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Responsible Investment in Long-term Equity Strategy (LTES)

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1. Introduction

As a long-term investor, PGGM Vermogensbeheer B.V. (PGGM Investments, hereinafter PGGM) is committed to investing responsibly. The Long-term Equity Strategy team (LTES) actively manages a portfolio of listed Sustainable Development Investments to provide our clients' participants with a stable pension while also contributing to the Sustainable Development Goals of the United Nations. PGGM recognizes that 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 its fiduciary duty.

This guideline addresses PGGM's management of ESG issues with regard to LTES. 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 guidelines cover all investments made by LTES, effective since 1 January 2021.

2. Investment strategy & approach

On behalf of Pensioenfonds Zorg en Welzijn (PFZW), the LTES team invests in public equities from a universe of Sustainable Development Investments (SDI) compiled by PGGM's Responsible Investment team based on revenues that companies derive from the provision of solutions (products and services) to the United Nations Sustainable Development Goals (SDGs)[1]. This impact universe is screened for PGGM's product-based exclusions and for violators of ESG standards (Global Compact, OECD guidelines and UN Guiding Principles on Business and Human Rights). Thus, the strategy is impact first.

While companies' positive contribution to the SDGs is determined by the SDI universe (and therefore a given for the LTES team), the actual investment portfolio is managed for maximum risk-adjusted financial return. Portfolio companies are analysed and monitored on their strategic and financial merits, and their ESG performance. Analysis and monitoring of a company's ESG performance provides LTES with insights into how ESG factors can affect their investment from a risk perspective.

Companies with a strong ESG track record (i.e. low to no incidence rate in all three ESG categories) are seen to pose lower investment and reputational risks to the team.

In addition to selecting companies from the revenue-based SDI universe and integrating material ESG factors in portfolio selection and management, LTES aims to quantify the real-world contribution of the portfolio companies to the achievement of the SDGs selected by our client PFZW (see paragraph 3.b.1). The real-world contribution – or SDG impact – of a portfolio company measures how much the company contributes to quantified targets within each SDG, for example, the amount of water saved (SDG 6) or the number of patients reached (SDG 3).

The LTES team actively manages their portfolio, which entails rigorous analysis and regular engagement with senior company executives and directors on companies' financial and ESG performance and real-world impact. In this way LTES aims to contribute to our clients' stated objectives of market-rate finance performance financial combined with measurable impact on selected SDGs.

The LTES team aims to be fully compliant with obligations arising from legislation and regulations. The relevant standards, codes of conduct or (inter)national initiatives or legislation that apply and have an impact on implementation are discussed below. For more detailed information please see 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, LTES takes the SASB Materiality Map into account when analysing ESG risks and opportunities in the investment process.

ESG risks are defined as material negative effects for the financial returns from ESG factors. Transitional and physical risks deriving from climate change are considered a sub-set of ESG risks and are therefore covered by the ESG integration process of PGGM LTES.

1 The data are obtained from Entis which is contracted through the SDI-Asset Owner Platform. PGGM's Strategy team turns the SDI universe into a suitable performance benchmark for LTES.

Beyond the SASB Materiality Map, LTES prepares an integrated, detailed investment case on every prospective portfolio company (selected from the SDI universe) for approval by its internal investment committee. The investment case includes strategic and financial information as well as a thorough analysis of ESG risks and opportunities starting from MSCI and Sustainalytics data. Such an analysis may (and has) lead to a decision not to invest in a company even though it is a part of the SDI universe. For example, LTES can choose not to invest in a company that has poor ESG performance, because of its track record of negative environmental externalities or its opaque governance and compensation structure. Environmental, social, or governance issues that are material to a specific sector or company can be a risk to the performance of the portfolio and PGGM's (and the client's) reputation. Conversely, strong ESG performance can be seen as an investment opportunity for LTES: ambitious waste management policies can lead to higher innovation and lower costs for a company.

Given the geographic/sectoral/etc scope of the holdings in LTES' portfolio, ESG issues that are material to its financial performance cover a broad range. Nonetheless the three ESG factors that could be deemed to be most material to the financial performance of the portfolio are: emissions and waste, resource use, and product safety. The likelihood of these sustainability risks affecting the financial performance of the portfolio is mitigated in part by LTES' active investment approach (in which the ESG profile of the holding is assessed and monitored) and in part by the holding being a part of the SDI universe. With the reasoning behind the latter argument being that a holding in the SDI universe provides products or services that contribute towards the SDGs – a so-called sustainable product offering – and are therefore likely to have a lower sustainability risk.

Once included in the LTES portfolio, companies are closely monitored for their ESG performance and risk management using third party ESG ratings, news media, press releases, broker information, and engagement with company executives and (external) stakeholders. Depending on the sector and company, material ESG risks may concern corporate governance, product safety or environmental management. LTES' active investment strategy affords ample opportunity for the timely mitigation of ESG risks and incidents through company engagement. Depending on the company's response, the LTES holding in the company can be re-assessed. All LTES engagements are logged in a proprietary database.

The overall ESG performance of the LTES portfolio is compared to the ESG performance of the SDI universe as well as to the FTSE-All World benchmark. However, the individual effect of the portfolio's ESG performance on the portfolio's financial performance cannot be deduced. This is because ESG is integrated into LTES' investment decision-making and engagement processes.

3.b Impact

In addition to a better-performing portfolio, LTES seeks to enhance the positive impact of its investments and to minimize adverse impacts even when they do not directly affect the financial performance.

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's largest client's ambition is to increase the SDI volume to 20% of the total portfolio by 2025. LTES provides an important contribution to that objective as its very investment universe consists of SDI only, i.e. companies that substantially contribute to one or more of the 17 SDGs.

The effort to measure portfolio companies' real-world impact, however, 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).

LTES engages with companies to measure and maximize their positive impact on one or more of these focus SDGs using impact indicators suggested by the Working Group on SDG impact measurement of the DNB-facilitated Sustainable Finance Platform (for example: tonnes of CO_2 emissions avoided, or volume of water saved). The Working Group has collectively identified a set of two to three quantified indicators at output, outcome and impact level for all the SDGs; each level denotes the depth and breadth of change resulting from the input (the investment in a company) and the activity (the product or service provided by the portfolio company).

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, but also has the responsibility to minimise adverse impact. Adverse impacts refer to negative impacts (harm) to individuals, workers, communities and the environment.

The investment case for every LTES investment includes possible adverse impacts of the operations of a holding, and if feasible, will aim to engage with holdings on opportunities for mitigation.

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.

The investment case for every LTES investment includes an explicit consideration of adverse impacts. A qualitative assessment is made to determine the extent to which the positive impact of the holding on the targeted SDG is outweighed by adverse impacts.

Based on its high likelihood and severity, climate change as a driver of adverse impact its prioritized. LTES contributes to the Dutch Climate Agreement[2] and our clients' most immediate objective of further reducing the carbon intensity of its listed equities portfolio by 30% between 2020 and 2025. As LTES invests in climate solution providers, it will also be key to the long-term ambition of our main client to own a climate-neutral investment portfolio by 2050 in line with the ambition of the European Union and the Paris Climate Agreement objectives.

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

LTES' integrated, active investment strategy aims at continuous ESG and SDG impact improvements. This includes mitigating ESG risks (whether financial or reputational), enhancing positive impacts and limiting adverse impacts, thereby contributing to the sustainability, continuity and quality of portfolio companies and markets.

LTES deploys all stewardship instruments in its active investment process. LTES first begins engagement with potential holdings in the pre-investment process, which provides an in-depth understanding and a good basis for sound investment decisions. Post-investment engagement typically integrates company strategy, finances, governance, ESG risk management, and impact measurement and reporting. LTES engages with significant stakeholders within the holding, and relevant external stakeholders, including industry experts. The team seeks to build long-term relationships with the holdings in its portfolio. The long-term relationship is ideally leveraged to collaborate with the holding on its positive SDG impact.

The engagement done by LTES covers topics that fall under all three ESG themes and the aforementioned positive impact on the SDGs. LTES also seeks to engage on potential sustainability risks and adverse impacts, observing the compliance and transparency requirements of imminent regulations such as the EU Non-Financial Reporting Directive.

All LTES engagements are logged in a database to monitor progress of engagements. Within the team engagement successes and best practices are discussed and, at times, communicated externally (for example through blogs). Information and insights gained from company analysis and engagement may lead to a re-assessment of the holding in a company.

PGGM Responsible Investment team applies customized voting principles across all its listed equities, including LTES, written down in our PGGM Voting Guidelines.

3.d Exclusion

The PGGM Implementation Guidelines on Exclusion are applicable to investments in all asset classes, including LTES. 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. These companies are rarely classified as SDI, so will not be part of the LTES universe.

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 LTES team provides an update of its responsible investment activities in the client's quarterly report. This includes information regarding stewardship activities, impact investing and integration of ESG-factors in its investment decisions. Also, any relevant negative impacts and our monitoring of these impacts are reported. In addition, the team contributes to PGGM Investments annual Integrated report and report on its responsible investment activities in the Principles of Responsible Investment (PRI) annual survey.

2 In Dutch "Klimaatakkoord"

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.

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