



Note to Premium Users

PERSPECTIVES ON UNETHICAL INVESTMENTS IN KIWISAVER FUNDS

Background

In recent weeks there has been some media coverage about how ethical, or NOT, investments in some of the KiwiSaver funds on offer are. In usual fashion, there has been a lot of noise around the topic – one, because the headline is attention grabbing and two, because it is an important topic for some investors.

At SavvyKiwi, we are particular that as Premium Users, you are given the relevant context to such topics, so you can take ownership of your own decisions rather than be led by 'noise'.

This briefing note is to provide our perspective on this topic, based on the last 17 years of hands-on experience with, and in-depth insights into, funds management and investment research. As such, please be aware that we will be biased by our own observations, and at best we can only provide our point of view. But, because we are fiercely independent of all Providers (i.e., we don't earn ANY kickbacks, commissions or fees from any of them) we will remain truly unbiased towards any fund or scheme provider. That, we guarantee.

This view will not take into account your personal circumstances or financial goals. Regardless, we hope that it provides you a perspective that you can include as part of your overall assessment of the issue.

How is your money invested in a KiwiSaver fund?

The contributions you make into your account, are pooled together across other individuals and these amounts in aggregate are then used to buy different types of assets – such as shares and bonds of companies, property, commodities etc., here in NZ and overseas. Each pool of money can also be called a 'fund'. There are over 200 such KiwiSaver funds you can choose to contribute to – they are all different in what assets they invest in, how they invest and the risks and returns associated with them.

If you are in an Active fund, a team of investment professionals makes decisions on what assets to invest in and when and how. They are able to sell out of certain assets based on their investment views.

If you are in a Passive fund, the assets invested in will be exactly those that make up a pre-determined basket of assets (called an 'index'). Regardless of whether the value of the individual stocks or bonds in that basket is going up or down, the fund will continue to be invested in them and the fund will rise or fall in value based on how the Index is trending.

Do fund managers have a guideline they need to follow when managing a fund?

All funds have a guideline or set of rules that they are obliged to follow – called a 'mandate'. Each fund will have its own mandate. The supervisor, or otherwise called the 'trustee', of each fund is responsible for ensuring the fund manager adheres to the mandate.

But, there are certain rules that are overarching and driven by legislation, and which all funds are obligated to follow.



Are KiwiSaver fund managers investing unethically?

Given all the recent attention on this topic and commentaries in the media, one would believe that KiwiSaver fund managers have been investing unethically. But before jumping to any conclusions, there are really two different issues here.

The first issue is whether any legislation has been breached – for e.g., parts of the legislation refer to not allowing investments in companies that manufacture cluster bombs. In this instance, if proven to be true that some funds are not complying with the word of the law, the issue would be that there has been a breach of legislation. So, regardless of how little of a fund has been invested in shares and bonds of such companies, it'd a breach. It will be hard to debate that.

The second issue is a lot murkier, so we will focus on that.

That is whether funds are investing in companies that are involved in areas that are considered to be unethical, but no legislation exists directing fund managers not to invest in them – rightly so. This issue is really debatable.

How sinful is 'sinful'?

At the danger of being a bit controversial – when it comes to 'ethics', it gets subjective. Also, everyone has a different tolerance level for unethical behavior. So, the real question is 'how ethical do you want to be?' It's not an easy question to answer.

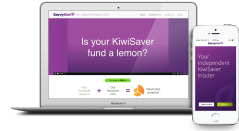
Consider this scenario. Say, you don't want to support tobacco related products and services. Retail shops at the Auckland International Airport sell tobacco and alcohol. This means, a small part of the companies revenues are generated from activities that profit from tobacco and alcohol. Would you then have a problem investing in shares and bonds of Auckland International Airport? Or, would you be ok with that - considering that only a negligible portion of the company's revenues are generated from such activities? But then, what is 'negligible'? There are no right or wrong answers.

Ultimately, it comes down to your ethical line-in-the-sand, and your tolerance for such issues.

So how do funds generally deal with these issues?

Typically, that comes down to what the 'mandate' of the fund allows the manager to do. Some funds have an explicit ethical mandate. Most funds don't.

In the range of about 200 KiwiSaver funds, there are about 6 funds that are explicitly required to be ethical. But remember, just as individuals have different degrees of ethical tolerance, each fund's definition of 'ethical' is different - although most of them avoid the commonly referred to sin-stocks and sin-bonds such as of those companies that deal with tobacco, alcohol, pornography etc.



This means that the remaining KiwiSaver funds are allowed to invest (within their own mandates), in whatever investments that maximizes your investment outcomes, some of which very well may be in companies and initiatives that may be deemed by some as being 'unethical'.

In sticking with the example in a recent media article, a certain scheme has been reported to have \$48mn invested in tobacco related investments. Putting that in context, it makes up around 0.5% of all the funds they invest. While fund mandates may not have been breached, the question still remains whether you can tolerate 50 cents of every \$100 you invest to go to tobacco companies.

Dealing with the moral dilemma and next steps

Most diversified funds have thousands of individual assets they invest in. While providers disclose these assets, it would be virtually impossible for you to delve into them individually.

If you have a particular interest in certain issues such as child labor, tobacco, alcohol etc., you are best to check directly with your KiwiSaver provider to confirm whether or not your fund is exposed to that issue.

In an Active fund, your fund manager can sell out of a stock if they identify any issues they are not comfortable with. In a Passive fund you will continue to be invested in whichever companies are on the Index, regardless of the nature or quality of the company.

As a first step – consider whether you have any particular issues you feel strongly about. Figure out what you are able to tolerate and what you would definitely avoid. It is best to stay focused on your objectives and your goals. Remember to make informed choices.

Back in April this year, before the recent controversies broke, we were on a panel at a Sustainability forum at the University of Auckland dealing with the very same issues. You can read the article here, where we do make a suggestion:

<http://www.stuff.co.nz/business/money/78875952/kiwisaver-should-have-ingredients-labels>.

If you have any questions or points to clarify, please feel free to write to our helpline hello@savvykiwi.co.nz. We are here to help.

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