PGGM Responsible Investment in Long-term Equity

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Adopted by PGGM Vermogensbeheer BV
1. Introduction

On behalf of its clients, PGGM Investments manages several public equity mandates, including both quantitative and fundamentally driven mandates. Together these mandates form a significant part of the total assets under management of PGGM. PGGM recognizes that 1) through the companies in which PGGM invests on behalf of its clients it has a significant impact on the environment and broader society as a whole, and 2) as a sizeable longterm equity investor PGGM has the opportunity to address ESG related issues directly with the executive management of a broad variety of companies. This document outlines how PGGM manages ESG related aspects with regards to its investments managed by the Longterm Equity Strategies (LTES) team. As there are material differences between the quantitative and fundamentally driven mandates managed by PGGM, both will be dealt with on a separate basis.

These guidelines are part of the PGGM Investments’ Responsible Investment Framework and its implementation guidelines. This framework is a more detailed elaboration of the PGGM Beliefs and Foundations for Responsible Investment. In addition, the PGGM guidelines on Exclusion are applicable to all public equity mandates managed by PGGM.

The balance of this document provides an overview of how PGGM views ESG aspects within public equity, how these aspects are incorporated into the decision-making process, and how identified ESG risks are managed.

The guidelines covered in this document are applicable for investments done as part of the fundamentally driven public equity investments managed internally by PGGM Investments’ longterm equity team. The guidelines are effective as of October 2017.

With the introduction of these guidelines PGGM Investments aims to improve transparency and governance. PGGM follows relevant developments closely and will update the guidelines when necessary. This policy does not confer any rights to any third parties.

2. Vision

PGGM recognizes that over the long term ESG factors can have a material impact on the financial performance of publicly listed companies. With its long-term investment horizon PGGM views it as its responsibility to capture the values and mitigate the associated risks related to company specific ESG factors. PGGM believes that the long term nature of the public equity investments undertaken by its LTES team on behalf of its clients uniquely positions it to engage with portfolio company executive management and exercise influence on specific ESG issues. Several examples of ESG factors that are deemed to be especially important are given in figure 1 below.

Figure 1: Sustainability 3x3 (source: PGGM)

In its handling of ESG issues PGGM defines three categories of instruments for responsible investment (figure 2).

Figure 2: Triptych with instruments for responsible investment

As far as the PGGM LTES team is concerned, all of these three categories are relevant for the following reasons:

- First, PGGM defines a cross organizational exclusion list of companies it does not want to invest in. The LTES team is thus bound by this list.
- Second, an indepth ESG analysis is an
integral part of the investment decisionmaking process for each of the portfolio companies. The analysis is done in order to identify specific ESG risks and ESG related areas that pose material reputational risks.

- Third, by taking investments into consideration in companies that sufficiently contribute to one or more of the four identified themes PGM is making the transition towards pro-actively investing in companies that provide a solution for an environmental or societal issue, e.g. water scarcity or access to healthcare. The impact mandate managed by the LTES team is aimed at specifically contributing to the four defined solution areas.

Next to taking the internal aspects of ESG into consideration, the longterm equity team has a strong focus on the positive external impact its portfolio companies have on the environment and broader society. PGM believes that working together with companies in quantifying and periodically measuring the impact portfolio companies have not only benefits PGM in terms of data collection. In fact it is expected to also benefit the respective portfolio companies directly as it allows them to highlight the environmental and social benefits that are related to their business activities. In a way it enables them to quantify their so-called ‘license to operate’.

3. Objective

The objective of these guidelines is to ensure transparency and increase public awareness in how PGM approaches and handles ESG issues in relation to public equities on behalf of its clients.

The primary goal of the long-term fundamental equity mandates PGM internally manages on behalf of its clients is twofold: 1) investments are undertaken with the aim to generate a satisfactory risk-adjusted financial return over the prospective life of the investment, and 2) the investment is to have a material positive environmental and/or societal impact by making a contribution to one or more of the four solutions, being water scarcity, food security, access to healthcare, and climate change. With that in mind (prospective) portfolio companies are analysed and monitored not only on strategic and financial merits but also on ESG performance.

Insofar that portfolio companies are associated with material ESG issues PGM will seek to engage with executive management and encourage risk mitigation and process improvements towards what are considered an industry’s best practices in terms of ESG processes.

Section 4. provides additional details on how PGM aims to reach its stated objective.

4. Implementation

PGGM’s LTES team manages portfolios aimed at generating both a financial return as well as a positive environmental and societal impact. It is the view of PGM that integration of in-depth ESG due diligence into the investment decision making process positively contributes to all of the goals of the investment portfolios managed by the longterm equity team.

Integration

PGGM LTES team integrates ESG analysis into its investment decision making process through application of the following steps:

- The cross-organizational exclusion list, as defined by PGM and approved by its clients, is applied to all prospective portfolio companies.
- A substantial part of the primary business activities of a prospective portfolio company needs to make a material contribution to one or more of the four defined social solutions focus areas, being water scarcity, access to healthcare, food security, or climate and environment.
- Thorough ESG analysis will be performed on a broad variety of topics to unveil material ESG risks associated with the company resulting in an overall score of 1 (high risk) to 5 (low risk). The analysis includes an assessment of a prospective portfolio company’s existing ESG policies, reporting and management system, as well as a survey of independent external sources on the company’s ESG performance.
- The final outcome of the ESG analysis will be an integral part of the investment case. Next to strategic and financial considerations, the resulting ESG risks and opportunities will be discussed within the investment committee and forms an equally important part of the ultimate investment decision.
- Post investment the ESG analysis will be updated and discussed within the longterm equity team as needed in case company specific circumstances change.

The Strategy team and Responsible Investment team have the ultimate responsibility for establishing the investable universe, LTES acts as a stakeholder in the decision-making process. The investable universe is approved by the client before becoming official. The central question for inclusion in the universe is the extent to which the business activities of a specific company materially contribute to one or more of the four defined solution areas in figure 2.

Engagement

PGGM’s LTES team engages with executive management of its portfolio companies on a regular basis. The team will address ESG related issues, next to strategic and financial issues, with the management of the relevant portfolio company. The aim is to exert influence and move a portfolio company towards its
industry’s best practices. Where needed, PGGM’s Long-term Equity team will collaborate in its engagement efforts with other stakeholders within PGGM, in particular with the Responsible Investment department.

The outcomes of the continuous engagement efforts undertaken by the LTES team are incorporated in an update of the ESG analysis.

Impact Measurement
Next to taking into account the ESG factors that focus on the internal aspects and processes of a (prospective) portfolio company, the team has a strong focus on the external impact that the primary business activities of a company have on the environment and the broader society.

Before becoming eligible for an investment, PGGM will assess whether a company makes a significant contribution to one or more of the four defined solutions areas.

Post investment the LTES team will seek to quantify the external impact of a portfolio company as much as possible. Insofar a portfolio company does not report metrics relating to the external impact its primary business activities have, the LTES team will seek to engage and cooperate with the company aiming to start quantifying and periodically measuring and reporting the impact the company has in one of the relevant theme(s).

Impact metrics for each company are periodically recorded in an internal database for analysis and anonymized report generation. PGGM recognizes that impact measurement is something that is new for many of the companies it engages with, and hence that in certain cases it will take time to start reporting on impact metrics.

For more information on PGGM Investments’ Responsible Investment Implementation Framework please contact our Responsible Investment department, +31 (0)30 277 99 11, or visit our website www.pggm.com