

PROFILES OF INVESTOR SYSTEMS AND RELATED APPROACHES



PGGM

Asset manager: Diversified/specialized financial service provider * Headquarters: Netherlands * AUM: US\$221 billion (2014)¹

AT A GLANCE

TOOLS OF INTENTIONALITY

- Additionality
- Diversity of Approach
- Evaluations
- Interconnectedness
- Locality
- Polity
- Self-Organization
- Solutions
- Standards Setting
- Utility

ON-RAMPS

- ESG integration
- Impact investment
- Investment stewardship
- Long-term value creation
- Universal ownership

ASSET CLASSES INTEGRATED INTO

- Fixed income
- Infrastructure and real assets
- Private equity
- Other
- Public equities
- Real estate
- Venture capital

YEARS INTEGRATING

3, since 2014

SYSTEMS & THEMES FOCUSED ON

- Environmental
 - Biodiversity
 - Climate change
 - Natural resources
 - Oceans
 - Renewable energy
 - Sustainable land use
 - Waste management and pollution
 - Water
 - Other
- Societal
 - Consumer health and safety
 - Corporate governance
 - Corruption
 - Employment, labor rights and working conditions
 - Food production and security
 - Human rights
 - Income inequality and financial inclusion
 - Infrastructure
 - Social equality and diversity
 - Other
- Financial
 - Shareholder rights
 - Stability
 - Transparency
 - Other

TOOLS OF INTENTIONALITY: THE PGGM "TIIPING" POINT

Of particular interest from the point of view of systems-level considerations are the commitments of PGGM to exploring policies and practices that intentionally emphasize **solutions to underlying systems-level challenges as well as self-organization through field building and thought leadership.**

By allocating several billion Euros of its assets under management to a portfolio that is “investing in solutions for sustainable development,” PGGM brings to its investment approach a sharp focus on issues that “contribute to ‘financial ambition’ with regular risk and return expectations” and at the same time are “intended to support positive impact on at least one of [its] selected themes” (Klop 2016). It has focused on four themes with environmental and societal challenges that address systems-levels considerations: climate change, water scarcity, healthcare, and food security. PGGM uses its expertise in these areas to identify investments that have substantive, measurable impact while producing competitive financial returns.

PGGM has also taken a leadership role in measurement and reporting. Its 2014 *Annual Responsible Investment* Report, for example, clearly defines and measures the ways in which its investment strategies are relevant simultaneously to society and to PGGM and its clients for climate change, water security, healthcare, food security and a “stable financial system that serves the real economy.” It also defines and measures the alignment of its investment strategies with the United Nations Sustainable Development Goals.

To a degree unusual among large asset owners today, PGGM’s focus on **solutions and the measurement of their benefits simultaneously to society and to its clients implies an understanding of the interrelationship between portfolio-level decision-making and systems.**

(“TIIPing” Point highlights notable use of specific tools by investor. Investor might use tools beyond those highlighted in this section.)

ABOUT PGGM

PGGM is the second- largest pension fund in the Netherlands with about 2.6 million participants. Systems-related activities are central to PGGM’s overall investment and advisory strategies. The foundation of PGGM’s approach is the firm’s belief that the health and stability of systems directly impacts the long-term viability and sustainability of client investment portfolios and vice versa. To that end, the focus of PGGM’s approach (referred to as the firm’s “responsible investment” approach) is sustainable development—defined as “development which meets the needs of current generations without compromising the needs of future generations” (PGGM (c))—within seven specific areas selected in consultation with clients:

- Climate change
- Water scarcity
- Healthcare
- Food security
- Financial system stability
- Corporate governance
- Human rights

Three core beliefs guide PGGM’s approach:

1. **Responsible investment pays off**; in other words, “sustainability factors materially influence the risk-return profile of investments an influence that will steadily increase over time” (PGGM (c)).
2. **Sustainable development promotes good and stable long-term returns for clients.**
3. **Capital is a driving force for sustainable development**; meaning that PGGM must consider how to make a positive contribution to sustainable development through its investment decisions (e.g. by investing in sustainable development solutions like renewable energy).

APPROACHES IN PRACTICE

➤ INVESTMENT ACTIVITIES

Investment beliefs statements

The **PGGM Beliefs and Foundations for Responsible Investment**, which are developed in consultation with clients, establish the firm's systems-related core beliefs and introduce PGGM's systems-related objectives, foundational principles, and focus areas.

Security selection & portfolio construction

Exclusions (Instrument 2). Assessments of the behavior and activities of entities invested in, and the pursuit of changes in behaviors that undermine sustainability or termination of investments when change fails; exclusion from investment entities involved in production or trade of products inconsistent with the investment beliefs of PGGM or its clients.

- Ceased investment in five Israeli banks that are involved in financing the expansion of settlements in occupied Palestinian territories.
- Added CNIM (France) and Motovilikha Plants (Russia) to the exclusions list for their involvement with nuclear weapons and rocket launchers that can produce cluster weapons, respectively.

Environmental, social, and corporate governance (ESG) integration (Instrument 3). The structural and systematic incorporation of material ESG factors (factors which have a significant impact on the underlying investment) in existing investment processes.

- Developed an ESG index, which incorporates 70 criteria for gauging ESG policy and performance of companies invested in or being assessed for future investment.
- Formed the Behavior Working Group, which: assessed PGGM and its clients' roles in a sustainable financial system; developed a vision for the definition of "sustainable financial system" and an action plan for PGGM activities in line with that vision; and drafted guidelines for clients on acceptable remuneration.

Highlights:

In 2014:

- Added two companies and government bonds of the Central African Republic added to exclusions list
- ESG factors analyzed for 100% of new investments in external investment funds

Corporate engagements

Engagement (Instrument 4). Activities undertaken to generate change in the ESG field through dialogue with companies and markets, including with regulators, supervisors, and sector organizations.

- Met with Japanese health and foreign affairs officials and pharmaceutical companies to strategize approaches to improving access to medicine in developing countries as part of the Global Health Innovative Technology fund.
- Jointly submitted a shareholders' proposal to Oracle, an American IT company, to change its governance and remuneration structures.

Legal proceedings (shareholder litigation) (Instrument 6). The conduct of legal proceedings as a shareholder in qualified companies (listed and unlisted) in which PGGM invests on behalf of its clients; includes recovering asset losses resulting from fraud etc., improving corporate governance, and preventing undesirable behavior (e.g., corruption).

- Continued to act as lead plaintiff in a class action lawsuit against American IT company Hewlett Packard (HP); the suit alleges that HP unlawfully concealed disappointing acquisition results from investors, which adversely affected share prices and resulted in significant losses.

Highlights:

In 2014:

- Engaged with 510 companies in 2014 about issues including the environment (21 results), social factors (32 results), and corporate governance (80 results)
- Recovered approximately €2.7 million as part of legal proceedings

Targeted investment programs

Investing in solutions for sustainable development (Instrument 1). Investments that seek to help solve socioeconomic and environmental issues alongside pursuit of financial returns; specifically, for climate change, water scarcity, healthcare, and food security (see Box 1).

- Invested in GDF Suez green bonds, which are used to finance renewable energy projects.
- Acquired the Ennatuurlijk heating network from Essent in partnership with energy service company Dalka; Ennatuurlijk is committed to increasing sustainability in the Netherlands through local energy production.

Investing in the Netherlands. PGGM believes that a strong Dutch economy is important to the long-term financial interest of its clients; as such, PGGM “invests in the Netherlands” through government bonds, investments in banks capital used to finance Dutch small and medium-sized enterprises, and so on.

Highlights:

In 2014:

- €123 million invested in solutions in climate change, water scarcity, healthcare, and food security in 2014
- €19 billion (10.5 % of pension assets) invested in the Netherlands in 2014

Manager selection, directives & monitoring

N/A

BOX 1. Investments in Solutions for Sustainable Development

Investing in solutions for sustainable development is one of six approaches employed by PGGM. According to a recent (February 2016) PGGM presentation, investing in solutions represents the intersection of traditional, finance-only, investments and philanthropy, where “focus on one or a cluster of issue areas where social or environmental need create a commercial growth opportunity for market-rate or market-beating returns.” Investments in solutions otherwise have four defining features:

1. They “contribute to ‘financial ambition’ with regular risk and return expectations”;
2. They are “intended to support positive impact on at least one of the selected themes, as established ex-ante or

expost”;

3. The “impact created by the investee is substantial relative to a baseline or relevant benchmark,” and;
4. That “impact is measured, managed and communicated in real terms.”

PGGM invests in solutions in four of its sustainability target areas (climate change, water scarcity, healthcare, and food security) and across asset classes; the firm has also made efforts to align the themes targeted by the “investing in solutions” portfolio with the United Nations Sustainable Development Goals. PGGM is developing indicators to measure the impacts of these investments.

Source: PGGM (c).

➤ OTHER ACTIVITIES

Participates in advocacy and peer exchange activities across a range of issues and topics

Recent activities include: (a) partnering with the Institutional Investors Group on Climate Change (IIGCC) and participating in meetings with European Commission (EC) representatives to develop a climate change plan for 2030—among other things, the plan aims for a 40% reduction in greenhouse gas emissions; (b) joining the Ellen MacArthur Foundation Circular Economy 100 and, as part of an organization subgroup, investigating the implications of the circular economy on the financial sector, and; (c) signing the Montreal Pledge, a commitment to measuring and reporting on greenhouse gas emissions related to investment portfolios.

➤ STAFFING

PGGM’s **responsible investment department** is tasked with the overall and ongoing development and execution of the firm’s systems-related policies; advises clients on the implementation and evaluation of some activities and directly implements others (e.g. exclusions, voting, engagement and shareholder litigation); provides overall firm thought leadership on systems and guidance to other PGGM departments’ thought leadership; and reports on policies and their progress to clients and the public. In total, PGGM has 14 dedicated responsible investment staff, led by the Managing Director for Responsible Investment.

➤ IMPACT MONITORING & REPORTING

PGGM reports on the cumulative progress of each of its six systems-related approach activities annually to the public through its *PGGM Annual Responsible Investment Report*. Among other things, the report describes each new action undertaken in the reporting year within each of PGGM’s seven sustainable development areas and provides aggregate information on progress toward outcomes within each systems-related activity (see Investment Activities section).

PGGM requires fund managers and its solutions-oriented companies to submit reports (or “fact sheets”) that (a) describe the social challenge(s) addressed by the investment and how the investment contributes to the solution, (b) report quantitative progress indicators, (c) discuss the long-term objectives pursued by the company or project and the broader impact that the company or project has on the sector, and (d) note any additional positive impact sought but not explicitly pursued by the investment.

POLICY DEVELOPMENT AND MONITORING

Various entities develop PGGM's *Beliefs and Foundations* and *Framework* and/or craft and execute the firm's systems-related approach and activities; including:

- **Investment Policy Committee:** primary responsibility for establishing firm systems-related policy and developing and revising the *Beliefs and Foundations* and *Framework*.
- **Investment Committee:** determines systems-related policy implementation, including development of the exclusions list (see Investment Activities section).
- **Clients:** each client develops its own systems-related policy. Clients participating in a particular fund discuss and can jointly decide fund-specific systems-related policies (e.g. new exclusions or exclusion criteria).
- **Advisory Board for Responsible Investment:** external advisory board established explicitly for PGGM and its clients; advises on operationalization of, and changes to, the *Beliefs and Foundations* and *Framework*, and provides other systems-related guidance upon request.

PGGM updates the *Beliefs and Foundations* and *Framework* as necessary to reflect the evolving systems landscape and to adapt to changing client needs. Both PGGM and clients can propose changes, which, depending on their extensiveness, are vetted by the PGGM Advisory Board for Responsible Investment and reviewed by clients. The *Framework* specifies implementation guidelines for four types of systems-related activities—ESG integration, active equity ownership (voting, engagement, shareholder litigation), exclusions, and investing in solutions for sustainable development—by asset class, and for both PGGM mutual funds and segregated mandates.

SUCCESSSES AND CHALLENGES

➤ SUCCESSES:

- Articulation of what future [PGGM] wants to invest in (including specific systems, investment target, 'investment solutions' brand)
- Actually building [a] universe of positive impact equities, which is quickly becoming some sort of in-house yard stick
- Cross-asset class exploration of ESG risks and opportunities for potential adjustment of Strategic Asset Allocation

➤ CHALLENGES:

- Narrowing of [the] investment universe, which flies in the face of Modern Portfolio Theory and other conventional thinking
- Leap of faith; projecting the future with, say, 20 years of hard data
- Unease with value judgments

SOURCES

PGGM (a). www.pggm.nl. Accessed in May 2016.

PGGM (b). *Annual Responsible Investment Report: 2014*. May 2015. Accessed from https://www.pggm.nl/english/what-we-do/Documents/responsible-investment-annual-report_2014_pggm.pdf.

PGGM (Klop, Piet) (c). *Investing in Solutions = Beleggen in oplossingen (BIO)*, in Dutch. PowerPoint presentation. February 2016.

PGGM (d). *PGGM Beliefs and Foundations for Responsible Investment*. May 2014. Accessed from https://www.pggm.nl/english/what-we-do/Documents/beliefs-and-foundations-for-responsible-investment_may-2014_pggm.pdf.

PGGM (e). *Responsible Investment Implementation Framework: PGGM Vermogensbeheer B.V.* May 2014. Accessed from: https://www.pggm.nl/english/what-we-do/Documents/responsible-investment-implementation-framework_may-2014_pggm.pdf. Principles for Responsible Investment. *RI Transparency Report: PGGM Investments*. 2014-2015. The Investment Integration Project. *TIIP Survey of Asset Owner and Manager ESF Systems-Level Investment Approaches (2016)*. Completed by PGGM. April 20, 2016.

NOTES

¹ AUM approximated to U.S. dollars using Yahoo! Finance currency converter and as of the day of the year reported (i.e. AUM reported for 2014 converted using rate from December 31, 2014).

Definitions of systems-related activities (instruments) reported in the Investment Activities section are as discussed in the Framework (PGGM (e)) and contain verbatim excerpts from the document.

Profile developed in: May 2016.

Profile developed by: The Investment Integration Project (TIIP). TIIP helps institutional investors understand the big picture, or “systems-level,” context of their portfolio-level decisions. “Systems-level” events, such as economic crises, ecosystems under stress, and societies in turmoil can disrupt the best-laid plans of investors and cost them dearly. Even seemingly “local” issues are now having much greater impact than they once did as the world becomes increasingly interconnected.

TERM DEFINITIONS

What are "Tools of Intentionality"?

Tools of intentionality are specific pathways through which investors can bridge the gap between daily portfolio management decision-making and systems-level investing. Investors use these tools intentionally because the portfolio-level discipline of efficiency alone does not naturally lead them to systems-level considerations. Investors can use these tools to manage risks and rewards at systems levels and facilitate impact in a variety of ways.

What are "On-Ramps"?

On-ramps are investment approaches that represent logical extensions of the concept that investment has impact on the world at large—and on its component environmental, societal and financial systems—and that that impact can be managed to maximize these systems' wealth-creating potential in society.

What are "Asset Classes Integrated Into"?

Into which asset classes does the investor incorporate a systems-related approach?

What are "Years Integrating"?

The number of years since investor initiated systems-related approaches.

What is the "Tipping Point"?

Description of investor's primary approaches to adopting/executing system-related considerations.

What is "About"?

General description of the investor and their approach to systems-related investing.

What are "Approaches in Practice"?

How does the investor's systems-related approach manifest itself? We examine five key investment activities as well as other intentional systems-related undertakings. We also look at staffing and impact monitoring and reporting.

What are "Investment Beliefs Statements"?

Inclusion of observations about environmental, societal or governance considerations in the investor's formal investment belief statements or in more general statements of beliefs about the relevance of these considerations at portfolio or systems levels.

What are "Security Selection & Portfolio Construction"?

The incorporation of environmental, social and governance factors into individual security valuation and portfolio construction.

What are "Targeted Investment Programs"?

Creation of specialized sector or theme-based funds with an explicit environmental or social focus and the stated purpose of serving sustainable or responsible investors.

What are "Corporate Engagements"?

Communication on environmental, social and governance issues with corporations indirectly through proxy voting, or directly through individual or collaborative dialogue, the filing of shareholder resolutions, or other means in order to promote improvements in practice.

What are "Manager Selection, Directives and Monitoring"?

Incorporation of systems-related or on-ramp themes into the selection and monitoring of external managers.

What are "Other Activities"?

Additional investment policies and practices beyond those captured in key investment activities. Those intentional policies and practices that seek to achieve systems-goals are highlighted. They vary considerably across investors.

What is "Staffing"?

When information is available, this section describes investor contracting with external entities to execute systems-related approaches; internal personnel whose responsibilities exclusively or primarily include developing, executing or overseeing investor systems-related approaches; committees/groups with systems-related responsibilities; training provided to staff.

What is "Policy Development and Monitoring"?

When information is available, describes the processes undertaken by the investor to develop systems-related approaches.

What is "Impact Monitoring and Reporting"?

Discusses whether and how the investor measures and reports on the non-financial outputs, outcomes or impacts (effectiveness) of its systems-related approaches, or has plans to do so. Also whether and how the investor reports on the content of its systems-related activities.

What are "Successes and Challenges"?

Discusses the main successes and challenges reported by the investor about its systems-related approaches. This includes successes and challenges reported on a TIIP survey or in an interview, or statements describing successes and challenges in publicly available materials.