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responsible investment policy

Prepared by

Investment Execution

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Contents

1. Introduction

We believe that our deep understanding of responsible investment and sustainability enriches our investment decision-making, in turn contributing to sustainable long-term investment performance and positively impacting the broader economy, society and environment.

HESTA is committed to creating better futures for our members. One of the ways we do this is through being a responsible investor with a long horizon strategy. This is reflected in our Core Investment Beliefs, which underpins how we look after member's assets:

> **"HESTA will be a responsible investor and recognises that members' best interests are served by supporting a healthy economy, environment and society."**
>
> **"HESTA has a long-term investment horizon, and the mind-set of a long-term investor."**

2. Purpose

The purpose of this Policy is to formally outline HESTA's principles and commitments in relation to Responsible Investment. Responsible Investment seeks to generate financial returns for members while better managing risk and generating sustainable long-term value. At a minimum, Responsible Investment consists of the integration of Environmental, Social and Governance (ESG) issues into HESTA's investment processes and decision-making and active ownership activities.

3. Policy

The Responsible Investment Policy will be consistent with HESTA's operational and investment strategies, policies and processes.

The Responsible Investment Policy applies generally to all of 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
- all geographic locations.

The manner and the extent to which HESTA incorporates ESG issues into investment processes and decision-making and active ownership activities will differ depending on each investment's characteristics.

The Responsible Investment Policy is applicable to HESTA's investment options, Eco Pool and Income Stream Eco, in a differentiated manner, as these investment options have been specifically designed with more stringent responsible investment approaches than the broader portfolio. A description of the responsible investment approaches used for Eco Pool and Eco can be found in the relevant Product Disclosure Statement documents.

For most of our investments, HESTA outsources selection and management to external investment managers. This outsourced investment strategy influences the manner in which the Responsible Investment Policy is implemented.

The Responsible Investment Policy outlines HESTA's approach to ESG risks and opportunities, as they tend to be distinguished from traditional financial and business risks and opportunities by a number of characteristics, namely they:

- manifest over a medium to long-term timeframe
- often emerge as high profile issues of public concern
- may be qualitative in nature and not easily quantifiable in monetary terms
- reflect externalities not yet fully captured by market mechanisms
- may be the focus of increasing regulation by governments.

ESG issues are not necessarily static and are likely to change over time. The risks and opportunities faced by the companies in which we invest will change as ESG issues become more important or community values or sentiments change.

4. Relevant Documents

The Responsible Investment Policy should be read in conjunction with HESTA's Core Investment Beliefs and Implementation Beliefs, the HESTA Active Ownership Policy and the HESTA Climate Change Policy.

5. Definitions

ESG: stands for Environmental, Social and Governance.

Environmental: refers to issues affecting the natural environment including climate change, resource and water scarcity, habitat and biodiversity loss, emissions to land, water and the atmosphere and waste generation.

Poor management of environmental issues by a company may ultimately result in risks such as direct financial costs in terms of higher regulatory compliance costs, 'clean up' costs or fines, increased costs associated with resource use and waste disposal as well as indirect financial impacts such as reputational damage. Further, environmental issues such as climate change and resource scarcity may lead to material increases in the level of risk associated with a project or asset and consequently the return required to justify that risk.

Conversely, good management of environmental issues by a company may result in opportunities such as direct financial benefits including savings from reduced environmental licensing or resource efficiency, and indirect financial benefits such as greater innovation and improved reputation. Opportunities may also come in the form of new products or services designed to alleviate environmental issues e.g. clean technologies, renewable energy, and nano-technology.

Social: refers to issues that impact people and the societies in which they live. At the macro level, social issues include war, poverty, human rights, aging populations, dislocation and migration of populations. At a more local level, social issues are those affecting individuals, whether they are employees, customers, suppliers or members of the local or broader community, including labour rights, human capital management, workplace health and safety, supply chain management and community relations.

Poor management of social issues by a company may ultimately result in risks such as direct financial costs including fines and penalties (for example, for instances of breaches of health and safety standards), or interruptions to operations as well as indirect financial impacts such as difficulty retaining staff, reputational damage and increased regulation by governments. Such risks are not limited to the direct activities of companies, but extend through the supply chain and to the communities in which companies operate. Over the longer term failure by a company to appropriately manage social issues can lead to the loss of their 'social license to operate'.

Conversely, good management of social issues by a company may result in opportunities such as financial benefits including lower compliance and reporting costs, and indirect financial benefits including improved satisfaction and retention of staff and customers, improved reputation and increased 'social license to operate'. Opportunities may also come in the form of new products or services designed to alleviate social issues e.g. use of mobile phones to distribute services to underserved communities, microfinance products.

Governance: refers to issues regarding how companies or assets are run or 'governed' and in particular the alignment of a company's board and management with the ultimate owners of the company, its shareholders. Governance issues include board composition and skills, executive remuneration, accounting and audit practices.

Universal investor: refers to an investor with a large investment portfolio diversified across asset classes, sectors and geographies such that they are effectively invested in a slice of the global economy. As such, they cannot diversify away all risk and are therefore affected by the health of the global economy.

Long term investor: refers to an investor that has an investment horizon of at least 10 years.

6. Responsible Investment Policy Principles

The Responsible Investment Policy is grounded in HESTA's key investment objective which is to continue to deliver sustainable, ambitious long-term returns for members. We agree with the growing body of research confirming that good ESG management by companies in which we invest will reduce risk and improve long-term returns, while poor ESG management will increase risks and reduce long-term returns.

As such, the consideration of ESG risks and opportunities in HESTA's investment processes and decision making is consistent with maximising HESTA members' long-term investment returns while minimising risk, and is entirely consistent with HESTA's fiduciary duty and the sole purpose test, to act in the best interests of fund members.

As a long-term and universal investor, the importance of considering ESG issues to HESTA is heightened.

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.

7. Responsible Investment Policy Framework

HESTA's overall approach to responsible investment is guided by the United Nations-backed Principles for Responsible Investment (PRI). The Principles require signatories to:

Principle 1: Incorporate ESG issues into investment analysis and decision-making processes.

Principle 2: Be active owners and incorporate ESG issues into our ownership policies and practices.

Principle 3: Seek appropriate disclosure on ESG issues by the entities in which we invest.

Principle 4: Promote acceptance and implementation of the Principles within the investment industry.

Principle 5: Work together to enhance our effectiveness in implementing the Principles.

Principle 6: Report on our activities and progress towards implementing the Principles.

When applying the Responsible Investment Policy to the companies in which we are invested, HESTA is guided by the principles of the United Nations Global Compact (UNGC), which are derived from: the Universal Declaration of Human Rights, the International Labour Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption. The UNGC Principles require businesses to:

Human Rights

Principle 1: Support and respect the protection of internationally proclaimed human rights; and

Principle 2: Make sure that they are not complicit in human rights abuses.

Labour

Principle 3: Uphold the freedom of association and the effective recognition of the right to collective bargaining;

Principle 4: Eliminate of all forms of forced and compulsory labour;

Principle 5: Effectively abolish child labour; and

Principle 6: Eliminate discrimination in respect of employment and occupation.

Environment

Principle 7: Support a precautionary approach to environmental challenges;

Principle 8: Undertake initiatives to promote greater environmental responsibility; and

Principle 9: Encourage the development and diffusion of environmentally friendly technologies.

Anti-Corruption

Principle 10: Work against corruption in all its forms, including extortion and bribery.

8. Responsible Investment Approach

HESTA will incorporate ESG issues into investment processes and decision-making including:

- considering ESG issues in the structure and diversification of the portfolio and in the allocation of assets between and within asset classes;
- identifying and understanding key ESG issues, such as climate change and human rights, within each of the major asset classes and across the portfolio as a whole;
- when selecting external investment managers in each of the major asset classes and incorporating ESG requirements into the contractual arrangements with them;
- ongoing monitoring and assessment of external fund managers in each of the major asset classes;
- being a responsible and active owner of companies with the aim of improving their ESG related policies, practices and performance;
- supporting the development of appropriate laws, legislation or standards which improve responsible investment and the ESG related policies, practices and performance of companies;
- collaborating with other organisations to enhance the achievement of these activities; and
- reporting on our responsible investment activities and outcomes to key stakeholders.

9. Responsible Investment Implementation

HESTA's approach to Responsible Investment implementation is shaped by the strategy of outsourced investment management. Under this strategy HESTA's requires external investment managers to have regard to the Responsible Investment Policy and consider ESG risks and opportunities in the selection and management of the companies in which they invest on HESTA's behalf.

HESTA's Investment Execution and Investment Management teams are jointly responsible for ensuring that external investment managers are aligned with our commitment to responsible investment and are appropriately incorporating ESG issues into the selection and management of investments and for otherwise implementing responsible investment, as relevant to each asset class.

Responsible Investment implementation activities will be prioritised based on a range of factors including the size of the asset class, the relevance and importance of ESG issues, the potential for HESTA to influence change (which is affected by a range of factors including investment type and style) and the progress of implementation to date.

Exclusions

The incorporation of ESG issues into investment processes and decision making by HESTA and its external investment managers does not eliminate ESG risks from HESTA's portfolio. Generally, HESTA's external investment managers are not excluded from investing in a company with ESG risks. They may invest in a company with ESG risks where the return is sufficient to compensate for the risk. This requires the manager to identify the ESG risks and factor them into the risk-return assessment.

HESTA has adopted this approach for two reasons. Firstly, as a Universal Investor HESTA cannot diversify away from ESG risks by excluding investments in a particular asset class, sector or geographic location, where the costs associated with the ESG risks are borne by other parts of the economy. For example, HESTA cannot diversify away from climate change risks by excluding investments in fossil fuel related companies. In this case, HESTA would still be exposed to climate change risks through investments in banks' lending to fossil fuel companies, insurance companies with liabilities for climate change related events and any company exposed to the physical impacts of climate change.

Secondly, HESTA considers that, for a Universal Owner, it may be more effective to use the tools available to responsible and active owners, including engaging with a company, and voting, to encourage them to improve their ESG performance, or advocating for better to laws, regulations and standards that require better ESG performance. In this way, responsible and active ownership may lead not only to improved ESG performance at the company level, but also to improved ESG performance across the entire economy. More information on our approach to responsible and active ownership practices can be found in HESTA's Active Ownership Policy.

In very limited circumstances HESTA may require managers to exclude investment in a particular company or group of companies. These circumstances include:

- if in HESTA's view the ESG risks to the company, or to HESTA, are not, or cannot be, appropriately or adequately reflected in the risk-adjusted return
- if the investment is inappropriate to the extent that it may have a negative impact on HESTA's reputation
- if the investment would lead to contravention of international treaties or conventions, including the UNGC, by the company or by HESTA; and
- in all these circumstances, all other strategies to appropriately and adequately reduce the ESG risks to HESTA have failed.

HESTA has processes to govern decision making in these circumstances.

HESTA currently has exclusions across the broad portfolio related to producers and/or manufacturers of tobacco or tobacco products; to producers of controversial weapons; and new investments in new thermal coal assets. HESTA's Eco Pool/ Eco Option, has more extensive exclusion related to tobacco, as well as exclusions relating to miners or processors of uranium producers and companies involved with fossil fuels. A detailed description of the current portfolio wide and Eco Pool/Eco exclusions can be found in HESTA's Product Disclosure Statement.

10. Collaborations

Consistent with HESTA's outsourced investment model, HESTA recognises that collaboration with others in the investment industry may increase the extent to which our Responsible Investment program can benefit HESTA members. We do not have the resources to do all of the necessary work alone – and 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 integrate ESG issues into our investment processes and to implement the PRI principles.

HESTA may seek to collaborate with others in the investment industry in relation to a particular investment process e.g. engagement with companies, or in relation to a specific ESG issue.

HESTA will identify and assess opportunities to work with others, formally through collaborative initiatives, or informally, to increase the effectiveness of our Responsible Investment program. Information on the formal collaborative initiatives in which HESTA participates is available on the HESTA website.

Involvement in collaborative initiatives involves the expenditure of resources — financial resources, human resources, or both. HESTA's decision on whether to participate or continue to participate in a collaborative initiative will be based on an assessment of whether the benefits to HESTA members outweigh the costs.

11. Monitoring and Reporting on Responsible Investment Policy Implementation

HESTA will monitor the implementation of the Responsible Investment Policy and report to the HESTA Board and Investment Committee, as applicable, on the implementation of the Policy on a regular basis including:

- Objectives
- Activities
- Outcomes

Where possible, reporting on Responsible Investment to the Board or Investment Committee, as applicable, will be incorporated into regular Investment Management and Investment Execution reporting, including the Investment Execution and HESTA Impact updates, and the annual asset class reviews.

HESTA will report on HESTA's Responsible Investment activities and outcomes to HESTA stakeholders including employees, service providers, members and other interested parties through the HESTA website.

HESTA will also meet any external reporting requirements required by law or as part of HESTA's involvement in collaborative initiatives.

In particular, HESTA will report annually to the PRI on the implementation of their Principles and will make this report and the PRI's assessment of HESTA's implementation publically available on the HESTA website.

12. Communication of the Policy

The Responsible Investment Policy and any related policies and guidelines will be communicated to all HESTA employees and service providers, as applicable.

The Policy will be made available to HESTA members and the wider community on the HESTA website.

13. Responsibility

The Trustee has delegated responsibility for Responsible Investment matters to Investment Execution. Approval and regular review of the Responsible Investment 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 ESG matters.

14. Review

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

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

- the legal or regulatory environment as it relates to ESG issues
- the asset classes in which HESTA invests, including the introduction of new asset classes
- the investment processes including asset allocation, portfolio structuring and diversification, selection, appointment and monitoring of asset consultants and investment managers
- strategy or operations
- member or community expectations.