Investment Policy Statement

Contents

Introduction

VicSuper's fiduciary duty is to optimise long term risk-adjusted returns for its members. To achieve the risk and return objectives of the VicSuper Fund (the Fund), the Trustee follows the investment approach outlined in this Investment Policy Statement (IPS). The IPS is the Trustee's key investment policy document and is an important part of VicSuper's Investment Governance Framework.

Why does VicSuper have an IPS?

VicSuper's IPS has been developed to clearly and transparently communicate our investment beliefs and principles to our key internal and external stakeholders. The IPS also outlines how these beliefs and principles work together to guide how VicSuper Pty Ltd (the Trustee) makes investment decisions on behalf of the Fund.

What are the objectives of the IPS?

The IPS is designed to:

- clearly and transparently communicate VicSuper's investment principles and beliefs;
- outline the responsibilities of the Trustee, VicSuper members and investment managers when making investment decisions; and
- describe how the Trustee formulates, implements, monitors and reviews the investment strategy.

The IPS is further supported by the Investment Governance Framework which provides in-depth details on how we implement our beliefs, principles and investment strategy.

Roles and responsibilities

The Trustee

The Trustee provides the oversight and broad investment governance for the Fund. It also ensures that the superannuation contributions of VicSuper members are managed responsibly. Additionally the responsibilities of the Trustee include:

- monitoring the Fund risk and return objectives;
- monitoring the performance of strategic asset allocation strategies;
- noting or approving recommendations made by the Investment Committee; and
- ensuring that ongoing communication and education on investments is provided to VicSuper members.

Investment Committee

The Investment Committee is comprised of four Trustee Directors and the responsibilities of the committee include:

- selecting specific investment managers to populate a portfolio structure with sufficient diversification;
- monitoring the investment performance (including fees) of investment managers;
- replacing investment managers when appropriate;
- implementing medium term deviations from strategic asset allocation; and
- making investment policy recommendations to the Trustee.
  - These responsibilities are supplemented with advice from external asset consultants and VicSuper's internal management team.

Members

Members are responsible for choosing investment options that are appropriate for their personal circumstances and should consider their age, income, risk tolerance and pre and post retirement objectives when making a selection. To assist, the Trustee will provide members with information on all available investment options and basic investing principles.

Investment managers

Investment managers must adhere to VicSuper's agreed investment strategy and mandate. They are responsible for notifying the Trustee of any deviations from the agreed strategy in a timely and accurate manner.

Investment mission and beliefs

Investment mission

"VicSuper's investment mission is to optimise members' retirement savings and incomes".

Investment beliefs

Belief	What this means for VicSuper
Investors are rewarded for taking long term market risk	• We take a long term perspective in relation to our investment horizon. • Long term asset class returns are driven by economic fundamentals, whereas short term returns are generally driven by factors such as confidence, liquidity and momentum. • Investment markets carry market risk (also known as systematic or non-diversifiable risk) as well as investment specific risk (i.e. diversifiable or unsystematic risk). • This is the investment rationale for VicSuper offering diversified investment options and not just a cash option (i.e. the risk free rate).
Asset allocation, diversification and time horizon are the most important factors in achieving long term returns	• Research has consistently shown that asset allocation is the main driver of long term investment performance. • There are essentially five primary sources of investment return above the risk free rate. A premium return is generated by: equity risk, credit risk, liquidity risk, insurance risk and skill. Most institutional funds have a concentration in exposure to equity risk.
Markets vary in efficiency and this means anomalies arise that can be exploited by buying a combination of a passively managed core and actively managed satellites	• The more inefficient a financial market, the more likely that anomalies arise which can be exploited by skilful, active managers. Indexing is generally more effective in large, highly developed markets. • Correlation between asset classes is not always priced efficiently in markets and is not constant. • Using a risk budgeting investment approach enables an agreed overall risk budget for the VicSuper Fund to be efficiently split between a passive core (with low risk and low cost) and (higher risk and more costly) satellite investments.
Active management of risk is best controlled at the stock selection level. Asset allocations must be managed on a strategic basis but with active tilts when appropriate	• We don't believe that changing asset allocation frequently (or market timing) is an efficient way to add value and reduce volatility. • Strategic asset allocation is therefore reviewed on a regular basis and updated where appropriate. • However, asset classes can be undervalued or overvalued for considerable periods. At these times, judicious tilting of asset allocations within wider ranges can be beneficial. • An approved maximum range (of +/- 15% around the strategic asset allocation) is set around major asset classes as well as the growth / defensive asset allocation.
We seek to optimise the costs versus benefits of our investments	• As a value for money superannuation fund, our costs must be kept as low as possible. However, this must not pass the optimal point where we are foregoing returns in order to minimise costs. • Where possible and advisable, we utilise a low cost passive management approach. • Indexation provides a low cost option due to low turnover and relatively low management fees.
As a global investor we believe that being an active owner is important in achieving long term shareholder value	• We are "universal investors" in a broad range of global companies and other assets. • Consequently, we have a vested interest in the long term sustainability of the global economy. • We believe that there is value in integrating ESG factors into our investment decision making processes. We also engage on cross market Environment, Social and Governance (ESG) issues that impact on our industry.
There is value in integrating ESG factors into our investments	• VicSuper uses an integrated model for integrating ESG factors (sustainability considerations) into our investment strategy. • We require all of our fund managers to include consideration of ESG factors in their investment processes.

Belief	What this means for VicSuper
Good governance and transparency helps us to act in the best interest of our members	• We are the trustees and fiduciaries of our members' retirement savings. • We understand that members are the ultimate owners of the companies and assets that we invest in on their behalf. Our members have the right to know how their money is invested and what they own. We embrace transparency by publicly reporting on: – our investment strategies, performance and member investment holdings – operational and investment activities through the annual VicSuper Performance Report – how we integrate the consideration of ESG factors into our investment decisions. • As fiduciaries of our members' super we need to have appropriate risk management structures in place. Our corporate governance structure: – protects the savings and privacy of our members, employers and other stakeholders – ensures we operate in a fair and transparent manner in compliance with legislation, our RSE Licence and Australian Financial Services Licence, constitution and trust deed – respects the rights of members, employers, employees and other stakeholders – allows members, employers and other stakeholders to have input into our decision-making – ensures a robust and effective system of internal controls and management of operational and investment risks.
Educated members will make better investment decisions.	• We believe that members are empowered through accessible and relevant education and advice. This enables them to feel confident about making superannuation investment decisions. • We help to educate our members by: – providing clear and meaningful information about our investments and benefit plans that centre on our beliefs about the long-term nature of investing – providing clear and concise educational material and tools that are focused on meeting member needs – informing members about the range of strategies available to assist in building their superannuation savings – Providing access to a wide range of channels including call centre, workshops, seminars, in person contact, printed publications and on-line tools – providing general advice through face to face appointments, workshops and seminars.

Formulating the investment strategy

The overall objective of VicSuper's investment strategy is to optimise risk-adjusted returns for members (see diagram 1). Our strategy determines how we construct our investment portfolio and it is formulated by:

- setting rolling 10 year risk adjusted investment objectives which are designed to deliver a return above inflation;
- determining a strategic asset allocation (set on a longer term basis);
- implementing dynamic asset allocation tilts (as we seek to capitalise on valuations when significant market inefficiencies and anomalies arise);
- selecting investment managers to populate a core (indexed/ enhanced indexed strategy) and satellite (active strategy with the aim to generate returns higher than the benchmark) investment structure; and
- integrating ESG factors into our investment process.

Asset allocation

The strategic asset allocation for each of VicSuper's investment options is focused on risk and expected 10-year average returns. The longer the time horizon for measurement of returns, the greater the likelihood we have of achieving forecast average investment returns.

Strategic asset allocations are reviewed annually. The Trustee approves changes to the strategic asset allocation and dynamic asset allocation ranges for each of our investment options. Strategic asset allocations are generally changed infrequently (for example, a change may be required when a new asset class is introduced) to ensure that we minimise and manage costs.

Using the strategic asset allocation as a base, the Investment Committee may implement dynamic tilts (confined within the approved range of +/-15% of the strategic asset allocation) if attractive opportunities to capitalise on valuations arise.

Scenario analysis and stress testing

Scenario analysis is an important feed into both determining strategic asset allocation and the implementation of dynamic tilts. In collaboration with asset consultants, the Trustee develops scenarios on macro-economic themes and/or specific shock events. The Trustee then stress-tests these scenarios to assess their potential impact on expected risk, return and diversification.

Asset classes

VicSuper currently invests in asset classes which include equities, fixed income, cash, real assets (e.g. property, infrastructure, timberland and agriculture), and alternatives (e.g. private equity).

Investment options available for members

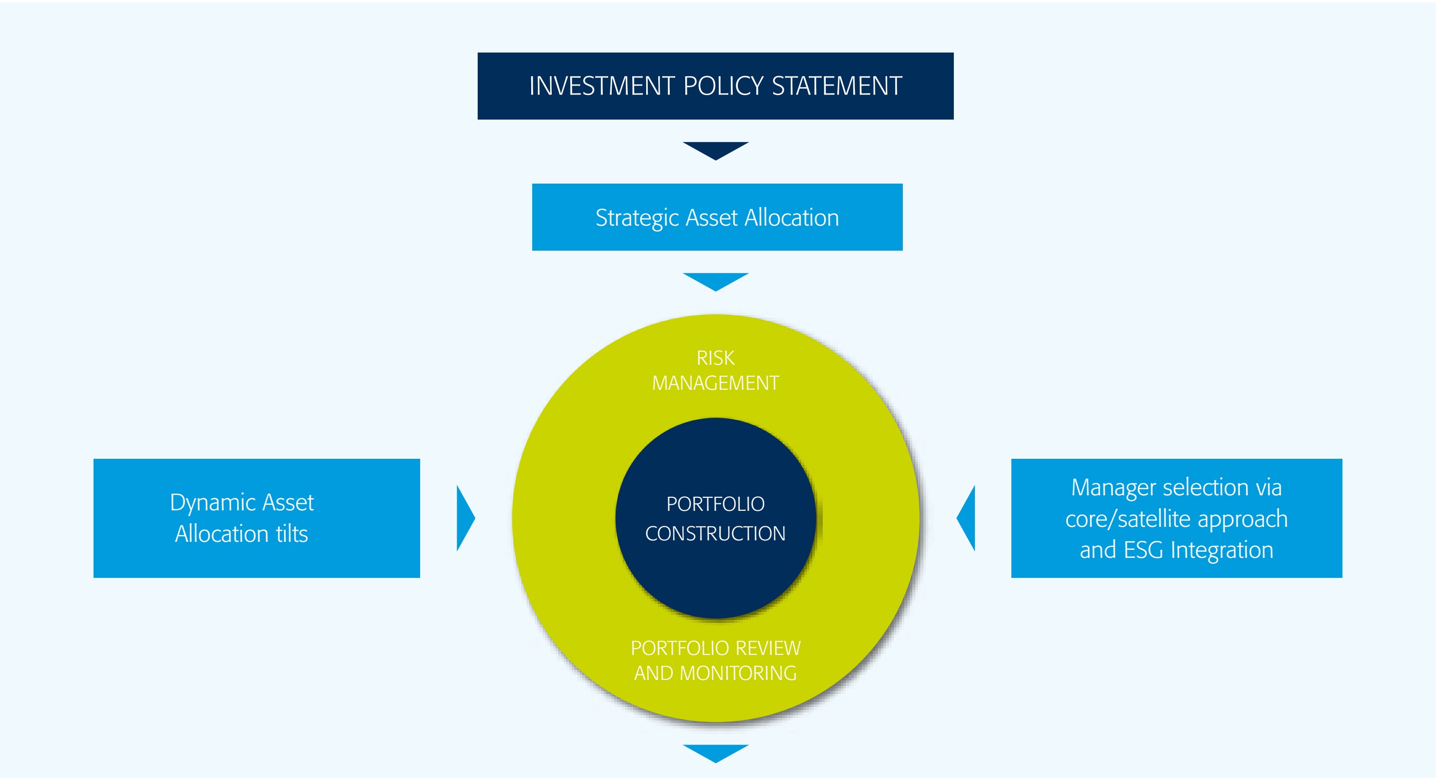
The Trustee currently provides members with the choice of six investment options. These options have diversified strategic asset allocations, with three investment options having single-asset class exposure. Investment options are structured to provide members with a range of exposures to market risk and different ranges of expected returns (measured over the long term).

Costs and fees

Investment-related costs that may be incurred include fees and charges associated with investment managers, external asset consultants, custodians, transition managers, lawyers, tax advisors and the internal investment team.

Investment management fees account for the majority of investment-related costs. The Trustee considers these investment management fees in the context of the asset class and investment structure. In agreeing to investment management fees, the Trustee seeks to balance the absolute cost of investment management with the potential for maximising after-fee returns at the VicSuper Fund level. For example, for asset classes like private equity, which are typically more expensive than listed equity strategies, VicSuper seeks to balance the likely after-fees return to members with the total cost of investment.

Diagram 1: VicSuper's investment strategy



Taxes

The impact of tax on investment returns is considered by the Trustee in the following ways:

- Investment objectives – The return targets are net of taxes.
- Asset allocation – In terms of strategic asset allocation modelling, the Trustee uses after-tax return estimates in their capital markets assumptions.
- Investment strategies – When undertaking due diligence on investments or investment strategies, the tax implications from particular investment structures are considered (such as unlisted real estate investments in the United States of America).
- Investment managers – The ability for investment managers to maximise tax efficiency is preferred. For example, in relation to investment in Australian listed companies, managers are required to consider maximising returns on an after-tax basis, thereby utilising franking credits available to superannuation fund members.
- Rebalancing and asset sales – The impact of tax is a key consideration when deciding whether to rebalance and to redeem a manager and/or sell assets.

Implementing the investment strategy

ESG Integration

The Trustee integrates ESG factors into its investment process. In this context, we consider 'sustainability' as synonymous with 'ESG integration'. VicSuper is both directly involved in the process of integrating ESG, via active ownership, and indirectly involved via its investment managers. Please click HERE for the 'Integrating ESG into investments' guide.

Manager selection

The Investment Committee selects investment managers to populate VicSuper's core and satellite investment structure. In order to minimise risk and style biases, the committee aims to diversify across managers based on investment styles within listed asset classes. Within the unlisted asset classes, other considerations such as high conviction in the management team are important.

'Core' investments constitute the majority of the VicSuper Fund's assets. This approach seeks to achieve investment returns equal to the relevant financial market (i.e. primarily indexed/enhanced indexed strategy). 'Satellite' investment managers are selected to outperform the market by actively investing in concentrated portfolios that aim to achieve higher returns. Active equity investment managers for example make their investment decisions based on extensive research and analysis of business and management quality and company earnings forecasts.

Essentially, the investment manager selection process is driven by:

- a strategic or operational review of VicSuper's investment strategy which identifies the need to terminate, replace or introduce a new investment style or strategy to the portfolio
- an asset class risk/return performance review, which identifies a particular need to introduce a new investment strategy or style
- fund manager performance, particularly underperformance that leads to termination and possible replacement.

Currency hedging

VicSuper's unhedged investments in international assets carry the risk that fluctuations in foreign currency rates may affect the market value of investments in Australian dollar terms. VicSuper's policy is to fully hedge international fixed income investments, because currency movements tend to swamp sources of other returns from fixed income investments. However, currency movements may provide some diversification benefits for investments in international equities. Hence, VicSuper uses the Fund's currency manager to overlay a hedging strategy (as such we are not 100% hedged).

Securities lending

VicSuper has a securities lending agreement in place with our custodian, National Australia Bank's Asset Servicing division (NAS). Securities included in the programme are listed Australian and international shares and international and Australian fixed income securities owned by VicSuper. NAS lends these securities as it sees fit – which generally means they are on-lent to major retail banks, investment banks and brokers. These borrowers in return pledge collateral (usually cash) to NAS. VicSuper and NAS receive a profit when this collateral is re-invested.

Valuation

The Trustee maintains a separate Valuation Policy to ensure assumptions and methodologies for the valuations of assets held within the Fund are sensible. The Trustee's general approach to asset valuation is in accordance with defined Accounting Standards. Accordingly, the valuation of the Fund's assets is defined as net market value – equivalent to fair value less estimated selling costs.

Liquidity

VicSuper manages the Fund's investments with regard to the ability of the Trustee to make timely member payments in the form of benefits, redemptions, withdrawals and pension incomes and to meet investment calls for the Fund. VicSuper's liquidity risk is managed under VicSuper's Liquidity Management Policy which is approved by the Trustee.

Risk management

VicSuper undertakes a number of investment risk management activities, these include:

Investment risk management

The Trustee is responsible for the sound and prudent management of investment risk – the risk associated with performing investment activities. Consequently the Board has identified investment risk as a key material risk for VicSuper with a risk appetite of 'moderate' when pursuing investment objectives.

The contributing factors identified for investment risk and the respective controls implemented to manage these can be found within VicSuper's Risk Management Framework. Ongoing risk reporting, monitoring and testing ensures VicSuper continues to operate within its predefined investment tolerance limits and that any breaches or weaknesses identified are investigated and rectified immediately.

Derivatives

As part of VicSuper's investment strategy, derivatives (securities that derive their value from another security or index) are used to manage the risk of movements in currency rates and prices of shares. VicSuper uses derivatives for their efficiency and relatively low cost. All positions are fully backed by cash. VicSuper does not borrow money to leverage the Fund in the manner applied by hedge funds. VicSuper does not use derivatives for speculative purposes or to leverage the Fund.

Risk reporting, risk budgeting and scenario analysis

Investment risk management is the responsibility of the investment team and is supported by an external consultant. This work includes risk budgeting, monitoring and risk analytics. A key objective of this work is the formulation and testing of risk scenarios.

Monitoring and reviewing the investment strategy

Annual reviews

The Trustee formally reviews and monitors VicSuper's investment strategy on a yearly basis through:

- Assessing the appropriateness of asset allocation and the potential inclusion of 'new' asset class investments or investment styles in the portfolio.
- Confirming any changes to the Strategic Asset Allocation and ranges for the dynamic tilts.
- Confirming the investment objectives are appropriate.

Monthly reviews

The Trustee monitors the investment performance and investment risk on a monthly basis, through a review of:

- Investment performance – VicSuper monitors performance in three ways: by asset class against asset class benchmark, by individual manager against benchmark and at the investment option level against a peer group comparison and the relevant CPI plus margin rolling return objective.
- Investment managers – VicSuper management seeks to engage with its investment managers and advisory relationships at least quarterly to ensure: the Fund's assets are being managed consistently with the respective mandates, the manager remains disciplined to its investment style and VicSuper is kept abreast of any changes that may impact the effective management of the Fund's investment (e.g. changes in the process, people and/or philosophy).
- Investment risk – Risk budgeting and modelling.

Interim reviews

Responsive interim investment strategy reviews may also be triggered by:

- Underperformance of investment options as reported by the Risk & Compliance team in the quarterly risk indicator report.
- Failure of a material outsourced provider.
- Changes in the external environment (regulatory, tax, legal).
- Underperformance / outperformance by a particular investment manager or strategy.
- Major macroeconomic changes such as growth outlook, interest rates, inflation.