



Harbour Investment Funds

Environmental, Social and Governance Policy

August 2022

# Environmental, Social and Governance Policy

## Introduction

Harbour Asset Management Limited (Harbour) is a client-focused, research-driven, investment manager. Our analysis across both equity and fixed interest markets is dedicated to producing superior investment results.

This document refers to Harbour's investment approach and the integration of the non-financial aspects of a company, commonly referred to as Environment, Social, and Governance (ESG) factors, into that process. This policy is reviewed and updated, at least on an annual basis, reflecting the evolving nature of Harbour's approach and is also subject to Board oversight and approval.

Harbour's approach to ESG considerations is neither a recent, nor a superficial part of the process. As a responsible corporate citizen, and as a signatory to the Principles of Responsible Investing (PRI), Harbour considers relevant ESG risks and opportunities, and we believe our ESG integration strategy strengthens our investment decisions.

## Beliefs

1. Harbour believes that companies that manage ESG considerations well are more likely to create shareholder value, with a reduced risk profile, compared to those who do not.
2. Harbour believes that strong corporate governance is often correlated with strong company management of environmental and social aspects.
3. Harbour believes that ESG risks and opportunities are increasingly able to be identified and measured for individual companies, and that these risks are often not fully reflected by the market in the security price.
4. Harbour believes that an integrative approach to ESG can lead to stronger investment returns than screening processes alone.
5. ESG monitoring and assessment is constantly evolving. Harbour believes in engagement on ESG matters and we reserve a divestment option where appropriate for the fund mandate.
6. Harbour's beliefs are based on a balanced understanding of the academic evidence and is consistent with empirical analysis of our own ESG process.

## PRI and RIAA:

Harbour became a signatory of the PRI in 2010, and we have submitted our investment process on an annual basis for assessment of our ESG integration strategy since 2014. The PRI has recognised Harbour as having a best-in-class ESG approach through multiple years of rating as A+ for overall strategy and governance in their assessment framework. Similarly, Harbour has been recognised by the Responsible Investing Association Australasia (RIAA) for having one of the leading ESG approaches in New Zealand<sup>1</sup>.

As a signatory to the PRI, we have committed to adopt and implement the following principles:

1. We will **incorporate** ESG issues into our investment analysis and decision-making processes
2. We will be **active** owners and **incorporate** ESG issues into our ownership policies and practices
3. We will seek appropriate **disclosure** on ESG issues by the entities in which we invest
4. We will provide acceptance and implementation of the Principles within the investment industry
5. We will work together to enhance our effectiveness in implementing the Principles
6. We will **report** on our activities and progress towards implementing the Principles

Harbour is also a member of RIAA in order to support their goal of seeing more capital being invested responsibly for a healthier economy, society and environment.

To find out more about the PRI and RIAA, please visit their websites at [www.unpri.org](http://www.unpri.org) and [www.responsibleinvestment.org](http://www.responsibleinvestment.org)

## Harbour's Responsible Investment Strategies

Harbour offers investment funds that primarily apply an ESG integration approach, reflecting our belief ESG issues influence investment risk and return and integrating these will strengthen decision making. We also recognise the importance of investing to drive social and environmental impact and therefore offer an investment solution that targets this specifically; the Harbour Sustainable Impact Fund. We define ESG integration and impact investing as:

**ESG Integration:** the systematic and explicit inclusion of material ESG factors into investment analysis and investment decisions.

**Impact:** investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return.

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<sup>1</sup> RIAA 2021 benchmark report on the state of Responsible Investing in New Zealand

# ESG Considerations:

## Environment

Environmental considerations, particularly climate change has been a growing part of our ESG process as improving data and scientific research highlights the materiality of these effects on companies over the long term. Our research programme has involved two major projects focused on climate change, the first a benchmarking study to assess carbon emissions disclosure and performance across the NZ market<sup>2</sup> and the second to gain insight into electric vehicles in NZ corporate fleets as a mechanism to decarbonise transport emissions<sup>3</sup>. Environmental factors can influence company performance through both acute and transitional effects such as write downs in asset values ('stranded' assets), regulatory costs and changes in consumer behaviour.

Our integration process, through our Corporate Behaviour Survey, includes the following environmental issues:

- Carbon emissions disclosure and trend
- Environmental impact and risk management
- Energy use
- Waste
- Taskforce for Climate-related Financial Disclosures (TCFD) alignment
- Biodiversity

## Social

The management of social considerations of a company remains an important focus with employee, supplier and community relations all playing a key role. They emphasise the need to look after human health and welfare through best practice safety systems and human rights processes which is particularly important when assessing companies with operations and/or suppliers in developing countries. Companies can suffer significant reputational damage if they mis-manage these social aspects. These issues were analysed in detail in our social justice research project that assessed the state of the NZ market in terms of their employee engagement, health and safety performance, diversity levels and modern slavery prevention practices.<sup>4</sup>

Examples of social issues considered in our process include:

- Occupational health and safety
- Employee relations
- Diversity and inclusion
- Human rights and modern slavery
- Supply chain management
- Community engagement
- Cyber security and data privacy

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<sup>2</sup> <https://www.harbourasset.co.nz/research-and-commentary/findings-from-carbon-emissions-research-project/>

<sup>3</sup> <https://www.harbourasset.co.nz/research-and-commentary/lifting-the-bonnet-electric-vehicle-adoption-or-a-lack-thereof/>

<sup>4</sup> <https://www.harbourasset.co.nz/research-and-commentary/social-spotlight-i-employee-engagement/>

## Governance

Governance issues form a key part of our process reflecting our belief that companies that are well governed tend to result in stronger environmental and social outcomes. Robust governance of companies is important to promote high standards of ethics and conduct that help avoid any lapses in operating/risk management processes and align with stakeholder outcomes. Many different governance factors are captured in our process with some examples below:

- Board composition including skills, independence and diversity
- Executive remuneration and incentives
- Corruption and ethics
- Anti-competitive practices

## Sustainability Outcomes

Harbour is a strong proponent of investing in companies that deliver positive real-world outcomes such as clean energy, medical advances and education solutions.

We are supportive of the UN's Sustainable Development Goals (SDGs), a set of 17 goals (and further underlying targets) for governments and businesses to meet by 2030 to improve the wellbeing of people around the world whilst also protecting the planet. Harbour's Sustainable Impact Fund has a dual objective to deliver positive social and environmental impact according to the SDGs whilst still achieving above market rates of return. This involves mapping each investment to a primary SDG, conducted thorough engagement, and tracking progress over time. More detail on this fund is provided in the investor documents (Product Disclosure Statement (PDS), Statement of Investment Policy & Objectives (SIPO) and Other Material Information (OMI)).

Harbour's other funds are also guided by the SDGs through the alignment of ESG metrics within our primary assessment tool (Corporate Behaviour Survey) as well as utilisation of SDG measurement screening from an external provider (currently ISS ESG).

This influences how we allocate capital in practice for example, regarding SDG 7 and 13 on Affordable and Clean Energy and Climate Action, we supported a renewable electricity generator as a cornerstone investor in a capital raising to develop a new geothermal power plant. This enabled the company to provide more clean energy to the country to help meet our climate targets.

There are numerous important global frameworks in place designed to help deliver positive real-world outcomes for the environment and society that we endorse. On climate change, we support the Paris Agreement and TCFD recommendations to provide targets to limit global warming and a framework to disclose relevant information to meet these targets. Similarly on natural capital we are supportive of the development of the emerging Taskforce for Nature related Financial Disclosures (TNFD) framework to address biodiversity and ecosystem impacts. Regarding human rights, we advocate the UN's Guiding Principles on Business and Human Rights for companies to adopt to prevent, address and remedy human rights abuses occurring in business operations.

## Harbour's ESG score

Companies are assessed by Harbour analysts on their competence in identifying and mitigating ESG risks and opportunities. Each company in our investment universe is allocated a Harbour ESG score based on their ESG competency. ESG scores are generated via one of two processes:

1. For New Zealand Securities, Harbour's analysts complete specific proprietary company Corporate Behaviour Surveys (CBS). Company scores are cross-referenced against an external ESG research provider's ESG recommendation if available, and a final score is produced.
2. For Australian Securities, an external ESG research provider's recommendation is translated into an ESG score.

### **Harbour's New Zealand Corporate Behaviour Survey (CBS)**

Harbour's CBS consists of over 80 questions and is completed annually. Events such as governance lapses, environmental mismanagement or poor labour relations provide hard evidence of poor corporate behaviour.

Approximately half of the points are weighted towards governance issues, and half towards social and environmental factors. This isn't to downplay Harbour's view of the influence of environmental or social risks on a company's performance but reflects Harbour's view that governance measures are more easily discernible. Harbour believes that there is often a correlation between strong governance performance and positive environmental and social outcomes. This view is based on Harbour's experience, and is consistent with academic research, that strong governance checks and balances often lead to more rigorous oversight of company environmental and social policy, and therefore better E and S outcomes. However, the weight of environmental and social issues in the survey has been gradually rising over time as compelling research and better-quality data emerges.

The CBS has proven to be a useful tool in objectively establishing our expectations with companies looking to list on the equity market. It has provided a solid foundation to address the range of ESG issues that senior management may not have considered, especially those early on their sustainability journeys.

Harbour seeks to constructively engage with companies to encourage ongoing improvement in corporate behaviour. The CBS is used as a tool to initiate conversations with management and boards on corporate behaviour standards. The CBS is completed annually, or when (in Harbour's opinion) there is substantial change e.g. a significant controversy for a company.

The CBS is confidential, although we are generally willing to discuss the overall conclusions with stakeholders.

### **Australian ESG Score**

ESG scores for Australian companies are established using external research from a global ESG research provider. As of June 2022, MSCI ESG is the current provider. MSCI's Intangible Value Assessment (IVA) describes different ESG factors in company specific research. The MSCI Impact Monitor measures the relevance and impact ESG issues would have on a company, depending on the industry. These scores combined form Harbour's ESG score for Australian securities.

Harbour assesses the effectiveness and quality of the external research provider annually.

### **Equity Process**

Harbour uses quantitative screens in its investment process to rank investment opportunities. Harbour's ESG score is included in all Harbour funds active quantitative screens along with other fundamental and quantitative factors in the investment process. All other factors being equal, a higher ESG score results in a better overall security ranking. These rankings are categorised into

deciles that are further filtered into a traffic light classification where the top three deciles are the 'green zone' and the bottom three are the 'red zone'. Portfolio Managers will then tend to select and overweight securities in the green zone and avoid/underweight companies in the red zone.

Securities are not excluded solely based on ESG scores. High risk ESG issues within companies, or issues of concern, are discussed between analysts and portfolio managers during the selection process. Companies with poor ESG scores are engaged where appropriate, to encourage the improvement of corporate behaviour.

## Fixed Interest Process

Harbour's Fixed Interest team utilises both the Harbour CBS and MSCI research, in addition to conducting its own ESG research into unlisted bond issuers. The team uses this research to both engage with companies, and also identify companies whose behaviour may lead to untenable risks. Similar to the equity process, the fixed interest process goes beyond just setting exclusions based on moral judgements on industries and assesses a company's behaviour and conduct relating to ESG considerations, and whether they are on a committed path to improvement.

This is done through systematic sector-by-sector meetings by the team to evaluate each issuer's management on E, S and G. This process leads to a three-tiered classification system where securities are either favoured, neutral or avoided in portfolios. Neutral and avoided issuers are still engaged where appropriate to promote improved behaviour.

## External Managers

Harbour manages Australasian asset classes in-house. External managers are used for our Global Equities Fund (T. Rowe Price) and within our multi-asset class funds, being the Harbour Income Fund, Sustainable Impact Fund and Active Growth Fund.

External managers, at a minimum, are assessed by Harbour to be aligned with two key principles:

1. Have a firm-wide commitment to improving ESG outcomes for investors. This commitment can be shown through active membership of industry groups (such as being a UN PRI signatory, RIAA or other industry leadership groups) and/or through other ESG firmwide initiatives.
2. Satisfy us during the due diligence process that they meaningfully integrate ESG into their investment decision making process

On an ongoing basis we also:

1. Undertake independent carbon footprint analysis of external equity managers to measure the carbon intensity of their portfolio relative to the benchmark. Adverse results are raised with the manager.
2. Engage with their responsible investment team to share our views of best practice and identify areas for improvement.

All external managers have proxy voting policies and are active owners. They all provide us with regular reporting on votes with and against management. The results of this show a strong depth of challenge to management voting.

## Engagement

Harbour is an active owner. Where conflicts arise with respect to company strategic direction, remuneration, or other material issues, Harbour aims to work with senior management, the Board of Directors, and other investors to find a satisfactory outcome for stakeholders. Harbour does not concern itself with day-to-day running of the business but focuses on strong shareholder outcomes.

More detail on Harbour's approach to engagement is provided separately in our Stewardship Policy. Examples of our engagements and their outcomes are provided in our annual stewardship summary on our website.

## Proxy Voting

Harbour votes on all resolutions for both annual meetings and extraordinary meetings. Harbour utilises a third party for external proxy voting research and as of June 2022 this is ISS Proxy Exchange. Harbour analysts that cover the company will evaluate this research along with any other relevant information in coming to a voting decision.

All voting is recorded in both soft and hard copies. A history of Harbour's voting for contentious resolutions such as those against management or ISS recommendations, is provided to Harbour's internal risk committee along with documented rationale to explain the decision. In addition, in those instances where Harbour does not vote in accordance with ISS Services, the reasoning is also documented.

More detail on Harbour's principles and processes in proxy voting are provided separately in our Stewardship Policy.

## Exclusions

Harbour believes in applying an integrative approach emphasising active ownership through engagement as a better way to influence changes in corporate behaviour rather than only negative screening. However, we have set a baseline standard of responsible behaviour to exclude companies involved in some of the most controversial business activities likely to lead to significant harm in society.

Therefore, we do not invest in companies that to our knowledge derive any revenue from:

- The manufacture of tobacco, nicotine alternatives and tobacco-based products
- The manufacture or testing of nuclear explosive devices (NEDs)
- The manufacture or sale of chemical and biological weapons
- The manufacture or sale of cluster munitions
- The manufacture or sale of anti-personnel mines
- The manufacture or sale of recreational cannabis
- The production of pornography
- The manufacture or sale of civilian automatic and semi-automatic firearms, magazines or parts

These exclusions apply across all internally managed Harbour funds aside from the NZ Index Shares Fund which aims to closely track its benchmark<sup>5</sup>. They do not apply to derivatives/collective

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<sup>5</sup> This Fund and its corresponding benchmark do not currently contain securities in any of the exclusions in this policy however in the situation where a producer of tobacco was to be included in the benchmark index for example, this would subsequently be invested in the Fund as well.

investment vehicles (e.g. ETFs, futures, options) which may be held by some Funds according to their investment guidelines. They do not apply to Funds that are managed by external managers, however those external managers are assessed during the appointment process for their alignment with our exclusions policy. These managers are then monitored and consulted where appropriate on a best-efforts basis for any contentious holdings that may result from any differences in policy.

Additional exclusions apply to our specialised sustainability labelled solutions that are detailed in the investor documents (PDS, SIPO and any additional information outlined in the Other Material Information documents). We also accommodate other ethical values clients hold in tailored solutions through segregated mandates.

Harbour utilises an external ESG provider (currently ISS ESG) for screening services to ensure the active monitoring and compliance of these exclusions. These services allow us to distinguish between the type of business involvement i.e. manufacturing vs. distribution/sales and determine the revenue exposure. Any issuers identified as breaching the exclusion criteria are notified to compliance and subsequently coded into the Bloomberg compliance system as restricted securities. Alternatively, clients that have exclusion lists as part of their segregated mandates are also coded into the Bloomberg compliance system and monitored accordingly.

Harbour's approach to exclusions is reviewed twice a year by an internal Exclusions Committee comprising members from the investment teams, client servicing and compliance. These reviews are informed by client feedback, industry research and surveys as well as regulatory requirements.

## Data

Harbour acknowledges that the availability of measurable, reliable ESG data is not perfect and is evolving over time.

Where Harbour utilises external ESG data providers for services such as exclusions screening, ESG scores and emissions data we note that there may be gaps in coverage due to a variety of factors. These can include small or newly listed companies that are not under the coverage of the external provider and for cases where there are data gaps, Harbour will exercise its best judgement to determine an appropriate proxy score or ethical involvement that would contravene our exclusions policy. This is based on Harbour analyst's extensive experience researching companies under coverage and we note in practice that data gaps tend to be minor across portfolios and are improving over time.

Where Harbour deems that data coverage is not sufficient to provide an accurate representation e.g. lack of carbon data for fixed income portfolios, we will refrain from reporting this data.

## Reporting

Harbour communicates our ESG activities with our clients on a quarterly basis. These activities detail our engagements and proxy voting over the period including aggregate statistics and key voting rationales. In addition, any conferences, presentations and industry involvement relating to ESG are included in the reports. Further information can be provided to clients on request.

Harbour's approach to exclusions is reviewed twice a year by an internal Exclusions Committee comprising members from the investment teams, client servicing and compliance. These reviews are informed by client feedback, industry research and surveys as well as regulatory requirements. Climate change metrics include the portfolio's total emissions, carbon footprint and weighted average carbon intensity. They are provided against each fund's respective benchmark to show a

comparison of absolute emissions exposure as well as normalising for capital invested and the revenue of the underlying companies. They are consistent with definitions under the TCFD guidance. Carbon data are not yet available for fixed interest holdings; however we are engaging with issuers to build a sufficient database.

A summary of our annual stewardship activities is provided on our website to show the outcomes of our active ownership and our progress over each year on our responsible investing objectives.

Other ESG information such as public policy submissions, research articles and fund level implementation can also be found on the Harbour website and/or investor documents.

## Harbour is committed to assessing ESG

Harbour takes an active role in promoting ESG in the investment community. As well as its active participation in the market, Harbour is a founding member of the New Zealand Corporate Governance Forum, an institutional investor group focused on increasing the standard of corporate governance in the New Zealand markets. Harbour itself actively works to improve the standard of governance in the New Zealand market. Harbour employees participate in domestic and international conferences and forums on ESG issues, and Harbour regularly speaks and publishes research on its views on ESG investment issues.

Harbour believes in the value of ESG and is confident that its ESG process enhances portfolio outcomes for Harbour clients. We welcome any further questions on the subject. Furthermore, our PRI transparency report is available for download from our website.

## Review of policy

The information provided has been prepared from sources believed to be accurate and complete as at the date of issue. This policy is reviewed annually or more frequently if required, reflecting the evolving nature of Harbour's ESG approach. As such this policy is subject to change at any time.