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Financial Markets Policy
Building, Resources and Markets
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Submission to the consultation paper on the New Financial Advice Regime - the draft Financial Services Legislation Amendment Bill and proposed transitional arrangements

The Responsible Investment Association Australasia (RIAA) welcomes the opportunity to make this submission in response to the Consultation Paper on the New Financial Services Regime.

RIAA is the peak industry body representing responsible and ethical investors across Australia and New Zealand. RIAA has 170 members who manage well in excess of $1 trillion AUM globally. Our membership comprises superannuation funds, KiwiSaver providers, asset consultants, fund managers, financial advisers, adviser dealer groups, researchers and analysts, and others involved in the industry, across the full value chain of institutional to retail investors.

RIAA works to see more capital being invested more responsibly, working to shift capital into sustainable assets and enterprises, and shape responsible financial markets, to underpin strong investment returns and a healthier economy, society and environment.

In order to achieve strong risk adjusted returns for beneficiaries, it is increasingly seen as critical that investors are considering environmental, social and corporate governance (ESG) factors as a part of a comprehensive investment decision-making process. A strong base of evidence has now clearly articulated the financial materiality of these ESG factors. For references to this strong evidence base, please refer to the box below.

Evidence for the financial materiality of ESG factors is well established.
Some key references include:

- RIAA (2016), Responsible Investment Benchmark Report Australia and New Zealand http://responsibleinvestment.org/resources/benchmark-report/aus-2016/
- Deutsche Asset and Wealth Management (2015), *ESG and Corporate Financial Performance: mapping the globallandscape;* *https://institutional.deutscheam.com/content/_media/K15090_Academic_Insights_UK_EMEA_RZ_Online_151201_Final_(2).pdf*
- Oxford University and Arabesque Partners (2015), *From the Stockholder to the*

Stakeholder; http://www.arabesque.com/index.php?tt_down=51e2de00a30f88872897824d3e211b11
- Kotsantonis, Sakis, Christopher Pinney, and George Serafeim (Harvard Business School) *ESG Integration in Investment Management: Myths and Realities, Journal of Applied Corporate Finance* 28, no. 2 (Spring 2016): 10–16. http://www.hbs.edu/faculty/Pages/item.aspx?num=51511
- Verheyden, T., Eccles, R. G., & Feiner, A. (2016), ESG for All? The Impact of ESG Screening on Return, Risk, and Diversification, Journal of Applied Corporate Finance, 28(2), 47-55, 2016 http://onlinelibrary.wiley.com/doi/10.1111/jacf.12174/abstract
- Nagy, Z., Kassam, A. & Lee, Linda-Eling. (2016) Can ESG Add Alpha? An Analysis of ESG Tilt and Momentum Strategies, Journal of Investing, Vol. 25, No. 2, pp. 113-124. http://www.iijournals.com/doi/abs/10.3905/joi.2016.25.2.113?journalCode=joi ; https://www.msci.com/documents/10199/4a05d4d3-b424-40e5-ab01-adf68e99a169
- Statman, M., & Glushkov, D. (2016). Classifying and Measuring the Performance of Socially Responsible Mutual Funds. Journal of Portfolio Management, 42(2), 140-151. http://www.cfapubs.org/doi/full/10.2469/dig.v46.n6.17

This growing acceptance that ESG factors are impacting upon financial returns have resulting in a strong portion of the investment industry in New Zealand considering these ESG factors systematically as part of their investment decision making. Indeed, our annual Responsible Investment Benchmark Report 2016 highlighted that as at the end of 2015, $78.65b was invested by New Zealanders using a responsible investment methodology (a link to the 2016 benchmark report fact sheet is available here - http://responsibleinvestment.org/wp-content/uploads/2016/07/RIA413_Benchmark_Factsheet_A4_NZ_v3.pdf).

Furthermore, RIAA Consumer Polling undertaken in late 2016 highlighted the importance of responsible investment amongst KiwiSaver investors with a clear majority of respondents believing that it was at least of some importance that KiwiSaver funds consider Environmental, Social, Governance, and/or ethical factors when investing with 95% responding that this should be given at least some importance (link here for further details - http://responsibleinvestment.org/wp-content/uploads/2016/11/20161107_Mobium_RIAA_KiwiSaver_FINAL.pdf). Ongoing news and concern about KiwiSaver holdings in particular has significantly raised the importance of responsible investing and it is becoming increasingly clear that many New Zealanders want assurances that their retirement savings and investments aren't being invested in possibly illegal or unethical activities.

RIAA firmly believes that the basis of evidence is now established that:

1. To deliver on your obligations to beneficiaries in delivering strong risk adjusted returns, an investor must be considering ESG factors

2. That the vast majority of consumers in NZ expect that their investments are being invested in a responsible manner, that as a minimum does no harm, taking into consideration ethical or values based considerations.

From this point of view, RIAA believes that in order to reflect the best interests of clients, a financial adviser must be considering ESG and/or ethical factors when providing advice to clients in order to ensure consumers are ***getting access to the type of advice they need*** (financial plus ethical considerations) as well as ***improving the quality of advice*** (with recognition that investment advice will necessarily be limited without regard for ESG factors according to the evidence presented above).

In terms of this submission, RIAA would like to comment specifically on the Code of Professional Conduct, and the role it can play in explicitly requiring Financial Advisers to take into account the vales and objectives of their clients when investing.

Our comments are related to questions 28 and 29: Noting the additional purpose of the new Act to "ensure consumers can access the financial advice that they need, and improve the quality of financial advice", RIAA believes it should be explicitly included in the new Code that financial advisers must consider their clients ESG and ethical preferences as part of knowing your client and investing in the best interests of that client.

Notwithstanding the importance of Code 1 (client's interests first), currently Codes 7, 8 and 9 imply the need for financial advisers to take into account a client's investment values (please note further explanation below). However, it is currently open to interpretation as to whether a Financial Adviser should go the next step and ask about for example, a client's ethical requirements. **It is RIAA's view that under the new legislation, the new Code should explicitly clarify this issue that financial advisers must explicitly ask questions regarding a client's ethical values, and any other ESG preferences**. For example, that a Financial Adviser must take in to account a client's values and preferences when providing a personalised financial adviser service (or equivalent under the new regime).

<u>Comments on current Code and implications for Responsible Investing</u>

1. Code 7 requires an Authorised Financial Adviser to ensure each client has sufficient information to enable the client to make an informed decision about whether to use the AFA's financial adviser services and/or to follow any financial advice provided by the AFA. For AFAs offering investment advisory services (as part of their financial adviser service), and under this code Advisers should be required to inform clients as to whether the underlying investments and managers take into account ethical and/or ESG issues in their investment process and to what degree.

2. Code 8 requires AFAs - when providing a personalised service to a retail client - to take reasonable steps to ensure that the personalised service is suitable for the client. The AFA must make reasonable enquiries to ensure that the AFA has a reasonable and up to date understanding of the client's financial situation, financial needs, financial goals, and tolerance to risk. This code

implies that the AFA should "know their client". In light of recent public concern around the ethical investments of Kiwiaver providers, in addition to our consumer polling, RIAA suggests that an important part of this is to understand whether a client has any "ethical" requirements regarding how their money is invested and that this should form a requirement as part of knowing your client. Ie clients must be asked if they have any ethical issues they would not be comfortable investing in.

3. Code 9 is associated with an AFA's requirement to provide a written explanation to a client regarding the basis on which an investment planning service (or a personalised service in respect of category 1 products) is provided. The AFA must take reasonable steps to ensure the client is aware of the principle benefits and risks involved. Considering the financial materiality of ESG factors, the AFA should be making clients aware of their understanding of the level of ESG risk in the products that they are recommending investment into, reflecting the degree to which an investment planning service or product takes into account responsible investment issues will materially impact the potential benefits and risks.

RIAA believes that by explicitly incorporating these changes into the New Financial Advice Regime does two things:

- Ensures advisers are considering all investment risks as they assess the best way to invest their client's money, including ESG risks; and
- Ensures that the Adviser is proactively knowing their client fully before providing investment advice, in order that the advice provided delivers strongly on financial outcomes and desires of the client.

In order to support these changes in the Financial Advice Regime, RIAA would encourage further work to ensure greater disclosure from retail fund managers and Kiwisaver providers regarding their approach to responsible investing (ESG and ethics). In light of recent public response to the exposure of KiwiSaver funds to controversial weapons and tobacco, RIAA believes that there is a case to require a base level of rules that prevent default funds investing in certain activities that breech New Zealand law or could potentially prejudice the reputation of New Zealand.

RIAA welcomes the chance to provide this submission, and we would welcome any opportunities to speak further about this submission.

Yours Faithfully,

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Responsible Investment Association Australasia

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