

KOINONIA FUND – RESPONSIBLE INVESTING

The following notes have been prepared to enable Koinonia Fund investors to understand how the Trustees apply responsible investment (RI) processes in managing the Fund. A response is also made to issues raised by the Securities Commission's Guidance Note 'Responsible Investment Disclosure by KiwiSaver Scheme Providers'.

In common with the United Nations 2006 Principles for Responsible Investment (UNPRI) the Fund's RI policy and practice includes environmental, social and governance considerations, but also includes other considerations which can be termed ethical, socially responsible, or sustainable. The Trustees are serious about RI because ethical considerations, in keeping with Christian values, are integral to the Fund's investment process.

These notes need to be read in conjunction with the following documents –

- The Ethical Investment Policy.
- Investment Management for the Koinonia Fund.

Those two documents can be found on the Koinonia website and explain the Trustees RI policy and how and where assets are invested.

Responsible Investment implementation issues

The following are some common examples of RI and ethical issues the Trustees consider. This is not a comprehensive list of all issues that do arise.

Industry

Specific industries may be excluded on grounds that the operations/activities display a moral hazard, e.g. tobacco is injurious to health, alcohol may be considered an addictive drug. In general terms the Trustees would exclude from the portfolio a company which was largely involved in the production of beer but may include a wine producer (Note: many churches use wine in the communion service).

The gambling industry would also be excluded as an undesirable industry for a church to invest in, as would pornography, prostitution and the promotion of unacceptable activities.

A company whose business is largely involved in the manufacture of armaments would be excluded. This should not be taken as indicating a pacifist approach to investment, and so sovereign bonds are included in the portfolio as it is recognised that one of the primary functions of Government is national security. This obviously involves maintenance of adequate and well equipped armed forces.

Company Style and Governance

Within a particular industry certain companies may be excluded for reason that a part of their activities include some of the above, their governance is open to question or the directors are considered to be unsuitable people upon whom to place investment trust. An example could be a food company, the industry being acceptable but a specific product is regarded as posing a potential health risk. A company's statement on their governance processes is part of the review of their annual report.

An additional safeguard is that the companies into which the Fund generally invests are the larger listed companies which are the subject of considerable public interest, media scrutiny, and regulatory and stock exchange surveillance.

Environment

Industrial growth has often been at the expense of community considerations when it comes to location, fuel usage, waste disposal etc. This may not be primarily for climate change concerns but rather for the well being of the people who may be affected. Examples would be a freezing works

built close to a residential area, operation of a coal fired power station or factories generating noise or traffic congestion close to a city or suburban zone.

The Trustees have a direct exposure to forestry which they regard as a sustainable investment playing a part in mitigating climate change by sequestering carbon dioxide.

Employment

While recognising that employees do not always show loyalty to their employers, it is equally true that the reverse is also the case. The manufacturing base of western economies has been transferred to low cost countries to utilise cheap labour. Conditions are often sub-standard in addition to the low rates of pay. The Trustees recognise that each country has its own cost structure and that therefore rates of pay should be fair and reasonable in relation to that country's cost of living. Consequently it is the relative working conditions which are of importance.

Executive Pay

The Trustees view executive pay seriously as it has, in recent years, become an ugly face of capitalism. With the onset of globalisation the increase in executive pay over recent years has vastly outstripped the rates of employee pay. A justification for this has been that due to globalisation, executive pay carries an international aspect in order to attract the most suitable people. In other words there is a deemed international pay scale which applies to chief executives and other senior management which is in stark contrast with the employment issues discussed above.

When faced with resolutions from companies in which the Trustees have an interest covering executive pay rates, there is active participation through the lodging of proxy votes at annual meetings, writing letters of protest or simply disposing of the investment.

The Securities Commission's Guidance Note 'Responsible Investment Disclosure by KiwiSaver Scheme Providers' suggest comment be made on the following issues:

1. The role or weight of Responsible Investment considerations

RI criteria are one of the factors that the Trustees consider in making investments. The Fund remains primarily an investment vehicle which seeks to provide funds for a member's retirement and should not be seen as a means of achieving specific ethical outcomes. The Trustees are committed firstly to being an investor and secondly to applying that investment process in a responsible fashion. As the documents referred to above show, there are times when the need to be an investor is seen as more important than the ethical purity of the portfolio.

In this context comment needs to be made about tracker funds and investment trusts. In the course of establishing a global portfolio, and in order to achieve a diversification of investments and to provide liquidity, the Trustees are inevitably faced with a need to hold some index tracking funds or investment funds.

2. Actions taken

The following actions are taken in implementing the Responsible Investment process:-

- Review of company annual reports and other documents.
- Exercising shareholder voting.
- Reading widely about investments and markets generally and comment made on particular stocks.
- Discussion among management and the Investment Committee concerning RI issues.
- Informing the Church of the processes and accepting debate on that.
- Interaction with other industry players in seeking to emulate best practice.
- Discussion with fund managers about their investments.

3. Scope

The policies cover all assets. As described generally above, some assets are excluded. The Trustees do not invest in a stock considered to be the best in an excluded sector, nor do they specifically seek investments seen to be "doing good".

The Trustees recognise there are difficulties in achieving purity in the case of responsible investing as there is an element of subjectivity when it comes to individual considerations. For example, Woolworths Ltd and Tesco Ltd include alcohol as a shelf product in their respective supermarkets. The percentage related to turnover while significant is not excessive and therefore these investments would not be ruled out on the grounds of selling alcohol.

BHP Billiton and Rio Tinto, being the world's major mining companies, produce uranium among a range of minerals. It might be argued that potentially uranium contains properties (waste) which may be harmful to humans and the environment and therefore these should be excluded companies. Equally there is an argument that both of these companies are well governed, and as an energy source, the absence of the CO₂ emissions is positive for the environment. Most RI funds would follow the former argument and exclude either one or both of these companies. The Trustees have no policy to exclude them.

The management of some sectors is delegated to external managers who in some cases exercise a particular ethical stance. In some other cases managers are considered by the Trustees to be careful and responsible investors without necessarily pursuing or articulating a particular ethical mandate (e.g. the overseas fixed interest portfolios are not screened to an ethical mandate but information provided by a manager shows that ESG factors are some of the things that the manager takes into account in deciding the risks and possible return available from any investment).

In some instances (e.g. private equity funds) there may only be discussion of an ethical issue about the investments of the Fund after the investment has been made. Such funds of necessity operate in a confidential manner in developing their investment options and it is only after the investment has been made that investors can form any opinion of the ethics of the investment undertaken. The comfort the Trustees have with the manager's style and ethos is a key factor when an external manager is appointed, and follow discussions about the Trustees ethical policies.

The following additional comments are offered to further explain the Trustees' RI policy and process:

How important is RI for existing and prospective members?

The Trustees see RI or ethical investing in the context of the total investment process applied to the Fund. It is only one of several factors to consider for prospective KiwiSaver investors. Members joining a KiwiSaver scheme should have a basic understanding of what type of investment it is, and whether it will meet their needs. They should choose an appropriate asset allocation suitable for their situation. Only after these issues are dealt with and understood, do questions of the ethos and style of the fund become relevant.

The Koinonia Fund is a non-profit scheme where the Trustees charge no fees for their own benefit, and where expenses and investment gains and losses are shared equitably across members.

The Trustees note that the pursuit of a RI policy may result in returns which are better or worse than otherwise would be the case.

RI is a subjective process

The application of RI or ethical principles is art rather than science. RI is essentially a subjective process that weighs up issues and makes an investment decision, or takes other action. Some examples of the subjective process that is involved include:-

- How conflicting activities and outcomes are weighed up against each other.
- The extent to which more distant or indirect factors are taken into account, and how relevant RI issues are in relation to suppliers and customers of the subject investment. (e.g. jet engine makers whose product can have military uses).

The Trustees do not use any precise or objective methods to make these judgements. The Fund does not have set benchmarks or other fixed criteria to drive decisions (e.g. percentages of turnover from excluded activities) as to whether an investment should be included or excluded from the portfolio, how proxy votes should be exercised, and when correspondence should be entered into with the company.

Likewise there is no clear cut line between 'RI funds' and 'non-RI funds'. Both will contain a mix of investments. The distinction is one of weighting and emphasis, rather than being a clear cut line. This is true of all aspects of our lives and investment is no exception.

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