



# **Term Investment Policy**

**Update: May 2017**

# Oikocredit's Term Investments

## A. Purpose

Oikocredit's mission is guided by the principle of empowering people. Our vision is a global, just society in which resources are shared sustainably and all people are empowered with the choices they need to create a life of dignity. Our values are the support of disadvantaged people, sharing, ecumenical spirit, grassroots participation, respect, integrity and engagement for a balanced ecosystem.

To realize this, Oikocredit has two major investment portfolios which make up its total assets.

1. Development Financing: Direct partner financing in developing countries.
2. Term Investments (TI): The portion of our total assets which are invested in liquid, conservatively-invested funds used to redeem share capital and to provide for Oikocredit's operating funds.

This policy refers to the Term Investment portion of Oikocredit's assets. It represents a revision, updating and harmonization of the *July 2011 Term Investment Policy (TI Policy)*, along with relevant aspects of the *Oikocredit Investment Policy Statement* and *Oikocredit Sustainability Guidelines* of November 2013. This Policy was the result of recommendations approved by the *Leading the way in ethical investment for development* conference, held in Vienna, February 22 to 24, 2017. The purpose of the conference was to review Oikocredit's *TI Policy* in terms of Oikocredit's mission.

The purpose of the Term Investment Portfolio is to provide a balance of risks, liquidity and investment income with Oikocredit's mission. As such, the TI portfolio should express and ensure the same ethical values as Oikocredit's development portfolio.

## B. Financial Criteria and Risk Management

### Risks

Oikocredit, as any other financial institution, has to balance its risks. To balance these risks, Oikocredit invests the TI portion of its total assets in easy-to-liquidate investment-grade securities.

### Liquidity

Oikocredit requires sufficient liquidity to be able to repay investors upon request of redemption of share capital. Liquidity is also needed to disburse to new approved partners when insufficient new capital is available.

### Income

Another requirement of the TI portfolio is to contribute a reasonable risk-adjusted return to Oikocredit's net earnings.

### **Term Investment portfolio mix (fixed income and equities)**

To minimize risks, preserve liquidity and ensure a secure source of income, at least 90% of the Term Investment (TI) portfolio will be invested in fixed income securities, such as investment-grade bonds and bond funds. These can include corporate bonds, government bonds or bonds of Development Finance Institutions (development banks). A maximum of 10% can be invested in publicly-listed equities (corporate shares).

### **Risk Parameters**

1. As stated above, the TI portfolio consists of two parts:
  - An international bond portfolio (min. 90% of total portfolio)
  - An international share portfolio (up to 10% of total portfolio)
2. Management will manage the bond portfolio within the following duration parameters:
  - Duration to be between 3.5 and 5.5
  - The Managing Board can decide to change the duration in exceptional circumstances
3. The bond portfolio consists entirely of "investment grade" bonds but is split in two parts representing two different risk profiles:
  - 80% of the bond portfolio is to be invested in bonds with a Moody's rating of AAA-A3.
  - Up to 20% of the bond portfolio may be invested in bonds with a Moody's rating of BAA1-BAA3. Any BAA3 rated titles in the bond portfolio must have positive outlooks from rating agencies Moody's and Reuters, or a neutral stance from one of either agencies combined with a higher rating than BAA3 or BBB-.
  - Management will maintain the 80% (highly rated bonds) - 20% (higher risk bonds) profile, but allow necessary flexibility due to upgrades and downgrades in the existing portfolio. If the 20% limit is exceeded, no new investments will be made in the 20% segment until the segment has gone down to below 20%.
  - Management will limit AAA and AA rated titles to no more than 6% of the total TI bond portfolio (except for government guaranteed bonds). For A rated titles the limit will be 3% of the TI bond portfolio and for all other rated titles it will be 2% of the TI bond portfolio.

### **Financial Scenarios**

On an annual basis, Oikocredit will prepare financial scenarios using appropriate short-, medium- and/or long-term frameworks to test the TI portfolio in terms of the balance of liquidity, risk and return. Oikocredit will notify the investment manager(s) on the results of these financial scenarios and provide an annual report to its members on the results.

## **C. Exclusionary Criteria**

Oikocredit's mission is to provide financial services and support to organizations to improve the quality of life of low-income people and their communities in a sustainable way. As such, Oikocredit is committed to the fundamental principle that it must avoid doing harm through its investments.

Oikocredit's *Sustainability Guidelines* state: "Oikocredit avoids investing in target entities which do not comply with certain environmental, social or corporate governance criteria or which have activities in certain controversial business areas/sectors." For the purposes of this *TI Policy*, these are expressed as exclusionary criteria that are absolutely prohibited (zero tolerance) or are tolerated within limits defined by the investment manager(s) or ESG rating agencies. The exclusionary criteria will be applied to both the bond and equity portions of the TI portfolio.

The exclusionary criteria represent an initial screening on the universe of potential securities to avoid investments that go against Oikocredit's values and pose significant reputational risk.

### **Corporate Securities**

The following are exclusions mandated by this policy for corporate securities.

#### **1. Zero Tolerance Exclusions**

- a. Companies involved in the extraction of oil, gas, thermal coal or other fossil fuel products
- b. Production or distribution of nuclear energy, or production or trade in radioactive materials
- c. Production or activities involving harmful or exploitative forms of forced labor/harmful child labor
- d. Production or trade in any product deemed illegal under host country laws or regulations or international conventions and agreements
- e. Production or trade in tobacco

#### **2. Exclusions subject to Investment Manager(s) or ESG rating agency assessments**

- a. Companies with controversies on international norms-based criteria, including conventions and core labor standards of the International Labour Organisation, the United Nations Guiding Principles on Business and Human Rights and international standards on corruption, the environment and climate change
- b. Gambling, casinos and equivalent enterprises
- c. Production or trade in pharmaceuticals, pesticides and herbicides subject to international phase outs or bans
- d. Production of strategic military equipment and armaments. Companies involved in such production will be permitted only if such production does not exceed 10% of total revenues.
- e. Production or trade in alcoholic beverages, excluding beer and wine
- f. Activities that impinge on lands owned, or claimed under adjudication by indigenous peoples or without the free, prior and informed consent (FPIC) of those peoples
- g. Production or trade in Genetically Modified Organism (GMO) products
- h. Trade in wildlife or wildlife products
- i. Production, trade, storage or transport of significant volumes of hazardous chemicals and waste, or commercial scale usage of hazardous chemicals according to European Union legislation.

### **Government and Development Bank Bonds**

Government and development bank bonds are subject to exclusions based on investment manager(s) or ESG rating agency assessments on international sanctions, or violations of global protocols on labor, corruption, human rights, environmental and climate change standards.

## **D. Positive Criteria (ESG)**

Oikocredit is committed to the pursuit of positive environmental, social and governance (ESG) practices in its investments. Oikocredit has affirmed this commitment in its *Investment Policy Statement* and by becoming a signatory to the Principles for Responsible Investing (PRI). The following are positive ESG criteria to be used in selecting and communicating information about its term investments. This positive screening process is applied after the removal of investments contrary to the exclusionary criteria. This positive criteria will be applied to both the bond and equity portions of the total TI portfolio.

The bond portfolio will be divided into two broad areas. The General Bond Portfolio, which will comprise at least 80% of the total bond portfolio, will be selected according to a best-in-class analysis of ESG practices along with a thematic approach that will identify key development themes. The General Bond Portfolio can include bonds and bond funds of corporations, governments and development banks. The remaining portion, up to a maximum of 20% of the total TI bond portfolio, will be invested in investment-grade Green and Social Bonds, including such bonds issued by development banks.

### **1. General Bond Portfolio and Equities -- Best-in-class**

Corporate securities in the General Bond Portfolio and the Equities portion of the total TI portfolio will only qualify for investment if they rank in the top 50% of ESG practices in their sector according to assessments by the investment manager(s) or ESG rating agencies. The investment manager(s) are required to provide Oikocredit with clear information about the process used to create the best-in-class ratings for this selection.

### **2. General Bond Portfolio and Equities -- Investment Themes**

Further, corporate securities in the General Bond Portfolio and the Equities portion of the total TI portfolio must have positive impact according to international standards in at least one of the following areas:

- a. environment
- b. health
- c. financial inclusion
- d. education and training
- e. food security
- f. sustainable job creation
- g. other areas, to be determined based on the Sustainable Development Goals (SDGs).

### **3. Government and development bank bonds**

Government bonds (bonds issued by developed, emerging or frontier market countries) will only qualify for investment if they are ranked in the top 50% of ESG country ratings according to assessments by the investment manager(s) or ESG rating agencies.

The investment manager(s) will give preference to bonds issued by development banks considered to have positive development impacts as ranked by the development sector and ESG rating agencies.

### **4. Green and Social Bond Portfolio**

As a social investor committed to global development, Oikocredit is dedicated to investing a portion of its TI bond portfolio in investment-grade Green and Social Bonds issued by development banks or other entities providing capital for global development. These may include Development Bonds issued specifically for development purposes.

Therefore, up to 20% of the TI bond portfolio will be invested in investment-grade green bonds or social bonds. Oikocredit will set a target of at least 10% of the TI bond portfolio to be invested in green or social bonds within five years of the time that this Policy is approved. To ensure that there is open and transparent information on the Green and Social Bond Portfolio, the investment manager(s) will provide Oikocredit with clear information about the composition of each green or social bond, and the use of funds from each bond. Further, Oikocredit will ensure that each green or social bond is clearly described in its communications to members and the public.

## **E. Criteria for the Investment Manager(s)**

Oikocredit is committed to selecting investment manager(s) that are in line with our mission and vision. As such, we will take measures to ensure that our investment manager(s) show high ESG standards in their own operations.

Oikocredit will employ an ESG rating system from a reputable ESG rating company to rank companies responding to requests for proposals to manage the TI portfolio. Such an ESG rating system will include exclusionary criteria described in Section C of this *Policy*.

Oikocredit will give preference to manager(s) ranking in the top 50% of its sector on this ESG rating in its investment manager(s) selection. Oikocredit finance staff will periodically review ESG ratings of the investment manager(s) conducted by independent parties.

The investment manager(s) will actively engage with Oikocredit finance staff at least once a year to receive feedback on how the *TI Policy* is being implemented. This regular dialogue will help Oikocredit to keep its criteria up-to-date and the investment manager(s) to improve ESG performance.

Oikocredit will evaluate the ESG performance of the investment manager(s) at least every two years.

## **F. Active Engagement**

Oikocredit believes that corporate engagement on ESG issues is an important activity for its TI portfolio. However, it recognizes that corporate engagement in a bond portfolio is limited. However, wherever possible, Oikocredit will engage either directly or through its investment manager(s) on issues of ESG importance.

If Oikocredit invests in shares, it will use its voting rights together with other like-minded investors to advance ESG issues of broad public interest or of particular interest to Oikocredit and its members, such as global development concerns.

Oikocredit will give preference to investment manager(s) that use their voting rights as active shareholders to achieve positive ESG impact. This will be exercised on the publicly-listed equity portion of the portfolio.

Oikocredit will require the investment manager(s) to provide regular information on how it uses its voting rights and opportunities for active engagement.

Every year, Oikocredit will inform companies dropped from its TI bond or equity portfolios due to ESG concerns that they have become ineligible for investment. Oikocredit will communicate this through a letter to management with suggestions for action to improve ESG performance.

## **G. Transparency and Reporting**

Oikocredit is committed to ensuring that the TI portfolio is transparently reported to its members and to the general public.

If Oikocredit chooses not to publish the individual titles of securities in the TI portfolio in the Oikocredit annual report, it will be reported in another public medium such as the website. This should include a summary with the major changes in the portfolio in the last year.

Oikocredit will explain in its reporting on the TI portfolio the purpose of and difference between the development portfolio and the TI portfolio.

The Oikocredit Asset Liability Committee (ALCO) will review the financial and ESG performance of the TI portfolio and make recommendations to the Managing Board and to the Investment Manager(s) for improving performance.

Day-to-day management of the bond portfolio is the responsibility of the CFO together with the Treasurer, and will be reviewed by the ALCO, upon advice from the Investment Manager(s) or outside investment consultant.

Oikocredit should create an Investment Advisory Committee (IAC) to make recommendations to the Managing Board to update its *TI Policy* every two years. This should include a review of specific positive and negative criteria that are important to Oikocredit's investment policies and sustainability guidelines. The IAC should include representation from the finance department, social performance department and the membership of Oikocredit.

## **H. Conclusion**

In implementing this *Policy*, Oikocredit aims to be viewed as a leading socially responsible investor with regard to its TI portfolio, taking into account liquidity, risk and income objectives.

**Amersfoort, May 2017**