other organisations to achieve these objectives (for more information on collaborations see section 1.8).

Climate change related restrictions in the entire portfolio – Thermal coal

HESTA is concerned that thermal coal and related infrastructure assets are at the highest risk of becoming stranded, in particular, those that are yet to be developed. For this reason the Trustee has adopted a policy which applies across the Fund that restricts exposure to new or expanded thermal coal mining assets and related infrastructure.

For the broader accumulation and income stream asset exposures, HESTA has restricted investments in new unlisted companies or new investments in existing unlisted companies, materially* involved in:

- thermal coal exploration activities;
- development of new 'greenfield', or expansion of existing, thermal coal mining (note: this does not include investment in operational improvements or efficiencies at existing mines given that the capacity remains unchanged);
- transportation of thermal coal.

HESTA will also restrict investments in newly listed companies (via IPOs) with material* involvement in the following activities, or participation in the direct funding via rights issues or share placements, of currently listed companies that have, or will lead to, material* involvement in the following specified activities:

- thermal coal exploration activities;

- development of new 'greenfield', or expansion of existing, thermal coal mining (note: this does not include investment in operational improvements or efficiencies at existing mines given that the capacity remains unchanged)

** Material is defined as more than 15% of revenue or net asset value.*

The limited nature of the restriction is guided by the view that:

- Fundamentally there are few assets that are un-investable due to climate change risks, as long as the climate change risks are fully priced into the valuation of the asset and higher returns are generated to compensate for the level of risk
- It is more effective to engage with investment managers to seek improved assessment of climate change risk in the due diligence and/or valuation models to ensure climate change risk is appropriately priced into valuation, and
- It is more effective to engage with underlying companies to seek changes that will result in reduced climate change risks (please see HESTA's Active Ownership Policy). This approach has the potential not only to result in improved climate change governance, management, performance and disclosure at the asset level, but has the potential to result in improved performance across the market.

Climate change related exclusions in Eco Pool and Eco – Fossil fuels

The Investment Options, Eco Pool and Eco, have an exclusion policy in respect to fossil fuels because these Investment Options have been specifically designed to invest in companies and other assets that demonstrate superior performance on a range of environmental, social and governance criteria, according to the expectations of members in those Investment Options. The fossil fuel exclusion excludes investment in any company that derives any revenue from the mining of thermal coal, or the extraction, production or refining of conventional and unconventional oil and gas; or derives more than 15% of revenue from the generation of electricity from fossil fuels or the transportation, distribution or retail of conventional and unconventional oil and gas; or more than 15% of revenue from the supply of equipment or services for the exploration and production of conventional and unconventional oil and gas activities..

8. Climate Change Collaborations

HESTA recognises that collaboration has the potential to increase the extent to which implementation of this Policy benefits HESTA members. We do not have the resources to undertake all of the work alone – nor could we do it as well without the help and support of other organisations. HESTA will therefore be an active participant in collaborations that can help us to incorporate climate change issues into our investment processes and decision making.

HESTA may seek to collaborate in relation to a specific climate change issue, such as carbon pricing, or in relation to a particular investment e.g. investment in low carbon technologies.

HESTA will identify and assess opportunities to work with others, formally through collaborative initiatives, or informally, to increase the effectiveness of the implementation of this Climate Change Policy.

The primary climate change related collaboration of which HESTA is a member and an active participant is the Investor Group on Climate Change Australia & New Zealand. To a lesser extent HESTA collaborates with ACSI and Regnan to engage with companies, regulators and other rule making bodies on climate change issues.

Membership of and participation in climate change related collaborations involves the expenditure of resources – financial, human or both. HESTA's decision to participate or continue to participate in a climate change related collaboration will be based on an assessment of whether the benefits to HESTA members outweigh the costs.

9. Monitoring and Reporting on the Climate Change Policy

HESTA will monitor and review implementation of the Climate Change Policy.

HESTA will report on a regular basis to the HESTA Board on the implementation of the Climate Change Policy including:

- objectives and priorities
- activities and initiatives

HESTA will report on climate change objectives, priorities, activities and achievements as part of HESTA's reporting on broader ESG issues (under the Responsible Investment Policy) to stakeholders including employees, service providers, members and other interested parties through the HESTA website.

From time to time, HESTA will report on our policies, activities, initiatives and achievements in relation to climate change as part of collaborative climate change initiatives.

10. Communication of the Climate Change Policy

This Climate Change Policy and any related policies and guidelines will be communicated to HESTA's key stakeholders including HESTA employees, HESTA members, service providers and the wider community on the HESTA website.

11. Responsibility for the Climate Change Policy

The Trustee has delegated responsibility for Climate Change matters to Investment Execution. Approval and regular review of the Climate Change Policy is the responsibility of the Investment Committee. The members of the Investment Execution and Investment Management teams have responsibility for oversight and implementation of climate change matters.

12. Review of the Climate Change Policy

This Climate Change Policy will be reviewed every three years in line with HESTA's strategic review process.

In addition, this Policy is required to be updated as necessary to reflect changes in:

- the science of climate change, including the scientific assessment of consequential changes to the physical environment
- the legal or regulatory environment as it relates to climate change
- member or community expectations related to climate change
- the asset classes in which HESTA invests
- the investment processes including asset allocation, portfolio structuring and diversification, asset consultant and investment manager selection, monitoring and review
- strategic or operational changes to HESTA.