Australian Government
Commonwealth Superannuation Corporation

CSC Annual Member Meeting
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Questions and Answers

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Investment Climate

Question: In 2021 I asked CSC to provide evidence it had influenced fossil fuel companies to reduce emissions. I didn't receive a satisfactory answer. Since 2021 Woodside has forged ahead with exploiting Scarborough & is pushing ahead with Browse; Santos has progressed its Pikka Phase1 oil project in Alaska: these companies are investing billions. What evidence can CSC provide to show it attempted to influence Woodside & Santos to decrease emissions in line with the Paris agreement? Will CSC escalate its **engagement** with them or **divest**?

Question: CSC claims its investment approach is "aligned with the Paris Agreement" . Yet a recent report from the International Institute for Sustainable Development found a clear consensus among various climate pathways, that if we are to meet the Paris goals or net zero by 2050, there can be no new oil & gas fields developed. How can CSC claim alignment with the Paris Agreement & engagement with companies for change when its investments in companies pursuing new oil and gas fields, such as Woodside and Santos, directly undermine it?

Question: What evidence can CSC provide to show it attempted to influence Woodside & Santos to decrease emissions in line with the Paris agreement?

Note: same answer for multiple questions

In summary, our engagement efforts focus on our comparative advantage to influence via:

(i) Our own shareholder votes – where we focus, in particular, on ensuring that companies have appropriately skilled directors on their boards, able to understand the complexity of developing a robust decarbonisation plan that can be measured and monitored. A recent example of this is the vote on AGL, after many years of engagement, a majority of shareholders (including CSC) voted to elect new directors to its board, on a platform of more rapid investment in decarbonising the business than was previously planned.

(ii) In collaborative efforts with organisations like Investor Group on Climate Change (IGCC) and Climate Action 100+ (CA 100+) to support the characterisation of robust transition plans and transparent reporting.

Portfolio-level impact for system consideration

CSC manages portfolio-level impact not company-by-company impact as practically every company, perhaps with the exception of those operating within nuclear jurisdictions, whether energy company or any other company, relies on fossil fuels (directly or indirectly) to produce the things the world consumes. Indeed, fossil fuel remains an important input into the production and distribution of renewables and the infrastructure required to make them firm (ensure sufficiency and reliability).

In the transition period towards reliable and sufficient renewables energy supply, fossil fuel rationing should arguably differentiate between those companies converting fossil fuels into, for example, non-discretionary consumables (food, healthcare, etc) and renewables infrastructure and away from those companies converting fossil fuels into items that represent next year's land fill (eg. discretionary consumption; crypto trading; etc.). So energy companies that are well-governed; have strong human capital management capability; and boards focused on genuine transition plans, are actually important ingredients into a robust transition.

The Paris Agreement involves national commitments capable of supporting global decarbonisation. In practice, this requires varied, non-linear emissions reductions pathways for different assets, sectors and regions; the Agreement does not specify decarbonisation objectives for any *individual* company (or investment portfolio).

Engagement for impact through change

As owners, we retain certain rights that enable us to influence businesses. Engagement is one means of achieving this, where the changes we seek are commensurable with business performance over the long term. For example, at the 2022 AGL AGM, after many years of engagement, a majority of shareholders (including CSC) voted to elect new directors to its board, on a platform of more rapid investment in decarbonising the business than was previously planned.

Real decarbonisation of this type requires emitters to invest in the new energy system so that they can permanently replace their old technologies. Large diversified resource companies such as Woodside and BHP [1] are generally more capable of such changes.

Our engagement activities prioritise effectiveness. With respect to Santos and Woodside, we have the large-scale, climate-focussed investor initiatives such as IGCC or CA 100+ where some of our investment partners are co-leaders. These initiatives co-ordinate, consolidate, and communicate investor expectations and concerns with greater effect than it would be possible for us to have if we acted alone.

In addition, we require our investment management partners to engage the material actively-held companies they hold on our behalf.

Where a companies' management and board skills are inadequate to the strategic challenge of sustainable value creation, and engagement to improve the quality of that oversight is unsuccessful, then our investment managers may elect to redeploy those funds to comparatively better corporate opportunities.

[1] *We value corporate transparency on these risks and BHP was the first resource company in Australia to report in accordance with the Taskforce on Climate-Related Financial Disclosures (TCFD) requirements. We support that action.*

Our managers would divest if they believed that:

- a company was investing at returns below their expectations or their own cost of capital (such as in an asset with high "stranded asset" risk);
- a company showed a refusal to engage with their concerns regarding any ESG-related items.

On occasion, we have escalated such concerns (where unaddressed after engagement) via voting that more assertively communicates our concerns to the board; and by voting for board composition that adds the necessary skill, diligence and/or commitment to decarbonisation.

Note: The following part of this response contains further details was given verbally by Alison Tarditi (CSC CIO) during the Q&A part of the meeting

I understand that what your question is motivated by is wanting to contribute to a reduction in greenhouse gas emissions into the world. That's our objective too.

I also understand that some customers like sending a signal via divestment of fossil fuel companies and that many financial institutions cater for that customer preference.

But I hope as this slide by, the 2 Degree Investing initiative[2] illustrates, and research undertaken now at Harvard University, Oxford University and most recently Zurich University supports, there's a very consequential but poorly understood distinction between:

a) portfolio impact which is what divestment delivers and the top half of this slide tries to illustrate and
b) real world impact which is rather more complex to achieve and illustrated in the lower panel.

Portfolio Alignment is not a valid proxy for GHG emission reductions in the world

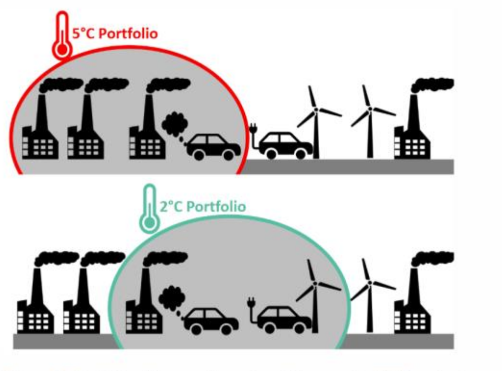

Figure 2. *Portfolio alignment is not a valid proxy for GHG emission reductions in the world.*

Source: Why "aligning with climate goals" doesn't equate to "contributing" to them - **2DII (2degrees-investing.org)**

[2] The 2 Degree investing initiative is an independent, credible and practical global not for profit that coordinates some of the world's largest research projects on sustainable finance.

Now the exclusion of all fossil fuel producers from your portfolio, which I understand is desirable to some customers, may reduce the risk of any potential write down in the value of your super should all those assets become stranded; and stranded simply means those assets become worthless before or during your retirement period.

But it does **not actually reduce** greenhouse gas emissions into the world, a phenomenon that we've long understood but that is now increasingly recognised by scientists, investors and activists alike as green wishing.

Divestment from coal producers

CSC has not therefore made a public commitment to achieve net zero greenhouse gas emissions within our investment portfolio. Nevertheless, we have actually managed to reduce the risks to your retirement outcomes by divesting from what we consider to be potentially stranded fossil fuel assets defined as companies that have little prospect of transitioning because they derive 70% or more of their revenue from thermal coal production and generation. Examples globally of those companies that we have divested from are Coal India, Peabody Energy Corporation, New Hope and Whitehaven in Australia.

Short term financial cost of not holding coal

Now it's important to note that here is a short term financial cost to you from not holding exposure to these sorts of companies, for example, Whitehaven Coal over the last eight or nine months has had a 181% rise in its share price. Now that has had a negligible impact on your superannuation outcomes representing 0.09% negative return which is very small because of all of the other investments that we have made for you that diversify the risk of not owning that company in the short term.

So, divestment is a tool for portfolio long term risk mitigation and, if simply extrapolated, the risk mitigations we have taken in your portfolios to date actually do put them in line with what others measure as Paris alignment. That's a 50% reduction in the public company carbon emissions from your portfolio by 2030 and 100% by 2050 if we can maintain the pace and I can't guarantee that that is possible but if we can.

But this work which is relevant to your financial outcomes has no impact on the amount of greenhouse gas emitted into the world because divestment is not a withdrawal of funding from the company. It's merely selling your stake to someone who by definition values the company more.

Addressing energy demand makes a real economy impact - limiting supply just benefits fossil fuel companies

More importantly in my opinion, divestment is ineffective and regressive because it focuses on the company supplying fossil fuels instead of focusing on demand. **Demand** is about energy efficiency and improving that. Supply constraints drive higher fossil fuel prices and higher fossil company or industry profits. Exxon made record profits in September 2020, US$20 billion or thereabouts which is about what Apple made. Profits that investors and companies themselves, encouraged by long-term investors, could recycle into new renewable infrastructure.

Any impact that rations use of an inelastic product, and by inelastic I mean as I mentioned in my formal points, demand for energy can't be shut off quickly, costlessly or easily because every company in the world outside of nuclear jurisdictions relies on fossil fuels to make the things that the world consumes. So, focusing just on supply and rationing through price means that you have effectively a regressive tax. It prevents parts of the developing world from accessing refrigerated transport for vaccines. It makes it unprofitable to transport or even to make some wind turbines but it's unlikely to have much effect on people who use private jets for a Christmas shopping spree.

CSC's contribution to net zero progress, consistent with fiduciary duty
So, while we haven't focused on marketing our progress towards net zero within your investment portfolios, because that would be an easy win, but it isn't genuine, we have committed to help accelerate progress towards a net zero global economy to the extent and speed possible consistent with our fiduciary duty to all our customers. And we've done that in three ways and I'll be very brief but happy to go into greater detail.

1. The first thing I mentioned in my prepared comments is **innovation capital.** Capital allocation supports decarbonisation only when it finances real world decarbonisation projects that wouldn't otherwise happen. We do this by investing a measurable share of your risk budget, more than $1 billion of your capital, into innovation, technology and development platforms focused on new renewable sources of energy and the infrastructure required to make them firm and scalable. These investments are reducing emissions in the real world by 251,000 tonnes per annum compared to servicing a similar level of energy demand using companies in the global energy index.

2. We also do it, as this question implies, through Now our influence is strongest where the link between CSC as financier and the activity **active ownership and engagement.** being financed is direct and that's obvious right, because we have control over those sorts of assets. So, we all know that the operations of buildings contribute 25% of global emissions. Our directly owned buildings use energy efficient technologies, electric chillers, LED lights, those sorts of things and energy reduction management systems and electrical alternatives to fossil fuel based plant and equipment and we purchase 100% renewable power for all of our buildings. Now that sequencing, energy efficiency first and then the purchase of renewable power is actually really important because it means we're reducing real demand for fossil fuel energy, not just earmarking apportion of the renewables in the grid for our use.

3. **Advocacy** is the third leg of what we're doing to try and improve the world that we live in. In our view real world impacts require practices aimed at aligning markets in their pursuit of a fair financial return to their purpose of creating value in the real economy and we have long defined value both by tangible things like plant and equipment as well as intangible things like institutional integrity,

healthy population and clean air. They're prerequisites to a sustained and inclusive prosperity that I think we all want.

To that end we work collaboratively with global peers, so other investors around the world, but also with development banks, scientists, NGOs, entrepreneurs and others towards developing sustainable investment vehicles that meet our customers' requirements for return and mobilise fresh capital that is additive to building a zero emissions economy. This is why we also don't offer a standalone ESG option which would be an easy marketing win for us but not necessarily part of the real world solution.

International engagement examples
Additionally, here are three examples of international companies in our portfolios who are in the process of transitioning to lower-carbon operations – something we can support them to deliver by remaining engaged, thereby creating sustainable value in your portfolio, and beyond to improve real world outcomes.

German electricity
RWE AG is a German multinational energy company. The company scored poorly on emissions because of their historical reliance on fossil fuels, and its price was penalised by the market. Renewables now comprise one-third of RWE's energy production. They have a plan to reduce emissions by 50% by 2030 and are committed to carbon neutrality by 2040.

Norwegian state oil
Equinor, previously Norwegian state oil, is another example. The company's plan is to be carbon neutral by 2030, and that's evidenced in their allocation of more than 25% of their total R&D budget to hydrogen and carbon capture and storage (CCS) technologies.

US Coal
WEC Energy is another example, a US company that is retiring old coal plants with a plan to achieve less than 10% revenue from coal by 2025. They're investing US$4 billion in solar, wind, battery storage technology, all critical to accelerating the transition to a new energy regime.

We can have a natural tendency to undervalue things that are complex – and climate action, which is inseparable from the other 16 UN Sustainable Development Goals (SDGs), is very complex. To translate paper virtue to real world impact requires deep system appreciation, support of companies making deep decarbonisation changes, and early stage investments that lean into innovations capable of leapfrogging us forward. We've been doing these things for two decades, well before they became fashionable.

Ultimately, we care about the risks and costs that our customers are exposed to as their super grows, and this is the discipline that grounds our investment approach. By analysing all environmental, social and governance risks well, we also expect to contribute a genuine net positive impact on the world in which we all live.

As with all aspects of portfolio management and system responsibility, we continuously monitor the evolving availability and quality of data, tools, technological and scientific developments. Our aim is to ensure that we remain aware to and able to utilise any new and better methods for delivering robustly constructed and responsible investment portfolios that genuinely improve our customers financial position *and* the world in which all of our portfolio assets operate and contribute.

Question: The IEA's 2022 World Energy Outlook concludes for the first time that global fossil fuel demand will peak/plateau, in all scenarios. Even in the least ambitious 'stated policies' scenario (aligned with 2.5°C of warming & inconsistent with CSC's own position), gas demand is projected to plateau by 2030. Taking into account this new piece of analysis, does CSC see an increased stranded asset risk in companies pursuing new oil and gas production projects, and, if so, how will CSC manage this risk?

Addressed in question above in detail.

In summary, for portfolio risk mitigation we have divested of stranded assets – defined as companies that have little prospect of transitioning; are expected to be of little value in absolute terms over the long-run; and are of little value to your overall outcomes in the short-term, even if their prices continue to rise.

For example, we divested from Whitehaven Coal, because it derives 84% of its revenue from coal, making transition to the new energy regime challenging and, therefore, greater valuation risk associated with a higher share of potentially stranded assets over the longer-term. However, over the short-term, the share price of this company is a beneficiary of energy supply constraints and it has risen 181% between 28 February and 31 October 2022. The impact on your portfolio from this opportunity cost is managed by how we construct your portfolio around this divestment. So the impact of this one company's very large price appreciation was contained to just -0.09%.

Question: Other large super funds (such as UniSuper) have started selling down their holdings in Woodside & Santos, and NGS Super has divested completely. The last two Portfolio Holdings Disclosure Statements show that CSC had not even begun the process of selling down its holdings in Woodside & Santos as at 30 June. Why not?

Question: The Albanese government has committed to net zero in the APS. In light of this, what is CSC's timeline for divesting from fossil fuels?

There is a critical difference between

- portfolio risk management and
- real world impact.

Two key ways investors with net zero goals should provide capital in emissions-intensive sectors are to:

(i) Allocate to climate solutions, which we have been doing through our private market allocations, as an early mover, for a long time.

(ii) Remain invested in already-financed emissions-intensive companies to encourage them along a credible pathway to reducing their emissions because this change will have material impact on the system. Assessing improvement paths is complex and the data to do so with high conviction is not always available. But we are working with our managers to ensure we do this with full awareness of global best practice tools and thinking.

That's why the United Nations Environment Program Finance Initiative's Net Zero Asset Owner Alliance states that any such commitment to net zero

> "must emphasize GHG emissions reduction outcomes in the real economy…especially through advocating for, and engaging on, corporate and industry action, as well as public policies, for a low-carbon transition of economic sectors in line with science and under consideration of associated social impacts. [3]

The reasons for emphasising engagement versus divestment can be summarised as

- *Energy* supply versus demand.
- *Capital* supply versus demand.
- *Concentration* of interests and influence.

Energy supply versus demand

Currently, the world's demand for energy overwhelmingly exceeds the supply of renewable energy and storage. In these circumstances, constraints on the *supply* of fossil fuels drive up its price, and the profits of fossil fuel producers. This is illustrated by the price and profit rises during 2022, exacerbated by the supply constraints associated with the Russia/Ukraine conflict.

Moreover, to the extent that high prices cause energy use by households and businesses to fall, these have their largest impact on those with the least capacity to pay. Lowest-margin wind turbine manufacture and transport would cease before highest-margin luxury consumer goods; refrigerated transport (e.g. for vaccines) in developing countries would be curtailed before private jet use.

Capital supply versus demand

Allocating capital to new industries enables them to fund R&D, establish new ventures, and expand into new markets before they have enough revenue of their own to pay for these things. Profitable companies, in contrast, generally fund activities from existing revenues.

Divestment is not a withdrawal from these companies, but a sale to - and purchase by - other investors. There is little-to-no impact on a company when an investor sells shares in a company whose shares are bought and sold every day.[4]

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[3] AOA_FAQ.pdf (unepfi.org)

[4] Broccardo, Eleonora and Hart, Oliver D. and Zingales, Luigi, Exit vs. Voice (April 22, 2022). Harvard Law School John M. Olin Center Discussion Paper # 1061, Available at SSRN: https://ssrn.com/abstract=3680815 or http://dx.doi.org/10.2139/ssrn.3680815

Concentration of interests and influence

In circumstances where divestment comes at a high cost and delivers a negligible benefit, we see it as preferable to remain invested, to retain the shareholder rights that provide us with some influence over the companies, and to recycle the returns that fossil fuel companies generate into industries of the future.

Generally, we would not expect investors with shorter term objectives to be equally likely to support those companies' investment in decarbonisation. We therefore do not believe decarbonisation is served by divestment, which concentrates their ownership and influence on these companies.

Orderly reduction in gas for energy security while renewables, storage and technology ramp up

Our fund exposure to gas related businesses is 1.4% as at 30 September 2022. Over time, we expect this to decline, but at a pace that allows countries around the world to continue to have reliable, uninterrupted and affordable energy until technology limits are overcome (e.g. when wind and solar energy is unavailable under certain weather conditions). This has a critical feedback loop into inequality and conflict and is just one example of the complexity within the global system, with its own unintended consequences.

Importantly, not all gas projects/investments are equal. Each scenario and development should be assessed on its own merit, taking into account individual differences. There will be some profitable projects that will be required to meet interim demand, while other projects will see risks to value, depending on local regulations, policies, proximity to demand and other factors.

The developed world is accelerating away from a high dependence on fossil fuels. However the pace of that transition remains constrained because our homes, hospitals, schools, essential services, even electric vehicles, still all require fossil fuel baseload until renewable energy generation, storage and transmission can achieve mass scale. Further, the costs of that baseload energy must rise materially through transition, with obvious implications for average living standards, as Europe is experiencing today.

In developing regions where dependency on fossil fuels still remains very high, those rising energy costs become a hard constraint, because they increase social instability and the potential for the propagation of geopolitical risk.

The shift in the energy sector has gained incredible momentum – in 2020, 37% of the world's energy consumption came from renewable sources[5]. That said, oil and gas are still used as backup to renewable sources, because we currently don't have the necessary battery storage to replace the role played by oil and gas – we still need to build it.

Eccles, Robert G. and Rajgopal, Shivaram and Xie, Jing, Does ESG Negative Screening Work? (April 30, 2022). Available at SSRN: https://ssrn.com/abstract=4150524 or http://dx.doi.org/10.2139/ssrn.4150524

[5] International Renewable Energy Agency, Renewable capacity highlights, 31 March 2021.

To keep up with today's global energy demands, and to ensure access to energy is equitable (i.e. affordable for all not just the most wealthy) investment in oil and gas has an important and necessary role as a transition fuel – for the time being.

Question: First, many congratulations on 100 years of serving those who serve Australia! As a PSSap member, I would like to know how you are navigating ESG trade-offs, especially future-proofing for tomorrow's economic realities in this most challenging of economic times. Many thanks to all of you at CSC.

CSC finances real world emissions reduction
CSC has been investing in new-energy-system assets for over two decades both directly, through our private asset portfolio, and via tailored public market indices. By being a first mover, we have been able to avoid trade-offs and instead capture strong financial returns for our customers while delivering positive impact in the world into which our customers will retire.

As at 30 June 2022, we had over A$1.012 billion invested in high-quality private and public assets including wind farms, waste management infrastructure projects and renewable energy initiatives that add to the net new supply of facilities.

These investments reduce our portfolio carbon emissions by over 251,000 tonnes of CO^2 per annum, compared to having this money invested passively to meet a similar level of energy demand (for financial year to 30 June 2022).

- We take a value-for-money approach when assessing investments in renewable assets. Often, this leads to investments in new renewable developments rather than mature operating assets. This contributes to the transition to a lower carbon world because we can add to the overall stock of installed renewable projects, rather than simply trade shares in existing assets.

- In September 2015, we invested in Macarthur Windfarm, then the largest windfarm in the Southern Hemisphere. As renewables became highly sought after assets amongst institutional investors, we were able to sell this to other investors in March 2022. During this period, this investment provided 14% per annum gross return to customers. We must ensure that any investment we make meets our customers financial objectives by offering a fair return for the risks and costs involved in the investment.

- We have now recycled this profit into an investment with Akuo, in partnership with Intermediate Capital Group, a global developer of renewable assets, diversified across types (wind, solar, biomass, hydrogen, storage) and geographies (15+ locations around the world). In addition, we have diversified across two other renewable-development platform investments. Because all three of these opportunities add to the net stock of new alternative energy assets, they make a genuinely additive contribution to the journey to net zero.

- Notwithstanding that significant capital investment in new-energy-system assets is required (US$ 1 trillion + annually) to meet ambitious climate targets, the development of new-energy-system projects globally is limited by physical constraints rather than lack of capital. These include grid capacity, planning constraints, supply chain issues and labour availability. Under such constraints, it is more challenging to find new-energy-system assets that contribute to real world carbon emissions reduction and offer attractive investment opportunities for our customers' retirement savings. We consequently remain highly selective and continue to monitor new opportunities.

Social Investments

Question: Do you invest in social housing?

Note: This response was given verbally by Alison Tarditi (CSC CIO) during the Q&A part of the meeting

CIO
No, we don't have any exposure to social housing at this point in time. A number of years ago, I travelled through the United States to look at social housing opportunities there, and they weren't compelling at that time in terms of the returns given the risks associated with their build and the quality of the social housing being offered. We are still open to investing in social housing, but to date, it hasn't provided a compelling relative return.

CEO
I'd just add, obviously conscious of the Government's announcements at the budget in that regard, and there's obviously a path that's going forward and a conversation that will take place with institutional investors around the globe, not just Australian superannuation funds on this. But we need to understand, and this is the point that investors such as ourselves have been trying to make, that there are structural issues with how things are taxed, et cetera, in Australia in particular, that actually are an impediment to investing - getting a return for the risk taken in the Australian market.

Obviously, we'd be hopeful that maybe some of those settings might change, and I would say they would need to change in order for us to balance the risk with a return for your portfolio. But we remain open to all opportunities around the globe, should they make sense.

Investment Markets

Question: Did UK Pound tanking in September 2022 affect Australian super funds?

The UK pension system and operating model is very different from that in Australia. In the UK, pension liabilities are generally "immunized" against inflation and interest rate risk, which means they hold a significant proportion of the portfolio in UK government bonds and this makes them vulnerable to discrete changes in interest rates. When interest rates rise, the price of bonds falls, meaning these funds incur material losses.

Australian super funds were not impacted to the same extent because our operating model is very different and superannuation liabilities are generally not explicitly "immunised".

The impact of deep and volatile currency movements such as for the Sterling (Pound) in September 2022 depended on each super fund's liquidity management, especially in relation to its currency hedging.

CSC has robust liquidity and risk management policies and processes in place to enable us to meet all demands on our cash from members, as well as our investment portfolio needs. Cashflows and liquidity positions are monitored daily and future needs anticipated and modelled. Furthermore, we run stress tests to assess scenarios, such as the size of currency, share or bond market movements which may trigger liquidity limits.

During the UK bond and currency market stress in September 2022, the sharpest and fastest sharemarket decline since the start of the pandemic in March 2020 and the Global Financial Crisis in 2008, CSC did not incur any liquidity stress events and we were prepared and therefore able to meet customer and portfolio cashflow demands.

Question: There was recently a book by Nouriel Roubini, an American economist, on the 10 megatrends and looking at the Fed's drive to reduce inflation and driving up interest rates and the potential recession that might be coming over the next year or two. What are your - I know this is crystal gazing, but I'm just wondering what are your thoughts over the next, say, two years in terms of the financial markets? In terms of how the impact of the potential recession might have and - in the financial markets?

Note: This response was given verbally by Alison Tarditi (CSC CIO) during the Q&A part of the meeting

I'm humbled to be asked a question that Nouriel Roubini has written a book on, because he's much more famous than I am. I don't have a crystal ball, which is why we try not to construct portfolios on the basis of a prediction for the next two years, because we genuinely are in a world of high uncertainty.

Uncertainty while moving from lowest cost and most efficient to quality(?)

It's not just the fact that inflation is the highest since the 1980s. We really see an extreme culmination of various trends, geopolitical, competition, technology's move from the trade vector to the security vector. People have recognised that pushing to the lowest cost and the most efficient outcome has actually lost quality in that process, and so countries and companies and individuals, I might add, are starting to recognise that maybe paying a little bit more for high quality is better than the cheapest thing.

We're manufacturing. We've built societies that are dependent on consumerism. At the same time, we're worried about the change in the climate, so you've got all of these structural issues, which are systemic in nature. Capital markets, which is why we don't oversell what we can do as investors against climate change or any systemic risk that people are worried about, because they're very complex problems.

Volatility in next two years with high inflation and interest rates
So I think the road for financial markets in the next two years is a volatile one as we swing between high inflation, high rates, and then the other side of that. Because nobody's quite sure how high rates have to go in order to combat this inflation. But everybody understands that hyperinflation is a very bad thing. It's very corrosive. It's bad for households, because your cost of living goes through the roof. It's bad for businesses, because you can't plan anything. You don't know how much inventory to have. It's bad for investors, because the value of everything gets eroded. So we know that that's a bad - and central banks have very clearly stated that they're going to lean against that, because they understand how bad it is if it becomes embedded.

The open question is, does that cause a recession? Can they engineer a soft landing? I could talk to you about this for days, but we've prepared your portfolios for a more volatile period ahead, one where inflation on average is higher. That doesn't mean equities can't rally, and they typically rally from a seasonal perspective after a midterm election in the United States into the year end. But from my perspective, at least, that's not a rally to be chased.

Investment Performance Net of fees

Question: Question for Alison, You discussed the great performing assets, (eg Canberra Data Centers at 46% return p/a since acquisition) can you share your three worst investments?

Note: This response was given verbally by Alison Tarditi (CSC CIO) during the Q&A part of the meeting

We use Canberra datacentre as an example, because we are here in Canberra, and I think it's nice that - and we've been able to make an investment into Australia through Canberra in particular.

The way I would answer this question is to say what I am proud of about our investment process and the governance model that we use, and the fact that we're quite innovative, is that we actually do concentrate legitimately on missing things under the water. So when I talk about the iceberg, I'm really thinking about the distribution of returns looks like that. Everybody reaches to the right to get the best investments. Our DNA means that we're always trying to avoid the worst investments, so that just by doing that, we shift the average return available to you to the right.

No permanent capital impairments

So I can honestly say that we are very proud of the fact that we had no CDOs through the GFC. We've had no liquidity events in hedge funds. We've had no liquidity events across the fund. We've never had an increase in defaults across our private equity portfolio, beyond what you would expect in a normal cycle. So I don't think about the worst investments we make in terms of capital write-down, because we haven't written your capital down. We have got a P&L, so some days, we're in profit, some days we're in loss, but they're not permanent impairments to your capital.

Opportunity cost of risk management

That's a feature of our investment approach that is differentiating versus our competitors. But I do think about your question in terms of opportunity cost, because every decision that we make is a decision that we're not making in a different direction, and sometimes, that has an opportunity cost, which means you don't get the best return available. But you're not getting an impairment of capital.

Government bond exposure

If I think about it in that way, I could think about the thing that comes to mind most recently is that we reduced our - your exposure to government bonds across the portfolio, because we were worried about inflation being underrepresented in a market's thinking, and that rates could rise quite aggressively. But we didn't go to a zero weight for bonds, which intuitively felt right, but you always have to think about the circumstance where you're wrong about something, because unless you're God or Madoff, you're not right all the time.

That was an opportunity cost, because US treasuries, so US government bonds of maturities 15 years and greater, which are a traditionally very defensive asset class, lost 27% of their value over the last 12 months. That compares to just a 20% loss in value from equity, so perversely, you were better off in equities than bonds. So we reduced your exposure, but we didn't reduce it to zero, so that was an opportunity cost for you.

Seed managers

The second, if I have to think of a second one, I think it was the speed at which we've rotated away from established investment managers to the new investment managers. We call them seeded investment managers, because we're the initial investor and we build the business with the investment manager. We've started rotating towards that style of public market active management about six years ago, and I think the opportunity cost to you is that we didn't move faster in that direction. We were a first mover amongst many of our competitors, but if we'd moved faster, those funds have done much better than the established. The reason for that is we've built them, purpose built them, to deliver returns for you, so I'd say that's the second opportunity cost.

Technology stocks
I think the third opportunity cost is, optimally, over the last 10 years, it's fair to say that the best allocation of capital has really been in five technology stocks until it wasn't. So our criticism would be, well, you missed that. So we're trying to build diversified portfolios that will be able to withstand any kind of environment, a technology shock to the negative, a technology shock to the positive, a recession and inflation, to make sure that through the decades in which your savings are exposed to the world, they're resilient.

But in doing that, we're not capturing the best returns, and also we're avoiding the worst returns, and so that in some people's minds is a mistake. In my view, it's just a prudent way to manage savings that you're going to depend on in retirement, but they'd be the three opportunity costs that I'd talk to in answer to that question. But it's a great question, and I reassure you that we diagnose every investment decision that we make, because we're a learning organisation, and the best learnings come from your failures, or in our cases, the opportunities that we've missed.

Question: How do you compete with the for profit superannuation funds like Australia super and the ever-growing fund merges in terms of performance return and fees?

We compete by recognising our comparative advantages and leveraging them, and by remaining focused on our well-defined customer base and their specific needs in retirement, rather than those of the average Australian because we are not open to everyone.

Our comparative advantages include our mid-range scale, our strong globally-recognised capacity for innovation and investment governance, our internal diversified skill sets, and our strong foundational partnerships with deeply skilled investment managers and service providers globally.

Scale is often seen as a strong advantage, and few spend time thinking about the consequences for customers of a fund that is “too big”. At around AUD $60 billion in funds under management, we’re considered a mid-scale fund. This means we’re in an ideal sweet spot to benefit from economies of scale and access to rare investment opportunities. But, we’re generally not so big that it limits what we can invest in.

Economies of scale
Scale is only important to the extent it enhances the efficiency of a super fund, so that it can manage its costs effectively. But excess scale can actually reduce your investment universe and begin to deliver diseconomies to customers too. This is less discussed. For example, a $200 billion super fund cannot invest effectively in actively-overseen Australian small cap companies, where the best long run returns are likely to be concentrated in the domestic equity market.

Our mid-range scale means that we can

- access a full range of domestic and international assets and strategies;

- manage costs to ensure value for money (rather than be lowest cost which is the primary benefit of large scale funds); and
- remain nimble with our risk management to ensure that our customers savings are protected in a volatile and uncertain environment and we can re-allocate to the best relative returns throughout any cycle.

To achieve long term member outcomes:

- We seek to leverage scale to maximise the benefits for customers in the form of total net returns;
- Scale allows us to negotiate on fees and tailor terms and conditions on mandates to pay for what our customers need, rather than be forced into commoditised pooled vehicles;
- Scale allows us to access a broad universe of investment opportunities, including both listed and unlisted assets, across most investment risk factors – if we don't have a particular risk exposure, it is a deliberate investment decision, not because we are constrained by scale;
- However, we are generally still agile enough to access smaller-scale, active management of across different market segments.

Question: Given the strong returns that index funds have had for low costs, why wouldn't CSC just invest in index funds rather than paying investment managers?

Question: Fees seems high... What if we reinvested these fees into a market tracking fund (eg ASX200 has a 7% pa over the past 5 years). Can you provide (perhaps on notice) what percentage return you can achieve vs what the extra capital through saved fees can achieve through a market tracking fund?

Note: *same answer for multiple questions*

Value for money, adjusted for risk

We use a combination of index and active management.

- We invest our customers' savings in high-quality private assets, actively-managed segments of public markets where the opportunity set is rich, and passively-indexed segments where public markets are most efficient.
- This combination varies over time as the conditions for markets changes and we seek to ensure we are optimising the probability that each of our customers will reach a comfortable retirement.
- We look for opportunities that are expected to be rewarded for the risks and costs involved, including resilience against downside and inflation risks.
- We only pay for what customers need to enhance your retirement outcomes. For example, we only pay fees for active management where performance is expected to contribute to better outcomes at the fund level, either by producing higher net real returns, or by reducing exposure to risks that we have to take in other parts of the portfolio.
- We hunt for investment opportunities where others are not (yet). As an early adopter, we actively search for emerging investment areas to deliver attractive returns net of fees.

Total costs can fluctuate over time, but on average, they have been reducing through time

- Importantly, we believe that what ultimately matters is the wealth that is able to be preserved as well as grown to ensure income in retirement is reliable. We expend costs not just to transact assets but importantly to reinvest in them, sustain their cashflow generation and enable them to continue to compete effectively as the world around them evolves. We also incur costs in building diversified sources of returns that contribute to the resilience of our customer's portfolios, making them less vulnerable to market conditions that may not always be benign, over the timeframes that matter to our customers, all the way up to and beyond retirement.
- In short, we are incurring costs to increase the probability of our average member achieving a comfortable retirement through portfolio diversification, high-quality private assets and agile asset allocation. We are conscious that value is not price and that we invest alongside market participants with different agendas, time horizons and appetites for loss.
- Examples of assets that are not able to be accessed cheaply include
    - high-quality private infrastructure like windfarms and satellites, private companies where the owners control the business and have expertise in the industries and ecosystem in which it operates, and
    - property assets where the costs of operating and pro-actively managing the assets to maintain their experiential, green and technology-efficient offerings are more visible and explicit than those involved in generic exposures to very small shares in such assets through listed markets (where these costs are subsumed in net returns).
- Risk is all about what happens next, rather than events to date. We incur costs to prepare our portfolios to be able to cope with the potential scenarios that can occur going forward, as discussed in previous Annual Member Meetings and customer newsletters. For example, out of the many scenarios we modelled, 2021–22 has seen significantly higher inflation, monetary policy tightening, e.g. with multiple Central Banks raising interest rates, ongoing COVID pandemic uncertainty and war in Ukraine impacting food and energy supplies and prices. The active management decisions we made in anticipation of these events contributed to the resilience of our portfolios.

Investment Portfolio Management

Question: How do you calculate your portfolio weights. Please answer including equities portfolio weights calculations.

Role of each asset in the portfolio

We construct a portfolio for each investment option by including different assets and considering each asset's potential role in the portfolio. Here are some examples:

• Does the asset generate returns above inflation, by investing in businesses that are expected to grow?
• Does the asset protect the value of your savings and diversify against market downturns?
• Can this asset be easily sold when required?
• Under what economic scenarios and market conditions will these assets grow or reduce in value?
• How stable and sustainable is the expected income from this asset over time?
• How sustainable and reliable is the expected capital growth from this asset over time?

We model different portfolio weights under different scenarios to consider the optimal weights to each asset given the Investment option’s objective.

Portfolio weights to different sources of returns and risk

We invest in five broad categories of opportunity:

• **Corporations**. By investing in public and private corporations, we aim to grow the real value of your savings.
• **Property and infrastructure**. By investing in and operating property and infrastructure assets, we aim to protect against the risk of inflation eroding the real value of your savings.
• **Government bonds**. By owning the debt of stable governments, we aim to protect investments against adverse events like economic recessions.
• **Active-risk strategies**. By proactively managing investment risks throughout the investment cycle, across a wide variety of opportunities and in different economic environments, we aim to protect your capital, preserve your purchasing power and grow the real value of your savings. (This is where we bring in our investment strategy expertise, to augment and manage our investment performance in underlying financial markets).
• **Foreign currency risk**. We proactively manage foreign currency risk through foreign currency hedging.

Equities

When we invest in stocks, we buy shares in companies. Not all companies are listed on a stock exchange (e.g. private companies).

Australian shares

Investing in Australian shares means you’re investing in companies listed on the Australian Securities Exchange (ASX). As companies’ fortunes change—up or down—so does the value of their shares. This fluctuation is reflected in your return. The companies’ profits determine the return on share investments,which is returned to shareholders in:
• dividends—usually once or twice a year
• capital gains or losses that have come from share-price fluctuations.

Market forces can affect share prices, and investing in shares is considered a riskier investment because there may be significant short-term fluctuations. Over the longer term, though, shares may offer relatively higher returns.

International shares

Investing in international shares is like investing in Australian shares except that the companies are listed on international stock exchanges, rather than the ASX.

As well as being exposed to global stock market fluctuations, investment returns are also influenced by foreign currency exchange movements.

We manage foreign currency exposure through currency hedging against the Australian dollar. We determine the level of hedging and it may change from time to time.

Private equities

Investing in private equities means we invest in companies that aren't listed on a stock exchange. These companies may be in Australia or overseas, and this investment gives us access to sectors or segments of economic growth that we may not access as efficiently through listed markets. Examples include the information technology and health care sectors, which can both create interesting and innovative change rapidly.

Private companies are generally managed by teams that have operational experience in their specialist industry.

Our portfolio weights for each Investment Option can be found on [Portfolio holdings disclosure (csc.gov.au)]

Retirement Income Strategy

Question: Can you please tell us more about the Retirement Income Strategy and how do we go about accessing this? thank you

We have always been focused on helping customers to achieve comfort in retirement, whatever that means for you and your circumstances. Our Retirement Income Strategy is no different. It's designed to accommodate your circumstances, be easy to understand and allow you to make an informed choice, or get appropriate support if you need it. For more information please refer to https://www.csc.gov.au/Members/Retirement/Plan-retirement/Retirement-income-strategy. As part of CSC's Retirement Income Strategy you may wish to choose from one of our retirement income solutions which will be released in 2023.

Question: Does CSC allow members in the PSS and in the default investment scheme, to turn those monies into an annuity or allocated pension or similar product.

Part of the Retirement Income Strategy spoken about tonight would be developing products for any of our customers to utilise once they reach the relevant ages they need to meet to access their super.

Question: Is the RIS a personalised service? and if so how do I access it?

We have always been focused on helping customers to achieve comfort in retirement, whatever that means for you and your circumstances. Our Retirement Income Strategy is no different. It's designed to accommodate your circumstances, be easy to understand and allow you to make an informed choice, or get appropriate support if you need it. For more information please refer to https://www.csc.gov.au/Members/Retirement/Plan-retirement/Retirement-income-strategy. As part of CSC's Retirement Income Strategy you may wish to choose from one of our retirement income solutions which will be released in 2023.

CSC Operations

Question: I am a PSS member, and currently work in a private sector. Can I make personal super contributions to my PSS super account from my after-tax income?

PSS preserved members are unable to contribute to the fund. As a PSS member, you may be eligible to join PSSap Ancillary. PSSap can accept all types of contributions, including personal after-tax contributions.

Before making any decisions you should read the PSSap Financial Services Guide (FSG), the PSSap Product Disclosure Statement (PDS) and PSSap Target Market Determination issued by Commonwealth Superannuation Corporation (CSC).

Question: How many contributing members does CSS still have? How many of those are under 55 and might still take the 54-11 option?

As at 30 June 2022 the CSS had 1,777 contributors remaining in the scheme, of that 358 had yet to reach age 55.

Question: In past year, set against KPIs and other metrics, how has CSC/CSS peformed in customer service delivery standards & IT/data integrity? WRT customer base comprising (overseas-based) Super scheme pensioners (and/or widows), re quality of service delivery & support to very elderly, vulnerable pensioners/widows who e.g. might have pensions suddenly/summarily stopped for inappropriate or incorrect reasons, and due to distant, overseas location might feel they are not prioritised or communicated with as much as they should?

We have been measuring our Net Promoter Score or NPS since 2017 through our Voice of Customer program called the Compass. Over this period we saw some common customer feedback to improve access to clear information about how superannuation and CSC schemes work because we do run 11 schemes. Tailored information about the relevant consideration for different life stages from career starters to pre-retirees to pensioners. How benefits are calculated and whether and how they fluctuate with investment markets or inflation and clearer information about fees, investment choice and insurance. We have been diligently addressing these across the business and our transformation program is vital in delivering the improvements that you, our customers, expect to see. To start with, we're improving the navigation of our website and have a renewed focus on producing valuable information that meets your needs wherever you are in your journey to retirement.

We're also improving the support we provide you in making decisions about your retirement. This includes both new and some enhanced education seminars making our financial planning services more accessible and better supporting the broader financial planning community who we know is so important for our customers. We are already starting to see results from these improvements. Our overall NPS for the 2021/2022 financial year was minus 7, an improvement of 5 points from the 2020/2021 financial year.

Question: What kind of financial advice services can we offer / recommend to someone who is looking to retire

We strive to provide superannuation services that are relevant, reliable and helpful to our customers.

We want our customers to be able to make informed decisions about their superannuation and their future income needs.

We provide to our customers:

- general information delivered over the phone and by email
- secure access to online services (account balances, investment options)
- education and general advice via public and in-house seminars and webinars
- information and general advice delivered person-to-person (known as 'one-to-one consultations')
- personal financial advice from financial planners who are salaried CSC employees authorised to provide advice by Guideway Financial Services (ABN 46 156 498 538, AFSL 420367).

More information on our services and the advisors can be found at www.csc.gov.au/Members/Advice-and-resources

Fees

Question: In regards to a Defined Benefit scheme, How are the management fees funded? Do the contribution schemes pay for this administration?

Management fees are funded through Government Consolidated revenue. Investment fees in the form of Indirect Cost Ratio (ICR) is factored into net returns for members. Contribution schemes don't pay for defined benefit scheme administration.

Superannuation Scheme Rules

Question: I am an ex commonwealth government employee and contributions are no longer being made to my csc super. Why are we not given a choice to merge our super with other active super accounts as I am paying 2 sets of fees and getting negative performance results which adds to further loss of superannuation funds?

Our customers generally fall into three categories:

Those eligible to make superannuation contributions who are either employed by a participating scheme employer (usually an Australian Government entity or the ADF), or customers who were formerly employed by a participating scheme employer and who are eligible to continue to contribute to PSSap or ADF Super.

Those with preserved or deferred benefits who are no longer able to contribute to their scheme because they no longer work for a participating employer and are not eligible to continue contributing. We continue to maintain accounts for these customers and they can generally start making contributions again if they join a participating scheme employer.

Those receiving a pension who have retired. Some ex-military customers receiving a pension may start making contributions again after 12 continuous months of eligible employment.

CSC customers also include former spouses following a family law split, customers who have multiple superannuation accounts with CSC, and eligible dependents of our members, e.g. children of deceased customers and spouses.

Question: some funds can transfer the investment directly out of the super fund and into a pension account . Pensions do not pay cap gains tax so if investment is sold there you ca realise your returns tax free

When a member commences a pension, CSC is required to transfer funded components of their benefit to the Consolidated Revenue Fund. If required, assets are sold to allow the relevant amounts to be transferred. The tax treatment of that member's pension is not directly impacted.

Question: I am turning 54 this December, when can I start drawing in on my super and what are the requirements?

There are limitations on making withdrawals from your super and what form you can withdraw it in (a pension, lump sum or a combination of these). In most cases, you can only withdraw your super after reaching preservation age, generally between the age of 55–60, depending on when you were born), and permanently retiring from the workforce. However, you may be able to access your super or some component of it earlier in some cases.

For more information on your retirement benefit refer to the various factsheets available on our website. You are encouraged to refer to this information as they provide important information about your benefit which can be complex

Question: Thank you for allowing us who are now working in the Private Sector to now transfer our industry super to PSSAP-Admin. Can you please explain the benefits of doing so?

Opening a PSSap Ancillary account allows you to stay with CSC for your super needs. Members working in the private sector can receive contributions from non-APS employers, grow their super balance with additional contributions or salary sacrifice, and access four investment options.

PSS and CSS members can also access additional insurance with LifePLUS cover, including Income Protection (subject to eligibility).

To join PSSap as an Ancillary member you must have been employed by an eligible employer for at least 12 continuous months and:

- be a current Contributing or Preserved member of PSS or CSS; or
- be a former PSS/CSS member who was a Contributor at any time on or after 7 March 2021.

PSSap Ancillary membership will be in addition to your current CSS or PSS membership. Before making any decisions you should read the PSSap Financial Services Guide (FSG), the PSSap Product Disclosure Statement (PDS) and PSSap Target Market Determination issued by Commonwealth Superannuation Corporation (CSC).

Question: Can the CSC or Government ever stop the indexation increase once a PSS DB pension has started? Or is the indexation guaranteed for life?

Capped defined benefits administered by CSC will continue to increase with Consumer Price Index (CPI), as long as there has been an upward movement in the CPI. Amendments to indexation require a change to the Trust Deed or the Government amending the *Superannuation Act 1990.*

Other

Question: What does negative net earning means in my statement?

Following years of record low interest rates, inflation, and atypical share market returns, markets have been experiencing significant corrections towards more sustainable levels since the beginning of the 2022 calendar year. As a result, Contributing and Preserved members of CSS and PSS may see negative returns on their annual statements for the 2021-22 financial year.

You can find out more information about our investment performance in the 2021-22 financial year by visiting https://www.csc.gov.au/Members/Investment/How-we-perform/2021-22-investment-performance-review

Question: What is the default for my transfer sum? I have a PSS defined benefit pension but also a transfer amount that I brought into the PSS when I left the private sector in 2002.

If you are a contributing PSS member, your post 1995 transfer amount will be invested in the PSS default investment option.

PSS preserved members can elect to invest their funded components in the PSS Default option, or Cash. For more information please visit:
https://www.csc.gov.au/Members/Investment/Investment-options

Question: Regarding your online services, will staff who have taken a lump sum withdrawal from their super be able to project their retirement and estimated pension etc online? Currently that feature is not available if you've taken a lump sum.

Currently that feature is not available if a member has taken a lump sum from their super. However, such members can contact customer service who can produce estimates for dates within 12 months from the date of request.

CSC is constantly working towards improving our customer’s experience when using our self-service options. Access to the iEstimator will be expanded to most CSC customers in the early part of 2023.

Question: Is PSS as good as CSS

The definition of good will depend on your needs, circumstances and stages of life. Benefit options and formulae used to calculate benefits differs between PSS and CSS schemes.
40.

Question: For a non-resident receiving a CSC income overseas, will I still need to lodge an Australian tax return?

Depending on the country you reside in, you may still be required to complete an Australian tax return. Questions regarding taxation to your personal circumstances should be directed to the ATO. Please refer to the ATO for more information on this:
https://www.ato.gov.au/general/international-tax-agreements/in-detail/what-are-tax-treaties-/

Question: How many people attending the meeting?

298 comprised of 254 online and 44 in person.

Question: For a non-resident receiving a CSC income overseas, will I still need to lodge an Australian tax return?

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https://www.ato.gov.au/general/international-tax-agreements/in-detail/what-are-tax-treaties-/