



Management of Environmental, Social and Governance Issues

Date: 28 February 2017

1. Integrating ESG factors into investment decision making

- 1.1 The Board believes that effective management of material financial and reputational risks and opportunities related to environmental, social and governance issues will support its requirement to maximise returns earned on the Funds.
- 1.2 The integration of ESG factors enables investors and companies to better understand the full spectrum of future risks and opportunities to which assets are exposed. Beyond its impact on the specific investments of the Funds, sound management of ESG factors contributes to the development of more efficient and sustainable markets, in turn enhancing long-term returns.
- 1.3 The Board builds this perspective into its investment decision-making including the integration of ESG into the process for selecting external investment managers, evaluation of ESG factors in direct investments, and the management of ownership rights.

2. Partnering with external investment managers

- 2.1 The Board has a statutory obligation to invest through external investment managers. As such, these investment managers play an integral role in implementing our ESG strategy. This model requires careful coordination and alignment between the Fund and its managers. As part of our manager selection and monitoring process, the Board considers the extent to which the manager is effectively managing financial risks and opportunities that may arise from ESG issues.
- 2.2 A formal manager review framework is in place that tailors the due diligence requirements in line with the potential ESG risks associated with a particular asset class and investment strategy. This process is underpinned by dedicated and ongoing engagement with our investment managers and supported by relevant analytics.
- 2.3 To the extent that formal or informal ownership rights accrue in the manager's portfolio and are delegated to the manager, due consideration is given to the manager's ability to exercise those rights in the best interests of the Board.
- 2.4 The outcomes of these ESG reviews are integrated into the Agency's overall manager onboarding and review process.

3. Direct asset investments

- 3.1 The Agency structurally integrates ESG considerations into the Future Fund's investment decision making process, including assessments of ESG and reputational risk issues for all new investments considered by the Investment Committee as well as the Asset and Manager Review Committees where relevant.
- 3.2 Where we make direct investments (eg in infrastructure, property, timberland or private equity), an evaluation of ESG and reputational risk factors is undertaken internally. The due diligence supporting direct investments typically features dedicated analysis by our investment managers to review the extent of ESG risk related to the assets under consideration. Where particularly complex or unique risks have been identified, the Agency may procure supplementary third party research to ensure these issues are accurately integrated in our investment decision making process.
- 3.3 The Board will review the governance arrangements of an investment vehicle before committing capital. Where applicable, the Board will seek appropriate information, engagement, enforcement and termination rights and will ensure its interests are effectively represented through appropriate active representation on the vehicles' governance bodies. The Board will oversee the quality of the governance of the underlying assets held through those vehicles either through its managers or directly as appropriate.

4. Exercising ownership rights

- 4.1 The Board believes that there is a positive relationship between good governance and investment value and acknowledges the value of exercising its ownership rights, including voting rights where relevant, across the broad range of its investments. Ownership rights are essential to ensuring the appointment and retention of fiduciaries of the highest quality, and motivating those agents to manage value creation over the long term.
- 4.2 The Board has developed high-level corporate governance principles to enable the consistent and principled exercise of ownership rights. While these principles are primarily tailored to proxy voting in listed equity markets, they also guide our expectations on governance practices in private markets. The principles are based on the premise that a corporation's actions should be consistent with the primary objective of generating long-term shareholder value. The principles are:
 - i) Companies should disclose accurate and material information on a timely basis to allow shareholders to make informed decisions.
 - ii) Companies should respect shareholder rights and their directors should engage with shareholders, particularly on major decisions.
 - iii) All shareholders should be treated equally and have the right to vote in proportion to their economic interest in the company.
 - iv) Companies should compose high calibre, commercially experienced and diverse boards of directors to provide superior business leadership and integrity.
 - v) Boards of directors should be composed to ensure the exercise of objective independent judgment.

- vi) Companies should establish a sound system of oversight, management and control of business risks.
 - vii) Boards should appropriately balance measures to protect the capital adequacy of the company with equitable treatment of shareholders.
 - viii) Structures that transfer power from shareholders to management or third parties to protect against takeovers are generally undesirable.
 - ix) Companies should have appropriate performance evaluation and incentive systems that align executives with long term shareholder interests and company strategy.
- 4.3 While the above principles are not exhaustive, and may not necessarily represent how voting will occur in any particular situation, they address (either individually or in combination) the typical issues that are put to shareholders globally to vote upon.
- 4.4 Ownership rights in the listed equities of Australian companies are exercised by the Agency on behalf of the Board. In determining voting decisions, the Board applies its voting principles, while also drawing on the insight of its external investment managers and research providers. As appropriate, the Agency will engage with companies to clarify issues relating to resolutions and to ensure that it is sending clear and constructive signals through its ownership activities.
- 4.5 Given the scope and complexity of exercising voting rights in multiple international markets, the exercise of ownership rights in the global (ex Australia) listed equities portfolio is delegated to the Future Fund's external investment managers. These managers are typically in the best position to analyse governance matters concerning the entities in which they invest on behalf of the Board.
- 4.6 The approach of external investment managers in exercising ownership rights on behalf of their investors is assessed as part of the due diligence process prior to the appointment of a manager. The exercise of those rights is subject to close oversight by the Agency and regular reviews of the managers' ownership policies and practices. The Board retains the right to override managers and determine voting decisions, although in the normal case, it does not expect to have to do so.
- 4.7 For some investment strategies or structures, our investment managers may be unable to vote our shares on our behalf in a manner that is consistent with our governance principles and expectations. In these cases, we will apply an alternative voting framework (eg insourcing; rules-based; delegation of voting rights) to ensure that the Board continues to exercise these voting rights in a consistent and informed fashion.
- 4.8 The Board is governed by Future Fund Act of 2006. Specifically, Division 8 of the Act outlines specific requirements to prevent conflicts of interest in Board decision making. The Agency is covered by the Public Governance, Performance and Accountability Act 2013. In addition to these legislative requirements, the Board has established rules for considering and opining on proxy voting decisions in line with applicable governance standards.
- 4.9 The Board will disclose, in its annual report, the extent to which it exercised its ownership rights and, in broad terms, the nature of its voting.

5. Engagement with investee entities

- 5.1 The Board recognises the value of focussed dialogue with company management, board and relevant fiduciaries to establish a climate of long-term asset stewardship, with active oversight from investors and accountability of management to the provider of capital. Company engagement also complements our voting activities to improve analysis and the signalling power of the votes cast.
- 5.2 We leverage the engagement activities conducted by our investment managers in making our voting decisions. These managers are the front line of engagement, given their in-depth company knowledge and contacts.
- 5.3 We also engage directly with key investee entities on pertinent ESG issues where this may promote better practice and yield long term value creation. This direct engagement is conducted mainly with Australian domiciled companies, given the size and influence of our investments in our local market and practical considerations.
- 5.4 We partner with our investment managers to coordinate engagement activities with investee entities to ensure that a consistent and mutually reinforcing approach is communicated.

6. Excluded investments

- 6.1 The Board may invest in any entities and assets where it is lawful do so subject to applicable laws including the Board's own legislative constraints. The Board in turn requires its investment managers to comply with applicable laws in connection with their investment activities on behalf of the Board. Where it comes to the attention of the Board that an investment may be unlawful the relevant investment will be excluded from the portfolio.
- 6.2 Australia has ratified a number of international conventions and treaties that limit certain activities. Where the Board determines that the activities of an entity or funding activity contravene such a convention or treaty, it will consider the exclusion of the investment from the portfolio.
- 6.3 Where serious breaches of ESG standards have been identified, the Board prefers engagement over exclusion, working with the entity to improve ongoing performance where appropriate. The Board reserves the option to exclude an investment for the most egregious sustained activities where the entity is unwilling or unable to change its practices.
- 6.4 The Board publishes the list of exclusions under this ESG Policy on the Future Fund website.

7. Contributing to a stronger investment system

- 7.1 The Board believes that it can play a role in advancing good practice for institutional investment, contributing to system integrity, protecting investor rights and building new markets. The Board believes that improving the stability, transparency and efficiency of the markets in which it operates will benefit the Future Fund as a long-term investor. This includes working with other market participants to promote best practice and address some of the systemic challenges to effective corporate governance and ESG integration.