VicSuper

Investment Policy Statement

July 2019

1. About this document

This document summarises the key elements of VicSuper's Investment Governance Framework (IGF).

The IGF is the totality of systems, structures, policies, processes, and people employed by VicSuper Pty Ltd (the Trustee) in its fiduciary capacity to manage the investments of VicSuper Fund (VicSuper) in the best interests of members. All elements of the IGF are housed within detailed Trustee-approved policies which are subject to annual review.

The IGF applies to VicSuper's Trustee Directors, Committees, Executive team, employees, contractors, service providers, and investment managers.

2. Why we do what we do

The Trustee aspires to excellence in terms of investment governance. The purpose of pursuing good governance is to improve the likelihood of achieving better risk-adjusted returns for members.

2.1 Investment mission

VicSuper's investment mission is to optimise members' retirement savings and incomes in a manner consistent with responsible investment[1] principles.

2.2 Investment beliefs

There are few absolute truths in investment, with many issues unable to be definitively proven. In light of such uncertainty, the Trustee has developed a number of investment beliefs that it believes are integral to strong investment governance. The purpose of having investment beliefs is to:

- ensure that VicSuper can fulfil its mission
- maintain a focus on matters of strategic importance
- save time and maximise efficiency
- enhance clarity of thought
- provide structure, consistency, and discipline to investment decision making at all levels of VicSuper
- provide a foundation to help navigate stressed market conditions

The Trustee's key investment beliefs are shown below.

Governance beliefs:

- Good governance and transparency help us to act in the best interests of our members.
- Clear decision making structures promote decisiveness, efficiency, and accountability, and add value to members.
- Diversity and inclusion leads to better decisions and less bias in investment decision-making.
- We believe an outsourced funds management model provides the best investment outcomes for our members.

Market beliefs:

- Investors are rewarded for taking long-term market risk.
- Asset allocation is the most important driver of investment returns.
- Markets vary in efficiency which means that anomalies arise that can be exploited through investment in a combination of passively managed core and actively managed satellite strategies.

1 Responsible investment is an approach to investing that incorporates environmental, social, and governance (ESG) factors into investment decisions to better manage risk and generate sustainable, long-term returns.

Responsible investment beliefs:

- We are a long-term and universal asset owner[2]. We believe that taking active responsibility for our portfolio helps identify and manage risks and enhance returns for our members. Active responsibility includes the identification of ESG-related risk and opportunities as well as actively engaging with investee companies and proxy voting in order to create long-term shareholder value.
- We believe that climate change has the potential to have a material negative impact on our portfolio due to its impact on the environment and society. We believe it is incumbent on us as fiduciaries to manage the financial risk due to climate change in our portfolio.

Risk beliefs:

- We view risk holistically and practically as anything that gives rise to permanent impairment of mission.
- Diversification is the primary means of reducing investment risk.
- Dynamic asset allocation is another useful, albeit lesser, means of managing risk.

Other beliefs:

- Management of costs (fees, tax, and implementation efficiency) is important.

3. Investment governance structure

There are three key entities within VicSuper's investment governance structure: the Trustee, the Investment Committee, and the Investment Management Committee.

3.1 Trustee

The Trustee is ultimately responsible for the IGF, the sound and prudent management of VicSuper's investments, and the regulatory compliance of VicSuper. It is assisted in its task by various Committees, external advisers, and internal staff.

3.2 Investment Committee (IC)

The IC is a Board committee with delegated authority as documented in a formally constituted Charter. The primary objective of the IC is to assist the Trustee in relation to the investment activities of VicSuper Pty Ltd, VicSuper Fund, and VicSuper Ecosystem Services Pty Ltd.

Membership of the IC consists of four directors (two member and two employer directors) including the Chair of the IC. Members of the IC including the Chair are appointed by the Trustee. The Trustee retains collective responsibility for the decisions, performance, and outcomes of the IC.

3.3 Investment Management Committee (IMC)

The IMC is an extension of the IC with delegated authority as documented in its own formally constituted Charter. The IMC's objectives are to improve the timeliness and efficiency of the implementation of strategic asset allocation, dynamic asset allocation, and manager appointment/termination decisions, within the framework stipulated by the Trustee.

Membership of the IMC consists of the Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, and Chief Investment Officer. The Trustee retains collective responsibility for the decisions, performance, and outcomes of the IMC.

2 A universal investor refers to a large (often institutional) investor holding a highly-diversified and long-term portfolio that is representative of global capital markets such that the investor has a financial interest in the wellbeing of the economy as a whole.

4. Investment objectives

The Trustee maintains a number of investment options to cater for different investment timeframes, risk appetites, and financial circumstances among members.

To assist in framing its investment strategy, the Trustee sets investment objectives that are specific and measurable for each investment option. It is assisted and advised in this process by an external asset consultant which utilises a rigorous analytical framework. Investment objectives are formally reviewed once a year.

The Trustee maintains three distinct investment objectives:

1. A return objective for all investment options.
2. A risk objective for all investment options.
3. Specifically for MySuper Product Dashboard purposes, a return target for the Growth (MySuper) Option on the FutureSaver platform only.

5. Investment strategy

The Trustee's investment strategy within each investment option is determined by taking into consideration advice from both an external asset consultant and internal staff.

5.1 Strategic Asset Allocation (SAA)

The Trustee sets each investment option's SAA and associated asset allocation ranges with the expectation that, over the long term (10 years plus), this asset allocation will maximise the probability of achieving investment objectives. SAA settings are meant to be long-term in nature, so are therefore set with the expectation that they may change relatively infrequently. The Trustee reviews them annually to assess that they remain appropriate, a process which occurs simultaneously with the annual review of investment objectives.

At all times, the Trustee requires that all investment options are adequately diversified, since diversification is integral to sound risk management. For this to be successful, it needs to occur on multiple fronts:

- At a broad level, the Trustee employs diversification across risk premia/factors. The Trustee targets the type of risk premia/factor that each investment option should be exposed to.
- For multiple asset class investment options, diversification is achieved across a number of fronts: risk factors, asset classes, investment managers, and counterparties. However, equity risk will typically be the largest driver of risk.
- For single asset class investment options, there are natural limits to diversification.

5.2 Asset class structures

To give structure to its asset class exposures, the Trustee recognises five headline asset classes and a number of associated sub-asset classes, as follows:

Equities:	• Australian Equities • International Equities • Emerging Market Equities
Alternatives:	• Private Equity • Alternatives – Growth • Alternative Credit
Real Assets:	• Infrastructure • Property • Agriculture & Timber
Fixed Interest:	• Australian Fixed Interest – Nominals • Australian Fixed Interest – Inflation-Linked • International Fixed Interest
Cash:	• Transactional Cash • Strategic Cash

The Trustee also employs a ‘Core’ and ‘Satellite’ structure within a number of asset classes, with the allocation to each varying depending on the nature of the asset class and available opportunities. While not strictly defined since judgement needs to be exercised:

- **Core:**
  - in relation to Equities and Fixed Interest (which are public markets), refers to exposures to investment managers in broad asset classes which are passive or enhanced passive in nature, and
  - in relation to Alternatives and Real Assets, refers to exposures designed to capture the essential characteristics of the asset class in question.
- **Satellite:**
  - in relation to Equities and Fixed Interest, refers to exposures to active investment managers and/or niche asset classes, and
  - in relation to Alternatives and Real Assets, refers to specialist exposures designed to enhance the returns of the asset class in question.

Asset class structures are reviewed on an annual basis through a formal sector review.

5.3 Dynamic Asset Allocation (DAA)

The Trustee believes that risk and return expectations over the medium term (one to five years) can vary considerably due to economic and market conditions, relative to long-term expectations, and that it can increase returns and reduce risk for investment options by temporarily increasing or decreasing exposure to asset classes relative to their SAA. As such, the Trustee augments its SAA approach with a thoughtful, disciplined, and risk-controlled DAA approach. DAA tilts are not meant to be highly tactical in nature and recognise that asset classes can be undervalued or overvalued for considerable periods of time.

5.4 Stress & scenario testing

The Trustee has a stress and scenario testing program in place. The purpose of such testing is to identify and assess, on a forward-looking basis, potential risk factors that would reduce the likelihood of VicSuper’s investment options achieving their investment objectives. Such analysis is used to determine whether a change to investment strategy and/or investment objectives may be required with respect to any individual investment option. Testing is conducted annually for SAA purposes and quarterly for DAA purposes, although it may be done more frequently in some circumstances.

5.5 Investment manager selection

Consistent with its investment beliefs, the Trustee utilises external investment managers to implement investment decisions since no member assets are managed in-house. As such, investment managers play a crucial role in helping the Trustee to achieve investment option investment objectives. In all investment manager selection (and termination) decisions, two key sets of factors are considered – rating view and portfolio fit. A favourable rating view and favourable view on portfolio fit are necessary for new appointments, based on a dual-advocacy advice model involving both internal staff and an external asset consultant.

5.6 Currency management

As a large institutional investor, the Trustee will invest outside Australia. While diversifying in nature, such foreign currency exposure exposes VicSuper to fluctuations in the market value of its non-Australian dollar investments. The Trustee seeks to manage this exposure, predominantly from a risk management perspective.

In terms of currency exposure that arises from investing in asset classes with a dominant offshore component, the Trustee's hedging principles are as follows:

- Hedge the benchmark exposure (or actual in the case of Real Assets) of any asset class where income and/or stability are critical. This is necessary since currency volatility would swamp the desired characteristics if the exposure is left unhedged. The asset classes that fall under this arrangement are Alternatives – Growth, Alternative Credit, Real Assets, and International Fixed Interest.
- Treat the remaining currency exposure – arising from International Equities, Emerging Market Equities, and (International) Private Equity – like an asset class, meaning that it has a strategic target exposure and permitted range, and is dynamically managed within that range.

5.7 Derivative risk management

As a large institutional investor, the Trustee is a natural user of derivatives. Derivative use arises from a number of areas, and the Trustee has a formal policy in place to govern the list of acceptable derivative instruments, the ways in which derivatives can be legitimately used to assist the Trustee with its investment mission, and the ways in which derivatives should not be used.

5.8 Responsible investment

The Trustee is committed to the responsible investment of members' retirement savings since it believes that this is both consistent with our objective of optimising members' retirement savings and incomes, and contributes positively to the world our members live and retire in.

Responsible investment beliefs direct our approach to responsible investment and form part of our broader investment beliefs (core responsible investment beliefs are contained in Section 2). The following responsible investment beliefs provide additional direction to the Trustee's responsible investment approach:

- ESG factors have the potential to be material to investment risk and return and may not be efficiently priced by markets. Considering ESG factors may lead to more complete analysis and better informed investment decisions.
- As a long-term investor, we believe that active ownership[3] has the potential to positively influence company behaviour and performance and can therefore contribute to long-term shareholder value.
- Engagement, rather than divestment, provides the ongoing ability to have a positive influence on our investments.
- As a universal investor, invested in a broad range of global companies and other assets, we have a vested interest in the long term sustainability of the global economy and a responsibility to contribute to the long-term health and stability of the market as a whole.

3 Active ownership refers to the use of the rights and position of ownership to influence the activity or behaviour of investees. For listed equities, active ownership involves engaging with investee companies, and voting eligible shares.

- Members' best interests are served through our fiduciary duty. Member outcomes will also be impacted by the state of the environment and the society into which they retire.
- Climate change has the potential to have a material negative impact on society and the environment. This will provide both opportunities and potential risks for the investment portfolio. We have a fiduciary duty to manage the financial risk due to climate change in our portfolio.

The Trustee's beliefs are implemented through a responsible investment approach based on four pillars:

1) ESG integration
2) active ownership
3) investing in sustainable outcomes, and
4) member choice (enabling members to invest their superannuation savings in line with their values).

We undertake responsible investment for all asset classes with the exception of Cash. For all asset classes, we select investment managers that integrate ESG factors into their investment decisions. Further, we classify a portion of our Private Equity, Property and Infrastructure, as well as all of our Agriculture investments, as investing in sustainable outcomes.

5.9 Engagement & proxy voting

The Trustee recognises that it has rights and responsibilities as a shareholder and co-owner of the companies that VicSuper invests in. As a fiduciary acting on behalf of members, the Trustee understands that engaging with companies through dialogue and voting at company meetings helps ensure there is alignment between how companies are managed and the Trustee's interests as a shareholder. These activities also help us to progressively drive positive change in corporate behaviour which in turn helps protect the long-term value of investments and our members' retirement savings.

Engagement is undertaken predominantly through specialist service providers, while proxy voting is managed through a variety of approaches that are specific to Australian, International Developed Market, and Emerging Market Equities. There are also circumstances under which we may participate in class actions against investee corporations.

6. Implementation

6.1 Monitoring & review

The Trustee has a plan in place to monitor VicSuper's investments, and review the investment strategy within investment options and the appropriate management of investment risk.

In terms of monitoring, there are several aspects – performance monitoring, exposure monitoring, asset class monitoring, investment manager monitoring, responsible investment related monitoring, and investment option strategic monitoring – with stringent procedures and reporting obligations in place over a variety of timeframes to allow appropriate oversight and management.

The investment strategy behind each investment option is subject to an annual review, as well as ongoing reviews of all its components through annual asset class / sector reviews, as discussed above. Nevertheless, the Trustee has identified triggers for interim reviews. The Trustee is also naturally concerned about the possibility that investment options may underperform their investment objectives and has a documented process in place to manage such situations.

Finally, the Trustee is ultimately responsible for the sound and prudent management of investment risk. The Trustee has identified investment risk as a key material risk for VicSuper, and as such, has first line controls in place to manage and mitigate the contributing factors, with relevant oversight on the control effectiveness. The identification, measurement, assessment, and management of investment risk is a vital aspect of the Trustee's investment governance and risk management frameworks.

6.2 Rebalancing

The Trustee has a rebalancing framework in place. Since asset classes experience continual variability with respect to their target weights, the rebalancing framework maintains discipline and control over those movements; helps ensure that investment options do not breach their asset class ranges; and helps to maintain a sensible balance between risk, return, and transaction costs.

6.3 Operational Due Diligence (ODD)

VicSuper is exposed to operational risk[4] within its investment managers due to the significant role investment managers play in executing the Trustee's investment strategy. Unlike investment risk, operational risk carries no upside to returns. Accordingly, the Trustee has a low tolerance for operational risk at its service providers and has a policy in place to effectively mitigate the exposure to ODD-related risk in its initial and ongoing assessment of investment managers.

6.4 Transition management

Where there is a material change in asset allocation, or a material appointment and/or termination of an investment manager, there is a formal process in place for the transition of assets so that it adheres to a number of best practice principles. These are total cost minimisation, simplicity, timeliness, and exposure management integrity.

6.5 Valuation

The Trustee has a formal valuation policy in place to help ensure equity between members, the fair allocation of investment returns to members, and that VicSuper's financial statements reflect the true and fair value of the underlying investments.

6.6 Liquidity management

As part of its approach to risk management, the Trustee seeks to be aware of liquidity risk and plan for liquidity risk events. The Trustee must maintain sufficient liquidity to meet its financial obligations. It employs a number of techniques to measure and monitor liquidity. It also has a methodology in place to manage liquidity, including a ceiling on the level of illiquid assets within each investment option, and a liquidity event management framework that applies in certain circumstances.

4 Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events as well as other non-investment risks arising from opacity in key tax, legal, and ESG exposures.

Get in touch – we're here to help

Call our Member Centre

1300 366 216 and speak to a VicSuper super consultant between 8.30am and 5pm, Monday to Friday

Visit us

Bendigo | Blackburn | Geelong | Melbourne CBD | Traralgon

Monday to Friday
8.30am to 5pm

To make an appointment to see a VicSuper financial planner call **(03) 9667 9200**

Send us a fax

(03) 9667 9610

Write to us

VicSuper
GPO Box 89
Melbourne VIC 3001

Browse our website

vicsuper.com.au

Download our app

vicsuper.com.au/mobileapp

Manage your account online

Simply visit our website to login

07/19