SUBMISSION TEMPLATE:

REVIEW OF KIWISAVER DEFAULT PROVIDER ARRANGEMENTS

SECTION 1: YOUR DETAILS

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Are you requesting that any of this submission be kept confidential? No

About the PRI:
The PRI is the world’s leading initiative on responsible investment. It works to understand the investment implications of environmental, social and governance (ESG) factors and to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions. Launched in New York in 2006, the PRI has grown to over 2,500 signatories, with a total of over $86 trillion in assets under management and is still growing.

SECTION 2: FEEDBACK ON DISCUSSION PAPER

1. What is your feedback on the proposed objective for the review?

The PRI welcomes the opportunity to comment on the discussion paper published by the Treasury and the Ministry of Business, Innovation and Employment in New Zealand. The PRI supports the objectives set out in the paper and welcomes the focus on responsible investment, which we consider an important aspect in securing the financial well-being of savers.

The majority of current default providers in New Zealand are signatories to the PRI (see below) and report about their organisations’ general approach to responsible investment on an annual basis:
The PRI will respond to questions 19, 20, 21, 24, 25 and 26.

Responsible investment has a crucial role in delivering the aims of the Kiwisaver Act, mainly increasing individuals’ wellbeing. As such our recommendations to the Ministry of Business, Innovation and Employment are:

- All default KiwiSaver providers should integrate ESG issues in their investment practices, processes and decision-making, consistent with their investment time horizons.
- All default KiwiSaver providers should understand and take account of beneficiaries’ and savers’ sustainability-related preferences.
- The Ministry should provide guidance on KiwiSaver disclosure requirements on ESG issues, including climate change.

19. Are there higher investment costs for responsible investing? If so, how likely are these costs to contribute to lower net returns?

While there can be investment costs associated with ESG research and analysis, the PRI notes that:

- Financial data providers (such as MSCI, FTSE Russell and Bloomberg) as well as sell-side research firms, consultancy services and proxy advisory services, are providing high-quality ESG data and analysis at scale, often within standard fee structures.
- As industry knowledge has grown, so too has the number of investors with the skills and tools necessary to extract investment insights and value from third-party ESG data and analytics.
- Many investors have successfully incorporated ESG integration techniques into existing investment processes.
- Evidence demonstrates that ESG integration out-performs (see question 20).

As such, the PRI recommends that savings products should be evaluated holistically, taking into account costs, long-term financial performance and beneficiary preferences.

In response to paragraph 124 (“Providers are currently required to include in their product disclosure statements (PDS) a statement of whether or not the scheme takes responsible investment into account in their investment policies and procedures”), PRI research identifies that weak policy design and limited monitoring of regulation are undermining the impact. In particular, New Zealand’s current comply or explain approach can give the impression that ESG integration is optional, whereas ESG integration is a requirement of a fund’s fiduciary duty. We seek to address this in later questions.
20. How does responsible investment affect returns? Does it increase or decrease returns, and to what extent?

There is strong evidence that the systematic and explicit inclusion of material ESG factors into investment analysis and investment decisions leads to better investment outcomes.

The key arguments in support of this statement include:

- There is a positive correlation between ESG and corporate financial performance. The 2014 paper 'The Impact of Corporate Sustainability on Organizational Processes and Performance' by Robert Eccles et. al. investigated the long-term effect of corporate sustainability on organizational processes and performance. Using a matched sample of 180 US companies, the paper found that corporations that had voluntarily adopted sustainability policies significantly outperformed those that had adopted almost none of these policies – termed as Low Sustainability companies. The paper also suggested that these high sustainability firms had generated significantly higher stock returns, suggesting that indeed the integration of such issues into a company’s business model and strategy may be a source of competitive advantage for a company in the long-run.

- The consequences of failing to effectively manage ESG-related risks can be significant. For example, one analysis of the financial costs of corporate fines and settlements shows that the ten largest fines and settlements in corporate history together amount to $45.5bn, that banks have paid out $100bn in U.S. legal settlements alone since the start of the financial crisis and that global pharmaceutical companies have paid $30.2bn in fines since 1991. Individual incidents and events can also have major impacts on corporate value. For example, the share prices of Vale S.A. fell by almost a quarter in the immediate aftermath of the Brumadinho mine disaster in 2019, and Volkswagen AG lost almost a quarter of its market value in 2015 after it admitted to cheating on U.S. air pollution tests for years. In 2015, the share price of oil major BP more than halved following the Deepwater Horizon spill.

- Companies with better ESG performance can have better access to finance. In their paper ‘Corporate Social Responsibility and Access to Finance’ (2014), Cheng et. al. found that that firms with better corporate social responsibility (CSR) performance, better stakeholder engagement and better transparency on ESG issues faced significantly lower capital constraints.

- There are significant investment opportunities associated with ESG issues. For example, it is estimated that between now and 2030, between US$5-7 trillion a year is needed if we are to achieve the Sustainable Development Goals worldwide. A least a further US$1.5 trillion a year is needed in the same period to meet the Paris goal of keeping the average global temperature rise well below 2 degrees Celsius and as close as possible to 1.5 Celsius.

- Firms with good ESG ratings on material issues outperform those with poor ratings. Khan et. al. in their 2016 paper ‘Corporate Sustainability: First Evidence on Materiality’ found that firms with good ratings on material sustainability issues significantly outperformed firms with poor ratings on these issues. They also found that firms with good ratings on immaterial sustainability issues did not significantly outperform firms with poor ratings on the same issues.

21. Should the default provider arrangements be used to achieve objectives in relation to responsible investment?
Yes.

The PRI recommends that default providers should integrate ESG issues into investment practices, process and decision-making, for the following reasons:

- There is empirical, academic and investment practice evidence that demonstrates that the systematic and explicit inclusion of material ESG factors into investment analysis and investment decisions leads to better investment outcomes.
- ESG integration has become an ‘investment norm’. There are many data points that demonstrate the prevalence of ESG integration in investment practice, including growth in PRI signatories, which now total more than 2,500, representing half the institutional investment market.
- Responsible investing is also consistent with the growing movement internationally for governments to support responsible investment. For example, the UK investment regulation requires pension fiduciaries to consider all material considerations in their investment process stated as: “financially material considerations” includes (but is not limited to) environmental, social and governance considerations (including but not limited to climate change), which the trustees of the trust scheme consider financially material”. There is political agreement for similar requirements in the EU.
- There is evidence that demonstrates that savers want ESG integration, as set out in the Discussion Paper (see also, question 24).
- Finally, the New Zealand government should set expectations for pension funds and providers to manage their investments in alignment with international standards which the government is committed to (for example the Paris Agreement, the Sustainable Development Goals and the UN Guiding Principles on Business and Human Rights).

The PRI makes two further recommendations, not covered in the discussion paper:

- Consistent with the recommendations of the New Zealand Productivity Commission, the Government should establish a financial disclosure framework aligned with the TCFD recommendations, to allow KiwiSaver providers to understand the risks and opportunities associated with climate change. This could be led by a government-backed pilot group on TCFD climate disclosures.
- The Ministry of Business, Innovation and Employment should consider a similar approach to the EU Taxonomy. The EU Taxonomy is a transparency mechanism, allowing investors to identify and respond to investment opportunities that contribute to environmental policy objectives, and allows for enhanced disclosure to their beneficiaries and savers.

The PRI would welcome an opportunity to discuss these recommendations with the Ministry in further detail.

24. Would default members want their funds to be invested more responsibly? If yes, is the same true if responsible investment means potentially limiting future returns?

Yes, as demonstrated by the survey results cited in the Ministry’s discussion paper.
We see similar trends in other countries. For example, 82% of over 500 UK DC pension members surveyed by Invesco were supportive of default pension investment being subject to a minimum ethical standard. 46% indicated that “they would choose a responsible investment option over a fund that included “all types of companies”, even if it meant lower returns.”

A global study by Schroders found that only a minority of people are concerned that sustainability would hinder returns, revealing that investors are increasingly convinced robust returns and a positive impact are not mutually exclusive. Also, 76% of investors stated that investing sustainably has increased in importance to them over the past five years and 64% had actually increased sustainable allocations.

25. To what extent is it a problem that default members do not have information about whether their investments are made responsibly? Would having more information make a difference to the behaviour of default members? What alternatives might there be to more/standardised information to address responsible investment concerns?

The PRI recommends that the Ministry should publish guidance for KiwiSaver providers on how information to beneficiaries should be reported, as well as guidance for reporting on climate change-related risks and opportunities (see Question 21, TCFD).

Given that pension beneficiaries vary widely in their financial literacy and levels of engagement, it is important that reports prepared for their consumption give prominence to key information that all beneficiaries should know, are written in plain English, are as short as possible while remaining meaningful, and are made available on mediums that make sense for savers (such as online). In general, these standards do not appear to be met under current reporting.

The PRI also recommends that the guidance should state that providers should take member sustainability views into account. The PRI believes this will increase member participation, knowledge and awareness of savings arrangements.

It is worth noting that integration of beneficiaries’ sustainability preferences does not necessarily entail undertaking member surveys. It can be possible for providers to make assumptions, for example, public opinion data and an understanding of the profile of the average scheme member. What is appropriate and proportionate for each scheme will vary depending on their size and resources; however all schemes should be able to take measures to ensure investments are in line with the best interests and preferences of their specific beneficiaries.

26. Do providers’ current responsible investment exclusions meet what default members would expect?

No, the PRI defines responsible investment more broadly than exclusions / screening and the PRI does not advise one approach over others:

The PRI defines responsible investment as an approach to managing assets that sees investors include environmental, social and governance (ESG) factors in:

- their decisions about what to invest in;
the role they play as owners and creditors.

Responsible investment aims to combine better risk management with improved portfolio returns, and to reflect investor and beneficiary values in an investment strategy. It complements traditional financial analysis and portfolio construction techniques.

28. If this option is adopted, what form should standard disclosure take? For example, should all providers be required to provide a statement listing all excluded companies by sector?

The PRI does not believe that publishing exclusion lists on their own will provide members with the information they need to make an informed decision about the sustainability of different savings options.

The PRI recommends a narrative disclosure on a range of ESG issues, including climate change, in simple, non-technical, non-jargon disclosure (see question 25).