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Responsible Investment in External Management

January 2017

PGGM

RI in External Management

1. Introduction

The External Management department of PGGM Investments - on behalf of our clients - selects, monitors and manages external managers for the funds and segregated mandates. PGGM Investments recognizes the important role External Management has with regard to responsible investment, which is to ensure that external managers apply our, and the policies and guidelines of our clients, and where relevant, proactively manage Environmental, Social and Governance (ESG) risks and opportunities.

This document addresses PGGM's standards for integrating ESG in selection and monitoring of external managers.

The guideline is part of PGGM Investments' Responsible Investment Framework and its implementation guidelines. These are a more detailed elaboration of the PGGM Beliefs and Foundations for Responsible Investment, which we share with our clients.

Furthermore, the PGGM Implementation Guidelines on Exclusion are applicable to both types of external management: the externally managed funds and the externally managed mandates. There are differences between the two types of external management in terms of the implementation of this guideline and its implications. The PGGM Implementation Guidelines on Exclusion form the basic minimum requirement and other guidelines also apply, where relevant, to externally managed funds and segregated mandates for individual clients. These can be supplemented with client-specific policy guidelines.

As a signatory to the UN-backed Principles of Responsible Investment (UNPRI), PGGM has committed to integrating ESG issues into investment analysis and decision-making processes and to promote acceptance and implementation of the Principles within the investment industry. External Management sees it as its responsibility to give substance to this by integrating ESG issues into the manager selection and monitoring process. We also believe that a stable financial system is an important condition for generating return for our clients. From this point of view External Management constantly scrutinizes its own behaviour and the behaviour of the appointed managers, for example in the area of fee and compensation structures.

This Responsible Investment in External Management guideline is effective as of 2017. With the introduction of this guideline External Management aims to clarify its expectations regarding responsible investment towards external managers and to form a consistent standard on the way we judge our external managers. External Management monitors relevant developments closely and will update the guideline when necessary.

This guideline does not confer any rights to any third parties.

2. Vision

Responsible investment is incorporated in the heart of PGGM's investment philosophy. It is a core belief that responsible investment pays off. PGGM believes that ESG factors can have a material impact on the financial performance of its investments and sees it as its responsibility to capture the value of and mitigate the risks related to ESG factors. We firmly believe that sustainable development is necessary in order to generate stable and good investment returns for our clients in the long term. Moreover, we believe in the driving force of our clients capital.

External Management aims to select external managers who share these beliefs and pay due attention to material ESG risks and opportunities in their investment decision making processes . One of the indications hereof is when the external manager is a signatory to the UNPRI and/or other relevant organizations. However, being a signatory is often not enough. We will seek further understanding of the actual activities of the manager in integrating ESG in their investment process. This is included in our selection and monitoring of external managers. We expect that the external managers live up to the spirit of our responsible investment beliefs in both their investment processes and in the way that they organize their business.

3. Instruments for Responsible Investment

PGGM uses the following instruments for implementing responsible investment in funds and segregated mandates for its clients:

3.1. Exclusions

By excluding companies PGGM seeks to prevent PGGM-managed investments contributing financially to practices incompatible with the standards and values of PGGM, its clients and their beneficiaries. We appoint external managers that can accommodate the implementation of our clients' exclusion policies and PGGM related guidelines.

3.2. ESG Integration

We define ESG integration as taking into account the effects of ESG factors on the investment risk and return. Specifically, PGGM defines this as the structural and systematic incorporation of material ESG factors in existing investment processes. Material ESG factors are those which have a significant impact on the underlying investment, for example by reducing risk, improving revenues or saving costs. We evaluate managers on multiple criteria. When looking at the ESG factor, we favor external managers that have policies and processes in place to incorporate material ESG factors in their investment decision making process.

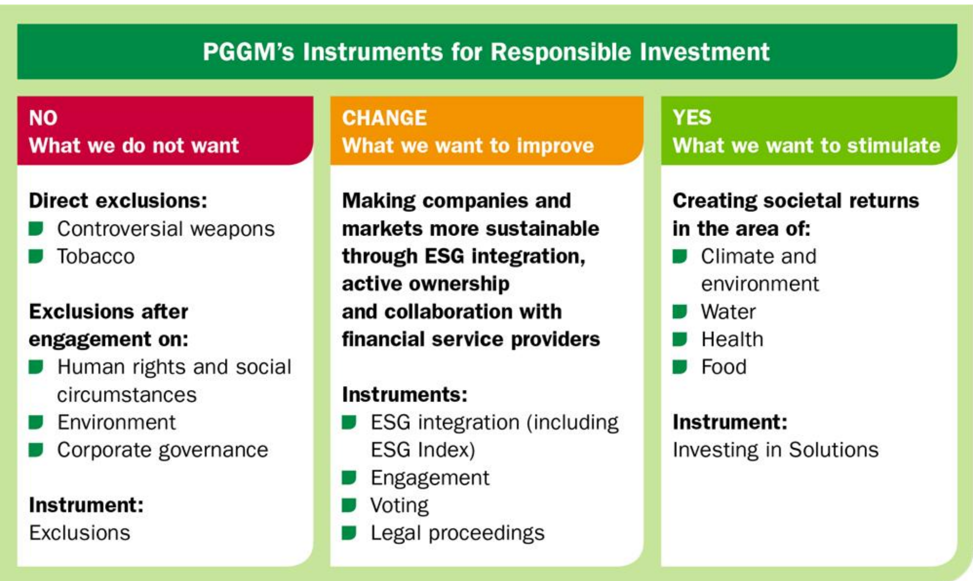

Figure 1: Examples of instruments for Responsible investment

3.3. Active ownership

PGGM offers the following active ownership services to its clients:

- Engagement**:** PGGM engages companies and market participants, including regulators. We do this in order to influence the quality, sustainability and continuity of companies and markets. External Management works closely with analysts and other engagers within and outside of PGGM.
- Voting at shareholder meetings: PGGM votes on all shares of all listed companies in the portfolio according to its own Voting Guidelines. By doing this PGGM can pursue specific ESG objectives on behalf of clients and ensure this is executed in a consistent manner across all portfolios (also see [PGGM's Global Voting Guidelines])
- Shareholder litigation: In case of (expected) misconduct, like fraud or corruption, by listed or unlisted companies PGGM can conduct legal proceedings as a shareholder on behalf of its clients.

Clients who do not use PGGM services in this area have usually appointed dedicated service providers to undertake their active ownership activities. It is therefore not expected from external managers to act as an active owner on our clients behalf. We do expect however that external managers keep us informed about their own active ownership activities through regular reporting to allow us to critically review the outcomes. This enables us to judge the external manager's relative positioning with regard to voting as we are looking for managers that ideally are like minded to our clients.

3.4. Investing in Solutions

For clients who – through their investments – wish to to make a positive contribution to the solution of important sustainability issues, we select investments which not only contribute financially to the return of the portfolio, but also create a social return by contributing to help solve specific socio-economic or environmental issues. PGGM can also help clients to shape (external) impact mandates based on specific client wishes. PGGM will measure and monitor the expected and actual social added value of these investments and will, where relevant, ask external managers to support us in this effort.

4. Implementation

External Management uses the PGGM Selection and Monitoring Framework (SMF) to assess the quality of potential external managers and for ongoing monitoring of current external managers. This framework consists of seven categories: Philosophy, People, Process, Performance, Planet (ESG), Platform/Organization, Price/Costs.

The category 'Planet' is the basis to determine the extent to which the external manager has integrated responsible investing in its investment process and to which extent it is incorporated in its day to day operations.

The SMF consists of 2 stages: Selection and Monitoring.

4.1. Selection: Attention to 'Planet'

In this stage the focus will be on understanding the managers' policies, beliefs and commitment regarding responsible investment and how the manager has organized the responsibility for it. We access the managers' degree of ESG integration and active ownership. Furthermore we evaluate the willingness to contribute to industry initiatives with regard to responsible investment.

We seek to appoint managers whose objectives and believes on responsible investment closely match those of PGGM and our clients. Other categories of the PGGM Selection & Monitoring Framework may also address elements of responsible investment, i.e. "People", "Philosophy" and "Process".

In order to do so External Management assesses the manager at least on the following four areas in the selection stage:

Responsible Investment Policy

- What are the managers beliefs on responsible investment?
- To what extent is ESG a part of the investment philosophy?
- Does the manager have a Responsible Investment Policy in place, and does it address all three elements of ESG?
- Has the manager signed up to the UN PRI or similar initiatives?

Governance of responsible Investment

- Who is responsible for responsible investment at what level?
- What are the skills and competences of the staff in this area, whether it is a dedicated responsible investment team or a portfolio manager who has to implement the policies?
- How are people trained on responsible investment?

ESG integration in investment processes

- How do their RI policies and guidelines affect the investment decision making processes?
- Which processes and systems are in place to consistently implement these policies?
- Do engagement activities and proxy voting guidelines of the external manager reflect their RI policies?

Reporting on responsible investment

- Does the manager regularly report on RI activities and how do these affect investment decision making?
- Does the manager report on ESG-related incidents in their portfolio and how does the manager act to address these?
- Is reporting publicly available?

As a minimum the external manager has to be able to implement the responsible investment requirements as specified in the mandate. The extent to which responsible investments plays a role in scoring the manager depends on the importance the client on whose behalf the selection is performed places on responsible investment and ESG-integration. If a manager scores poorly on "Planet" this can further contribute to an overall negative score, meaning the manager will not be selected. In general we favour external managers that have articulated their believes on responsible investment and that have demonstrably integrated ESG in the investment process.

4.2. Monitoring: Attention to 'Planet'

The same four areas used in the selection stage are evaluated on a structural basis when External Management monitors the appointed external managers and periodically meets with management. Before meeting with management, we determine the relevant subjects for the discussion. Responsible investment is a standard agenda item. Where available, the manager's responsible investment reporting provides important input to this discussion. We will structurally consider relevant developments, research and/or incidents regarding responsible investments during the review period. The appointed manager will be asked to explain how the investment strategy and decisions by portfolio managers align with our expectations, as stated in the Asset Management Agreement and if and how investment decisions have been influenced by ESG considerations. In our review meetings we will encourage the manager to improve their ESG and incident reporting.

Besides the responsible investment activities directly related to the given mandate, External Management also attaches great importance to understand the activities the manager has undertaken in relation to its own investments and those of other clients. We also encourage our external managers to work together with relevant stakeholders to enhance effectiveness in implementing the Principles for Responsible Investment.

External Management will continuously monitor the progress of the responsible investment activities of our external managers. Besides that we will compare their activities to what is considered best practice in the market regarding responsible investment in asset management. This also enables PGGM to create its own benchmark against which the managers' responsible investment activities can be scored. Any possible improvements will also be input for future discussions.

The responsible investment criteria are used as a formal component of overall manager performance evaluation.

PGGM determines in the contract with the manager how ESG factors will be discussed, which assessment criteria apply to them, what reporting requirements and KPIs are laid down and how the ESG performance of the underlying investments are monitored.

For more information on Responsible Investment in External Management please contact the External Management department, +31 30 277 99 11 or visit our website www.pggm.com

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