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AUTUMN

KEVA

RESPONSIBLE INVESTMENT BELIEFS

Responsible investment beliefs

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AIMS

PURPOSE OF THIS DOCUMENT

The purpose of this document is to define Keva's responsible investment beliefs.

These beliefs help both stakeholders and decision makers to understand the choices made in the investment operation. They aim to increase the transparency of investment operation and to enhance stakeholder confidence. The document is based on Keva's Investment beliefs.

This document lays down Keva's principles of responsible investing and applies to all asset classes. The operational processes and investment opportunities in the context of responsible investing depend on the characteristics of each asset class.

BACKGROUND

The starting point to Keva's definition of responsible investment is its basic task to manage its cross-generational pension liability. The pension liability covered by the Pension Fund extends decades ahead. The Act on Keva (66/2016) lays down that Keva, in its capacity of managing local government pension funds, is a long-term investor which must ensure the security of and return on investments *(Parliament of Finland, 2017)*.

In real terms, the net expenditures that will be covered by investments in the coming decades clearly exceed the current value of the fund. The difference between expenditure and income in real terms means that it is necessary to accept investment risks to earn higher returns *(Sharpe, 1964)*.

The long strategic time horizon and the need for future returns imply a requirement to understand the long-term risks and opportunities associated with investment decisions. ESG (Environmental, Social, Governance) criteria for investments create a framework for assessing long-term risks and opportunities.

There is strong evidence that better investments from an ESG perspective, are also better in terms of long-term investment performance. In practice, this is often reflected in lower capital costs and higher profitability of the investees. *(Eccles et al., 2014, Khan et al., 2016, Cheng et al., 2014)*

In the long run, taking ESG opportunities and risks into account patiently over time, will reduce the externalities facing the natural and social environment with regard to Keva's investment assets.

DEFINITIONS AND CONSTRAINTS

As a diversified owner internationally, Keva is always invested in part of the global economy and as such has exposure for example, to financial, social and economic risks. There is a risk/return correlation on the capital market *(Sharpe, 1964)*. From the viewpoint of Keva's success in fulfilling its basic purpose, it is necessary to carry risk.

ESG assessment is used in a bid to measure the extent of and to limit the long-term risk of investments. The letters in ESG stand for Environmental (E), Social responsibility (S) and good Governance (G) criteria.

DEFINITIONS

1. Environmental (E) refers to, for example, climate change, limited natural resources and water, the diversity of species, emissions onto the ground, into the water and air, and also to e.g. waste management.
   a. The long-term investment risks associated with this could include direct costs such as environmental fines, or indirect costs as a result of damaged reputation of the investee. Also, environmental degradation may have a negative impact on overall economic growth.
   b. From an investor's perspective, economic benefits can be gained through, for example, increased resource efficiency of the investee and in the longer term through the enhanced reputation of the entity invested in. Furthermore, it might be possible to invest in technologies to reduce negative environmental impacts.

2. In the context of social responsibility (S), aspects assessed include for example human rights, ageing and migration. At a local level, such aspects include, for example, employee rights, safety, supply chain management and a company's public affairs.
   a. Poor management of social responsibility may result in, for example, a fine, discontinued operations or indirectly to a high employee turnover rate, damaged reputation or increased regulation.
   b. Well-managed social responsibility may result in, for example, fewer reporting requirements and costs, better employee stability or a better reputation. Also, it might be possible to invest in products and technologies to reduce social problems.

3. Good governance (G) refers to how well the entity invested in is managed from the perspective of the long-term owner and other stakeholders. Good governance becomes especially important if the institutional framework is weak. This is often the case, for example, in emerging markets.

NATURE OF ESG INFORMATION

Keva forms its conception of the responsibility of an entity in which we invest based on our own research and that of our partners. ESG information differs from the traditional, quantitative information provided by investment analysis. ESG risks, opportunities and their measurement methods have the following features:

1. ESG information is intended to support traditional investment analysis and seeks to analyse long-term risks and opportunities.

2. When they materialise, ESG risks often cause concern among stakeholders and the public. Different stakeholders focus on different issues. At the overall level, it can sometimes be challenging to reconcile differing interests while ensuring the strategic leeway needed to reach the long-term investment returns required to carry out Keva's basic purpose. *(Polonsky and Clulow, 2005, Hopwood et al., 2005)*

3. ESG information is increasingly available from various sources. This makes it easier to analyse investments from the ESG perspective. In terms of methods, an ESG analysis is, however, largely qualitative and it can sometimes be challenging to make the link to economic outcomes.

4. ESG data and methods are developing rapidly. However, using different tools available, the measurement of the same phenomenon might give different results. Also, the final outcomes measured using the same tools might change as a function of time.

5. The relevant ESG risks and opportunities faced by entities invested in might change over the course of time. This could be driven by either development of the entity invested in, or development of ESG analysis methods. As a result, the ESG ratings of an individual investment might change. An investor's task is to look ahead. From this perspective, Keva can, for example, invest in and seek to impact entities which we believe can improve their ESG profile.

BASIC BELIEFS

Investment returns are, in the long term, driven by economic growth. Economic growth should therefore be sustainable, because pensions are by nature long-term liabilities.

1. Keva believes that taking ESG factors into account has a positive impact on the long-term economic development of the entities invested in, although the importance of individual ESG indicators will vary by asset class, industrial sector, geographically and as a function of time. *(Friede et al., 2015, Clark et al., 2015, Khan et al., 2016, Fulton et al., 2012)*

2. The diversification of investment assets is an effective method to maximise risk-adjusted returns in the long term. Keva considers static limitation of the investment universe as generally either reducing returns or increasing risks. Keva strives to raise the ESG profile of its investment assets on average and, where possible, to be an active owner. This implies pursuing positive choice rather than constraints *(Amel-Zadeh and Serafeim, 2017).*

3. As a long-term investor, Keva strives to understand the long-term ESG risks and opportunities of the entities it invests in. Keva believes that focusing on the relevant factors from the perspective its long-term investment risk and/or return will, in the long term, reduce also the externalities facing the natural and the social environment with regard to Keva's investment assets.

4. Responsible investing is only possible if investment operations are long term and determined by nature. ESG risks and opportunities are predominantly long-term phenomena.

5. Keva's investment assets are widely spread geographically. The target countries are different in terms of development level, institutional structure and thus also different in terms of responsibility indicators *(Ioannou and Serafeim, 2012).*
   a. Geographically different regions of investment are subject to different requirements.
   b. Keva compares the responsibility in each region with the general level of responsibility in that region, monitoring at the same time the implementation of international standards in the entities we invest in.

6. As a diversified and long-term investor, Keva considers it to be problematic from the perspective of returns on our entire portfolio if one of the investments owned generates negative value to other investments in the portfolio in a way that affects the long-term playing field of other investments owned. *(Hawley and Williams, 2000, Gjessing and Syse, 2007)*

7. The statistical distribution of returns on investments narrows as a function of time. Also, ESG risks and opportunities are predominantly long-term phenomena. In addition, investments and ESG methods of measurement are developing. For these reasons, active changes in the ESG profile of the portfolio take place patiently and during the course of a long period. *(Levy and Duchin, 2004)*

COMMITMENTS AND COLLABORATION

Keva became a signatory to the United Nations Principles of Responsible Investment (UN PRI) in 2008. These principles have developed globally as a starting point for best practices in responsible investment and they also guide the development of Keva's responsible investment processes. A UN PRI signatory strives to:

1. Integrate ESG analysis into its investment process.
2. Be an active owner and incorporate ESG issues into its policies.
3. Promote ESG reporting in the entities in which it invests.
4. Promote acceptance and implementation of the principles of responsible investment within the investment industry.
5. Promote responsible investment in collaboration with other investors.
6. Report on its activities and progress in implementing responsible investment.

UN PRI measures the development of the investor's processes each year. Keva also monitors compliance with international conventions *(e.g. the UN Global Compact, ILO labour conventions) amongst its investees.*

MAIN FEATURES OF THE STRATEGY

Keva's decisions to invest are based on our basic task of safeguarding the ability to pay current and future pensions. Taking the ESG perspective into account is an inherent part of a long-term investor's process.

Keva considers that responsible investment processes are in a continuous development with increasing accuracy over time, as measurement methods and terminology evolve. The weight of the asset-class-specific approach in analysis will vary depending on how important and measurable the ESG factors are in the asset class concerned. The core components in implementing the strategy are more accurate quantification of the long-term investment risks, more effective active ownership mechanisms and documentation.

From a risk management perspective, it is fundamental to integrate ESG information into the investment process and decisions. Keva is continuously stepping up integration of the ESG perspective with regard both to the assets we manage ourselves and those where management is outsourced. Active ownership and dialogue create an enabling environment to influence entities we invest in. In this case, there will also be a wider benefit from the operation for communities, the environment and financially via the more sustainable practices of the entity invested in. *(Dimson et al., 2015)*

Keva wants to promote transparency and ESG processes in the entities in which we invest in the manner appropriate to the perspective of Keva's remit. Keva is happy to collaborate with other investors and stakeholders. Keva reports annually on responsible investment.

ORGANISATION

The Board of Directors decides the long-term policy of Keva's investment. The principal guidance documents, Investment Beliefs and the Responsible Investment Beliefs determine this policy. Development of the responsible investment strategy and processes is reported to the Board of Directors twice a year.

The Responsible Investment Steering Group drives the practical development of responsible investing. The Steering Group is composed of a representative from each of Keva's investment units. Head of Responsible Investments convenes the Steering Group.

The group makes development proposals to investment units and to the chief investment officer, disseminates information internally, is responsible for Keva's annual UN PRI reporting and prepares and presents questions relating to responsible investing to the chief investment officer for decisions.

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