University of Melbourne

Sustainable Investment Framework

Approved 9 March 2021

Background

The University of Melbourne (the University) is committed to sustainability in everything it does, from teaching and learning to research, campus operations, community engagement, and university governance. This Sustainable Investment Framework (SIF) outlines the University's approach to sustainability, particularly climate change, in its investment portfolios and processes.

Development of this SIF has been informed by:

- The University's Sustainability Plan
- The University's fiduciary duties and obligations as trustee of the University's investment funds
- Guidance provided by the Australian Prudential Regulation Authority (APRA) on climate change and fiduciary duty
- Global best practice in responsible investment, as enshrined in the six principles of the UN-backed Principles for Responsible Investment (PRI)
- Recommendations from the global Financial Stability Board Taskforce on Climate Related Financial Disclosure (TCFD)[1]
- Best practice in sustainable investing among leading global university endowment funds and investment managers

The University's investments are managed by third party Fund Managers who appoint underlying Portfolio Managers to invest the University's funds. The portfolio is primarily invested via units in pooled investment trusts where the University's funds are commingled with those of other investors. Therefore, the University does not have decision-making powers over whether to buy and sell individual company holdings.

The University, working in partnership with its Fund Managers and other partners, will implement this SIF in a staged manner. How the University will oversee implementation of this SIF, including delegations, is outlined in the Measuring and Monitoring Our Sustainable Investment Performance and Governance of the Sustainable Investment Framework sections below, as well as in the University's Statement of Investment Management and Principles (SIMP).

This SIF only applies to the University's listed equity, unlisted property and unlisted infrastructure investments (the management of which has been outlined) and focuses primarily on how the University will address climate change risks in its investment portfolio. In the future, the University is

[1] The TCFD is a 32-member industry group, chaired by Michael Bloomberg. In June 2017, the TCFD published its recommended disclosure framework for managing risks and opportunities linked to climate change. The recommendations apply to companies, asset managers, and asset owners; the recommendations focus on governance, strategy, risk management, and metrics and targets for identifying and disclosing material climate change factors.

in the process of extending this SIF to its entire long-term investment portfolio and may expand it to address other environmental, social, and governance (ESG) issues beyond climate change.

Our Sustainable Investment Beliefs

The University's Sustainable Investment Beliefs form the basis of this SIF.

As articulated in the SIMP, the University believes that companies which effectively manage their ESG responsibilities should deliver better risk-adjusted returns over the long term. For example, the University believes that companies which effectively manage climate change-related risks will be better positioned to manage the transition to a low-carbon economy and the physical impacts of climate change than companies which do not.

The University also believes that, by making active use of its ownership rights as a steward of capital, it can contribute to better risk-adjusted returns in its investment portfolio and a more sustainable future.

The University acknowledges the threats posed by climate change and fully supports steps towards a lower emissions future. These steps include limiting global warming to no more than 2 degrees Celsius by the end of the century as recommended by the Intergovernmental Panel on Climate Change (IPCC) and as targeted under international climate change agreements including the Paris Agreement. The University believes that climate change will result in increased risk and potential opportunities for its investments. Therefore, the University has a fiduciary duty to address how the risk-adjusted performance of its investments may be affected by climate change.

As an extension of its commitment to *Growing Esteem* and as reflected in the SIMP, the University believes that long-term investors can position their investments to benefit from shorter-term behavioural biases in investment markets. The University believes that climate change presents an example of when the market may not be correctly pricing longer-term investment risks and opportunities. Therefore, the University believes that the SIF will allow it to deliver better long-term risk-adjusted returns, while also *growing in the esteem of future generations*.

The University believes that its financial strength is essential to its ability to fulfil its core functions as an educational institution, including the support of research into the technologies addressing climate change, and the fostering of open, evidence-based debate on societal challenges. Moreover, it believes that active shareholder engagement has an important and valuable impact on corporate decision making. As a consequence, the University does not believe that a strict exclusion (or divestment) approach is the most effective way for it to meet its fiduciary duty in regard to climate change risk, nor to drive progress on climate change mitigation. A strict exclusion approach might compromise the University's financial strength by narrowing the universe of possible investments, and such an approach would lead the University to forgo its ability to engage with or influence investee companies (via its Fund and Portfolio Managers) in discussions around climate change risk management and disclosure.

Our Sustainable Investment Objectives

The University has developed this SIF as a means of reflecting its beliefs about climate change and investment risk (and opportunity) in its investment policy and processes. The aims of this SIF are to

establish a set of criteria, processes, and systems by which the University can measure how it is meeting the following sustainable investment objectives:

1) Improve investment outcomes by integrating ESG factors, including climate change risk and opportunity, into the investment decision-making process, consistent with the University's fiduciary duties.
2) Improve the carbon footprint of the University's listed equity, property and infrastructure portfolios where possible and compatible with its overall investment objectives.

Our Sustainable Investment Approach

Integration

The University will incorporate material ESG issues, with a focus on climate change risk, into investment analysis and decision-making processes, as recommended under Principle 1 of the PRI.

Climate Change Risk Integration by Fund Managers

The University will assess and monitor the performance of each of its Fund Managers on its ability to integrate climate change risk and opportunity into the portfolio management process, including in the selection of underlying Portfolio Managers. This assessment will include the following:

1) Is the Fund Manager aware of climate change risk and its potential impact on the University's investment portfolio? Has the Fund Manager considered the potential impacts on fund performance that may arise, for example, from physical, transitional, and legal / liability factors?
2) Is climate change considered in the Fund Manager's investment framework? If so, what process is used to quantify climate change risk, and how is that incorporated into its investment decision-making?
3) How is climate change risk identified, assessed, and managed as part of the Fund Manager's portfolio risk management?
4) Has the Fund Manager stress tested the relevant portfolio of assets against a range of climate change scenarios, including a 2-degree Celsius scenario? What was the outcome of the scenario testing and what steps are being taken to improve portfolio resilience?
5) How have potential long-term investment opportunities linked to climate change been identified and considered by the Fund Manager?
6) How is the Fund Manager exercising its stewardship responsibilities, through voting and engagement, to mitigate climate change risk for the University's portfolio holdings?

A Fund Manager may propose alternative criteria for demonstrating its integration of climate change risk and opportunity into investment decisions. The University will determine whether these criteria adequately address the University's objectives.

Additional Climate Change Risk Assessment

If the approach to climate change risk integration by a Fund Manager is deemed by the University to be inadequate, the University will undertake a more in-depth material climate change risk assessment of the underlying listed equity portfolio. In determining material climate change risk linked to specific investments, the University will consider the indicators outlined below:

1) Whether a company's core business activity is aligned with a transition to a low-carbon economy.

2) Whether the company has developed a strategy for transitioning to a low-carbon future and outlined steps to reduce its direct (Scope 1 and 2) greenhouse gas emissions and any indirect emissions linked to its core products.
3) Whether the company has invested in, or begun developing, products that will support a shift to a low-carbon economy, such as renewable energy, energy storage systems, or electric vehicles.

The University believes that companies which fail these three climate change risk assessment indicators are generally at greatest risk of value destruction. Additional climate risk indicators may be added to this assessment in future as better risk analysis tools and approaches become available.

If the University's additional risk assessment identifies any companies it believes are facing material climate change risk, the University will engage with the relevant Fund Manager to share the University's assessment and request that the Fund Manager addresses the risks identified. Options available to the Fund Manager to address the risks might include, but are not limited to, direct engagement with the identified companies (as outlined in the approach to Active Ownership below) or disposal of material holdings in those companies.

If, on the basis of its overall assessment, the University determines that the Fund Manager is not appropriately integrating climate change risk and opportunity into its investment processes, the University will reassess its ongoing relationship with the Fund Manager.

Portfolio Resilience to Climate Change

The University will require each of its Fund Managers to test the resiliency of its portfolio managed on behalf of the University to various climate change scenarios as recommended by the TCFD, to ensure the Fund Manager is aware of and actively addressing systemic risks. This test could include factors such as the risks associated with the advent of new clean energy technologies, the impacts of climate change on resource availability including water, the physical impacts of climate change arising from more severe or frequent weather events, and the policy risks arising from global government commitments to decarbonise the economy. The University and its Fund Managers will assess the results of this scenario testing to identify additional opportunities to improve the resiliency of the investment portfolio to the impacts of climate change.

Active Ownership

As a long-term investor focussed on sustainability, the University is committed to responsible investment stewardship and active ownership. This commitment includes ensuring that the University's shares are voted at company annual meetings and, where appropriate, the University engages with companies (via its Fund Managers) to improve corporate governance and sustainable business practices. The aim of the University's active ownership approach is to improve the risk-adjusted return outcomes of the portfolio. These actions are consistent with PRI Principles 2 and 3.

Proxy Voting

The University's Fund Managers are responsible for voting on shares held on its behalf at all shareholder meetings. The University expects its Fund Managers to vote in a way that encourages good governance, recognises climate change as a systemic risk, and seeks appropriate disclosure on climate change and other material ESG issues by investee companies. Where proxy voting is delegated by a Fund Manager to a proxy adviser or underlying Portfolio Manager, the Fund Manager will assess the voting criteria of the third party for alignment with this SIF.

Specifically, the University supports the recommendations of the TCFD and will generally support shareholder proposals aimed at encouraging companies to report in line with the TCFD recommendations.

Engagement

The University will engage with its Fund Managers and investment advisers to ensure active consideration of ESG factors, including climate change, in the processes of: strategic asset allocation, Portfolio Manager selection, and portfolio monitoring and reporting.

The Fund Managers have primary responsibility for engaging with underlying Portfolio Managers and their selected investee companies regarding material ESG risks. Following an Additional Climate Change Risk Assessment as previously described, the relevant Fund Manager is responsible for engaging with companies identified as having a high climate change risk exposure. The objective of this engagement is to improve understanding of climate change risks and to encourage the company to take steps to mitigate these risks. The Fund Manager may appoint a dedicated service provider to undertake this engagement on its behalf.

The University will request annual engagement updates from its Fund Managers.

Collaboration

The University is a member of the UN Global Compact and a supporter of the UN Sustainable Development Goals. The University will look to collaborate with other parties to develop or adopt strategies to improve the management of investment risks related to climate change and sustainability issues, and to capitalise on opportunities linked to a low-carbon transition. The University may also leverage collaborative opportunities to engage with companies and regulators on climate change and sustainability, such as through the Investor Group on Climate Change, the PRI Clearinghouse, the CDP (formerly known as the Carbon Disclosure Project) or other collaborative initiatives yet to be determined.

Measuring and Monitoring Our Sustainable Investment Performance

The University, in partnership with its Fund Managers and investment advisers, will measure and monitor performance against this SIF on an annual basis. Key performance metrics against which this SIF will be assessed are as follows:

1. **Fund Managers' performance in integrating climate change risk and opportunity** into the investment process. The University's Fund Managers will be required to report at least annually on progress in climate change risk management and integration, in line with the indicators outlined in Climate Change Risk Integration by Fund Managers.
2. **Additional climate change risk assessment**. If a Fund Manager's approach to addressing the investment implications of climate change on the investment portfolio is deemed inadequate by the University, or further comfort is desired, the University may undertake a more in-depth climate change risk assessment of the underlying listed equity, property and infrastructure portfolios as outlined in Additional Climate Change Risk Assessment. This assessment will enable the University to identify any material holdings that represent an unacceptably high risk based on the assessment indicators. Where such holdings are identified, the University will engage with the relevant Fund Manager as outlined previously,

and the Fund Manager will be required to report on the steps it has taken to address the University's concerns, such as engagement or disposal of material holdings.

3. **Carbon footprint**, as one measure of the investment portfolio's positioning for a low-carbon economy, against which performance can be tracked over time. The University will focus on the weighted average carbon intensity (WACI) of the portfolio as this metric normalises for size and is the carbon footprint metric recommended by the TCFD. The University will compare the WACI of its underlying portfolio to that of its benchmarks. The University aims to reduce the carbon footprint of its portfolio over time where possible and compatible with its other investment objectives.
4. **Active Ownership activities**, with a specific focus on how the Fund Manager(s) is incorporating climate change into its proxy voting and engagement activities and progress against engagement objectives.
5. The University will assess its ongoing relationship with a Fund Manager if it determines that climate change risk and opportunity are not being adequately integrated into the investment processes of that Fund Manager

Reporting on Our Sustainable Investment Progress

The University will report publicly on its performance against the SIF in its annual Sustainability Report.

Governance of the Sustainable Investment Framework

Oversight of the SIF is the responsibility of the University's Investment Management Committee (IMC), which reports to Council through the Finance Committee. The Chief Financial Officer (CFO) is responsible for ensuring implementation of the framework. The CFO will report annually or more frequently if required to the IMC on the University's performance against this SIF.

This SIF will be reviewed annually as part of the IMC's annual strategy review. The purpose of the annual review will be to strengthen and improve the SIF over time by learning from industry best practice.

Property and Infrastructure Extension

Property and Infrastructure Specific Considerations

In addition to the requirements of the SIF, we expect fund managers of property and infrastructure assets to:

- Report on relevant metrics over time as the industry develops. Suggested metrics include but are not limited to Global Real Estate Sustainability Benchmark (GRESB) results for property and % of Renewables for infrastructure. We encourage our managers to propose alternative metrics where necessary.