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Responsible Investment in Systematic Equity Strategies

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1. Introduction

As a long-term investor, PGGM Vermogensbeheer B.V. (PGGM Investments, hereinafter PGGM) is committed to investing responsibly. On behalf of its clients, PGGM manages several public equity mandates. Together, these mandates form a significant part of the total assets under management of PGGM. One of these mandates is the systematic equity strategies (SES) mandate, driven by multifactor models.

PGGM manages SES investments in order to contribute towards a stable pension for its clients' participants. Environmental, social, and governance (ESG) factors can have a material impact on the financial performance of the portfolio, especially in the longer term. As such, integrating ESG issues into investment analysis and decision-making processes is part of PGGM's fiduciary duty, either by reducing investment risks or by increasing (expected) returns.

PGGM recognises that through the companies it invests in, it has a significant impact on the environment and broader society as a whole, and that it has the opportunity to address ESG-related issues directly with the executive management of a broad variety of companies. This guideline addresses how PGGM SES invests responsibly. The guideline is a further refinement of PGGM's Responsible Investment Framework and its implementation guidelines and the relevant fund prospectus and ancillary documentation. In addition, the obligations arising from compliance with legislation and regulations apply. The guideline covers all investments made by the SES team, effective since January 2021.

2. Investment strategy & approach

The primary goal of the SES mandate is to generate a satisfactory risk-adjusted financial return over the prospective life of the investment. In addition, PGGM SES conducts research on ESG factors to assess their potential to directly add value to the investment portfolio and to consider their potential to improve the ESG profile of the strategies, on top of their financial characteristics.

By having in place a transparent responsible investment guideline for SES, as further outlined in this document, and by actively taking into account ESG-related performance in investment decisions, the SES team offers a positive contribution that is best practice and in line with clients' stated objectives.

PGGM complies fully with obligations arising from (ESG) legislation, regulations and stewardship responsibilities. Some of the applicable (ESG) legislation and regulations, or relevant standards, codes of conduct or (inter)national initiatives which have an impact on SES investments are discussed below. Minimum ESG standards and practices are enhanced rapidly and, hence, PGGM monitors these developments closely. For more detailed information please refer to the PGGM Investments website.

3. Implementation

3.a. ESG integration

PGGM defines ESG integration as systematically taking into account those ESG factors that have a material effect on investment risk and return. Across its entire portfolio PGGM uses the Materiality Map of the Sustainable Accounting Standards Board (SASB) as the framework to identify material ESG issues per sector. Similarly, SES takes SASB Materiality Map into account when analysing ESG risks and opportunities in the investment process. ESG risks are defined as risks for the financial returns from material ESG factors.

The SES team explores the possibilities for ESG integration in multifactor models. Potential ESG factors are assessed based on their relationships with other factors in the model and their potential to add value to the investment process. Depending on the outcome of such evaluations, ESG factors are considered for addition to the model. Having good and reliable data is challenging, but key to this effort. The team makes use of ESG data from MSCI, Sustainalytics and Trucost.

All 26 "sustainability-related business issues" from the SASB Materiality Map are relevant and potentially material. The PGGM SES portfolio comprises many companies that operate in a diverse set of countries and sectors, which gives it exposure to a broad variety of ESG risks and opportunities. The SES team invests in diverse sectors so all ESG factors could potentially have a negative influence on the value of the portfolio. Particular attention is given to the following risks:

- Transitional and physical risks deriving from climate change which are considered a sub-set of ESG risks and are therefore covered by the ESG integration process of SES. Changes in regulation, particularly in the field of GHG emissions and/or pollution (transition risk), would impact companies, although some sectors more than others. Depending on political action, the likelihood and magnitude is rather unpredictable. The same holds for changes in taxation (higher carbon prices in exchange for e.g., lower income taxes or green subsidies). Physical climate risks will expose companies in flood- or draught-prone areas, as well as companies depending on suppliers in those areas.

- The likelihood of litigation risk (e.g. an oil company being held responsible for environmental damage) to impact the portfolio is assessed as modest due to the PGGM's carbon reduction strategy (see paragraph 3.b.2 of this guideline).

3.b. Impact

In addition to achieving a better-performing portfolio through the integration of ESG-risks, SES seeks to enhance the positive social and/or environmental impact of its investments and to minimize adverse impacts of investments on sustainability factors.

1. Positive impact: investing in the SDGs

In 2016 PGGM and APG defined Sustainable Development Investments (SDIs) as "investments that yield market-rate financial returns while generating a positive social and/or environmental impact" (i.e. contribute to the Sustainable Development Goals). In 2020 Australian Super, British Colombia Investment Management Corporation joined APG and PGGM in the SDI-Asset Owner Platform which owns a taxonomy of products and services (solutions) that contribute to the SDGs. With a set of decision rules the taxonomy forms the basis for the classification of investments as 'SDI'.

PGGM largest client's ambition is to increase the SDI volume to 20% of the total portfolio by 2025. The effort to measure portfolio companies' real-world impact, is currently limited to seven focus SDGs: #2 (zero hunger), #3 (good health and wellbeing), #6 (clean water and sanitation), #7 (affordable and clean energy), #11 (sustainable cities and communities), #12 (responsible consumption and production) and #13 (climate action). To estimate and monitor the impact on these focus SDGs, the indicators suggested by the Working Group on SDG impact measurement of the DNB-facilitated Sustainable Finance Platform are used.

The SES team is exploring the possibilities for increasing the allocation of SDIs, without compromising the risk-adjusted financial return of the portfolio. Such explorations are still at an early stage.

2. Adverse impact: minimise negative impact

The social and environmental impact of the capital entrusted to PGGM by its clients is significant. PGGM can stimulate a positive contribution to a sustainable world and has the responsibility to minimise adverse impact. Adverse sustainability impacts refer to negative impacts (harm) to individuals, workers, communities and the environment. The SES team has embraced this responsibility and has integrated it in its investment process along with other ESG issues.

As from 1 January 2022 at the latest, PGGM shall avoid new investments in companies that are in very severe violation of the OECD Guidelines for Multinational Enterprises (hereinafter OECD guidelines) and/or the UN Global Compact principles. When feasible, PGGM shall undertake best efforts to divest existing exposures to these companies all-together and/or shall engage with the companies, or a selection thereof, that are in (very) severe violation of the OECD guidelines and/or the UN Global Compact principles.

Based on its high likelihood and severity, climate change as a driver of adverse impact is prioritized. Clients of PGGM's have committed themselves to the Dutch Climate agreement[1] and to the Paris Climate Agreement to align policies consistent with the objective to limit the global temperature rise to a maximum of 1.5 °C. The ambition is to have a climate neutral investment portfolio by 2050 - in line with the ambition of the European Union and the Paris objectives.

Since 2017, the SES team has been reducing the carbon footprint of its portfolio. By 2020, the carbon intensity of the portfolio was reduced by approximately 50% from its starting point. As an intermediate step towards 2030 and 2050, PGGM aims to reduce the footprint by another 30% until 2025.

3.c. Stewardship (engagement, voting, litigation)

PGGM actively uses its influence as a shareholder, thereby contributing to the quality, sustainability and continuity of companies and markets. PGGM sees it as its responsibility to engage with market parties and companies about their policies and activities. In this way, it attempts to realise ESG-related improvements. Engagement activities are focused on (improving) portfolio companies measurement of impact, on improved reporting and on integrating the SDGs into the business strategy of portfolio companies. Insofar as portfolio companies are associated with material ESG issues, PGGM engages to encourage ESG risk mitigation and process improvements towards industry best practice. The voting right is one of the most important rights of a shareholder. PGGM applies customized voting principles across all its listed equities, written down in its PGGM Voting Guidelines.

In order to recover investment losses and enforce good corporate governance, PGGM conducts legal proceedings for its clients when necessary. PGGM does so as a shareholder in listed companies, both in the Netherlands and in other countries.

1 In Dutch "Klimaatakkoord"

3.d. Exclusion

The PGGM Implementation Guidelines on Exclusion are applicable to investments in all asset classes, including public equity mandates. The PGGM-wide product-based Exclusion List consists of companies engaged in controversial weapons, tobacco, tar sands as well as thermal coal utilities and mining companies.

By excluding companies on the basis of the above elements, PGGM seeks to prevent PGGM-managed investments contributing financially to practices incompatible with the standards and values of PGGM, its clients and their beneficiaries.

4. Transparency

Each quarter the SES team provides an update of responsible investment activities in quarterly reports to its clients. This includes information regarding impact investing and integration of ESG factors in investment decisions. Also, any relevant negative impacts as well as monitoring of these impacts, are reported. In addition, SES contributes to the PGGM Investments annual Integrated report and reports on responsible investment activities in the PRI's annual survey.

5. Annex

Please note that there is an Annex applicable for this ESG-guideline. This Annex forms an integral part of this ESG-guideline and may be updated from time to time. The applicable Annex is available on our website.

PGGM
Noordweg Noord 150
PO Box 117, 3700 AC Zeist, Netherlands
T +31 (0)30 277 99 11
www.pggm.nl

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