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Review of the KiwiSaver Default Provider Arrangements
Mindful Money Submission

We welcome the opportunity to make this submission and would be pleased to make the submission publicly available. We would also be pleased to discuss the issues or provide further information.

Introduction

Mindful Money has been established as a registered charity (a programme of Sustainable Initiatives Aotearoa, CC#51919) in order to engage and educate the New Zealand public about impacts of their investment decisions on social wellbeing and the environment.

Mindful Money undertook research and consultation with the industry and experts for 18 months and commissioned (jointly with the Responsible Investment Association of Australasia) a public survey on responsible investment, undertaken by Colmar Brunton. The survey also identified key barriers to responsible investing including a lack of objective information, a lack of time to do the research and compare the options, and a lack of confidence in the available funds. On 25 June 2019, Mindful Money launched its online platform to overcome these barriers (www.mindfulmoney.nz).

The website allows members of the public to easily see the percentage of their funds and the companies in each of ten 'issues of concern' identified in the survey. The issues of concern are those that two thirds or more of the public want to avoid, drawn from the survey results. Mindful Money's fund finder allows users to see which funds most closely match their criteria. Methodology papers are available on Mindful Money's website.

Mindful Money is engaged in a campaign with a range of fund providers, financial services companies and civil society allies to build awareness and understanding amongst the public about responsible investment (or 'ethical investment' as more commonly understood by the public). We are finding a receptive audience, keen to find out where their KiwiSaver funds are invested and how they can find a more ethical KiwiSaver.

The approach of ethical investment aligns with the wellbeing economy, action on climate change, the Sustainable Development Goals and international actions towards sustainable finance (Mindful Money is active in the Sustainable Finance Forum, a programme of the Aotearoa Circle). Mindful Money's conference on 3rd September featured a keynote address by the Minister of Finance and two panels that addressed policy and consumer engagement issues.

In the following sections, Mindful Money outlines the key issues with regard to responsible investing, which is the main focus of the submission, and then responds to the relevant consultation questions.

Investing Responsibly

Default providers have a duty to act responsibly

Most investors in default funds do not choose the fund – they are allocated to it. Therefore, the government has a responsibility, over and above regulations that apply to other KiwiSaver funds, to ensure that default funds meet public expectations and reflect values held by the majority of the public.

This approach is common to the expectations of Crown Financial Institutions (CFIs), which have a duty of "avoiding prejudice to New Zealand's reputation as a responsible member of the world community." The CFIs, notably the NZ Super Fund, have determined that a responsible investment framework is required in order to implement this duty.

The duty of acting responsibly, which is required of CFIs, should also be required of default KiwiSaver funds. The expectation should be set that responsible investing policies and practices will be required of default funds in order to meet this duty.

A large majority of the public expects KiwiSaver funds to be managed responsibly

Responsible investing has become an expectation of New Zealand investors. As cited in the discussion paper for this consultation, the 2018 survey of the New Zealand public, developed by Mindful Money and the Responsible investment Association of Australasia (RIAA) and undertaken by Colmar Brunton, showed that 72% of consumers want their fund provider to be responsible. This high level of public support has been echoed in other unpublished surveys undertake by the Commission for Financial Capability (CFFC), ANZ and Kiwi Wealth.

The survey found that these views are not by any means confined to a particular group in society. It is not only young New Zealanders who have this expectation. The survey showed that there is stronger support for responsible investing from those over 60 years old.

This expectation has been demonstrated by the public outcry in 2016 over tobacco and cluster bombs in KiwiSaver portfolios and subsequently over firearms in portfolios, in the wake of the Christchurch shootings. As a result, most funds have moved to exclude these sectors from their portfolios, and this has set a new expectation for investment managers in New Zealand.

A baseline of exclusions should be required of default providers

The duty of responsibility, as outline above, has been interpreted by the New Zealand Super Fund (NZSF) as requiring exclusions that reflect strongly held beliefs by a large majority of New Zealanders (such as avoiding investments in tobacco). They also include respect for international norms on issues such as human rights, labour rights, anti-corruption, environmental protection and action on climate change that are reflected in international treaties signed by the government.

This baseline of exclusions should be required for all default providers, and updated regularly by regulators, with advice provided by a group that includes representatives of Crown Financial Institutions (CFIs), fund providers and those with expertise in responsible investment.

Mindful Money's position is that a wider set of exclusions is required of all fund managers, in particular with regard to fossil fuels. Our analysis is that the activities of the fossil fuels sector are inconsistent with keeping global temperature rise below 1.5˚C and there are growing risk of stranded assets and corporate failures. We would recommend that the baseline of exclusions should encompass all of the sector, rather than the specific companies excluded in the NZSF climate strategy at present. This reflects sound investment practice as well as upholding New Zealand's reputation for action on climate change.

ESG analysis and implementation should be required for default providers

Responsible investing has broad support in the investment management sector as shown internationally by the high level of membership in the Principles of Responsible Investment (members' assets under management now total around US$90 trillion) and in New Zealand (72% of total AUM are under some form of responsible investment management, according to New Zealand RIAA Benchmark Report 2019).

There is growing recognition that consideration of social and environmental issues is an integral part of fiduciary responsibility. As social and environmental issues become material to a broader range of companies, their incorporation into decision-making processes becomes essential for delivering on long term performance. The risks associated with climate change have brought this into sharper focus, including through the work of the Taskforce on Climate-Related Financial Disclosures.

Responsible investing is also consistent with a wellbeing economy and the growing movement internationally for governments to support responsible investment as a key part of their sustainable finance initiatives, such as in the EU Sustainable Finance Action Plan, Canada's Expert Panel on Sustainable Finance, China's Guidelines for Establishing a Green Finance System and the UK's Green Finance Strategy. Mindful Money is an active participant in the Aotearoa Circle's Sustainable Finance Forum.

In the finance sector, these issues are addressed through analysis of Environmental, Social and Governance (ESG issues). All default funds should have the responsibility to undertake ESG analysis and demonstrate how these issues are implemented through portfolio selection and management.

Default providers should be required to have systems to support responsible investment practices

Default providers need to commit to the policies and systems that are required to implement responsible investment policies. These include:

- Comprehensive and up-to-date policies for responsible investment, including research and analysis on the impact of portfolio decisions on society and the environment
- Disclosure of relevant and comparable information on providers' website and in their PDS and SIPO
- Internal verification systems on alignment of practices with responsible investing policies, undertaken at least annually and reported to the regulator
- Systems for consulting with investors to be able to offer services to meet their values and needs
- Exclusion from sectors and companies that reflect the views of the providers' investors, with verification provided by mechanisms such as the Mindful Money Fund Checker tool
- Demonstration of capacity and capability for sound responsible investment management through staffing, expertise, research systems and management approaches
- A commitment to play an active role in corporate governance, including through collaborative arrangements or in the mandates of fund managers

Default providers should be required to show that their systems are robust and credible

As a baseline for qualification as a default fund, providers should be able to demonstrate that they have a duty to act responsibly, abide by minimum levels of exclusions (such as those adopted by the New Zealand Super Fund) and integrate ESG into investment management.

However, default fund applicants will have differing levels of commitment, experience and track record in doing so. The choice of default funds should have the credibility and extent of responsible investing as one of the key criteria for default fund selection.

Currently there are few clear standards for responsible investing and few forms of verification. The Responsible Investment Association of Australasia has an authoritative and credible certification system. It can be one of the factors that is used to demonstrate credibility.

Mindful Money includes the RIAA certification as a criterion for inclusion on its platform, but also uses direct analysis of portfolios to provide verification. This is an objective way of looking beyond policies and processes to analyse which companies are in fund portfolios. Inclusion on Mindful Money's platform is another source of credibility, as is analysis of the data which is freely available on the website.

Other forms of credibility that should be provided as part of the default fund selection process include membership of the Principles for Responsible Investment and other responsible investment forums, and the provider's track record in implementing responsible investment practices in the past.

Responsible investing should be one of the criteria for selecting default funds

Beyond the minimum requirements, the Responsible Investment credentials of default providers should be one of the key factors that is included in the selection of default funds. This includes the factors listed above. Priority should be given to the providers that are able to demonstrate higher standards in terms of meeting the needs of investors for responsible investing, the strength of their systems and the credibility of their claims.

In addition, the selection criteria should include the commitment of providers to improve the social and environmental impact of their funds over time. International statistics show there has been huge growth in the availability of listed companies, green bonds and alternative assets with positive benefits. The default funds that make commitment to progressive increase their holdings in such companies, within financial and liquidity constraints, should be prioritised.

Additional regulation is required

As a related issue, regulatory action is needed to improve the coverage, robustness and comparability of information on responsible investment. Currently there is well-defined information required on a wide range of issues in the PDS and SIPO, including requirements that relate to the calculation of fees, past returns, asset allocations etc, but no standards for reporting on responsible investment.

Regulators need to establish clear requirements for common standards for reporting. The FMA has set an expectation for inclusion of ESG-related risks and reporting on policies and practices for responsible investing, but without the metrics that would require consistent reporting and comparability across funds.

Responses to Specific Questions

Section 2: Criteria for the Review

Question 2: Criteria

The current criteria are focused on the benefits for individuals. However, investment decisions also impact on others and on the environment. Therefore, the list of criteria should include the contribution of default funds to achieving wellbeing more broadly.

This should include the wellbeing of New Zealand society, others internationally impacted by investors' decisions, and the environment. The measures in the Living Standards Framework provide a useful guide to the dimensions of wellbeing impact.

Question 2: A new criterion should be added: Contribute to societal wellbeing

Section 4: Fees

Question 12: Value for fees

It is important to ensure that there is a level playing field for providers that use different strategies. There are different cost structures for funds with different strategies and levels of service. If a provider is able to provide higher net financial returns through better research and management, requiring higher costs and higher fees, they should not be disadvantaged compared to a manager that uses passive funds (such as low-cost ETFs). The aim should be to provide best value to investors, not the lowest cost.

There should also be a fair basis for comparison. For example, the KiwiSaver default funds that extensively use passive funds outsource portfolio management to others. While their fees may appear to be far lower than directly managed funds, the other costs of funds management are hidden. For a fair comparison, their fees should include not only their own management costs but also the management fees of the funds in their portfolios.

Question 12: When setting fees, the government should look at the value being provided to investors, and the full costs, both provided directly and outsourced through passive funds.

Questions 14 & 15: Fixed vs percentage fees

High fixed costs for KiwiSaver default providers fall more heavily on youth, those with low incomes and those with low levels of savings. This is a form of regressive charging, with a greater proportion of the cost falling on those with small balances, who are generally least able to afford the charges.

Question 14/15: The government should encourage providers to reduce the proportion of their fees derived from fixed fees towards a higher proportion of percentage fees. This may be coupled with Option 5 or 6 if providers do not respond.

Question 15: Fee options

The emphasis should be on ensuring high value to investors in relation to the fees they pay, not just low fees. As shown in Section 6 of this submission, there is strong public demand for responsible investing. It also contributes to wellbeing. From the perspective of an investor concerned about the impact of their funds on people and the environment, a low cost approach that ignores the consequences of investment is not good value.

For example, higher costs are required to meet consumer expectations for responsible investment management. This may vary from a small increase in the cost of a responsible ETF to a larger cost for active management including:

- research and analysis for portfolio selection
- monitoring of companies in the portfolio on compliance with ethical standards
- research and engagement with companies as part of corporate governance responsibilities
- research and rating agency services
- costs of certification etc.

Fund managers who make the investment in capability to manage funds responsibly should not be disadvantaged compared to those who do not.

It should be noted, as submitted under Section 6, that higher costs of managing responsible investment funds do not necessarily equate to lower net returns. The weight of evidence from comparisons of responsible investment funds compared to conventional funds show that, on average, responsible funds earn higher net returns. The focus should be on a customer-centric approach of providing value and meeting customer needs, not just low fees.

Question 15: The government should use a variation of Option 2 that requires providers to justify their level of fees according to the services provided to customers, including responsible investing. Value to investors should be the main criterion, rather than low fees.

Section 6: Responsible Investment

Question 19 & 20: Costs and returns for responsible investing

There has been considerable research on the question of net returns from responsible investing. Most of the following studies look at net return after fees, which is a better measurement of performance than focusing on comparing fees.

Corporate sustainability: Analysis of companies shows returns that are higher than average for companies with high sustainability performance.

- A time series of companies over 20 years, in a comprehensive analysis by Harvard Business School Associate Professor, George Sarafeim, shows the benefits of companies reducing their costs by cutting waste and pollution, and increasing their income through innovating around sustainability. Companies with good sustainability practices had average returns 4.8% per year higher than those with poor sustainability.
- Nordea Markets uses MSCI's sustainability ratings of companies to analyse their financial performance. Their analysis shows the top ESG performers have had higher financial returns of 5% per annum on average since 2012, compared to the bottom ESG performers. High ESG standards are also associated with lower volatility and risk.

Responsible investment portfolios: Reviews of research studies also show above market financial impacts from responsible investment portfolios. This suggests that markets are not fully reflecting the higher sustainability returns in market prices.

- Deutsche Bank (2012) looked at more than 100 academic studies of sustainable investing around the world, 56 published research studies, 2 literature reviews and 4 meta-analyses, in what the authors claimed to be the most comprehensive review of the literature undertaken. The research found that responsible investment was shown to have a positive impact in 77% of studies, 22% showed no impact, while only 1% had a negative impact. All of the academic studies showed that high scores for CSR and ESG management are associated with a lower cost of capital.
- A meta-analysis of 200 studies published in 2014 by the Smith School at Oxford University shows a large majority of companies with good sustainability practices had lower cost of capital, better operational performance and higher share price increases compared to the market average.
- Analysis by Bank of America Merrill Lynch in 2016 shows higher returns from responsible investment portfolios (those with high ESG ratings) and lower risk. The analysis created 4 categories for ESG scores and found significantly higher average returns for those investments in the top two quartiles. The impact on risk was even stronger, showing far lower downside risk and bankruptcies from companies rated highly for responsible management.

Market Indices: High returns from ESG portfolios is shown by the track records of stock market indices made up of companies screened by environmental, social and governance (ESG) criteria.

- The longest-established index, the MSCI KLD 400 Social Index (previously known as the Domini 400 Social Index) saw an annualized rate of return of 7.64% over the last 10 years through May 2017, compared to 4.87% for the Standard & Poor's 500 Index over the same period.
- In 2015 Morgan Stanley research looked at the same MSCI KJD 400 index over a longer timeframe and showed that annual returns beat the S&P 500 by 45 basis points till 2014 since its inception in 1990. The latest data for the MSCI KLD 400 index is shown below.

Responsible investments in Australasia. Comparisons by the Responsible Investment Association of Australasia between responsible funds and mainstream funds show higher returns for responsible investment across most time periods for both the New Zealand and Australian markets.

- RIAA's annual benchmark surveys show that responsible investing has consistently outperformed the market. The comparison of average returns for responsible investment funds (mainly negatively screened funds) with the average of all funds and for the Australian market shows higher returns over five years (6.43% vs. 5.60%) and 10 years (12.39% vs. 8.91%).
- The New Zealand Super Fund uses a combination of negative screening and ESG analysis. They have undertaken a review of the research and concluded that companies that do well on ESG metrics, do well financially. They recognise that more than 80% of relevant studies show positive links between ESG ratings and measures such as lower cost of capital, higher profitability and higher share price.

Negative Screening: The evidence of higher returns is more mixed when negative screening is the main tool for investing responsibly.

- The NZ Super Fund review notes that the positive results from ESG investing are not reflected for negative screening. In particular, there can be lower benefits from diversification for portfolios that are screened to exclude a large number of economically significant sectors.
- The Deutsche Bank study referred to above found strongly positive results for ESG management but more mixed results where negative screening was the dominant strategy.

- However, there is contrary evidence that negative screening can result in better returns in cases where systemic risk is being avoided. For example, the sharp decline in coal prices and bankruptcy of major coal producers in recent years has shown the financial benefits from divestment of coal. A broader analysis of fossil fuel divestment, undertaken by the academics from the University of Waterloo in Canada, looked at different scenarios of divestment from coal, oil and gas and utilities. They found positive returns from each variant of divestment in the 2011-15 timeframe.

Impact investing: There is little data available for the field of impact investment, where companies are aiming to provide positive social and environmental benefits. These strategies are not a significant approach for any KiwiSaver funds at present.

- The expectation is that returns will be lower, and some funds are explicit about their trade-offs in accepting a lower rate of return in order to achieve high social benefits. However, an interesting study from Cambridge Associates shows comparable returns from the more mature impact investments. This suggests that the sacrifice of financial return for doing good may be less than expected.

Question 19 and 20: The weight of evidence now shows that, on average, responsible investing provides returns that are as high or higher than conventional investing, with risks that are generally lower for the comparable asset mix.

Question 21: Should responsible investing be required for default providers?

As argued above, responsible investing should be a requirement of default providers. This reflects:

- the need for regulators to require standards that reflect public expectations and values, as shown by the duty of responsibility that applies to Crown Financial Institutions
- the extent of public support - as cited in the consultation paper for this review, the 2018 survey developed by Mindful Money and RIAA, undertaken by Colmar Brunton shows 72% of New Zealanders expect their provider will consider ethical and responsible issues in their investments.
- The widespread practice of at least some ESG and exclusion practices by CFIs and the majority of current KiwiSaver providers
- The need for ESG analysis and management in order to manage growing risks of climate change and other sustainability factors, and to fulfil fiduciary responsibilities
- The need for coherence in government policy, requiring a wellbeing and sustainability approach to be applied to the financial sector

Responsible investing should therefore be a requirement for all default providers.

In addition, the strength and credibility of responsible investment practices should be an important factor in the selection of default providers. There are currently no clear standards, definitions and reporting requirements for responsible investing and there are a wide range of practices.

The selection process for default fund providers should therefore include the strength and credibility of the responsible investing policy, systems and practices as a key criterion. A listing of the key elements of the systems requirements are as follows:

- Comprehensive and up-to-date policies for responsible investment, including research and analysis on the impact of portfolio decisions on society and the environment
- Disclosure of relevant and comparable information on providers' website and in their PDS and SIPO
- Internal verification systems on alignment of practices with responsible investing policies,

undertaken at least annually and reported to the regulator
- Systems for consulting with investors to be able to offer services to meet their values and needs
- Exclusion from sectors and companies that reflect the views of the providers' investors, with verification provided by mechanisms such as the Mindful Money Fund Checker tool
- Demonstration of capacity and capability for sound responsible investment management through staffing, expertise, research systems and management approaches
- A commitment to play an active role in corporate governance, including through collaborative arrangements or in the mandates of fund managers

In response to unsubstantiated claims for responsibility, systems of certification and assurance have been developed to provide information to the public on ethical investment credibility. The selection process should therefore refer to existing assurance processes. Verification can be provided by factors such as RIAA certification and inclusion on Mindful Money's platform.

Question 21 (a): Default providers should be required to have sound responsible investing policy and practices. The strength and credibility of the policy, systems and practices should be a key criterion in the process to select default providers. The selection process should also assess the credibility of the responsible investment policy, using criteria such as certification by RIAA and inclusion on the Mindful Money platform.

Beyond the minimum requirements, the Responsible Investment credentials of default providers should be one of the key factors that is included in the selection of default funds. This includes the factors listed above. Priority should be given to the providers that are able to demonstrate higher standards in terms of meeting the needs of investors for responsible investing, the strength of their systems and the credibility of their claims.

In addition, the selection criteria should include the commitment of providers to improve the social and environmental impact of their funds over time. International statistics show there has been huge growth in the availability of listed companies, green bonds and alternative assets with positive benefits. The default funds that make commitment to progressive increase their holdings in such companies, within financial and liquidity constraints, should be prioritised.

Questions 21 (b) Beyond minimum criteria, the selection process for default providers should include a positive weighting for providers that are able to demonstrate higher standards in terms of meeting the needs of investors for responsible investing, the strength of their systems, the credibility of their claims and their commitment to raise the positive impact over time through the inclusion of impact investing.

Question 22: Do default members want responsible investing? What if there is a trade-off?

The 2018 public survey by Mindful Money and RIAA, undertaken by Colmar Brunton, showed that 72% of investors expect their KiwiSaver funds to be managed responsibly. This is consistent with other New Zealand surveys and with international data.

The survey also provides reasons why more consumers are not currently invested in more ethical funds. The problem is not a willingness to do so, but a lack of objective information, a lack of time to undertake research and compare the options and a lack of confidence in the available funds. Mindful Money aims to overcome these barriers but, with less than three months since the launch of our platform, we have a long way to go before we can reach even a small percentage of the public who want this information.

With regard to potential trade-offs, more than half (57%) of investors rate financial returns as the priority issue. However, as shown above, there is strong evidence that there is no such trade-off with responsible investment management. Financial returns are, on average, at least as high and risks generally lower.

Question 22: Surveys show that most New Zealand investors want their funds to be managed responsibly. The survey results include members of default funds. There is a weight of evidence to show that returns to responsible investing is, on average, at least as high as conventional investing, so there is no need for investors to trade-off ethics for returns.

Question 23: Information on responsible investing

Currently consumers are confused by the range of terms used for responsible investments, the claims made, and the different measures cited. From Mindful Money's experience and our 2018 survey it is clear that this is a barrier for consumers. This is one of the reasons that Mindful Money was developed.

Consumers can get information on companies in their portfolio through the Disclose register filings, and Sorted's Smart Investor has made this information more accessible. However, it is impossible to be able to tell from the name of a company which sector it operates in and whether it breaches acceptable standards on human rights, animal welfare, environmental responsibility etc. Mindful Money's website does this analysis. It makes the task of comparing funds across different dimensions of responsibility far easier.

However, there are other categories of information that are not provided from Mindful Money's website, and which should be part of the regular KiwiSaver reports. For example, disclosure of information according to specified guidelines is required in the following areas:

- Exclusions lists and a clear definition of how exclusions are defined
- ESG analysis and management, including how the results of ESG analysis are taken into account in portfolio selection, monitoring and management
- The activities and (where available) outcomes of engagement with companies, including priority issues for engagement
- The names of the companies delivering positive social and environmental benefits, and a description of their activities and their benefits (through case studies) and, where available, aggregate measures across the portfolio
- Specific sustainability indicators for portfolios where available (such as carbon footprints and use of carbon risk strategies, Board and staff diversity, and average pay rates for CEOs compared to median employee pay)

It is important that there is regulatory guidance on the increased levels of disclosure to avoid greenwashing and ensure comparability of data between providers. Regulations are needed to improve the coverage, robustness and comparability of information on responsible investment.

By comparison, there are regulations on a wide range of financial issues in the PDS, SIPO and quarterly reports, including requirements that relate to the calculation of fees, past returns, asset allocations etc. However, there are no corresponding definitions and standards for reporting on responsible investment.

Question 23: Regulators need to establish clear requirements for common reporting standards. The FMA has set an expectation for inclusion of ESG-related risks and reporting on policies and practices for responsible investing, and now needs to specify the definitions and standards that would result in robust and consistent reporting. allowing comparability across funds.

Question 24 & 25: Should there be requirements for default funds to have exclusions and what exclusions?

Requirement for exclusions: Most investors in default funds do not choose the fund – they are allocated to it. Therefore, the government has a responsibility, over and above regulations that apply to other KiwiSaver funds, to ensure that default funds meet public expectations and reflect values held by the majority of the public.

This approach is common to the expectations of Crown Financial Institutions (CFIs), which have a duty of "avoiding prejudice to New Zealand's reputation as a responsible member of the world community." The CFIs, notably the NZ Super Fund, have determined that a responsible investment framework is required in order to implement this duty.

The duty of acting responsibly, which is required of CFIs, should also be required of default KiwiSaver funds. The expectation should be set that responsible investing policies and practices will be required of default funds in order to meet this duty.

Having no requirement for exclusions would fail to meet the government's responsibilities to meet consumers' expectations, fail to uphold the expectation that ESG factors are a part of fiduciary duties and good investment management, and fail to support the government's commitment to a wellbeing framework.

Exclusions and ESG management should be a requirement of all default providers.

Types of exclusions: It is clear from the results of Mindful Money and RIAA survey in 2018 that public expectations of exclusions extend beyond the level currently specified by default providers. However, in setting a required minimum standard for default providers, it is necessary to establish a benchmark that applies to the average investor and ensure that it can evolve over time.

This duty of responsibility has been interpreted by the New Zealand Super Fund (NZSF) as requiring exclusions that reflect strongly held beliefs by a large majority of New Zealanders (such as avoiding investments in tobacco) and include respect for international norms on issues such as human rights, labour rights, anti-corruption, environmental protection and action on climate change that are inherent in international treaties signed by the government.

Mindful Money recommends that this framework includes the full exclusion of fossil fuel producing companies for consistency with government policy of zero net emissions by 2050, and in the light of high financial risks from liabilities and stranded assets.

This baseline of exclusions extends beyond current practice of default providers. It should be required for all default providers, and updated regularly by regulators, with advice provided by a group that includes representatives of Crown Financial Institutions (CFIs), fund providers and those with expertise in responsible investment.

Question 24: The current exclusions for most default providers do not meet the expectations of consumers. There should be a requirement for exclusions and ESG management for all default providers.

Question 25: In Option 1, the government should adopt an exclusion scheme that is based on a duty of responsibility similar to the CFIs, and exclusions that express that duty. This will include "ethical exclusions" such as tobacco and norms-based exclusions such as cluster munitions, human rights violations, high emissions sectors (such as fossil fuels) and serious corruption.

Question 26: Standard Disclosures for Responsible Investment

This option for disclosure should not be a choice with Option 1. Both options are needed. A standard method of disclosing responsible investment criteria and exclusions is important in providing information to investors, and in facilitating comparisons between providers. Standards disclosures should initially be applied to default funds, but in future should become a requirement for all KiwiSaver funds to avoid confusion and allow easier comparison between funds.

It is important to recognise that responsible investment is about more than exclusions. Other strategies include ESG analysis and management, engagement to raise standards and investing in companies that provide social and/or environmental benefits. Disclosure is needed for all aspects of responsible investment policy, not just exclusions.

Question 26: In Option 2, standard disclosures should take the form of clear statements of responsible investment policies and practices. This should include information on each of the approaches used, including the information listed in the response to Q.23 above.

Question 27: Costs and Benefits of Options

Mindful Money considers that Options 1 and 2 are complementary and should both be required.

Criterion 1: The most relevant measure is not the level of fees, but net returns. As the data shows (under Q.19 & 20 above) net returns for responsible investing are as high or higher than conventional investing.

Criterion 2: As a note with regard to trust and confidence in KiwiSaver, the objections to responsible investment requirements in para 155 are largely allayed if the default funds are required to use exclusions that are the same as, or similar to those used by Crown Financial Institutions.

Criterion 3: While administration and compliance costs would increase under options 1 and 2, these are necessary costs for sound management of funds, risk management and social responsibility.

Criterion 4: There is rapid growth in responsible investing worldwide. Asset managers are looking for assets and funds that can demonstrate high standards of ESG attributes and create positive social and environmental impacts. This is consistent with New Zealand's international reputation for high social and environmental attributes. The raising of standards for responsible investment in the New Zealand market therefore has the potential to encourage additional inflows of capital.

Criterion 5: The combination of Options 1 and 2 would also provide more of a level playing field for competition. Currently there are unsubstantiated and misleading claims being made about responsible investing by default providers and others in the market. Improvements in the extent and robustness of reporting will support fair competition.

It should be pointed out under para 160 that distortion of capital flows is already an issue. The exclusion of tobacco means that capital flows are reduced to produce tobacco with adverse public health outcomes. These 'distortions' should be regarded as the correct incorporation of externalities which otherwise are excluded from market prices. The adjustment of market signals to reflect externalities is sound economic practice and is a legitimate aim of public policy. On that basis the adoption of responsible investment practices reduces distortions, rather than increasing them.

The combination of options 1 and 2 meets the expectations of default members for responsible investment management, while providing for:

- A baseline of exclusions that is consistent with CFIs
- Incentives for stronger and more credible responsible investment policies though the selection process
- Requirements for improved information for default members, which could then be extended to all KiwiSaver funds

Question 27: Mindful Money considers that Options 1 and 2 are complementary and should both be required.

Section 7: Capital Market Development

Mindful Money supports the aim to use default KiwiSaver funds to support and develop New Zealand's capital markets. We would like to make the following points:

- ***We consider that the major gap is growth capital for productive enterprises, particularly SMEs (Q.29)***
- ***We agree with the approach to remove impediments to investment in alternative assets (Q.30)***
- ***We agree with Option 1 as a means to strengthen New Zealand capabilities for active investment management***
- ***We agree with Option 2 as a means to provide capital to alternative assets***
- ***We would like to propose that the selection of default providers includes investment in alternative assets as a criterion (along with responsible investing), and that preference be given to those giving priority to positive social and environmental benefits from those investments.***