Submission

to the

Financial Markets Authority

on the

Consultation paper: Proposed guidance on green bonds and other responsible investment products

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NEW ZEALAND BANKERS ASSOCIATION
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About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes that contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.

2. The following seventeen registered banks in New Zealand are members of NZBA:
   - ANZ Bank New Zealand Limited
   - ASB Bank Limited
   - Bank of China (NZ) Limited
   - Bank of New Zealand
   - China Construction Bank
   - Citibank, N.A.
   - The Co-operative Bank Limited
   - Heartland Bank Limited
   - The Hongkong and Shanghai Banking Corporation Limited
   - Industrial and Commercial Bank of China (New Zealand) Limited
   - JPMorgan Chase Bank, N.A.
   - Kiwibank Limited
   - MUFG Bank, Ltd
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited

Background

3. NZBA welcomes the opportunity to provide feedback to the Financial Markets Authority (**FMA**) on the consultation paper: *Proposed guidance on green bonds and other responsible investment products* (**Consultation Paper**). NZBA commends the work that has gone into developing the Consultation Paper.

4. If you would like to discuss any aspect of the submission further, please contact:

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Introduction

5. NZBA supports FMA providing guidance to issuers on its expectations, particularly where that will help reduce the risk of potential harm to investors. However, we query whether specific guidance on green bonds and other responsible investment products is needed at this time given ongoing developments in this relatively new area, both in New Zealand and globally. We are concerned that guidance could quickly become out of date.

6. Instead, FMA could provide guidance more generally on issuers' compliance with their obligations under the Financial Markets Conduct Act 2013 (**FMCA**). In particular, in relation to the concept of products being 'true to label'. Examples of responsible investment products could be included in that guidance.

Question one: Key features of an investment product that is green, ethical or otherwise responsible

Reference to 'Green bonds' includes green, social and sustainability bonds

7. There is a difference in the market understanding of the key features of responsible investment products in the debt capital markets space (such as green bonds or social bonds) and responsible investment in the managed funds space.

8. The market for green bonds has been in existence since 2007 and the global market understanding of what these are is fairly settled – evidenced by an explanation on the NZX's Green bonds page[1] and the fact of growth in global issuance of green bonds since 2007.

9. Globally, green bond issuances are typically structured in accordance with International Capital Markets Association (**ICMA**) green or social bond principles. These are used to identify and apply bond proceeds to a range of green or social expenditure categories. Typically, these bonds will carry a form of independent review, eg CBI certification (green bonds only), Moody's Investors Services assessment, or Sustainalytics opinion.

10. A key tenet of the market is disclosure. Companies are evolving rapidly as stakeholders demand greater transparency around environmental, social and corporate governance (**ESG**) related objectives. As a result, it is expected that details of ESG reporting will become integrated with annual financial reporting. Indeed, some New Zealand companies are already producing integrated reports.

11. In contrast, responsible investment is still an emerging area. While we consider the United Nations Principles of Responsible Investment (**UN PRI**) provide a useful set of principles,[2] we agree there is no standard practice for responsible investment in the wider managed fund industry and in the debt capital markets space.

[1] https://www.nzx.com/services/listing-on-nzx-markets/debt/green-bonds
[2] https://www.unpri.org/pri/what-is-responsible-investment

12. We consider that best practice in the responsible investment space has the following components:

    (a) Ensuring that ESG factors are incorporated into the investment decision-making process.

    (b) Active ownership such as proxy voting and corporate engagement with the aim of creating benefits for both shareholders and society as a whole.

    (c) Negative screening principles are applied – certain industry sectors are excluded on ethical or responsible grounds.

    (d) Positive screening principles are applied – additional weightings or exposures are implemented on ethical or responsible grounds.

    (e) Evidence can be provided, in the case of 'green products', that proceeds raised are being utilised solely for 'green' initiatives or projects.

13. Rather than considering responsible investment solely in terms of exclusions, we believe that a more holistic approach is likely to lead to better investment outcomes for investors.

14. We also note the New Zealand Sustainable Finance Forum, which was established to deliver a Sustainable Finance Roadmap to help New Zealand shift to a financial system that supports sustainable social, environmental and economic wellbeing. The Forum's work should be taken into account as part of a wider market review.

Question two: Key risks associated with green, ethical or otherwise responsible investment products

15. Generally, we believe the key risks are the same or similar to those for non-green, ethical or otherwise responsible investment products. We have the following general concerns about green, ethical or otherwise responsible investment products:

    (a) Marketing and/or labelling of products to make them appear more green/ethical than they really are (greenwashing) can lead to investor confusion.

    (b) Reduction in the investible universe through sector/company exclusions can lead to materially increased tracking error risk and potentially lower returns. Also, use/promotion of concentrated or single sector specialised products where a more diversified approach would be more appropriate.

    (c) Focus on competition amongst providers of how responsible their products are, rather than performance outcomes for investors.

    (d) The potential for increased fees and costs compared to traditional products.

Question three: Appropriate certifications, standards or sector exclusion lists

16. In respect of green bonds, we note that the key frameworks are 'Green Bond Principles', 'Social Bond Principles' and 'Sustainability Bond Guidelines' issued by ICMA in 2014.

17. In respect of responsible investment, we consider exclusion lists as a relatively minor sub-set within a much broader responsible investment framework. We consider that focusing disclosure requirements on exclusion lists is likely to have a reductive effect on investors understanding of what responsible investment is. Taxonomies are being developed, largely in Europe, which may help to provide a market standard for a broader range of products.

Question four: Disclosure for a responsible investment product

18. New Zealand, as a small market, needs to ensure that it is consistent with global market practice so that it can continue to sell into global markets. A bespoke New Zealand framework for green bonds would not be helpful and we support the FMA's decision not to set out prescriptive definitions of 'green', 'ethical' or 'responsible'.

19. In terms of disclosure, our view is that wholesale investors do not need any further information beyond; (a) understanding the framework that is being used, and (b) the independent review.

20. Retail investors may benefit from standardised disclosure about what green, ethical or responsible products are and some issuers do try to include such information.[3] For example, a checklist indicating which of the various responsible investment techniques the product incorporates; exclusions, positive screening, ESG integration, sustainability themed investment, corporate engagement, active proxy voting, impact investment.

21. There is already a lot of information readily available, for example through provider websites, engagement with investors, and via the Disclose website. There are also third parties such as Mindful Money which offer additional information (although based on exclusion alone). However, some formal disclosure could be beneficial to address any investor confusion. Any formal disclosure requirements must be fit for purpose and flexible so that they do not become obsolete, given the continuing evolution of best of practice in this area.

22. In general, we would encourage the adoption across providers of a 'common language' when discussing responsible investing. This would ensure investors could more clearly understand the difference in approaches taken and make more informed choices between providers.

Question five: Key questions an investor should ask about responsible investment products

23. In relation to the managed funds space, key questions are:

- Are ESG factors integrated into the investment decision-making process for all investments?

- Does the fund have an active proxy voting policy whereby the fund manager makes an informed vote on important matters regarding the company?

[3] https://www.aucklandcouncil.govt.nz/about-auckland-council/investor-centre/information-for-investors/Pages/green-bonds.aspx - see here for example on Auckland Council's Green Bonds page.

- Does the fund manager actively engage with company management to influence corporate behaviour and create change for the benefit of society and/or shareholders?

- Are certain sectors/companies excluded and why?

- Does the fund have exposure to any sustainability themed or impact investments? If so, how is any impact measured and disclosed?

- Is the fund a member of a relevant industry body such as the UN PRI or RIAA?

Question six: Due diligence and governance arrangements that should be in place to support green, ethical or responsible investment objectives

For an issuer of green, ethical or responsible investment products, including MIS managers as issuers of ESG funds

24. We believe the following due diligence and governance arrangements should be in place to support green, ethical or responsible investment objectives of products:

    (a) Independence of screening provider – for example, does the MIS engage a specialist independent ESG firm to identify securities that fall within the exclusions framework and definitions? Relying on a third party list (eg the New Zealand Super Fund published list of exclusions) could result in exclusions being implemented in a manner which is inconsistent with the manager's exclusion policy.

    (b) Regular review of responsible investment and proxy voting policies.

    (c) Understanding and acknowledgement to investors of the potential return/risk considerations against the objectives of the product.

    (d) Measurement and reporting of the effectiveness of the impact of responsible investment policies (ie engagement outcomes – evidence that the product is doing what it says it is doing).

    (e) Reporting of materiality attached to asset exclusions – eg 5%/10% max revenue exposure etc.

For a MIS manager investing in green, ethical or responsible investment products?

25. For a MIS manager making an investment in a product, then the manager should consider the ability and/or flexibility of collective investment vehicles to implement asset restrictions and the potential impact on investors of investing in third party product, particularly if the vehicle is domiciled offshore (which may be tax inefficient for investors).

Question seven: Statement of Investment Policy and Objectives for registered MISs that have green, ethical or responsible funds

26. We consider that a simple option could be for default providers to confirm whether they integrate ESG factors into the investment decision making process, exclude certain sectors or companies from their portfolios, or possess an external accreditation (for example UN PRI signatory) in the PDS.

27. However, we consider that there is value in making space available to engage with default members on other aspects of the proposition, rather than just core disclosure and a common prescriptive form of disclosure may assist with comparability.

Question eight: best practice features that MIS managers should include in disclosure

28. In our view, it is vital that managers explain what responsible investment techniques are incorporated in their fund.

Question nine: other disclosure issues that guidance should cover

29. We consider that the key disclosure issue is around the marketing and/or labelling of products to make them appear greener/more ethical than they really are (greenwashing) which can lead to investor confusion.

Question ten: other matters guidance should include

30. We support:

    (a) promoting and facilitating the further development of the broader responsible investment product market by providing greater clarity about the FMA's expectation; and

    (b) ensuring investors have a clear understanding of what they are being offered and the risks involved and are able to make informed and deliberate choices.

31. We would also reiterate the risk that the focus could become competition amongst providers of how responsible their products are, rather than performance outcomes for members. Any guidance should address this risk.