KPMG

Background Paper on Responsible Investment in New Zealand

Commission for Financial Capability

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Dear Kate,

KPMG New Zealand (KPMG) is pleased to provide you with a Background Paper on Responsible Investment in New Zealand.

The objective this Background Paper is to help the Commission for Financial Capability (CFFC) to address Question Five in its 2019 review of retirement income policies:

— 'Information about the public's perception and understanding of ethical investments in KiwiSaver, including the kinds of investments that New Zealanders may want to see excluded by KiwiSaver providers, and the range of KiwiSaver funds with an ethical investment mandate'.

To answer this question, KPMG has undertaken a comprehensive literature review and analysis of reports and academic articles on responsible investment, including key trends and factors relevant to the growing popularity of responsible investment globally and in New Zealand. Research findings are organised into the following sections:

— Introduction to responsible investment
— Responsible investment around the world
— Responsible investment in New Zealand
— Responsible investment by KiwiSaver Funds
— Barriers and constraints to responsible investment
— Conclusions and recommendations.

Please do not hesitate to contact us if you require clarification of the above matters.

Yours sincerely,

Dr. Charles Ehrhart	Ms. Erica Miles
Director	**Director**

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Additionally, we reserve the right but not the obligation to update our report or to revise the information contained therein because of events and transactions occurring subsequent to the date of this report.

1 Acronyms

Acronyms	
AUM	Assets under management
CEO	Chief Executive Officer
CFFC	Commission for Financial Capability
ESG	Environment, social and governance
EU	European Union
FMA	Financial Markets Authority New Zealand
GFC	Global Financial Crisis
GSIA	Global Sustainable Investment Alliance
NZX	New Zealand Stock Exchange
PDS	Product Disclosure Statement
PRI	United Nations Principles for Responsible Investment
RI	Responsible Investment
RIAA	Responsible Investment Association Australasia
S&P	Standard & Poor's
SDGs	United Nations Sustainable Development Goals
SRI	Socially Responsible Investment
TAUM	Total assets under management
UNEP FI	United Nations Environment Programme Finance Initiative
UNHCR	United Nations High Commissioner for Refugees
UNICEF	United Nations Children's Fund

2 Background

The Commission for Financial Capability (CFFC) is an independent government-funded organisation 'helping people get ahead financially.' Its tripartite mandate[1], is structured around three functions:

— Leading and coordinating the National Strategy for Financial Capability to improve the financial capability of New Zealanders of all ages

— Reviewing and reporting to the Minister of Commerce and Consumer Affairs every three years on the retirement income policies implemented by government

— Monitoring the Retirement Villages Act (2003) and administering its dispute provisions, informing and educating New Zealanders about the sector, and monitoring the effects of retirement villages' legislation, and appointing members to disputes panels as vacancies arise.

The Terms of Reference[2] guiding the CFFC's 2019 review of retirement income policies for the Minister of Commerce and Consumer Affairs requests information about the public's perception and understanding of ethical investments in KiwiSaver, including the kinds of investments that New Zealanders may want to see excluded in products offered by KiwiSaver providers; and the range of KiwiSaver funds with an ethical investment mandate.

To fulfil this request, the CFFC has asked KPMG to prepare a Background Paper analysing the nature and state of responsible investment in New Zealand and overseas. The Background Paper has been developed through a review and analysis of publically available secondary sources, supplemented by interviews with subject matter experts. It provides insight into responsible investment issues and trends and is organised as follows:

— Conclusions and recommendations

— Introduction to responsible investment

— Responsible investment around the world

— Responsible investment in New Zealand

— Responsible investment by KiwiSaver Funds

— Barriers and constraints to responsible investment

While the Terms of Reference guiding the CFFC's 2019 review use the phrase 'ethical investment,' this report uses the more common label of 'responsible investment' (RI) to describe proactive ethical and sustainable investment approaches taken by asset managers and investors.

1 As established by the New Zealand Superannuation and Retirement Income Act, 2001 and the Retirement Villages Act 2003 and further elaborated upon in the Commission's 2015 National Strategy.

2 Question 5.

3 Conclusions & recommendations

Social and environmental responsibility has become a focal point in recent years, with this trend spilling over into the financial markets (Amel-Zadeh & Serafeim, 2018). As a result, institutional and retail investors around the world are pouring significant assets into funds claiming to invest "responsibly." With the proportion of responsibly invested assets relative to total managed assets rising to more than 63 per cent during the 2016-2018 period, this phenomenon is especially pronounced in the New Zealand/Australia market (RIAA, 2018).

Fund managers, institutional investors, retail investors, and regulatory bodies have found it difficult to keep pace. Indicating the scale of growing complexity, nearly 300 policy instruments – more than half of which were established between 2013 and 2016 – that have been established to encourage and guide more responsible investments in the world's 50 largest economies (PRI & MSCI, 2016). The European Union (EU) is leading this charge in an effort to protect well-intentioned retail investors and enable the financial sector to play its part in the transition to a sustainable economy. Efforts in New Zealand have lagged behind.

Negative screening remains the most common responsible investment strategy amongst KiwiSaver funds – both those branded as "ethically orientated" and others. Negative, or exclusionary screening, simply entails excluding certain sectors, companies or practices from a fund or portfolio based on Environmental, Social and Governance (ESG) considerations (RIAA, 2018). This mirrors early stages in the international responsible investment movement, which has subsequently progressed to more pro-active, or positive screening and shareholder engagement.

Mainstream economic theory cautions that responsible investment strategies may underperform in the market and result in lower than market rate financial returns. However, the data suggests otherwise (Clark, Feiner, & Viehs, 2014; Bordon, Sullivan, Martindale, & Feller, 2015; Friede, Busch, & Bassen, 2015; RIAA, 2018). Research over the past decade has shown the dichotomy between ESG investment and profitability to be false. Over 2,000 research articles, including a meta-study by the University of Oxford and Arabesque Asset Management in 2014, have examined the relationship between ESG performance and financial performance (Clark, Feiner, & Viehs, 2014; Friede, Busch, & Bassen, 2015). The evidence overwhelming concludes that this relationship is positive: that is, long-term financial performance improves with better ESG performance.

KPMG has reviewed publicly available information for funds from KiwiSaver providers as of April 2019. The most significant shortcomings and risks to responsible investment by KiwiSaver funds and providers include: ambiguous and inconsistent terminology; ambiguous policies; confusing documentation; redundancy; and immature processes. On the basis of these shortcomings and risks, international experience and lessons learnt, as well as well-documented barriers and constraints to the spread of responsible investment strategies amongst managed portfolios, KPMG recommends that the CFFC consider working with partners to:

- **Develop** consumer-focused guidance on responsible investment, including information about the positive risk/return profile of responsible investment options
- **Develop** fund manager-focused guidance documents on responsible investment, in an effort to encourage responsible investment options beyond exclusion
- **Raise** the profile of responsible investment certification schemes (in particular the existing scheme provided by the Responsible Investment Association of Australasia) amongst fund managers and retail investors
- **Undertake** further research on barriers to responsible investment and the integration of ESG risks and opportunities in investment decisions in New Zealand.

In addition, KPMG suggests that the CFFC consider including the following recommendations in its 2019 review of retirement income policies and report to the Government:

- **Enhance** clarity, consistency and transparency within New Zealand's fund markets by:
  - Establishing clear and consistent definitions for responsible investment, including themed investments such as impact and green investment
  - Establishing a clear and detailed classification system, or taxonomy, for responsible investment and encouraging its uptake across New Zealand's financial system. This system should reflect parallel efforts in Europe and Australia

- Requiring clear, consistent and transparent ESG reporting by companies so that fund managers, institutional investors and retail investors can make informed decisions.

— **Safeguard** the stability and integrity of New Zealand's responsible investment fund market by:
  - Introducing measures to clarify asset managers' and institutional investors' duties regarding sustainability
  - Strengthening or establishing responsible investment product certification schemes
  - Establishing labels for green financial products. This would help investors easily identify products that comply with green or low-carbon criteria
  - Requiring funds to regularly (e.g. annually) clearly, consistently and transparently disclose responsible investment activities (e.g. exclusions, shareholder activism, and themed investments) as well as performance. The external assurance of these disclosures could be made mandatory.

4 Introduction to responsible investment

While the Terms of Reference guiding the CFFC's 2019 review of retirement income policies for the Minister of Commerce and Consumer Affairs uses the phrase "ethical investment," this report uses the more common label of "responsible investment" (RI) to describe proactive ethical and sustainable investment approaches taken by fund managers and investors. The United Nations Principles of Responsible Investment (PRI) describes RI as "an approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, to better manage risk and generate sustainable, long-term returns" (PRI, 2019, p. 4).

4.1 The basics

Responsible investment is not a new concept. There are competing claims as to its origins, including Islamic finance (a centuries old practice that places ethical limits on profit generation) and the founding of the Methodist church (which avoided investments in alcohol, tobacco, weapons and gambling) (Adil, Goud, Alim, Radhi, & Hasan, 2015). Regardless, responsible investment - as we know it today – began in the 1960s. During that period, socially conscious investors sought to address equality for women, civil rights and labour by excluding unethical stocks (and at times entire industries) from their portfolios. This process of negative screening is termed Socially Responsible Investment (SRI), and it paved the way for responsible investment. Responsible investment is distinct from SRI in that it recognises the link between strong ESG considerations, corporate responsibility and share price performance.

Responsible investment typically encompasses a wide range of ESG considerations, often including:

— **Environment**. Climate change (physical and transition risk), resource depletion, waste, pollution, and deforestation.

— **Social**. Working conditions (including worker pay and child labour), workforce diversity, impact on local communities, animal welfare, and health and safety.

— **Governance**. Executive pay, bribery and corruption, political lobbying and donations, board diversity and structure, and tax strategy.

When institutional investors began to factor ESG considerations into their investment decisions, the prominent economist Milton Friedman (best known for his work on the power of free markets) cautioned that this would adversely affect a firm's financial performance (Hill, Ainscough, Shank, & Manulland, 2007). Subsequent research has proven the opposite (see section 2.3). Indeed, responsible investment not only generates better outcomes for communities and the environment, it also delivers enhanced long-term financial returns. As a result, in 2004 the UN Secretary-General Kofi Annan invited 50 major global financial institutions to participate in a UN-led initiative to integrate ESG into financial markets. This resulted in the Principles for Responsible Investment (PRI, which has now become the world's leading proponent of responsible investment, (see section 3). Following the development of the PRI, responsible investment has moved to the forefront of investor decision-making across the financial sector, including superannuation, asset management, community finance and financial advisory services.

Responsible investment is a proactive process. It takes a systems approach that includes environmental and social impact analysis, critical selection, and longitudinal monitoring. Selection can be informed by a range of strategies, usefully categorised as follows:

— **Integration of ESG factors**. ESG information relevant to a company's industry, geography and business model are systematically integrated into investment analysis in order to identity ESG related risks and opportunities.

— **Negative/exclusionary screening**. Certain sectors, companies or practices are excluded from a fund or portfolio based on ESG considerations. Common exclusions include gambling, alcohol, tobacco, weapons, pornography and animal testing. Negative screening is usually the first step for the majority of responsible investors.

— **Norms-based screening**. Investments are screened against minimum standards of normative business practice based. Norms-based screening can rely on criteria developed by international bodies, such as the United Nations Global Compact, International Labour Organisation, United Nations Children's Fund (UNICEF) or United Nations Human Rights Council (UNHCR), and/or exclude investment in companies that contravene specific conventions, such as the United Nations Convention on Cluster Munitions.

— **Positive/best-in-class screening**. Certain sectors, companies or projects are selected for a fund or portfolio based on positive ESG performance. Best-in-class screening involves identifying companies with superior ESG performance across all environmental, social and governance considerations.

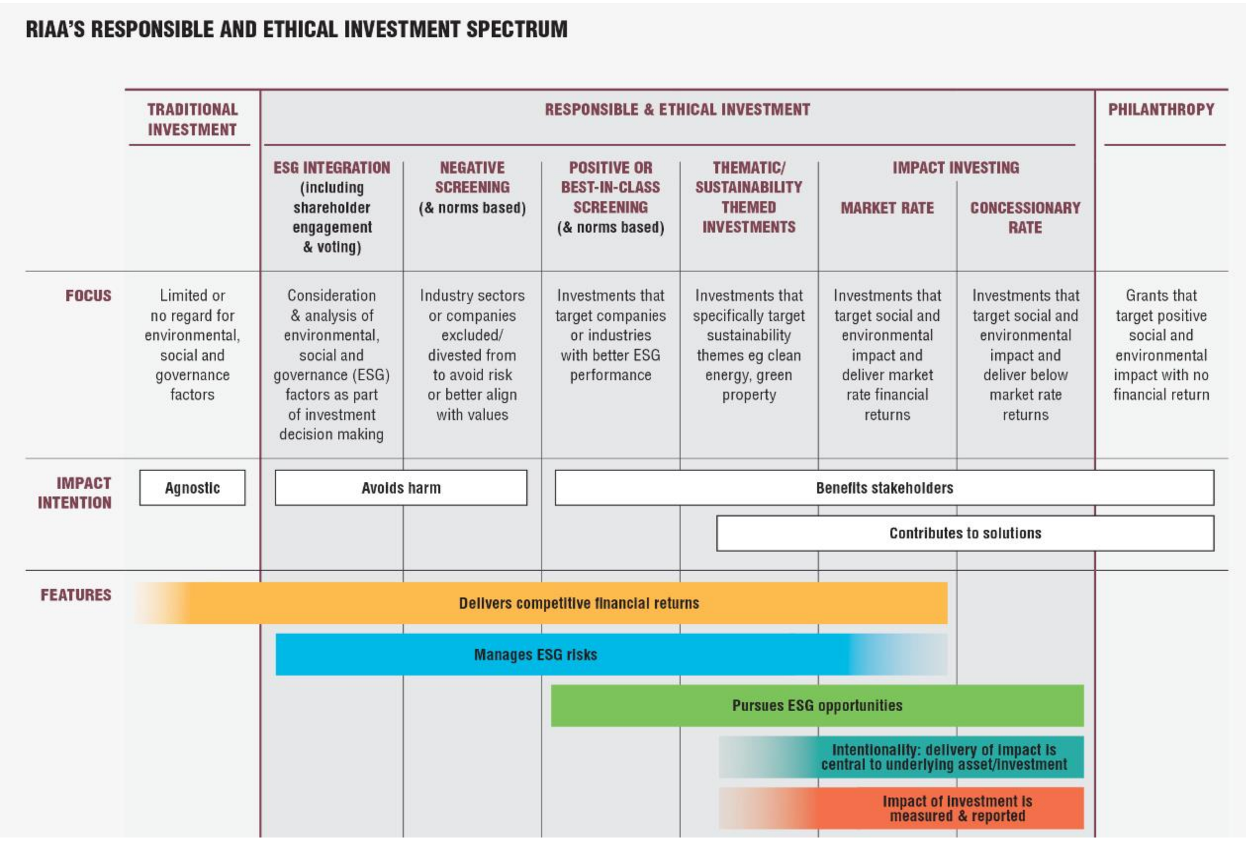
— **Sustainability themed investing**. Certain sectors, companies or projects are selected for a fund or portfolio based on their positive contribution to environmental sustainability (e.g. clean energy, green technology or sustainable agriculture).

— **Impact investing**. Investment decisions are made with the objective of generating social and/or environmental – as well as financial – returns. These targeted investments are typically made in private markets and include investments in businesses with a clear non-financial purpose and community investing, where capital is directed to under-served individuals or communities.

— **Corporate engagement and shareholder action**. Shareholder power is used to influence corporate behaviour, including through direct corporate engagement (i.e. communicating with senior management and/or boards of companies), filing or co-filing shareholder proposals, and proxy voting that is guided by comprehensive ESG guidelines. Divestment can be used as a strategy of last resort, though this precludes further opportunities to engage and improve a company's ESG performance "from within."

In practice, these strategies exist along a spectrum (see Figure 1, below) and are, increasingly used in combination by New Zealand fund managers and investors (RIAA, 2018).

Figure 1: Spectrum of responsible and ethical investment



Source: (RIAA, 2018).

Figure 1 was developed by the Responsible Investment Association Australasia (RIAA), which is the primary membership-based organisation of responsible investors in Australia and New Zealand.

Despite meaningful differences, all of these strategies share an underlying belief that ESG considerations are essential to understanding the full value of an investment – i.e. that financial, human, social and natural value are inextricably intertwined. Of note, this holistic approach to understanding "value" aligns well with the New Zealand Government's Living Standards Framework, intended to help analyse and measure intergenerational wellbeing.[3]

4.2 The business case

In the past, responsible investment was widely assumed to result in lower than market rate financial returns (Katz, Schundler & Nathanson, 2017). However, research over the past decade has shown the dichotomy between ESG investment and profitability to be false. Indeed, over 2,000 research articles, including a meta-study by the University of Oxford and Arabesque Asset Management in 2014, have studied the relationship between ESG performance and financial performance (Clark, Feiner, & Viehs, 2014; Friede, Busch, & Bassen, 2015). The evidence overwhelming concludes that this relationship is positive: that is, financial performance is improved with better ESG performance.

This positive correlation also applies to New Zealand. Last year, RIAA research demonstrated that responsible investment funds outperformed against most benchmark traditional funds over an extended time period. While the research sample size was small, similar markets in Australia (which have a much larger sample size) returned similar results (RIAA, Responsible Investment Certification Program, 2017).

Table 1: Performance of responsible investment funds against benchmarks, New Zealand

NZ Share Funds	**1 Year**	**3 Years**	**5 Years**	**10 Years**
Average responsible investment fund (between 1-2 funds sampled depending on time period)	29.9%	17.3%	19.3%	10.0%
NZ OE Equity Region NZ	21.8%	14.6%	15.8%	8.8%
S&P/NZX 50 TR NZD	22.0%	14.7%	15.6%	7.6%
International share funds	1 Year	3 Years	5 Years	10 Years
Average responsible investment fund (between 2-8 funds sampled depending on time period)	14.2%	22.6%	10.5%	6.7%
Large-cap international share fund average	20.9%	11.5%	13.3%	4.9%
MSCI World ex-Australia Index	20.0%	12.8%	15.0%	5.9%
Multi-sector growth funds	**1 Year**	**3 Years**	**5 Years**	**10 Years**
Average responsible investment fund (between 6-18 funds sampled depending on time period)	14.7%	7.0%	10.4%	6.4%
Large-cap international share fund average	12.0%	6.3%	8.5%	-
				Over Performance
				Under Performance

Source: (RIAA, 2018)

[3] The Living Standards Framework measures value not just by contribution to gross domestic product but vis-à-vis human, social, natural, and financial/physical capitals.

The impressive performance of responsible investment funds may be explained by a combination of factors. Eccles, Ioannou, and Serafeim (2014) compared the performance of 90 'high sustainability' companies to 90 'low sustainability companies' between 1993 and 2009. They found that companies in the former category are more likely to have established processes for stakeholder engagement; are longer-term oriented; and exhibit higher standards of measurement, transparency and disclosure of non-financial information. Subsequent analyses have strengthen this understanding of superior performance by 'high sustainability' companies. For example:

— **Competitive advantage in product, labour and capital markets**. "Abnormal returns" can be generated as a result of more efficient resource use, superior human capital development, and innovation management (Nagy 2016).
— **Superior risk-adjusted stock returns**. Better management of company-specific business and operational risks reduce the probability of suffering incidents that can impact share prices (RIAA, 2018).
— **Long-term outlook**. Better development of long-term business plans, have been linked to improved firm performance (Gregory, Tharyan & Whittaker, 2014).

This growing body of evidence that ESG investments are safer investments, has led to an increase in demand for independent ESG ratings. Investors need accurate, reliable, and up-to-date data on ESG ratings to help them evaluate the large numbers of companies they review. The three main global ESG rating providers are Thomson Reuters, MSCI and Sustainalytics. Each of these rating providers acknowledge the limitations of ESG auditing. Challenges include the need to continually update a company's ESG score, and identity new opportunities.

Another "major challenge" is to demonstrate that the positive correlation between strong ESG performance and returns amounts to causation (MSCI, 2017).In response to this, Sustainalytics' worked with Russell Investments to produce a 2018 paper, Materiality Matters: Targeting the ESG Issues that Impact Performance, that outlined a method to more accurately identify ESG factors "materially linked" to financial performance (Steinbarth & Bennett, 2018). Such data is particularly valued by institutional investors whose primary motivation is to obtain a financial benefit (Eccles et al, 2016). According to Scott Bennett, co-author of Materiality Matters, this research makes it possible for ESG investors to distinguish between companies that score highly on ESG issues financially material to their business, from those that score highly on issues that are not financially material to their business. Tests on this new material ESG method between 2012 and 2017 suggest that it is a better predictor of returns than traditional ESG scores (Steinbarth & Bennett, 2018).

Research on ESG will continue to be undertaken by academics, research institutions and investment fund managers. This is encouraging and presents an opportunity to address the limitations of existing ESG research; a narrow range of sample companies, and the failure to adequately account for variables relevant to the relationship between financial returns and ESG considerations.

4.3 Supply and demand

The 2007/08 Global Financial Crisis (GFC) provided a stark reminder of the interdependence between societies, economies and financial markets (Woods & Urwin 2010). It also provided clear evidence that efforts to maximise short-term profit can have devastating social and economic consequences. The UN-backed PRI noted that the GFC was a key driver of change within the financial system. Indeed, heightened mistrust of the industry led to an internal effort to reform and the mainstreaming of responsible investment. Today, financial institutions are aware that consumers and investors demand greater transparency and responsibility in financial markets (Banerjee, 2010). Demand is also fueled by the increasing desire of investors (especially younger investors) to align investments with their personal values (Chapman Tripp, 2018). The results are evident is the rapid, worldwide growth of responsible investing assets.

Responsible investment assets continue to grow globally and locally (GSIA, 2018; RIAA, 2018). In New Zealand, growth has been "significant", with Assets under Management (AUM) increasing by 40 percent from NZD$131.3 billion to NZD$183.4 billion during the period 2016 to December 2017 (RIAA, 2018, p. 4).

New Zealand investors are actively seeking investments that consider ESG issues. A recent survey of over 7,000 members of the Kiwi Wealth KiwiSaver Scheme found that 93 per cent of members expect their KiwiSaver funds to be invested responsibly (Kiwi Wealth , 2018). This growth has been almost entirely limited to screening (RIAA, 2018). A smaller, but more general survey found that 95 per cent of New Zealand investors think that ESG factors should be considered as part of investment decisions (Baker, 2016).

Table 2: Growth in responsible investing assets, 2016-2018

Region	2016	2018
Europe	$12,040	$14,075
United States	$8,723	$11,995
Japan	$474	$2,180
Canada	$1,086	$1,699
Australia / New Zealand	$516	$734
TOTAL	$22,890	$30,683

Source: (Global Sustainable Investment Review, 2018).

Note: Asset values are expressed in billions of US dollars. All 2016 assets are converted to US dollars at the exchange rates as of year-end 2015. All 2018 assets are converted to US dollars at the exchange rates at the time of reporting.

Note: GSIA use the term Sustainable investment, (deemed to be equivalent to responsible investment for the purposes of this report).

Figure 2: Proportion of responsibly invested assets relative to total managed assets (2014-2018)

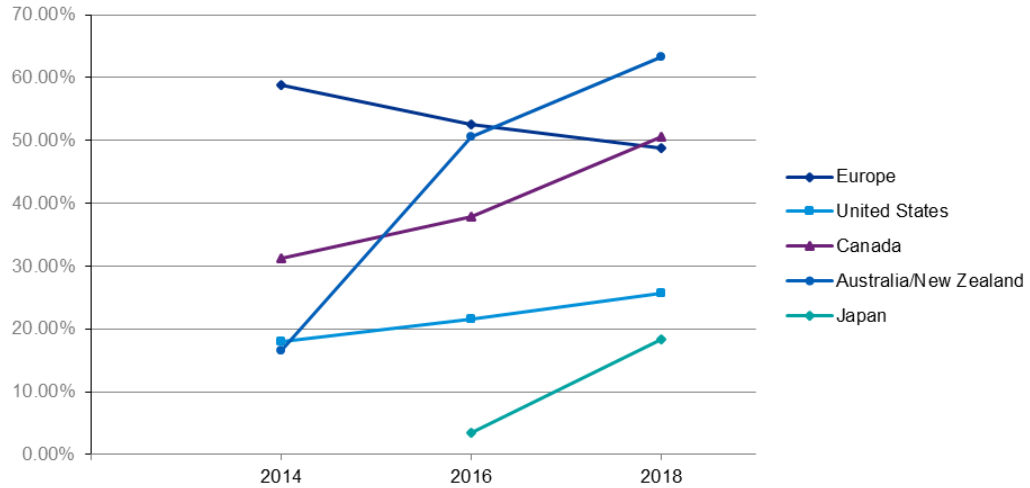


Table 3: Growth of responsible investment by region 2014 - 2018

	2014	2016	2018
Europe	58.8%	52.6%	48.8%
United States	17.9%	21.6%	25.7%
Canada	31.3%	37.8%	50.6%
Australia/New Zealand	16.6%	50.6%	63.2%
Japan		3.4%	18.3%

Source: (Global Sustainable Investment Review, 2018)

Note: In 2014, data for Japan was combined with the rest of Asia, and was not available.

Table 4: Indicative growth of responsible investment in New Zealand 2016 – 2017

Responsible investment approach	2016 Responsible investment assets under management ($bn)	2017 Responsible investment assets under management ($bn)	Per cent growth
Screening (including negative, positive, best in class and norms-based screening)	42.3	85.9	103%
Sustainability themed investing	0.4	0.4	0%
Impact investing and community finance	0.1	0.1	0%
Core responsible investment total	42.8	86.4	102%
Broad responsible investment total ESG integration	88.6	97.0	9%
TOTAL RESPONSIBLE INVESTMENT	**131.4**	**183.4**	**40%**

Source: (RIAA, 2018).

Note: This table does not reflect the entire NZ market. The drivers of significant growth from 2016 and 2017 are addressed in Section 4, "Responsible investment in New Zealand."

5 Responsible investment around the world

This section examines major developments in responsible investment around the world, including reform efforts; legislative landscapes; mechanisms for responsible investment; and the application of these mechanisms in practice.

5.1 International efforts

In the past two decades, a concentrated effort has been made to reform the global financial sector by integrating ESG considerations into investment decisions. As discussed above, the PRI, which was launched in April 2006, catalysed the mainstreaming of responsible investment. With the twin objectives of developing a more sustainable global financial system and exploring the full implications of responsible investment strategies – the PRI is widely recognised for its global leadership in promulgating responsible investment.

Today, the PRI has over 2,300 signatories, representing a majority of the world's professionally managed investments. New Zealand has 27 PRI signatories. Signatories are publically committed to responsible investment in line with the PRI's six principles. These include the incorporation of ESG considerations into investment analysis and decision-making, ownership policies, and practices, as well as reporting on progress. Notably, PRI signatories are in different stages of integrating responsible into their investment practices. This makes reporting especially important; transparency enables the PRI to leverage its networks and resources to help signatories to improve performance.

In 2016, the PRI commissioned an independent analysis of its global impact and challenges. The resulting report, From Principles to Performance, recognises the PRI's global leadership position, and success in helping to embed ESG considerations within the core processes of investors around the world (Redqueen, 2016). However, it also concluded that "considerable work remains to be done to make all investment responsible" and recommended that the PRI clarify its purposes. In response, the PRI produced A Blueprint for Responsible Investment in 2017, identifying three priority areas of impact (PRI, 2017, p. 10):

— **Strengthen** and deepen work with responsible investors to "foster a community of active owners, showcase leadership and increase accountability and convene and help educate responsible investors";

— **Promote** sustainable markets by encouraging policy makers to introduce measures and regulations to support responsible investment (and to remove barriers); and

— **Support** signatories to take action on climate change and the UN Sustainable Development Goals (SDGs)

The European Commission (the Commission) has also been influential in developing a sustainable financial system. The Commission believes that the integration of ESG considerations into investment, plus channeling investment into climate, environment, and socially oriented ventures is crucial for the EU to deliver on its commitments under the Paris Agreement and contribute towards achieving the UN's Sustainable Development Goals (European Commission, 2018). To achieve these objectives, the PRI is helping the Commission with an Action Plan for Financing Sustainable Growth that is expected to be released mid-2019. The key points known thus far include:

— **Establishing** a clear and detailed EU classification system – or taxonomy – for sustainable activities. This will create a common language for all actors in the financial system;

— **Establishing** EU labels for green financial products. This will help investors to easily identify products that comply with green or low-carbon criteria;

— **Introducing** measures to clarify asset managers' and institutional investors' duties regarding sustainability;

— **Strengthening** the transparency of companies on their ESG policies. The Commission will evaluate the current reporting requirements for issuers to make sure they provide the right information to investors; and

— **Introducing** a 'green supporting factor' in the EU prudential rules for banks and insurance companies. This means incorporating climate risks into banks' risk management policies and supporting financial institutions that contribute to fund sustainable projects.

The UN's Global Investors for Sustainable Development (GISD) Network represents a third major effort to reform financial systems (United Nations: Department of Economic and Social Affairs , 2019). It is expected to help accelerate responsible investment by identifying policy barriers, transferring knowledge, facilitating partnerships, and defining a standards framework for SDG-aligned investments (United Nations: Department of Economic and Social Affairs , 2019).

5.2 Legislative landscapes

Responsible investment policies and legislation, especially with regards to fiduciary and sustainable impact duties, are rapidly maturing around the world.

Nearly 300 policy instruments – more than half of which were established between 2013 and 2016 – have been established to encourage and guide more responsible investments in the world's 50 largest economies (PRI & MSCI, 2016). However, most governments are not embedding these policies into capital markets (*Ibid.*). In part, this is due to the incompatibility of new financial policies – i.e. those embracing "long-termism" and a more holistic view of value – with capital markets historically focused on short-term profits for shareholders (Edmans, Fang & Huang, 2018). This past and present bias towards short-termism is fuelled by the practice of tying the pay-packages and bonuses of executives and managers to share price. As exemplified by the GFC, this can encourage key decision makers to overlook dubious investments and long-term risks (Sethi, 2005).

To shed light on the dangers of a financial system driven by short-term profit taking, the UN commissioned a report from the law firm Freshfields Bruckhaus Doringer to set out "A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment" (Freshfields Bruckhaus Doringer , 2005). Commonly referred to as the Freshfields Report, it concluded that ESG considerations should be integrated into all investments; "[this is] clearly permissible and is arguably required in all jurisdictions (*Ibid*, p. 13)." Such consideration, they say, is a matter of fiduciary responsibility to savers – one that not only considers financial interests in the short term, but also their long-term social and environmental interests.

At its time of publication, the Freshfields Report was considered quite radical. By the end of the year however, a perfect storm of international incidents – including financial corruption and widespread acknowledgment that climate change is the greatest market failure the world has ever seen – had shifted widespread option (UNEP Finance Initiative , 2009). Following the 2007/08 GFC, recommendations made in the Freshfield's Report have been taken more seriously; it is no longer accepted that institutional investors have unfettered discretion with regard to investment decisions, and demand is high for the incorporation of ESG considerations into investment processes. For instance, British pension funds have been under increasing pressure to consider the ESG impacts of their holdings. This is more so following the United Kingdom's Department of Work and Pensions' introduction of regulations on the fiduciary duties of pension scheme trustees. These regulations will require pension scheme trustees to consider financially material ESG risks and opportunities, including climate change. They also clarify that schemes may develop policies on how to consider pension savers' values (IPE, 2018). The new regulations will come into force from October 2019.

The PRI, Generation Foundation and the United Nations Environment Programme Finance Initiative (UNEP FI) are continuing the discussions started by the Freshfield's Report on the financial sectors fiduciary duties. They are of the opinion that there are positive duties to integrate ESG considerations into investment processes and that doing so is a necessary prerequisite to a more sustainable global economy. This opinion is consistent with the recent development of "Stewardship Codes," which place voluntary obligations on investors to influence company behaviour to be more responsible via greater shareholder engagement and voting (PRI & MSCI, 2016).

5.3 Eco-labelling

The EU regards certification schemes as a key part of financial reforms because they decrease the risk of greenwashing investment products – especially in the retail market.

A number of initiatives exist in Europe to help investors and consumers assess and select "green" and "sustainable" financial products. Eco-labels, for instance, have been developed to protect the consumer and reduce greenwashing. Some of these labels and schemes define the "greenness" of an investment portfolio by setting a requirement or threshold. Common financial eco-labels include:

— The Energy and Ecological Transition for Climate Label (TEEC) in France
— Nordic Swan Ecolabel in the Nordic countries
— Luxflag Climate Finance Label in Luxembourg
— Austrian Ecolabel in Austria
— Blue Swan in Germany
— Responsible Investment Association in Canada.

The EU Joint Research Centre recently released a draft report on the development of EU Ecolabel criteria for retail financial products, and a preliminary report containing the legislative, market and technical analysis to support proposals (European Commission, 2019).

In New Zealand and Australia, the Responsible Investment Association of Australasia (RIAA) promotes, advocates for, and supports approaches to responsible investment that align capital with achieving a healthy and sustainable society, environment and economy (RIAA, 2018). The RIAA Investment Certification Program allows investment products to be certified as responsible investment products. This certification process is currently being updated, the new scheme is expected to be publicised in the third quarter of 2019 (RIAA, Three-Year Strategy Financial Year 2016-2018, 2015).

5.4 Pension Funds

Public pension funds have been pioneers, and remain highly active, in responsible investment (Sieva¨nen , Rita, & Scholtens, 2013). Likely, this is due to their long-term investment horizons.

Since the 1980s, the overwhelming majority of responsible investment has been implemented via institutional investors (particularly pension funds), with long-term investment horizons and risk profiles (Sieva¨nen , Rita, & Scholtens, 2013). Indeed, there is a clear link between long-termism and responsible investment: many key sustainability issues are essentially a long-term, slow-burning phenomena, the impacts of which are not seen for years or decades (Lie & Kiernan, 2017). For this reason, sustainability-driven investment risks and opportunities are especially relevant for funds whose mandates and investment horizons are similarly long, and whose holdings are highly diversified by geography, asset class, and industry sector (*Ibid*.).

Key drivers of responsible investing for institutional investors include:

— **Long term focus.** Asset owner institutions interviewed identified a link between responsible investment and long-term performance.
— **Culture.** One third of asset owners referred to their organisations' culture, purpose, and ultimate beneficiaries as a very strong driver for responsible investment.
— **Investee performance.** ESG considerations are seen, by a majority of interviewees, as drivers – or barriers – to profitability and shareholder value. Companies that are doing well according to ESG parameters are expected by these asset owners, to do well financially in the long term (*Ibid*.).

The role of leadership organisations in climate change, such as the California Public Employees Retirement System (CalPERS), French public service additional pension scheme (ERAPF), Norway's Government Pension Fund Global, and Dutch PGGM Asset Management, may provide critical signposts for future action by the broader investor community (*Ibid*.) These pension funds are widely recognised as global leaders in responsible investment, and they continue to push expectations for responsible investment onto managed funds and external managers (Sieva¨nen , Rita, & Scholtens, 2013).

5.5 Shareholder engagement

As previously discussed, using shareholder power to influence corporate behaviour is an increasingly common form of responsible investment. Efforts to influence typically take the form of direct corporate engagement (i.e. communicating with senior management and/or boards of companies); the filing or co-filing of shareholder proposals; and proxy voting guided by comprehensive ESG guidelines (Global Sustainable Investment Review, 2018).

Shareholder engagement, and the publicity around these engagements, has increased notably in the past few years (Freedman, Hall, & Robertson, 2019). BlackRock, the world's largest asset manager with USD $6.52 trillion AUM, has been especially vocal – and successful – in shifting corporate behaviour (BlackRock, 2019). In 2017, it's CEO and Chairman Larry Fink wrote to the CEOs of BlackRock investees, calling on them to play their part in addressing global ESG issues (BlackRock, 2017). Fink continues to write publically disclosed letters on an annual basis, with the latest focusing on governance, the company's approach to board diversity; corporate strategy and capital allocation; compensation that promotes long-termism; environmental risks and opportunities; and human capital management (BlackRock, 2019). Given that these letters are sent by one of the largest and more 'traditional' global investment managers, they represent a particularly strong signal that financial market are shifting.

Following in Fink's footsteps, State Street Corporation and Vanguard, both sizeable investors, have also sent letters to the CEOs or Board Members of companies in their portfolios, outlining their expectations of corporate governance (Serafeim, 2018). Another example is Climate Action 100+, an investor-led initiative to ensure that the world's largest corporate's take action on climate change. The initiative commits investors to the Climate Action 100+ Sign-on Statement, which requires them to work with the companies in which they invest to "ensure they are minimising and disclosing the risks and maximising the opportunities presented by climate change" (Climate Action 100+, 2019). To date, 323 investors from dozens of countries have signed the Sign-on Statement. Collectively, they manage more than USD$32 trillion (*Ibid.*)

5.6 Divestment

Some of the world's largest pension funds and institutional managers are delivering an even blunter message by publically committing to divest from fossil fuel companies for social, environmental, and financial reasons (e.g. diminishing returns and the risk of stranded assets). In 2018, 985 institutional investors, with $6.24 trillion AUM committed to divest from fossil fuels, up from $52 billion just four years ago (Divest Invest, 2018). Indeed, fossil fuel divestment is now a mainstream financial action that is starting to have a material impact on the fossil fuel industry (CISION PR Newswire , 2018). Pension funds taking this action include:

— Norges Bank Investment Management (the world's largest pension fund built on taxes from oil and gas extraction in the North sea)
— The New York State pension fund
— The Rockefeller Brothers Fund
— Axa.

Collectively, the divestment of these funds away from fossil fuels demonstrates that pension funds are responding to pressure from consumers and lobby groups (McKibben, 2018). Additionally, large institutional investors recognise that the impacts of greenhouse gas induced climate change pose an existential threat to the financial sector. As investors begin to collaborate and coordinate their shareholder engagement strategies, we are likely to see a continued shift in the behaviours and practices of companies to better align with ESG considerations (Serafeim G. , 2018).

5.7 Passive investments or Exchange Traded Funds

The passive investment sector or Exchange Traded Funds (ETF) has been engaging in activism on key social and environmental issues through ESG-themed (ESG, ethical, and low carbon) investments.

Responsible investment strategies are traditionally associated with active management (Dale, 2017). In turn, active management has been perceived in a negative light; it was considered costly and time consuming, relative to more passive (market-tracking) investment strategies (*Ibid*). An interesting development of the new generation of ESG-driven financial innovations can be seen in the ETF sector. These are quickly becoming a popular vehicle for passive responsible investment, due to their low cost and daily transparency. The first ETF was launched in 2005. Today, there are an estimated 120 ESG ETFs globally (Harvard Business Review , 2019).

The growth of such indexes has been mirrored by the growth of external research companies providing ESG data, for instance, MSCI and Sustainalytics. Constantly improving ESG research and analytics capabilities has seen a more systematic, quantitative, objective and financially relevant approach to ESG investing globally (Tidd & Subramanian, 2019). Fewer than 20 companies disclosed ESG data in the early 1990s; the number of companies issuing sustainability or integrated reports had increased to nearly 9,000 by 2016 (Amel-Zadeh & Serafeim, 2018).

6 Responsible investment in New Zealand

Kiwis have historically limited engagement and experience in share markets (Burns & Dwyer, 2007). Indeed, just one out of five Kiwis owns shares versus two out of five Australians and half of all Americans (Sharesies & NZX Smartshares, 2018). However, research commissioned by RIAA and Mindful Money in 2018 suggests that those New Zealanders that *are* engaged in share markets have a high affinity for responsible investment (Colmar Brunton, 2018):

- 72 per cent of respondents expect their investments to be made responsibly and ethically
- 62 per cent of respondents claim they would change funds if they discovered their money was being invested in activities inconsistent with their values

Despite this apparent affinity, the 2018 Annual KiwiSaver Report notes that of $48.6 billion invested in the KiwiSaver scheme, just 8,528 participants with approximately $107 million have selected "socially responsible" funds (Financial Markets Authority, 2018).

Table 5: The number of members per type of KiwiSaver fund as at 31 March 2018

KiwiSaver fund type	Number of members
Socially responsible	8,528
Default conservative	431,779
Growth	1,066,506
Balanced	699,189
Conservative	863,251

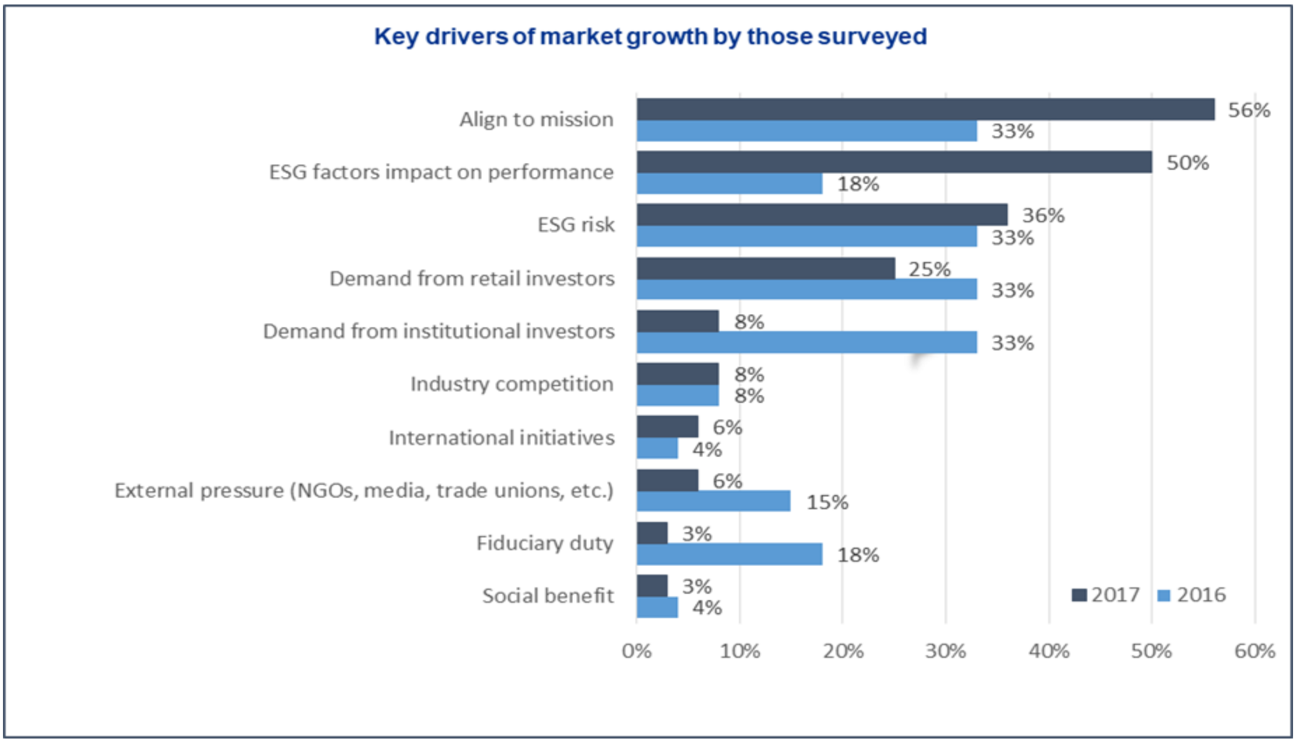
Source: (Financial Markets Authority, 2018).

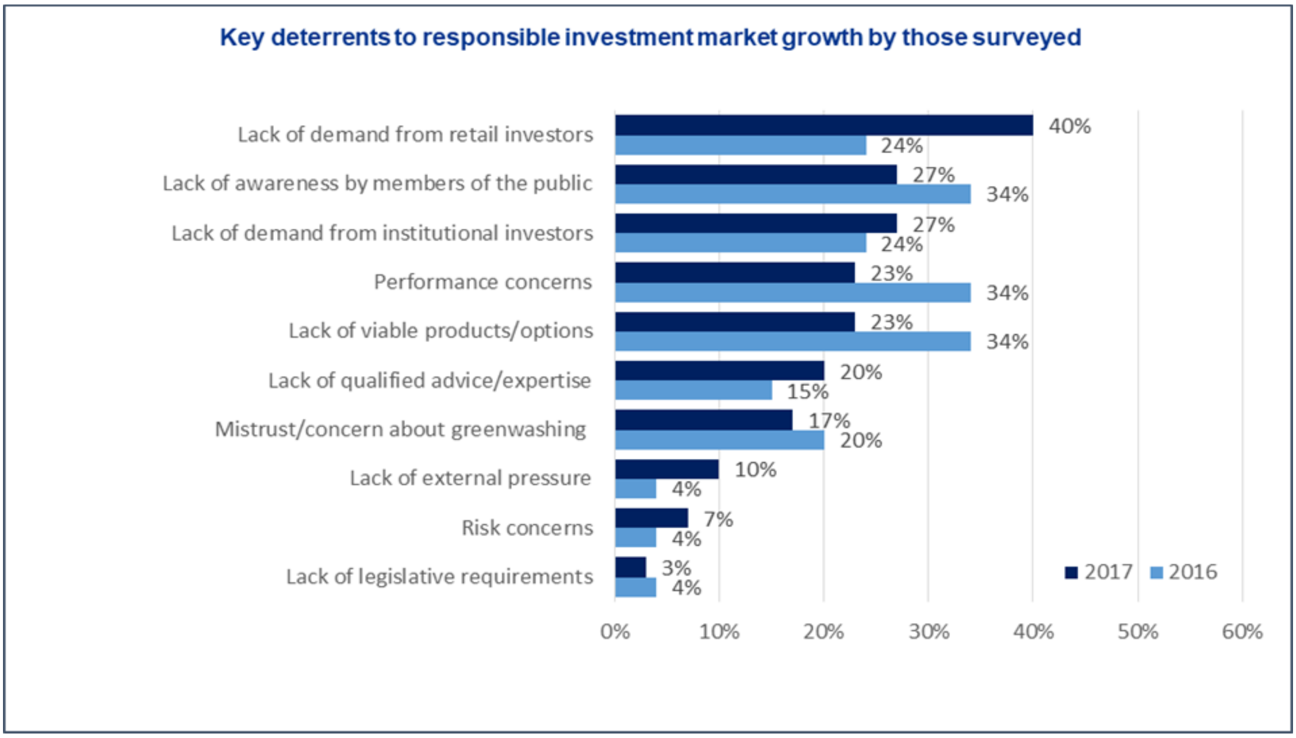
Note: This table does not include single sectors funds such as cash, shares, fixed interest, property or other.

Research undertaken by RIAA (2018) suggests that the discrepancy between retail investors' purported preferences and practices may be due to a number of barriers, the most important of which are:

- Lack of consumer awareness about responsible investment options
- Lack of appropriate products/options for responsible investment, which may be partially due to limited demand and competition
- The misconception that responsible investment strategies underperform vis-à-vis their peers (see also: Bordon, Sullivan, Martindale, & Feller, 2015).

Figure 3: Key drivers and deterrents of responsible investment market growth





Source: (RIAA, 2018).

Note: This table does not reflect the entire NZ market. Many of the people surveyed are RIAA members or PRI signatories.

The proportion of responsibly invested assets relative to total managed assets in New Zealand increased by 40 per cent from NZD$131.3 billion to NZD$183.4 billion during the period 2016 to December 2017 (RIAA, 2018, p. 4). Though this growth is ostensibly world leading, it is really a story about excluding a few of the most offending sectors, companies or practices (esp. gambling, alcohol, tobacco and controversial weapons). Moreover, New Zealand's figures showing the rapid adoption of responsible investment strategies by fund managers and institutional investors are fundamentally skewed by the Guardians of New Zealand's Superannuation Fund, which holds NZD$41.6 billion in AUM. Simply put: decisions by the Superannuation Fund dominate aggregated figures; and since they consider ESG "material to long term returns" and are at the cutting edge of responsible investment on climate change, it is hardly surprising that the New Zealand market as whole appears world leading (O'Connor, Rae, & Sethi, 2015, p. 2; Lie & Kiernan, 2017).

6.1 Responsible Investment Association Australasia (RIAA)

The Responsible Investment Association Australasia (RIAA) is the primary membership-based organisation of responsible investors in Australia and New Zealand. It aims to support long-term responsible investment and sustainable capital markets by delivering tools for investors and acting as a hub to build capacity, knowledge and collective impact amongst fund managers (RIAA, 2018).

RIAA benefits experienced fund managers by providing them with a platform to discuss and improve best practices, strategies, and operational mechanisms for responsible investment (Spiller, 2018). As such, RIAA is considered "influential" for those "already in the tent." However, it is worth noting that membership in RIAA does not necessarily mean fund managers are engaged in either upskilling or professional conversations. RIAA also serves consumers through its Certification Programme, which was developed in 2005 to provide them with standardised and consistent information about how each investment product or financial adviser takes ESG issues into account.

Despite these services and benefits, RIAA's value to New Zealand's responsible investment ecosystem remains unclear. Neither the Superlife Ethica Fund nor Craigs Investment Partners Quay Street Balanced SRI Fund (both of which are "ethically orientated" funds), for example, have joined RIAA or sought RIAA certification. While there may be a number of explanations for this, the most likely reason is that RIAA does not yet hold enough cache in the New Zealand market to drive fund manager or investor behaviours. As retail demand grows and consumers become savvier about their options, the value of RIAA's services and benefits – as well as its impact – are likely to increase.

7 Responsible investment in KiwiSaver Funds

New Zealand's KiwiSaver scheme is a voluntary, work-based savings initiative which came into operation on 2 July 2007. The 2018 Annual KiwiSaver Report notes 8,528 members with approximately $48.6 billion invested. Of this total, slightly less than $107 million were in "socially responsible investing" (Financial Markets Authority, 2018).

7.1 From scandal to growth

On 21 August 2015, Stuff published an article entitled, "KiwiSaver, cluster bombs, mines and nukes" (Stock, 2015). It reported that three companies on the Guardians of New Zealand's Superannuation Fund exclusion list – noted for their involvement in the manufacture and supply of "cluster munitions" and, or "anti-personnel mines" – appeared in popular KiwiSaver growth funds. A year later, on 18 August 2016, the New Zealand Herald published an in-depth investigation entitled, "Dirty secrets of your KiwiSaver." This expose revealed that, of the $32.5 billion invested by KiwiSaver funds, $152 million were invested in companies involved with cluster bombs, landmines, tobacco, nuclear explosives and human rights infringements blacklisted by the Guardians of the New Zealand Superannuation Fund (Tutty & Nippert, 2016). In the months following the scandal, thousands switched their KiwiSaver schemes; the Financial Markets Authority (FMA) reported that in the period between March 2016 to March 2017, 75,155 KiwiSaver investors switched or transferred out of default schemes (Financial Markets Authority, 2017). While the motivation behind these switches is difficult to verify, it would appear that this did prompt multiple corporations – including BNZ (which had more than $50 million invested in tobacco) and Westpac, ANZ and ASB (all of which had investments in weapons) – to divest from morally dubious investments.

The KiwiSaver scandal exposed New Zealanders, many for the first time, to the concept of 'responsible investment'. It also caused many KiwiSavers to reflect on whether or not their investments were in sectors or industries that they opposed for ESG reasons. Notably, the scandal was also one of the first times that KiwiSaver funds had to justify (and then choose to divest or defend) their investment positions to the New Zealand public.

Data from the 2018 RIAA report suggests that the scandal sparked a sea change in the attitudes of institutional investors to responsible investment; post 2016, AUM by RIAA members that actively screen or exclude particular sectors doubled (RIAA, 2018). The report goes onto note that the dubious investments drawn attention to by the New Zealand Herald are now likely to be excluded, from both KiwiSaver and managed funds, as a minimum standard of good investment practice. Also subsequent to the scandal, Vanguard in October 2016 launched a new passive fund for KiwiSaver schemes (Dale, 2017). This passive fund, while included in Vanguard's International Shares Fund, excluded 23 'unethical' companies and has increased investment in renewable energy; it making ongoing efforts to exclude fossil fuel reserves.

7.2 Current characteristics

Section 199 of the KiwiSaver Act (2006) stipulates that the Product Disclosure Statements of all KiwiSaver funds must contain a statement confirming whether or not ESG considerations have been taken into account. Table 6 draws information from these Statements and other publicly available sources to provide an overview of "ethically orientated" KiwiSaver funds (as per the CFFC's Fund Finder tool) and traditional KiwiSaver fund providers as of April 2019.

Table 6: KiwiSaver characteristics – comparison of ethically orientated funds and traditional providers (not individual funds)

	KiwiSaver fund	Exclusions in place	Responsible investment strategies in addition to exclusions	Responsible investment Policy	RIAA membership	At least one fund certified by RIAA	PRI Signatory
Ethically 'Orientated' KiwiSaver Funds	AMP Responsible Investment Balanced Fund[4]	✓	— Having a sharp focus on ESG risks. — Engagement.	✓	✓	✓	✓
	OneAnswer ANZ Sustainable International Share Fund	✓	— Selects 'best in class' sustainable equities	✓ – (not a standalone document)	✓	No	✓
	Craigs Investment Partners QuayStreet Balanced SRI Fund	✓	— Positive Screening	✓	No	No	No
	Superlife Ethica Fund	✓	— None	No	No	No	No
	Booster Socially Responsible Investment Balanced Fund and Booster Socially Responsible Investment Growth Fund	✓	— Analyse each investment according to ESG criteria	✓	✓	✓	No
Traditional	Amanah	✓	— Ethical mandate	✓ (not a standalone document)	No	No	No
	Aon	None	— ESG Integration — Engagement — Proxy Voting	✓	No	No	No
	ASB (used to have an ethically orientated fund)	✓	— ESG Integration — Engagement — Proxy Voting	✓ (not a standalone document)	No	No	✓ 2018

[4] It was difficult to find the difference between the AMP Responsible Investment Balanced Fund and the other AMP KiwiSaver Funds. This may be because they have similar exclusions and similar approaches to both funds.

KiwiSaver fund	Exclusions in place	Responsible investment strategies in addition to exclusions	Responsible investment Policy	RIAA membership	At least one fund certified by RIAA	PRI Signatory
BNZ	✓	— All external managers are PRI signatories — Incorporate ESG into decision making	✓ (not a standalone document)	No	No	No
Fisher Funds	✓	— None	✓	✓	No	✓ 2017
Generate	✓	— ESG Integration via ESG DD on all investments — Active ownership	✓	No	No	✓ 2018
Juno	✓	— Responsible investment policy states investing in Best in Class	✓	No	No	No
KiwiWealth	✓	— Ensure external managers have an RI policy — Consideration of ESG issues into the investment processes.	✓	✓	✓	No
Lifestages	No	— None	No	No	No	No
Mercer	✓	— Sustainable Themes — ESG rating system to identify those managers that make good use of ESG factors in their investment process. — Shareholder engagement	✓	✓	✓	No

KiwiSaver fund	Exclusions in place	Responsible investment strategies in addition to exclusions	Responsible investment Policy	RIAA membership	At least one fund certified by RIAA	PRI Signatory
Milford	✓	— ESG Integration — Engagement — Proxy Voting	✓	✓	No	✓ 2018
Nikko Asset Management New Zealand[5]	No	Global policy of: — ESG Integration — Engagement — Proxy Voting	✓ (at a global level)	✓	No	✓ 2007 (at a global level)
NZ Funds	✓	— ESG Integration	✓ (not a standalone document)	No	No	No
Simplicity	✓	— None	No	✓	No	No
Summer	✓	— Use The Guardians Fund exclusion list	✓ (not a standalone document)	No	No	No
Westpac	✓	— ESG Integration — Engagement — Proxy Voting	Yes	No	No	No

Source: Online research was undertaken via publically available information 9 April 2019.

Note: Standalone Responsible Investment policies were (generally) signed and dated. Best practice includes regularly reviewing and updating as necessary and where relevant.
Note: Returns and fees data is publically available for the consumer via various tools; FMA, CFFC sorted tool, Mindful Money tool and RIAA tool.

Negative screening is the most common responsible investment strategy amongst all KiwiSaver funds (RIAA, 2018). This mirrors the early international responsible investment movement (Sieva¨nen , Rita, & Scholtens, 2013). Internationally, the early responsible investment movement was predominantly based on negative screens, but current practices tend now to be based on pro-active positive screening and shareholder engagement (Sieva¨nen , Rita, & Scholtens, 2013).

Managed funds in New Zealand appear to have slightly broader exclusions relative to other countries, encompassing human rights abuses, environmental/climate and animal welfare (Lie & Kiernan, 2017). Exclusions that came out of the KiwiSaver scandal of 2016 are now the expected minimum standard of good investment practice in New Zealand (RIAA, 2018).[6] RIAA (2018) note that we are increasingly observing the integration of ESG, or broad responsible investment

[5] Nikko Asset Management New Zealand ("Nikko") have a global responsible investment policy, interestingly, according to the KiwiSaver PDS for all schemes (dated 19 February 2019) Nikko do not take "ESG considerations into account in the investment policies and procedures of the scheme as at the date of this product disclosure statement". KPMG is not aware why Nikko has this misalignment between the global and local expectations. The policy ends with "we do not exclude particular asset types, industry sectors or securities wholly on moral or ethical grounds, unless this is expressly built into the product's investment strategy or client agreement".

[6] Differing terminology between one provider's documentation and definitions and another's means that exclusions are not always easily comparable. For example, across the current KiwiSaver schemes KPMG found the following terms that could be grouped in the "certain types of weapons" category: Controversial weapons; Companies involved in the manufacture of nuclear weapons, cluster

practices, with negative screens, as the market matures to reflect both consumer expectations as well as recognising the investment performance implications of ESG factors.

The force of changing consumer and fund manager expectations appears to be reflected in the lack of consistent material difference between "ethically orientated" funds and "traditional" providers in the preceding and following tables.

Table 7: Exclusions by "traditional" KiwiSaver providers[7]

Exclusions	Providers
Tobacco	21 of 24 providers exclude this within some of their KiwiSaver funds
Certain types of weapons	21 of 24 providers exclude this within some of their KiwiSaver funds
Fossil fuels	8 of 24 providers exclude this within some of their KiwiSaver funds
Gambling (and/or casinos)	8 of 24 providers exclude this within some of their KiwiSaver funds
Alcohol	6 of 24 providers exclude this within some of their KiwiSaver funds
Processing of whale meat	6 of 24 providers exclude this within some of their KiwiSaver funds

munitions and antipersonnel mines (together, "controversial weapons"); Armaments; Nuclear weapons; Manufacture or testing of nuclear weapons; Explosive nuclear weapons; The manufacture or testing of nuclear explosive devices; Anti-personal mines; Civilian firearms; Cluster ammunitions; Military weapons; and "If international conventions oppose or New Zealand laws prohibit investment in an industry, such as manufacturers of cluster bombs, land mines or nuclear weapons."

[7] These figures do not include the Medical Assurance Society KiwiSaver Plan ("MAS") as this is a membership based for medical professionals. The MAS KiwiSaver option was also not included KiwiSaver master list provided by CFFC (dated 28th March 2019). Aon, integrate ESG issues into the investment but do not exclude particular companies or sectors as part of their responsible investment strategy. Nikko have a responsible investment policy at a global level but according to their PDS (dated 19 February 2019) do not take ESG considerations into account for KiwiSaver funds, and Lifestages do not take ESG into account (according to their PDS). From this publically available data, KPMG was unable to determine if these providers adhere to the above exclusions list.

Table 8: Exclusions by "ethically orientated" KiwiSaver funds during same period

"Ethically" orientated fund	Exclusions						
	Tobacco	Certain types of weapons	Fossil Fuels	Gambling	Alcohol	Adult entertainment	Additional
AMP Responsible Investment Balanced Fund	✓	✓	✓	✓	✓	✓	
OneAnswer ANZ Sustainable International Share Fund	✓	✓		✓		✓	Nuclear weapons
Craigs Investment Partners QuayStreet Balanced SRI Fund	✓	✓	✓	✓	✓	✓	Nuclear power, toxic waste and production
Superlife Ethica Fund	✓	✓	✓	✓	✓	✓	
Booster Socially Responsible Investment Balanced Fund and Booster Socially Responsible Investment Growth Fund	✓	✓	✓	✓	✓		Nuclear weapons

7.3 Shortcomings and risks

KPMG reviewed publicly available information, including Product Disclosure Statements for KiwiSaver providers as of April 2019. We observed the following:

— **Ambiguous and inconsistent terminology**. Responsible investment terminology and definitions (spanning selection strategies and investment processes) vary between and even within KiwiSaver fund providers. This can confuse retail investors and make it difficult for them to compare investment strategies. This inconsistency does not appear to be intentional. Rather, it would seem to be a symptom of rapidly evolving conditions outpacing consensus-building processes and regulatory frameworks.

— **Ambiguous policies**. Responsible investment policies and frameworks can ambiguous. For example, one KiwiSaver fund states that, "companies which exhibit highly unethical behaviours or companies that cause substantial harm to society or the environment" may be excluded leaving selection and retention criteria are open to interpretation by the fund manager. Another fund has declared that a divestment will be made "from a relevant fund within six months of becoming an exclusion, or as soon as is practical and cost-effective to do so" without clarifying what practical or cost-effective mean. In a third case, a fund's responsible investment policy states that armaments will be excluded from the investable universe. However, the same policy later states that exclusions may be invested in under "certain circumstances or special cases".

— **Confusing documentation**. The current generation of Product Disclosure Statements can still be too confusing. This is corroborated by research from the FMA which concludes that investors see Product Disclosure Statements as an improvement on previous offer documents. However, even experienced investors can still struggle to fully understand them (Financial Markets Authority, 2018).

— **Redundancy.**[8] Some KiwiSaver funds present regulated exclusions – e.g. investment in cluster munitions – as a voluntary market differentiator when they are not (e.g. investment in the development or production of cluster munitions is illegal under the Cluster Munitions Prohibition Act 2009 under the Oslo Convention on Cluster Munitions 2008, to which New Zealand is a party).

— **Immature processes**. Few KiwiSaver funds provide details about monitoring processes. The risk is that "set and forget" mind-sets can enable exclusions to creep into portfolios over time. Nor, apparently, are active shareholder engagements or outcomes tracked year on year.

[8] "Redundancy" refers to a claim that is truthful but unhelpful. RIAA (2017) provides the example of manufacturers labelling a product as "CFC-free". While this may be true, it is not a differentiator – as suggested by the labelling – since CFCs have been banned for over 20 years.

8 Key barriers and constraints

Well-documented barriers and constraints to the spread of responsible investment strategies amongst managed portfolios, identified by Sullivan, Martindale, Feller and Bordon (2015), PRI (2017), RIAA (2018), the Colmar Brunton research co-commissioned by RIAA and Mindful Money (2018), and CFFC (2019) include:

— **Lack of knowledge and understanding about ESG issues**. When investors and companies are not aware of the benefits of ESG considerations, this limits the uptake of responsible investment. Similarly, uptake is limited by the absence of access to information about the various ways in which to implement ESG strategies.

— **Personal values and perceptions**. The misconception that ESG issues are purely 'ethical', and may compromise financial returns, deters investors seeking to generate healthy returns from investing responsibly.

— **Complacency with the status quo**. Stems from the false belief that ESG considerations are not material financial risks. Poor understanding of the dangers of a financial system that prioritises financial gain at the expense of human, social and natural capital, as well as transparency, stability and long-term prosperity – also contributes to the status quo.

— **Limitations in mainstream financial theories**. Commonly used financial theories focus on generating a profit for shareholders, and do not incorporate non-financial risks and returns. When these theories are embedded at an institutional or individual level, it takes time and effort to integrate ESG considerations into financial analysis.

— **Competing organisational priorities**. This applies especially to risk management and funding requirements that may lead to an excessive focus on short-term performance, and a consequent lack of attention on long-term value drivers.

— **Lack of legislative guidance by the New Zealand Government**. The absence of policy signals and regulations to promote responsible investment has been identified by the PRI as a key issue to address in order to increase the uptake of responsible investment (PRI, 2017).

— **Limited demand from domestic consumers**. Most likely due to lack of knowledge, misperceptions and complacency with the status quo.

— **Lack of data about non-financial outcomes**. ESG issues can be hard to measure and, therefore, manage. The growth of external research companies providing ESG data may reduce this barrier.

These constraints can exert their influence at global (institutional fund) or local (KiwiSaver) levels.

9 Glossary

Glossary	
Consumer	Within the context of this report, a "consumer" is a New Zealander contributing to their retirement and/or first home via a KiwiSaver fund. "Consumers" are not investment professional and rely on publically available information to inform their investment decisions.
Divestment	The selling off of a subsidiary business interest or investment.
EU Classification system / taxonomy	The EU taxonomy will be a "living" list of all economic activities that can genuinely be considered environmentally sustainable; defining and providing a common understanding of what is green.
Ethical investment	Responsible investing, also known as ethical investing or sustainable investing, is a holistic approach to investing, where social, environmental, corporate governance (ESG) and ethical factors are considered alongside financial performance when making an investment.
Exchange Traded Funds	An exchange-traded fund (ETF) is a collection of securities—such as stocks—that tracks an underlying index.
Fiduciary responsibility	The legal obligation of one party to act in the best interest of another. The obligated party is typically a fiduciary, that is, someone entrusted with the care of money or property. Also called fiduciary obligation.
Fund	An investment fund is a supply of capital belonging to numerous investors used to collectively purchase securities.
Green investment	Green investment approaches target specific themes, such as focusing solely on environmental issues (PRI, 2017).
Impact or community investment	Targeted investments aimed at addressing social or environmental issues while also creating positive financial returns for investors. Impact investing includes community investing, which involves projects that have a defined social purpose, as well as environmental investing that typically aims to finance initiatives that address key environmental issues (RIAA, 2018).
Institutional investors	Institutional assets are managed on behalf of institutional asset owners such as pension funds, universities, foundations and insurers through investment products with higher minimum investment levels (GSIA, 2018).
KiwiSaver	As described by the KiwiSaver Act (2006), KiwiSaver schemes facilitate individuals' savings, principally through the workplace for the individual's retirement in New Zealand.
Managed assets	Management of investments on behalf of others.
MSCI	MSCI are a global provider of equity, fixed income, hedge fund stock market indexes, and multi-asset portfolio analysis tools.
Negative or exclusionary screening	Screening that systematically excludes specific industries, sectors, companies, practices, countries or jurisdictions from funds that do not align with the responsible investment goals. This approach is also referred to as values-based or ethical screening. Common criteria used in negative screening include gaming, alcohol, tobacco, weapons, pornography and animal testing (RIAA, 2018).

Glossary	
Norms-based screening	Involves the screening of investments that do not meet minimum standards of business practice. Standards applied are based on international norms such as those defined by the UN. In practice, norms-based screening may involve the exclusion of companies that contravene the UN Convention on Cluster Munitions, as well as positive screening based on ESG criteria developed through international bodies such as the UNGC (United Nations Global Compact), ILO (International Labour Organisation), UNICEF (United Nations Children's Fund) and the UNHRC (United Nations Human Rights Council).
Passive investment	Passive investors limit the amount of buying and selling within their portfolios. The strategy requires a buy-and-hold mentality. That means resisting the temptation to react or anticipate the stock market's next move. The prime example of a passive approach is to buy an Exchange Traded Fund that follows an index.
Physical risk	Potential physical risks of climate change include flooding, drought, seal level rise, heat stress and wind.
Portfolio	Portfolio investments are investments in the form of a group (portfolio) of assets, including transactions in equity, securities, such as common stock, and debt securities, such as banknotes, bonds, and debentures. A portfolio investment is a hands-off or passive investment of securities in a portfolio, and it is made with the expectation of earning a return.
Positive/best-in-class screening	Involves screening investment in sectors, companies or projects selected for positive ESG or sustainability performance relative to industry peers. It may also be referred to as best-in-class screening. It involves identifying companies with superior ESG performance from a variety of industries and markets (RIAA, 2018).
Proxy voting	A proxy vote is a ballot cast by one person or firm on behalf of a shareholder of a corporation who may not be able or have the desire to attend a shareholder meeting, or who otherwise desires not to vote on an issue.
Redundancy	Redundancy refers to a claim that is truthful but unhelpful. RIAA (2017) provides the example of manufacturers labelling a product as "CFC-free." While this may be true, it is not a differentiator – as suggested by the labelling – since CFCs have been banned for over 20 years.
Responsible investment	Responsible investment is an approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, to better manage risk and generate sustainable, long-term returns (PRI, 2017).
Retail investors	Retail assets are personal investments by individuals in professionally managed funds purchased in banks or through investment platforms with relatively low minimum investment levels.
Shareholder engagement or shareholder activism	Refers to the employment of shareholder power to influence corporate behaviour. This may be conducted through direct corporate engagement such as communications with senior management or boards, filing or co-filing shareholder proposals and proxy voting in alignment with comprehensive ESG guidelines (RIAA, 2018).
Themed investment	Relates to investment in themes or assets that specifically relate to sustainability themes. This commonly involves funds that invest in clean energy, green technology, sustainable agriculture and forestry, green property or water technology. This category also includes multi-strategy portfolios that may contain a variety of asset classes or a combination of these themes (RIAA, 2018).
Transition risk	Potential transition risks of climate change include changing policy, liability and technology.

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