Responsible Investment Association Australasia

Responsible Investment Benchmark Report 2017

New Zealand

This report was prepared by RIAA based on survey data gathered and collated by KPMG

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Responsible Investment Association Australasia

The Responsible Investment Association Australasia (RIAA) is the peak industry body representing responsible, ethical and impact investors across Australia and New Zealand. RIAA is a growing active network of over 185 members managing more than $1 trillion in assets, including superannuation funds, fund managers, consultants, researchers, brokers, impact investors, property managers, banks, community trusts and financial advisers.

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

We do this by actively promoting the concept of responsible investment, across the finance industry and to the investing public, with the objective of increasing the uptake and deepening the impact of responsible investment.

RIAA works closely with and for its members on this cause, offering valuable services and benefits for members including:

- being a hub of relevant and timely ESG and ethical information for our members, through our program of regular research, events, conferences, field trips and webinars;
- acting as a strong voice for the industry to promote and grow demand for responsible and ethical investment through our Certification Program, media and communications; and
- working to build the capacity of the industry in responsible investing through education, networking and thought leadership.

As this report shows, there has never been a more important time to be on top of the developments in responsible investing and there's no better way than by becoming a member of RIAA.

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Executive summary

Background

Each year since 2002, the Responsible Investment Association Australasia (RIAA) has commissioned research into the size and growth of responsible investment across Australasia. This 2017 report is the third stand-alone New Zealand report, a companion report to the 2017 Australian Responsible Investment Benchmark Report. The aim of this research is to gather data on the various forms of responsible investment and to present analysis of growth in the sector.

The New Zealand Responsible Investment Benchmark Report charts the ongoing growth of responsible investing strategies, whilst also identifying the key drivers of increased capital flows towards responsible investment (RI) and the barriers to uptake with the intention of increasing the adoption and quality of RI strategies.

This report details industry data on the size and growth of the New Zealand responsible investment market over the 12 months to 31 December 2016.

Key findings

This Responsible Investment Benchmark Report reinforces that a responsible approach to investing – one that systematically considers environmental, social and governance (ESG) and/or ethical factors across the entire portfolio - is increasingly seen as the expected minimum standard of good investment practice in New Zealand.

Consumer demand combined with media and political pressure in 2016 has significantly shifted more of the investment industry towards a responsible investment approach.

1. As at 31 December 2016, responsible investment constituted $131.3 billion assets under management (AUM), up a significant 67% from $78.7 billion AUM in 2015.

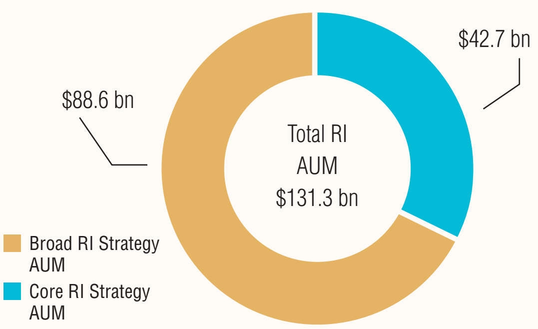


Figure 1
Responsible investment AUM are split into two distinct categories based on their strategy: Broad responsible investment or Core responsible investment

2. The Survey identifies a massive growth in Core responsible investments – those that are screened – of over 2,500% reaching $42.7 billion due primarily to the rapid response by KiwiSaver providers to put in place negative screens across tobacco and controversial weapons.
3. Broad responsible investment – those primarily undertaking an ESG integration approach – grew by 15% to reach $88.6 billion AUM.
4. Data analysis on the performance of funds was not undertaken on the NZ sample, however in the companion Australian Benchmark Report, it was found that Core responsible investment funds are outperforming equivalent Australian equities and multi-sector balanced funds over 3, 5 and 10 year time horizons.
5. Despite this strong financial performance, perceptions of RI funds' underperformance (together with lack of public awareness and lack of viable product options) were indicated by survey respondents as the biggest barrier to growth of the RI sector.
6. There has been a massive increase in the use of negative screens in NZ in the last year, with increased frequency of tobacco and controversial weapons screens.

Broad responsible investment

Broad RI approaches – whereby ESG integration is the principle RI strategy - continue to make up the largest portion of total responsible investment AUM, with **investment organisations that manage $88.6 billion in AUM**.

These organisations span community trusts, investment managers and asset owners including crown financial institutions.

Core responsible investment

In 2016 Core responsible investment strategies have emerged as a significant part of the total responsible investment AUM, jumping up substantially to $42.7 billion AUM due primarily to the inclusion this year of assets from eight of the largest KiwiSaver providers who implemented negative screens across tobacco and controversial weapons in late 2016.

Core responsible investment assets as a proportion of New Zealand's total professionally managed assets increased to 61% in 2016, up from 2.5% in 2015 – a remarkable jump.

Core responsible investment approaches apply at last one of the following primary strategies: negative, positive or norms based screening; sustainability themed investing; or impact investing and community finance.

The most substantial portion of Core responsible investment involves **screened investments which constituted $42.3 billion of the total Core RI $42.7 billion (up from $1.3 billion AUM in 2015)**. The major screened issues included tobacco, controversial weapons, but also nuclear power and gambling.

Sustainability themed investments grew modestly to $0.4 billion (from $0.3 billion) an increase of 34%.

Although impact investing interest is growing, only a single investment was identified in 2016.

Performance

Alongside growth in assets, the Australian companion report assessed the performance of Australian responsible investment funds compared with their benchmark index and the average of equivalent mainstream funds.

Importantly, this companion report found very strong performance results from Core responsible investment products:

- Core responsible investment Australian equities funds outperformed the average large-cap Australian share funds across three, five and 10 year time horizons.
- Core responsible investment international share funds outperformed large-cap international share funds over three and 10 year time horizons.
- Core responsible multi-sector growth funds (balanced funds) outperformed their equivalent mainstream multi-sector growth funds over three, five and 10 year time horizons.

Key drivers and detractors of RI growth
For the first time this year the survey asked investment organisations to identify the key drivers of RI growth and key factors that have deterred RI growth. The top three responses were:

Top drivers
- ESG risks identified as of increasing importance
- Alignment of investment strategy with underlying investors values/beliefs
- Increased demand from institutional investors

Top detractors
- Performance concerns
- Lack of awareness of RI by the public
- Capacity constraints due to a lack of appropriate products/options

While the acknowledgement of the importance of ESG risks is consistent with the growth of Core and Broad ESG funds, the consideration of performance concerns is not supported by actual performance.

Outlook

The public focus on the underlying investment holdings of the KiwiSaver market in 2016 has caused a massive shift in the industry towards negative screening of funds, which has effectively caused an entire industry to switch to a base level of responsible investment practice in an incredibly short period of time.

Based on the raised public awareness that has come from this focus on KiwiSaver investments, combined with the rising awareness within the investment industry that ESG risks are of increasing importance, it is reasonable to expect the significant growth of RI AUM to continue in future years. With this growth in demand and awareness, we would expect to see an increasing diversity of products coming to market with ever more sophistication in the RI strategies being employed.

The number of Core responsible investment asset managers has increased from 12 to 21 in this year's survey and the number of products identified from 27 to 51, suggesting product development is addressing one of the barriers to RI AUM growth.

More work is needed to publicise the relative performance of RI Core funds versus equivalent mainstream funds and to engage stakeholders and influencers on the basis of misplaced perceptions.

About this report

Purpose of the report

This report is the third annual Responsible Investment Benchmark Report for New Zealand prepared by the Responsible Investment Association Australasia (RIAA). The report details industry data on the size and growth of the New Zealand responsible investment (RI) market over the 12 months to 31 December 2016 and compares these results with the broader New Zealand financial market.

Through this report, RIAA aims to support the ongoing growth of the responsible investment industry consistent with its objective of both broadening the uptake of RI whilst deepening the impact. Through providing clear and transparent data on the development of the market, the size and the RI strategies being put in place, RIAA aims to support more investors to undertake a responsible approach to investment. Furthermore, by identifying the key drivers of increased RI AUM and the barriers to uptake, RIAA works to increase the adoption and quality of RI strategies.

Responsible investment

Responsible investment is an increasingly sophisticated component of the financial sector across superannuation, asset management, banking, community finance and financial advisory services.

Responsible investing considers a broad range of risks and value drivers as part of the investment decision making process, beyond and in addition to reported financial risk. It is a systematic approach that takes environmental, social, governance (ESG) and ethical issues into account throughout the process of researching, analysing, selecting and monitoring investments. It acknowledges that these factors can be critical in understanding the full value of an investment.

It guides the investment approach of a broad range of products and services, from large investment managers who integrate ESG factors into their decision-making, to so called 'deep green' ethical investment funds that apply exclusionary screening criteria over their investments and impact investments that intentionally seek to deliver positive social and environmental outcomes. It includes superannuation funds that apply multiple RI strategies across all asset classes, to the banks taking an ethical and socially minded approach to lending. The developing maturity of the responsible investment industry is demonstrated by organisations applying a number of RI strategies to deliver value to fund beneficiaries.

Given the volume and variety of responsible investment and banking products available in Australia and New Zealand, individual investors are best positioned to determine the products and services most closely aligned to their values and beliefs. In other words, the determination of what constitutes adequate or appropriate ESG screening for a particular product is subjective and dependent on the individual investor's expectations. There is a high level of variability in the degree to which these factors are weighted, analysed and incorporated into investment decision making.

Responsible investment strategies

To enable comparison of New Zealand's responsible investment market with those of other regions, this report has been prepared in line with the seven strategies for responsible investment as detailed by the Global Sustainable Investment Alliance and applied in the Global Sustainable Investment Review 2016[3], which maps the growth and size of the global responsible investment industry. These strategies are:

1. Negative/exclusionary screening
2. Positive/best-in-class screening
3. Norms-based screening
4. Integration of ESG factors
5. Sustainability themed investing
6. Impact/community investing
7. Corporate engagement and shareholder action

Full definitions of each responsible investment strategy can be found in the Glossary.

International context

RIAA is a proud member of the Global Sustainable Investment Alliance (GSIA), together with Eurosif (The European Sustainable Investment Forum), UKSIF (UK Sustainable Investment & Finance Association, US SIF (The Forum for Sustainable & Responsible Investment) and VBDO (Dutch Association of Investors for Sustainable Development).

GLOBAL SUSTAINABLE INVESTMENT ALLIANCE GSIA

3 www.gsi-alliance.org/members-resources/trends-report-2016

Core versus Broad responsible investment

For the purposes of this report we distinguish between Core and Broad responsible investment. This allows us to differentiate the data to allow for an enhanced analysis of the responsible investment industry and the degree to which responsible investment strategies are integrated into products and services.

Core responsible investment approaches apply at least one of the following primary strategies: negative, positive or norms-based screening; sustainability themed investing; impact investing, community finance; or corporate engagement.

Core responsible investment approaches are made up in large part of those funds traditionally referred to as SRI or ethical investments, as well as sustainability themed funds and impact investments. A significant portion of Core responsible investment products are available as retail products.

Broad responsible investment approaches use ESG integration as the principle responsible investment strategy. This involves the systematic inclusion of environmental, social and corporate governance (ESG) factors into traditional financial analysis and investment decision making based on the acceptance that these factors are important drivers of risk and value in companies and assets. This strategy is often accompanied by a structured approach to corporate engagement and other active ownership and stewardship mechanisms.

The Broad responsible investment market is largely comprised of institutional funds that apply ESG integration as part of a mainstream investment offering. These products for the most part do not include an ethical, SRI or sustainability themed investment strategy selected by the investor – or where they do, these are not the primary responsible investment strategies – and are usually wholesale or institutional products.

As this report demonstrates, asset managers are increasingly applying multiple responsible investment approaches. For example, a fund may apply Broad ESG integration as well as Core responsible investment strategies such as negative or positive screening. In such a case, we have categorised the fund according to the primary responsible investment strategy being pursued. The primary strategy is identified by the organisation in their survey response. In addition to this, RIAA performs a review of all survey responses to ensure that strategies are categorised consistently across the cohort of responses and that investor responses are categorised consistently year on year.

It is important to note that this report aims to clearly and conservatively estimate the size of the value and volume of the responsible investment industry. Therefore, for the purpose of this report, AUM included under a Broad responsible investment strategy only includes asset managers demonstrating industry leading ESG integration practices as opposed to including all self-declared ESG managers.

RIAA and KPMG have undertaken a detailed desktop analysis of all asset managers that are signatories to the PRI as well as other asset managers that RIAA's database indicates as practicing ESG integration. This has included both asset managers domiciled in New Zealand, as well as a selection of international asset managers with a strong presence in this market and strong ESG credentials who manage assets for local clients – in this case only assets specifically identified as managed for local clients were included in the assessment. Only those that score above 80% against the RIAA assessment methodology are included in the summary, consistent with the approach this Survey has used for the past three years. For more detail on the assessment methodology, please see the breakout box on 'How RIAA defines leading practice in ESG integration'.

Methodology

REPORTING BOUNDARY

This report covers the 2016 calendar year and where possible, data disclosed has been recorded as at 31 December 2016. Data from some investment organisations was not available on a calendar year basis and in these cases data was taken from the closest available reporting date. All financial figures are presented in NZD.

The financial sector is a globalised industry. Responsible investment funds may be held in one country, managed in another and sold in a third, meaning that a level of estimation is applied in order to demarcate the boundary of the New Zealand market. This does impact on the accuracy/usefulness of reporting survey results as proportional to the market size as reported with Morningstar's statistics for total assets under management (TAUM). Morningstar's TAUM figures are limited in their coverage of the full investment market by covering only those assets managed by the New Zealand managed funds industry through retail and wholesale funds, discrete mandates and listed investments, but does not capture overseas fund managers and direct investments. However, in the absence of a more appropriate measure, TAUM continues to be used for comparison purposes. This report is intended to inform readers of the range of responsible investment products that are available in New Zealand. As such it includes assets managed within the New Zealand region, as well as assets managed outside the region where these are on behalf of New Zealand clients.

DATA COLLECTION

Data used to compile this report was generously provided and collected from the following sources:

- Directly supplied by 13 asset managers, superannuation funds, financial advisers, banks and community investment managers through a data collection survey of the value of AUM, drivers and barriers to growth, investment strategies and fund performance;
- Morningstar statistics for total assets under management (TAUM) in New Zealand and the average performance of mainstream managed fund categories. Morningstar also provided a secondary source of AUM data for some of the funds listed;
- RIAA's database and industry contacts; and
- Desktop research of publicly available information regarding assets under management, performance data and investment strategies from sources including company websites, annual reports and PRI Responsible Investment Transparency Reports.

The response rate to the 2016 Benchmark Report New Zealand survey was 50% (62% in 2015). Where survey responses were not received, publicly available information was used where available. In total, this research managed to gather a comprehensive summary of the full responsible market in New Zealand.

Responses that identify the key drivers of RI and detractors were only taken from survey respondents.

No data has been extrapolated from its original source.

DATA ANALYSIS AND REPORTING

As many asset managers apply several investment strategies, the data collection survey required respondents to identify a single primary responsible investment strategy. The survey also requested to respondents to nominate any secondary strategies applied in order to determine the depth of responsible investment strategies applied, to identify any overlap of approaches and to assist in categorising funds. This approach was used in order to create an accurate depiction of the responsible investment environment in New Zealand.

Fund overlaps between survey respondents have been removed, where identified, from the reported figures. RIAA is continuously working to improve its data collection process to enhance the quality of reported figures and to ensure that all products in the New Zealand market are identified.

It is important to note that all information in this Survey is 'self reported' by respondents and only limited analysis is performed over statements made. There is no assurance of statements.

DATA COMPLETENESS

Many of the products in the New Zealand responsible investment market are not bound by any public reporting, disclosure requirements or independent review (assurance). This report includes both retail and wholesale investment products, as well as increasingly superannuation fund mandates, individually managed accounts, and separately managed accounts. Some investment custodians are reluctant to supply information for reasons of privacy or commercial confidentiality. Data pertaining to funds held outside of managed responsible investment portfolios was not accessible. For this reason, as well as matters identified in the Reporting Boundary section above, this report provides a conservative depiction of the responsible investment environment in New Zealand.

How RIAA defines leading practice in ESG integration

Over the past decade, responsible investment has grown to a point where a significant proportion of the investment industry has now committed to implementing a responsible investment approach. For large institutional investors, this has focused primarily on applying ESG integration practices to traditional investment decision making.

Defining and measuring ESG integration practices is challenging due to limited disclosure and a broad variation in depth of integration - from systematic implementation embedded into investment valuation practices and company engagement, to more ad hoc approaches.

For the purposes of this report - to define the size of the responsible investment industry in New Zealand - RIAA aims to include those assets managed by asset managers who are practicing a leading approach to ESG integration, rather than all assets managed by organisations who have self-declared that they are implementing responsible investment.

For the third year in a row, RIAA undertook a desk top review of asset managers who are self-declared responsible investors - either via their commitment to the PRI[4], or other public commitments - and rated each of these eight organisations against a framework of leading practice to ESG integration. This framework was developed by RIAA based upon global definitions and existing assessment frameworks for ESG integration practices, and remains the same as the framework used by RIAA in last year's report. This assessment was conducted in addition to assessing 91 Australian-based asset managers.

The framework acknowledges that although it is difficult to prescribe a single best practice process for the integration of ESG factors into investment decision making, there are a number of leading practices and constituent parts of leading practice which can be identified. RIAA has established a framework drawing on the core pillars of leading ESG integration practices that assesses and scores:

- Publicly stated commitments to responsible investment;
- Responsible investment policy;
- Commitments to the transparency of processes and approach;
- Systematic processes for ESG integration, as well as evidence demonstrating how this process is applied as part of traditional financial analysis;
- Evidence of activity in other areas of active ownership and stewardship including voting and engagement;
- Membership of a collaborative investor initiative; and
- Coverage of total AUM by responsible investment or ESG practices.

These pillars were weighted to ensure balance between evidence of systematic investment processes versus policies and public commitments. Using this framework, RIAA then assessed the 91 Australian and 8 New Zealand asset managers based on their publicly available information including websites, PRI responsible investment transparency reports and all other available material. All asset managers were scored using this criteria.

The New Zealand asset managers that scored more than 80% have been included in the Broad responsible investment category in this report. This was so that only those demonstrating leading practice would be included in determining the size of the New Zealand responsible investment market.

The methodology was developed specifically to apply fairly to asset managers across all asset classes and sizes.

Any portion of the AUM managed by these asset managers that was already accounted for under the Core responsible investment strategies was excluded to avoid double counting.

This is one of the approaches used in this report to calculate the total Broad responsible investment. Refer to the following section for the full approach.

4 At the time of writing, eight New Zealand asset managers were signatories to the PRI.

Responsible investment in New Zealand

The responsible investment industry in New Zealand has significantly grown in 2016 to make up an ever greater portion of the overall investment market in New Zealand. Our research reveals that $131.3 billion in AUM is managed under responsible investment strategies as at 31 December 2016, a growth of 67% since 2015.

When compared to the total professionally managed assets (TAUM) in New Zealand, reported by MorningStar as $70.1 billion, this represents a significantly larger figure. This figure surpasses the total value of professionally managed assets due to many of the assets captured in this report being managed outside of NZ on behalf of the largest institutional asset owners in this study.

Of this total AUM, a majority – almost two thirds or $88.6 billion - is accounted for by asset managers and asset owners undertaking a Broad responsible investment approach, using ESG integration as their primary RI strategy. This demonstrates a growth of 15% year on year.

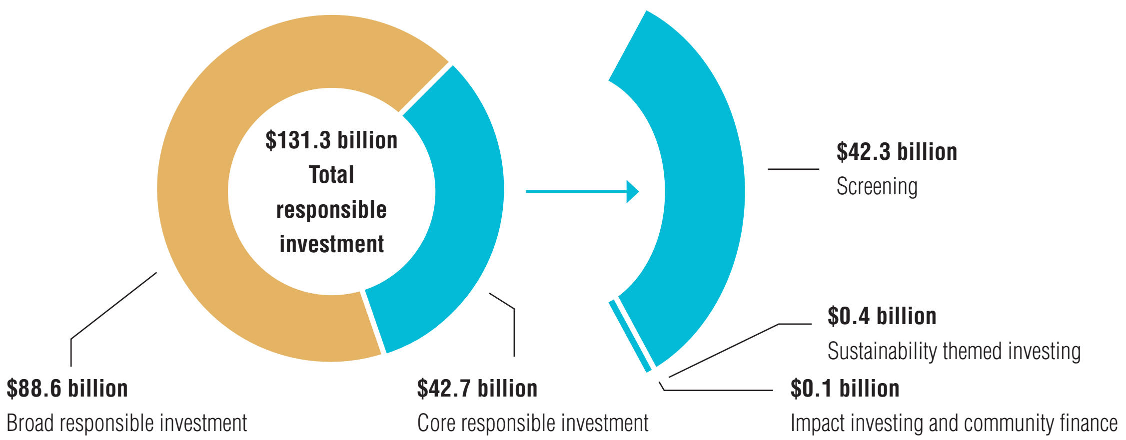
In 2016, Core responsible investment funds increased significantly from $1.3 billion to $42.7 billion AUM, constituting 61% of New Zealand's TAUM. This staggering step up is due primarily to the incorporation of negative screening across tobacco and controversial weapons by the largest KiwiSaver providers.

Figure 2
Responsible investment AUM – totals by year

Responsible investment approach	2016 Responsible investment AUM ($bn)	2015 Responsible investment AUM ($bn)	Change
Screening (including negative, positive, best in class and norms-based screening)	42.3	1.3	3,219%
Sustainability themed investing	0.4	0.3	34%
Impact investing and community finance	0.1	–	–
Core responsible investment total	**42.7**	**1.6**	**2,649%**
Broad responsible investment total ESG integration	**88.6**	**77.1**	**15%**
TOTAL RESPONSIBLE INVESTMENT	**131.3**	**78.66**	**67%**

NOTE: Numbers in this table have be rounded, affecting some totals

Figure 3
Responsible investment by approach



Core responsible investment

Core responsible investment funds grew significantly during 2016, increasing by 2,649% to $42.7 billion at 31 December 2016 compared with $1.6 billion for the previous year.

At $42.7 billion AUM, Core responsible investment funds represent 61% of the TAUM held in New Zealand, increasing from 2.5% of TAUM in 2015.

The $42.7 billion of Core responsible investment in New Zealand is held by 21 asset managers managing 51 products (an increase from 27 in prior year). A range of Core responsible investment strategies have been applied to these funds and the key trends in these strategies are detailed below:

Screening, primarily negative, is the major RI approach being applied to this significant increase in Core RI funds. The use of screening has seen a significant amount of growth year on year with AUM increasing by 3,219% on 2015.

In August 2016, news reports revealed that KiwiSaver funds had investment holdings in tobacco, cluster munitions, land mines and nuclear devices. This resulted in questions as to the legality of investments in producers of cluster munitions. Subsequently, it rapidly became apparent that the average New Zealander was not content to have their KiwiSaver investments invested in such industries, which resulted in a very rapid response from the industry whereby the largest KiwiSaver providers put in place exclusions across these main industries in their default funds and often full product ranges.

This shift is potentially the most rapid and significant shift towards screening of any financial market globally in recent years, to the extent that as at end of 2016, $41 billion in AUM is newly captured Core responsible investment AUM from nine asset managers and KiwiSaver providers.

This 2016 survey indicates that managers are increasingly screening issues from portfolios, both labelled 'ethical' portfolios as well as mainstream portfolios. Overall there was an increase in the number of issues screened, with the most commonly observed screens being controversial weapons and tobacco, followed by gambling, nuclear power and alcohol driven by KiwiSaver providers.

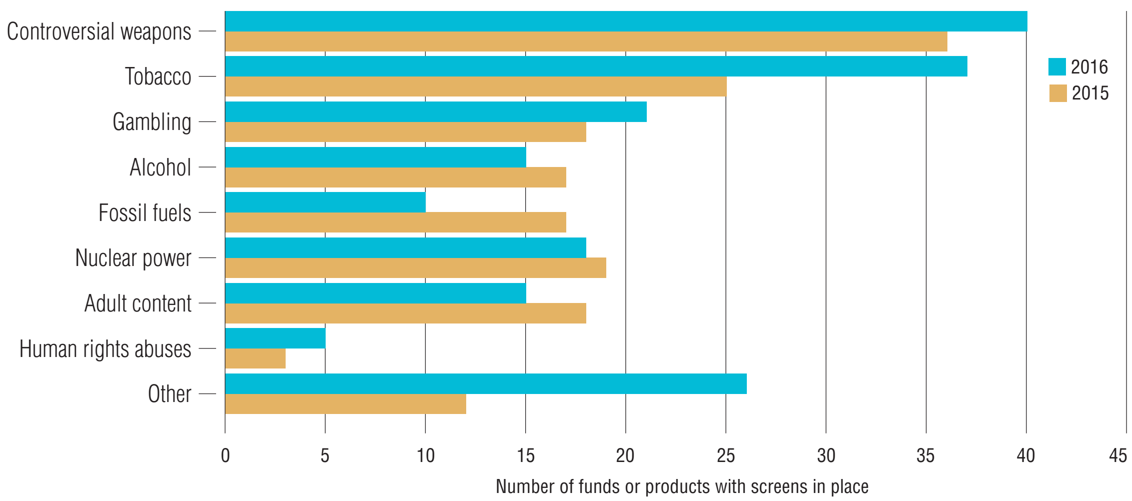
Other issues such as animal testing/cruelty, environmental impact and human rights issues were also reported. See Figure 3 below.

Core responsible investments using a screening approach include a number of distinct groups of organisations in NZ, but is primarily made up of KiwiSaver providers.

Others include faith based investors - such as the NZ Anglican Church Pension Board and Methodist Trust Association – community trusts – such as Foundation North, Rata Foundation, Waikato Community Trust and Otago Community Trust and managed funds.

Some funds have traditionally marketed themselves as being ethical or socially responsible funds, and typically include more than just a base level of screening across one or two issues. Those ethical

Figure 4
Frequency of issues been screened



or SRI options captured in this report include products from:

- Amanah
- AMP Capital
- ANZ One Answer
- Booster
- Dimensional
- Koinonia
- QuayStreet
- Smartshares (formerly Superlife)
- Trust Management

Those KiwiSaver providers that have been captured in this survey as incorporating screens across products that are not marketed as ethical or SRI funds – usually including a base level of negative screens across tobacco and controversial weapons – include the following:

- AMP Capital
- ANZ New Zealand Investments
- ASB Group Investments
- Booster
- Fisher Funds Management
- Generate Investment Management
- KiwiWealth
- Simplicity
- Westpac

As noted in previous years, we see in the NZ market some very significant asset owners who incorporate screening into their funds, such as the Accident Compensation Corporation, New Zealand Superannuation Fund and Government Superannuation Fund Authority. These funds, for example, all incorporate screening across tobacco, controversial weapons (cluster munitions, nuclear explosive devices, anti-personnel mines) and whaling sectors, however, also incorporate an ESG integration approach across their investments. For these asset owners, we have included them under their primary RI strategy that we take to be Broad RI - ESG integration.

Sustainability themed investing also experienced growth of 34% in 2016. This growth was most significantly contributed by products across sustainable agriculture (Southern Pastures), a water themed fund (Pathfinder) and global equities sustainability themed fund (Dimensional).

There was very little reported activity within the category of impact investment and community finance, with only a single investment identified in 2016.

PERFORMANCE OF CORE RESPONSIBLE INVESTMENT FUNDS – AUSTRALIA

The Australian companion report assessed the performance of Australian responsible investment funds compared with their benchmark index and the average of equivalent mainstream funds.

The average performance in each time horizon has been determined using the asset-weighted returns (net of fees) as reported by each responsible investment fund within its category. Mainstream performance indices and fund comparison data were calculated by MorningStar using a comparable methodology.

To date, we have not undertaken the same analysis with our sample of NZ funds due to a few factors that limit our ability to do such an analysis including the small sample size of funds in NZ and the diversity of funds sampled in this research across regions and asset classes, meaning a consistent benchmark is hard to establish. However as the sample size increases, in the future we will endeavour to run performance analysis on NZ products.

Taking the Australian data, this report has again found very strong performance results from Core responsible investment products.

Core responsible investment Australian share funds outperformed large-cap Australian share funds and the benchmark for all periods except the one year term.

Responsibly invested international share funds outperformed the average mainstream international share fund in the three and 10 year time horizons, but slightly underperformed over the one and five year terms.

Additionally, responsibly invested balanced portfolios outperformed the multi-sector growth fund average for all periods expect one year.

Figure 4
Performance of Core responsible investments against mainstream funds (from 2017 Australian Benchmark Report)

Australian share funds		1 Year	3 Years	5 Years	10 Years
	Average responsible investment fund (between 20-39 funds sampled depending on time period)	7.0%	7.0%	13.0%	6.3%
	Large-cap Australian share fund average	8.8%	5.4%	10.8%	3.8%
	S&P/ASX300 accumulation index	11.8%	6.6%	11.6%	4.4%

International share funds		1 Year	3 Years	5 Years	10 Years
	Average responsible investment fund (between 6-23 funds sampled depending on time period)	4.3%	10.3%	14.2%	4.3%
	Large-cap international share fund average	5.6%	9.6%	16.8%	3.8%
	MSCI World ex Australia Index	7.9%	11.5%	18.6%	4.7%

Multi-sector growth funds		1 Year	3 Years	5 Years	10 Years
	Average responsible investment fund (between 6-9 funds sampled depending on time period)	3.3%	8.0%	12.3%	4.8%
	Multi-sector growth fund average	6.3%	5.9%	9.7%	3.7%

Broad responsible investment

Beyond Core responsible investment, ESG integration constitutes a major force in the mainstream investment industry today. As at this survey period eight New Zealand asset managers and seven asset owners have declared their commitment to responsible investment by becoming signatories to the PRI. Signatories to the PRI commit to incorporating ESG considerations into investment analysis and decision-making processes and to publically report on their performance.

Combined, these investment organisations demonstrate that ESG integration is becoming a key consideration in mainstream investment strategies.

RIAA has always taken a conservative approach to estimating the value of AUM relating to funds that consider ESG factors. The AUM attributable to asset owners and asset managers comprising the $88.6 billion AUM in this report was determined using a combination of approaches including RIAA's responsible investment survey results as well as a desktop assessment of eight asset managers who are self declared responsible investors (primarily from PRI signatory lists). As outlined in the earlier section on 'How RIAA defines leading practice in ESG integration', these asset managers were reviewed against a framework of leading practice in ESG integration as determined by RIAA, and based on global research, in order to determine those asset managers demonstrating a leading approach to ESG integration.

In this year's report, included in the Broad RI assets are:

- The largest asset owners applying multiple RI approaches;
- Asset managers that apply an ESG approach coupled with screening (mainly for institutional mandates);
- Community trusts undertaking ESG integration through their external managers; and
- Asset managers demonstrating leading practice in ESG integration taken from our assessment.

To ensure no double counting, RIAA's survey asks asset owners to identify the underlying asset managers, and where there is overlap, those assets are removed from the total AUM.

This assessment found that three domestic asset managers in New Zealand, representing $10.4 billion AUM, are applying a leading approach to ESG integration in their Broad responsible investment approach. These three managers are:

- Harbour Asset Management
- HRL Morrison
- Southern Pastures

Where asset managers report some of their funds under Core RI, the Core RI fund value was excluded from the Broad RI to eliminate double counting.

These three asset managers were able to clearly demonstrate a systematic process to ESG integration in their investment process, through policies, clearly defined approaches to stewardship, active ownership that includes engagement and voting, and meaningful disclosure.

The other organisations considered as part of Broad RI are:

- Accident Compensation Corporation
- Devon Funds Management
- Foundation North
- Government Superannuation Fund Authority
- New Zealand Superannuation Fund
- Northern Trust Asset Management
- Otago Community Trust
- Rata Foundation
- Mercer (NZ)

Figure 5
Largest responsible investment asset managers and asset owners

Market drivers and future trends

This survey clearly shows that there has been a significant increase in the number of products subject to responsible investment strategies across the investment industry as well as in increase in AUM in those strategies driven by both by retail and institutional investors.

It is increasingly clear that appropriate and properly executed RI strategies can have a significant positive impact on the environment and society whilst at the same time generating sustainable financial returns that outperform comparable mainstream funds.

In order to gain insight into the factors behind the increased use of responsible investment strategies we asked respondents to identify and rank the key drivers of increased adoption of responsible investment strategies and AUM and the key factors in the market that have restricted growth.

Figure 6
Key deterrents: % of those surveyed that identified key risk

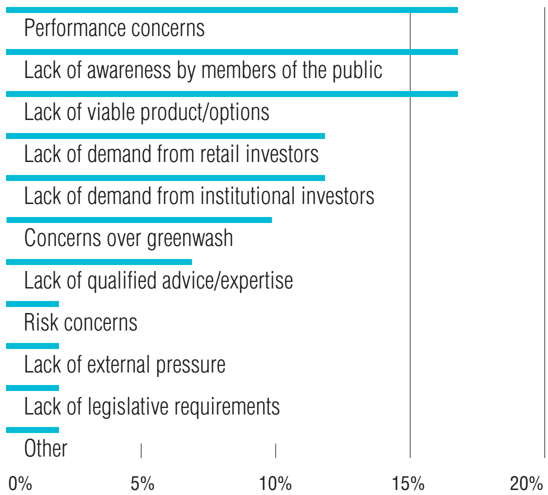
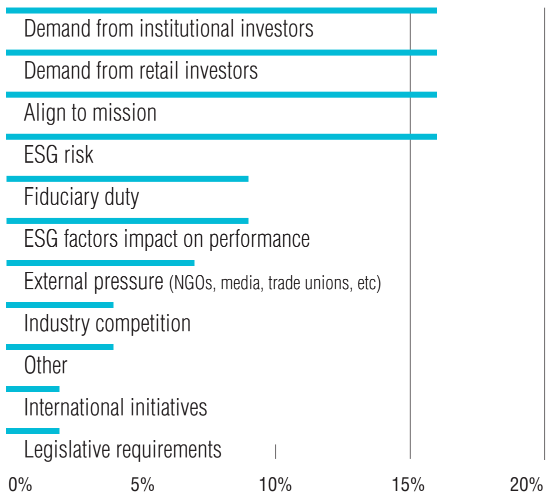


Figure 7
Key drivers of growth



KEY DETERRENTS

The largest factor deterring additional growth identified is associated with concerns around the financial performance of responsible investments (17% of respondents). This finding is not supported by the performance findings within this report or other similar findings that consistently show comparable or outperformance against most benchmarks over an extended time period.

A perceived lack of awareness of responsible investment by members of the public was identified by 17% of respondents. This issue combines both a lack of understanding of the impact of ESG issues on the overall performance of assets and a lack of awareness of the availability of RI products.

Another 17% of respondents identified the lack of viable products as key factor preventing the growth of responsible investment. This points to a lack of capacity in the industry and one that is being rapidly overcome by an emergence of new products, with this survey identifying a doubling of products over the year from 27 to 51.

KEY GROWTH FACTORS

16% of respondents attributed growth to the desire by underlying investors for investment products aligned with organisational missions or values.

At 16% each, equal weighting was also given by survey respondents to demand from retail investors and demand from institutional investors as a considerable driving factor behind the growth of responsible investment - somewhat unsurprising considering the shift in the KiwiSaver landscape in 2016.

Importantly, another 16% identified that the growing awareness of the importance of investors managing ESG risk to achieve good returns remains a key driver of growth – that is, the market is increasingly aware that this is not just about consumers wanting to align investments with their values, but is equally about delivering strong returns.

It is also noted that even though demand from institutional and retail investors is identified on both sides of the results (both as a driver and deterrent) it appears as though respondents see demand as a net driver of growth.

Appendix A

GLOSSARY

AUM – Assets under management
ESG – Environment, social and governance
GSIA – Global Sustainable Investment Alliance
PRI – UN backed Principles for Responsible Investment
RIAA – Responsible Investment Association Australasia
TAUM – Total assets under management

DEFINITIONS OF RESPONSIBLE INVESTMENT STRATEGIES

Broad responsible investment – investment that applies ESG integration as the key responsible investment strategy.

Core responsible investment – investment that applies at least one of the following responsible investment strategies:

- Screening of investments – negative, positive or norms-based screening
- Sustainability themed investing
- Impact or community investing
- Corporate engagement and shareholder action

ESG integration – ESG integration involves the systematic and explicit inclusion of environmental, social and governance factors into traditional financial analysis and investment decision making by investment managers. This approach rests on the belief that these factors are a core driver of investment value and risk.

Negative 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.

Positive 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.

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 United Nations (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).

Sustainability themed investing – 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.

Impact investing – 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.

Corporate advocacy and shareholder action – 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.

Appendix B

ORGANISATIONS INCLUDED AND ASSESSED AS PART OF THIS REPORT

Amanah KiwiSaver
Accident Compensation Corporation
AMP Capital
ANZ New Zealand Investments
ASB Group Investments
Booster Financial Services
Devon Funds Management
Dimensional
Direct Capital
Fisher Funds Management
Foundation North
Gareth Morgan Investments / Kiwi Wealth
Generate Investment Management
Government Super Fund Authority
Grosvenor Financial Services
Harbour Asset Management
HRL Morrison
Mercer (NZ)
Methodist Trust Association
Mint Asset Management
New Zealand Superannuation Fund
Nikko Asset Management
Northern Trust Asset Management
Otago Community Trust
Pathfinder Asset Management
QuayStreet Asset Management
Rata Foundation
Salt Funds Management
Simplicity
Smartshares (formerly SuperLife)
Southern Pastures Management
The New Zealand Anglican Church Pension Board
The Waikato Community Trust
Trust Management
Westpac / BT Funds Management

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RESPONSIBLE INVESTMENT ASSOCIATION AUSTRALASIA DISCLAIMER

The information contained in this report has been prepared based on material gathered through a detailed industry survey and other sources (see methodology). The report is intended to provide an overview of the current state of the responsible investment industry, as defined by the Responsible Investment Association Australasia. The information in this report is general in nature and does not constitute financial advice. Past performance does not guarantee future results, and no responsibility can be accepted for those who act on the contents of this report without obtaining specific advice from a financial adviser. RIAA does not endorse or recommend any particular firm or fund manager to the public.

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The services provided in connection with this engagement comprise an advisory engagement, which is not subject to assurance or other standards issued by the Australian Auditing and Assurance Standards Board and, consequently no opinions or conclusions intended to convey assurance have been expressed.

The findings in this report are based on a qualitative study and the reported results reflect a perception of the respondents. No warranty of completeness, accuracy or reliability is given in relation to the statements and representations made by, and the information and documentation provided by, asset manager and owners consulted as part of the process.

The sources of the information provided are indicated in this report. We have not sought to independently verify those sources.

KPMG is under no obligation in any circumstance to update this report, in either oral or written form, for events occurring after the report has been issued in final form.