



Kernel Wealth Limited ESG Policy

Date: October 2021

1. Policy

1.1. Purpose

Kernel Wealth Limited (Kernel) as the Managed Investment Scheme manager of the Kernel Funds operates a number of funds. Some of these funds are categorised as sustainable and others while not categorised as sustainable, adhere to certain principles as does Kernel as a fund manager, employer and corporate entity. Sustainable is also defined differently by different audiences for different purposes and as the FMA notes in their December 2020 guidance: “[terms] do not have commonly shared meaning (including the terms ‘ethical’, ‘responsible’, ‘sustainable’, ‘green’ and Environmental, Social and Governance (ESG))”. This policy has been written with consideration to that FMA guidance available at www.fma.govt.nz/compliance/guidance-library/disclosure-framework-for-integrated-financial-products/. This policy is publicly available on the Disclose Register and the Kernel website.

The purpose of this policy is to define sustainable and ESG for the collective understanding of employees and investors. Further, to outline the principles and policies that underpin the non-financial criteria and features of sustainable funds

1.2. Scope

This policy applies to all funds designated as 'sustainable' and managed by Kernel and therefore is relevant to all Kernel employees.

1.3. Taxonomy

Kernel aligns to the European Commission taxonomy published in 2021 for sustainable finance (“Sustainable”). The EU taxonomy is first of its kind in aiming to address multiple environmental goals as well as social and governance objectives. It aims to be a common language between investors, issuers, project promoters and policy makers, helping investors to assess whether investments are meeting robust environmental standards and are consistent with high-level policy commitments such as the Paris Agreement on Climate Change.

Sustainable (Finance) refers to the process of taking environmental, social and governance (ESG) considerations into account when making investment decisions. Sustainable (finance) is understood as finance to support economic growth while reducing pressures on the environment and taking into account social and governance aspects.

Environmental considerations include climate change mitigation and adaptation, as well as the environment more broadly, for instance the preservation of biodiversity, pollution prevention and the circular economy. The S&P Global Corporate Sustainability Assessment for the ESG Tilted index scores on up to 10 criteria depending on the industry. These range from Operational Eco-efficiency to Genetically Modified Organisms (GMO) to Product Stewardship. The full list of questions and criteria can be found at https://portal.csa.spglobal.com/survey/documents/CSA_Companion.pdf

Social considerations include issues of inequality, inclusiveness, labour relations, investment in human capital and communities, as well as human rights issues. The S&P Global Corporate Sustainability Assessment for the ESG Tilted index scores on up to 10 factors related to social factors depending on the industry. These range from Corporate Citizenship & Philanthropy to Talent Attraction & Retention to Labour practice indicators. The full list of questions can be found at

https://portal.csa.spglobal.com/survey/documents/CSA_Companion.pdf

Governance considerations – including management structures, employee relations and executive remuneration – plays a fundamental role in ensuring the inclusion of social and environmental considerations in the decision-making process. The S&P Global Corporate Sustainability Assessment for the ESG Tilted index scores on up to 11 factors related to governance factors depending on the industry. These range from Corporate Governance to Tax Strategy to Cybersecurity. The full list of questions can be found at

https://portal.csa.spglobal.com/survey/documents/CSA_Companion.pdf

Ethical – we avoid the word “ethical” when referring to funds, as ethics are a complex and subjective area coloured by personal values. Kernel adheres to its corporate values published on our website. Fairness and fair dealing underpin the choice and marketing of products.

Responsible – we also avoid the word “responsible” when referring to funds, as Kernel currently does not believe the term is widely understood.

1.4. Principles

Each Kernel sustainable fund has a specific criteria set by the underlying index provider (S&P Dow Jones Indices) within which Kernel will select and weight companies. For the investment strategy and permitted investments of each fund, see the Statement of Investment Policy & Objectives.

- At least monthly, Kernel investment team will check the index composition and index announcements for changes to criteria or eligibility
- While Kernel does not make independent verification of the eligibility of a particular company to meet index criteria, where the investment team have concerns (directly or raised by an investor or stakeholder), they will consult the index provider and/or provide information to confirm eligibility.
- Where ineligible holdings are identified in the fund, the investment team will within one month, following consultation with the Investment Committee, liquidate such holdings.
- The Investment Committee may also, in its discretion, exclude any company that is a constituent of the relevant index and report the exclusion and rationale to the Board.

1.5. Policies

Each fund investment strategy is based on a carefully constructed methodology by S&P Dow Jones Indices to systematically assess eligibility and weighting factors. For three of Kernel’s funds this includes non-financial factors as independently observed or assessed, and/or reported by listed companies.

NZ 50 ESG Tilted Fund

This fund adheres rigidly for constituent selection to the S&P/NZX 50 ESG Tilted index. That index is part of global series of S&P ESG Tilted Indices, with a globally standardised scoring system. Rather than just an inclusion/exclusion filter, the methodology also overweights (underweights) companies with relatively high (low) S&P DJI ESG Scores.

Kernel NZ 50 ESG Tilted

- Start with S&P/NZX 50 Portfolio index
- Exclude companies with certain business activities based on Sustainalytics assessment (Controversial Weapons, Thermal coal & Tobacco)
- Exclusion due to low UNGC Score or Rep Risk (e.g. Gambling)
- Upweight/downweight on basis of SAM ESG score while maintaining sector balance

Exclusion of specific business activities

As of each rebalancing reference date, companies with the following specific business activities, as determined by Sustainalytics are excluded from the index's eligible universe:

Sustainalytics Category of Involvement	Description
Controversial Weapons	The company is either 25%+ owner of a company or is directly involved in the core weapon system, or components/services of the core weapon system that are considered tailor-made and essential for the lethal use of the weapon.
Thermal Coal	The company extracts thermal coal and/or generates electricity from thermal coal for more than 5% of its revenue.
Tobacco	The company manufactures tobacco products, supplies tobacco-related products/services and/or derives revenues from the distribution and/or retail sale of tobacco products. This also applies if a company owns 10%+ of a company involved in these activities.

Please refer to <http://www.sustainalytics.com> for more information.

Exclusion due to low UNGC Score or Rep Risk

Sustainalytics' Global Standards Screening (GSS) provides an assessment of a company's impact on stakeholders and the extent to which a company causes, contributes or is linked to violations of international norms and standards. The basis of the GSS assessments are the United Nations (UN) Global Compact Principles. Information regarding related standards is also provided in the screening, including the Organization for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, as well as their underlying conventions.

Sustainalytics classifies companies into the following three statuses:

- Non-Compliant: classification given to companies that do not act in accordance with the UNGC principles and its associated standards, conventions and treaties.
- Watchlist: classification given to companies that are at risk of violating one or more principles, for which all dimensions for Non-Compliant status could not be established or confirmed.

- Compliant: classification given to companies that act in accordance with the UNGC principles and its associated standards, conventions and treaties.

As of each rebalancing reference date, companies classified as Non-Compliant, according to Sustainalytics, are ineligible for index inclusion.

In addition to the above, SAM uses RepRisk, a leading provider of business intelligence on environmental, social, and governance risks, for daily filtering, screening, and analysis of controversies related to companies within the indices. In cases where risks are presented, SAM releases a Media and Stakeholder Analysis (MSA) which includes a range of issues such as economic crime and corruption, fraud, illegal commercial practices, human rights issues, labour disputes, workplace safety, catastrophic accidents, and environmental disasters. The S&P Index Committee will review constituents that have been flagged by SAM's MSA to evaluate the potential impact of controversial company activities on the composition of the indices. In the event that the S&P Index Committee decides to remove a company in question, that company would not be eligible for re-entry into the index for one full calendar year, beginning with the subsequent rebalancing.

Re-weighting according to S&P DJI ESG scores

Index constituents are initially weighted based on the constituents' weights in the S&P/NZX 50 Portfolio index, then tilted such that companies with higher or lower S&P DJI ESG scores are over or underweighted ("tilted") while maintaining sector balance in the underlying index depending on constituent count and composition.

This means that companies performing better (worse) compared to their sector peers are overweighted (underweighted) without removing entire sectors or distorting the sector diversification. In other words, industrial companies are compared to other Industrial companies, not underweighted or removed because of comparisons to IT companies.

The indices employ a transparent, rules-based weighting scheme starting from companies' S&P DJI ESG scores, which are then re-standardized. The S&P DJI ESG Scores are built from the SAM (part of S&P Global) 'Corporate Sustainability Assessment' (CSA).

A company's S&P DJI ESG score may either be calculated from data received directly by a company completing the comprehensive assessment (together with supporting documents), or – in the absence of this – by using publicly available information. SAM uses the CSA results to then calculate the S&P DJI ESG Scores that are used in the index methodology. The scores are calculated according to an industry specific weighting which can be found at

https://portal.csa.spglobal.com/survey/documents/CSA_Weights.pdf.

Global Green Property

This fund adheres rigidly for constituent selection within the Dow Jones Global Select ESG RESI (NZD hedged) index. That index is part of global series of Dow Jones Green Real Estate Indices designed to measure the performance of publicly traded real estate securities while overweighting those companies with relatively high GRESB total scores and underweighting those with lower or zero total scores. GRESB are a global leader in measuring and assessing the ESG performance of real estate companies. See more at www.gresb.com

Kernel Global Green Property

- Start with Dow Jones Global Select Real Estate Securities Index
- Assign GRESB Real Estate Assessment score if available
- Weight of any constituent below the 50th percentile by rank is reduced by 30%
- Excess weight is distributed on a pro-rate basis to constituents ranking in the top quartile

GRESB Total Score

All listed companies that are both an equity owner and operator of commercial and/or residential real estate, are assigned an ESG total score from GRESB annually, if available. The GRESB Real Estate Assessment is structured around seven aspects and contains approximately 50 indicators. The assessment evaluates performance against seven sustainability aspects, including information on performance indicators, such as energy, GHG emissions, water and waste.

The methodology is consistent across different regions, investment vehicles, and property types, and aligns with international reporting frameworks such as GRI and PRI. The GRESB total score is an overall measure of ESG performance – represented as a percentage.



Sample Real Estate assessment graphics ©2021 GRESB

As of the rebalancing reference date in December each year, constituent's weights are adjusted to improve the overall ESG profile of the index. Specifically, all companies in the index are ranked by GRESB Total Score from highest to lowest with unscored companies assigned a score of 0. The weight of any constituent below the 50th percentile by rank is reduced by 30%. The excess weight is distributed on a pro-rata basis to constituents ranking in the top quartile.

Exclusion of specific business activities

As of each rebalancing reference date, companies with the following specific business activities, as determined by Sustainalytics are excluded from the index's eligible universe:

Sustainalytics Category of Involvement	Description
Controversial Weapons	The company is 10%+ (0% threshold for tailor made and essential) directly involved in the core weapon system, or components/services of the core weapon system that are considered tailor-made and essential for the lethal use of the weapon.

Fossil Fuels	The company extracts thermal coal, oil sands, arctic oil & gas, or is involved in oi & gas production and generation and generates more than 0% of its revenue from these sources (10% threshold for oil & gas supporting products & services).
Tobacco	The company manufactures tobacco products (0% revenue threshold), supplies tobacco-related products/services and/or derives revenues from the distribution and/or retail sale of tobacco products (5% threshold). This also applies of a company owns 10%+ of a company involved in these activities.
Gambling	The company has gambling operations (5% revenue threshold), or provides gambling related equipment, products, and/or services accounting for more than 10% of revenues.
Adult entertainment	The company produces adult entertainment (0% revenue threshold), or distribution of adult entertainment accounts for 10%+ of revenue.
Alcohol	The company produces alcoholic beverages (5% revenue threshold), or is involved in the retail distribution of, and/or involved in related products and services of, alcoholic beverages accounting for 10%+ of revenue.

Please refer to <http://www.sustainalytics.com> for more information.

Exclusion due to low UNGC Score or Rep Risk

Sustainalytics' Global Standards Screening (GSS) provides an assessment of a company's impact on stakeholders and the extent to which a company causes, contributes or is linked to violations of international norms and standards. The basis of the GSS assessments are the United Nations (UN) Global Compact Principles. Information regarding related standards is also provided in the screening, including the Organization for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, as well as their underlying conventions.

Sustainalytics classifies companies into the following three statuses:

- Non-Compliant: classification given to companies that do not act in accordance with the UNGC principles and its associated standards, conventions and treaties.
- Watchlist: classification given to companies that are at risk of violating one or more principles, for which all dimensions for Non-Compliant status could not be established or confirmed.
- Compliant: classification given to companies that act in accordance with the UNGC principles and its associated standards, conventions and treaties.

As of each rebalancing reference date, companies classified as Non-Compliant, according to Sustainalytics, are ineligible for index inclusion.

In addition to the above, SAM uses RepRisk, a leading provider of business intelligence on environmental, social, and governance risks, for daily filtering, screening, and analysis of controversies related to companies within the indices. In cases where risks are presented, SAM releases a Media and Stakeholder Analysis (MSA) which includes a range of issues such as economic crime and corruption, fraud, illegal commercial practices, human rights issues, labour disputes, workplace safety, catastrophic accidents, and environmental disasters.

The S&P Index Committee will review constituents that have been flagged by SAM's MSA to evaluate the potential impact of controversial company activities on the composition of the indices. In the event that the S&P Index Committee decides to remove a company in question, that company would not be eligible for re-entry into the index for one full calendar year, beginning with the subsequent rebalancing.

Global Clean Energy

This fund adheres rigidly for constituent selection within the S&P Global Clean Energy Index (NZD). Listed companies in developed and emerging markets that meet the eligibility criteria are reviewed for specific practices related to clean energy in their business description. Companies are identified as being in the clean energy business for their involvement in the production of Clean Energy or provision of Clean Energy Technology & Equipment.

Kernel Global Clean Energy

- Identify all developed and emerging market listed companies that derive at least 25% in aggregate revenue from their involvement in the production of Clean Energy or provision of Clean Energy Technology & Equipment, as defined by RBICS, and companies from "Renewable Utilities" and "General Utilities" (that generate 20% of their power from renewable sources) as defined by the GICS Sub-Industry sectors.
- Carbon intensity screened by assigning an exposure score of 0, 0.5, 0.75 or 1 based on business's primary activities.
- Weight according to free-float market capitalisation and exposure score, subject to liquidity and maximum weights
- Ensure weighted average exposure score is greater than 0.85

For more information on RBICS, please see [here](#).

For more information on GICS, please see [here](#).

Companies are assessed by their primary activity and S&P Dow Jones Indices assign as score as follows:

Exposure Scores			
0	0.5	0.75	1
Eliminated, no exposure	Moderate clean energy exposure	Significant clean energy exposure	Maximum clean energy exposure

All companies with a score of 1 are added, then 0.75 then 0.5 until there are 100 companies.

For all companies selected in the prior steps, those with an S&P Trucost Limited (Trucost) carbon-to-revenue footprint standard score greater than three are excluded from index inclusion. Companies without Trucost coverage are eligible for index inclusion. If there are 100 stocks selected in the previous step, those excluded stocks with a carbon-to-revenue footprint standard score greater than three are replaced with the next highest ranked stocks in order to reach the index's target constituent count of 100. Replacement stocks must have a carbon-to-revenue footprint lower than those being replaced to qualify for index addition.

Carbon-to-Revenue Footprint

The carbon-to-revenue footprint data used in the methodology is calculated by Trucost and is defined as the company's annual GHG emissions (direct and first tier indirect), expressed as metric tons of carbon dioxide equivalent (tCO₂e) emissions, divided by annual revenues for the corresponding year, expressed in millions of US dollars. Trucost's annual research process evaluates the environmental performance of a given company with one output of this process being its annual greenhouse gas emissions profile. For more information on Trucost, please refer to www.trucost.com.

Finally, constituents are weighted at the semi-annual reference date based on the product of each constituent's free-float market capitalisation and exposure score, subject to liquidity and maximum weights. If the index's weighted average exposure score (being the sum of the product between each constituents' exposure score and its final optimized weight) falls below 0.85, the lowest ranking stock with an exposure score of 0.5 is removed until the index's weighted average exposure score reaches 0.85. Therefore, it is possible for the final index constituent count to be below 100 so that overall the portfolio has significant clean energy exposure.

Exclusion of specific business activities

As of each rebalancing reference date, companies with the following specific business activities, as determined by Sustainalytics are excluded from the index's eligible universe:

Sustainalytics Category of Involvement	Description
Controversial Weapons	The company is 0%+ directly involved in, or has a 25%+ ownership in a company that is involved in, the core weapon system, or components/services of the core weapon system that are considered tailor-made and essential for the lethal use of the weapon.
Small arms	The company is 0%+ involved in the manufactures and sells assault weapons, small arms, key components of small arms, and/or is involved in the distribution or retail of these products.
Military contracting	The company is 5%+ involved in the manufactures and sale of military weapon systems or components, or provides tailor made products or services to support military weapons (10%+ threshold).
Tobacco	The company manufactures tobacco products (0% revenue threshold), supplies tobacco-related products/services and/or derives revenues from the distribution and/or retail sale of tobacco products (5% threshold).
Thermal Coal	The company extracts thermal coal (5%+ threshold) and/or is involved in the generation of electricity from thermal coal for more than 25%.
Oil sands, shale energy, Arctic oil & gas exploration	The company is 5%+ involved in the extraction of oil sands, exploration and/or production of shale energy, and/or the exploration of oil & gas in the Arctic region.

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Exclusion due to low UNGC Score or Rep Risk

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1.6. Reporting

As part of monthly reporting for all funds categorised as sustainable, Kernel will publish the following non-financial metrics for the index upon which the fund is based.

- **Carbon Footprint** – The aggregation of operational and first-tier supply chain carbon footprints of index constituents per USD 1 million invested.
- **Weighted Average Carbon Intensity** – The weighted average of individual company intensities (operational and first-tier supply chain emissions over revenues), weighted by the proportion of each constituent in the index.

1.7. Review

This policy will be reviewed annually.