Feedback form — Consultation paper: Green bonds and other responsible investment products

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Green bonds and other responsible investment products: [your organisation's name]' in the subject line. Thank you. **Submissions close on Thursday 24 October 2019.**

Date: 24 October 2019 Number of pages: 8 including Feedback Form

Name of submitter: Ainsley McLaren

Company or entity: Harbour Asset Management Limited

Organisation type: Fund Manager

Contact name (if different): Jorge Waayman, Simon Pannett (Green Bonds)

Contact email and phone: jorge@harbourasset.co.nz, tel 04 460 8319, simon@harbourasset.co.nz, tel 04 460 8314

Question number	Response (please click on link)
1	*#What do you consider to be the key features that make a financial product green, ethical, or otherwise responsible?*
2	*#What are the key risks associated with green, ethical or otherwise responsible investment products?*
3	*#Which certifications, standards or sector exclusion lists do you think are appropriate for green, ethical or otherwise responsible investment products?*
4	*#What should disclosure for a responsible investment product include? How will this ensure investors are not misled about the nature, characteristics or suitability for purpose of a responsible investment product?*
5	*#What are the key questions an investor should ask about responsible investment products?*
6	*#What due diligence and governance arrangements should be in place to support green, ethical or responsible investment objectives: a. For an issuer of green, ethical or responsible investment products, including MIS managers as issuers of ESG funds? b. For a MIS manager investing in green, ethical or responsible investment products?*
7	*#What should be included in a Statement of Investment Policy and Objectives for registered MISs that have green, ethical or responsible funds?*
8	*#What best practice features should MIS managers include in disclosure to ensure investors properly understand the nature of underlying investments?*
9	*#What other circumstances raise disclosure issues that our guidance should cover?*
10	*#What other matters should our guidance include to:*
Green Bonds	*#Introduction*
Green Bonds	*#Disclosure*

Green Bonds	*#Responsible Nature*
Green Bonds	*#Event of Default*
Green Bonds	*#Ring-Fenced Assets?*

Feedback summary – We have answered these questions from two different perspectives, both of which apply to Harbour Asset Management Limited ("Harbour", "we", "our", "us"). We issue managed funds under our MIS license (refer Part 1) and we are also an investor in green bonds (refer Part 2).

Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

Thank you for your feedback – we appreciate your time and input.

Proposed guidance on green bonds and other responsible investment products

We have answered these questions from two different perspectives, both of which apply to Harbour Asset Management Limited ("Harbour", "we", "our", "us"). We issue managed funds under our MIS licence and we are also an investor in green bonds.

Our responses are presented separately for clarity.

Part 1: Investment Product Issuance

1. What do you consider to be the key features that make a financial product green, ethical, or otherwise responsible?

We believe that each of these terms should be clearly defined in order to promote transparency to investors in the type of product they are investing in. These terms are often used interchangeably by both providers and consumers of the products which can lead to a misalignment in expectations and outcomes. We have provided our recommendations of how these terms should be defined below:

Green:

This tends to be the more ambiguous term with no formal definitions from any of the main ESG organisations. We believe this term refers to an environmental strategy/investment that aims to deliver a positive impact e.g. renewable energy, forestry, water technology etc.

Ethical (or SRI):

We support the RIAA definition mentioned in their benchmark reports: "…This approach involves screening that systematically excludes specific industries, sectors, companies, practices, countries or jurisdictions from funds that do not align with the responsible investment goals…"[1]

We believe that ethical investing involves value judgements about what is an acceptable investment and what is not. Ethical is a type of responsible investing, but not all responsible investing funds are necessarily ethical. Because ethical investing includes value judgements about what constitutes 'ethical', different options would suit different investors depending on their beliefs.

Responsible Investment (RI):

We support the RIAA definition: "…A process that takes into account environmental, social, governance (ESG) and ethical issues into the investment process of research, analysis, selection and monitoring of investments…"[2]

To us, responsible investing is an umbrella term. It can include ethical investing, but not exclusively.

---

[1] https://responsibleinvestment.org/wp-content/uploads/2018/08/RIAA_RI_Renchmark_Report_AUS_2018v6.pdf

[2] https://responsibleinvestment.org/what-is-ri/ri-explained/#approaches

It is also important to distinguish between an investment with a sole purpose of providing an environmental or social outcome and a company that manages its environmental and social externalities from its primary business activity.

2. What are the key risks associated with green, ethical or otherwise responsible investment products?

There is a taxonomy issue. Different labels such as green, ethical and responsible can be conflated by providers depending on their perception of the label that is more marketable to potential investors. This can create confusion for investors who attempt to compare products that may have the same label but offer a different type of financial product.

Another issue is 'greenwashing'. We would like to stop misleading or deceptive statements/ representations using the words green, ethical, and responsible. These terms are at risk of being utilised to market financial products which may not include any more responsible, ethical or green investing than any other financial product on the market. Investors may perceive a higher value from these products and can pay a higher fee for a service that the product does not actually offer. This represents fraudulent behaviour that needs to be regulated.

3. Which certifications, standards or sector exclusion lists do you think are appropriate for green, ethical or otherwise responsible investment products?

The Green Investment Group, part of Macquarie Bank, have established guidelines around what qualifies as a green investment. This could be used by the FMA as guidance in formulating standards for New Zealand.

In terms of responsible investing, we trust and would recommend RIAA's certification programme. The programme is robust in the criteria and process used in order to achieve certification for a responsible investing product. It includes submission of a detailed questionnaire that is reviewed by their certification team and Board sub-committee, and all data provided is independently verified. Annual spot audits are also conducted by RIAA or a third party to ensure integrity of the product.

We do not think responsible investment products should be rated solely on consultant assessments because the underlying data is often derived from ESG research houses which differ in their methodologies. The focus should be on the transparency and robustness of the process, not on the subjective ESG ratings of the product's security holdings.

4. What should disclosure for a responsible investment product include? How will this ensure investors are not misled about the nature, characteristics or suitability for purpose of a responsible investment product?

We believe responsible investment products should be required to disclose their processes clearly, so investors are able to make informed choices about whether the responsible investment product suits their values and beliefs. This includes elements such as negative screening of particular securities or industries, integration of ESG research and the sources of the research.

Disclosures should distinguish between different types of responsible investment strategies because each represents a different process that leads to different investment outcomes. These strategies include screening, integration, thematic and impact investing.

If the product is labelled ethical, it should be required to disclose what ethics it is following specifically (ie anti-smoking, anti-gambling, religion-based, vegan).

Responsible and ethical investing should go beyond the exclusion of securities which are banned in New Zealand (ie cluster munitions). Simply following applicable laws should be the basic standard for all financial products, and not sufficient to qualify as responsible or ethical.

5. What are the key questions an investor should ask about responsible investment products?

a) Is the manager clear about what they are doing?
b) Are they doing what they say they do?
c) How do they achieve their responsible objectives?

6. What due diligence and governance arrangements should be in place to support green, ethical or responsible investment objectives: a. For an issuer of green, ethical or responsible investment products, including MIS managers as issuers of ESG funds? b. For a MIS manager investing in green, ethical or responsible investment products?

a) We encourage supervision of MIS schemes via auditing & licenses. We believe the Supervisor is the best option to oversee and govern whether an MIS manager is meeting the industry standards around responsible and ethical products.

b) Please refer to our submission following.

7. What should be included in a Statement of Investment Policy and Objectives for registered MISs that have green, ethical or responsible funds?

A clear statement about how the manager is achieving their responsible investment objectives, ie whether it involves negative screening of particular securities or industries, integration of ESG research and the sources of the research.

Disclosures should distinguish between different types of responsible investment strategies because each represents a different process that leads to different investment outcomes. These strategies include screening, integration, thematic and impact investing.

If the product is labelled ethical, it should be required to disclose what ethics it is following specifically (ie anti-smoking, anti-gambling, religion-based, vegan).

8. What best practice features should MIS managers include in disclosure to ensure investors properly understand the nature of underlying investments?

How the responsible investment objectives are achieved, ie negative screening, integration, thematic or impact, and which, if any, ethical considerations are specifically included.

9. What other circumstances raise disclosure issues that our guidance should cover?

Responsible and ethical investing should go beyond the exclusion of securities which are banned in New Zealand (ie cluster munitions). Simply following applicable laws should be the basic standard for all financial products, and not sufficient to qualify as responsible or ethical.

10. What other matters should our guidance include to:

- Promote and facilitate the further development of the broader responsible investment product market by providing greater clarity about the FMA's expectations; and
- Ensure investors have a clear understanding of what they are being offered and the risks involved, and are able to make informed and deliberate choices?

Incorporate the concept of responsible investment in programmes designed to improve the financial literacy of investors in New Zealand.

Alert investors to the potential for greenwashing.

Part 2: Green Bonds

This part of our submission relates to our role as a consumer of debt security regulation.

Our view can be summarised as follows:

We believe the responsible debt securities market in NZ is evolving alongside global best practise. Given the evolving nature, and generally high degree of probity displayed, we believe prescriptive guidance is unnecessary and could be detrimental. Instead we would encourage a general guidance note incorporating the below specifics:

- The terms sheet should be required to disclose a description of the bond's responsible and (mandatory) certification as well as a description of the consequences of the bond losing its responsible status.
- We believe investors would benefit from a succinct understanding of an issuing entities' 'responsibility' beyond the assets backing a particular debt issue.

Introduction

First, a word on terminology: the consultation paper refers extensively to 'green <u>bonds</u>' while distinguishing between green, ethical and otherwise responsible <u>financial products/schemes</u>. We believe the debt securities market may evolve beyond 'green bonds' to encompass a range of 'otherwise responsible' debt securities. Thus, we use the umbrella term 'responsible debt securities' rather than the specific 'green bond'.

As a general comment, we believe the responsible debt security market is more advanced in setting transparent and reasonable standards than is the market for unit trust investment products. Indeed, we believe the debt securities brought to market thus far have followed global best practice in transparency, concise documentation, certification and on-going verification. As an appendix, we provide an example of the information currently provided to investors noting it is clear and concise and, in our view, a fair representation.

Disclosure

Investors in responsible debt securities face two unique risks 1) that they are misled about the nature of debt instrument, i.e. what made the responsible bond 'responsible' and 2) that the debt instrument fails to remain 'responsible'.

We think transparency goes some way to mitigate against these risks. The market has evolved to disclose a) a description of the bond's nature including a link to the certification methodology and b) what happens in the event of a loss of responsible status. We would consider it reasonable to make these disclosures mandatory. We believe a terms sheet is a sufficient capture of this information and do not believe a separate PDS document is necessary which would likely dissuade issuance.

We warn against any regulation that:

- Requires lengthy disclosure and therefore becomes obscured and/or difficult for investors to digest
- Is overly prescriptive. Best practice is a fluid concept globally. For example, the Climate Bond Initiative is still finalising standards for hydro assets and setting detailed standards may inhibit the New Zealand market evolving alongside global best practise as it currently is. We believe it would be too difficult to define standards or, for example, prescribe a list of approved certification agency, given ongoing evolution.

We lament the obstacles in being able to provide a rigid standard as presented above. Prescriptive regulation could reduce the risk of investors buying bonds that fail to meet their expectations regarding the degree of responsibility; ultimately it could reduce the risk of 'greenwashing'. However, we accept this is the reality given evolving standards, the on-going emergence of certification agencies and developing processes of ratings agencies.

Instead of issuing prescriptive guidance, we would encourage the FMA to provide a general guidance note with respect to green bonds encouraging best practice and highlighting its powers should issuers (and originators) act to mislead or confuse investors.

Responsible Nature

We think it's important that investors realise an issuer of a responsible bond is not necessarily a 'responsible' entity in its entirety – the bond may be helping them become more so. This is one area where the industry would benefit from more clarity. Thus far, issuers have described the use of proceeds and we would encourage this continuing. While other submitters may not go this far, we would also encourage the addition of a succinct disclosure regarding the issuer's overall 'responsibility' to protect against both 'greenwashing' and misleading investors. We look beyond the green label at an entity's entire behaviours when assessing the ESG credentials of an issuer. Unfortunately, we are unaware of a third-party entity, akin to a ratings agency, that currently provides a summary metric for all issuers. This is the point we feel most strongly about.

Event of Default

Bonds issued in NZ have followed global norms in that a loss of green status does not constitute a default event or trigger a requirement for repayment. We believe it would be possible, and indeed preferable for many investors, for responsible debt securities to require repayment in the event of losing their status. However, while theoretically possible, given intercreditor agreements, this would likely make responsible financing too complex and expensive for issuers and thus dissuade issuance. We therefore accept the global norm.

Ring-Fenced Assets?

With regards to your question on page 5 of the consultation document about the requirement for responsible debt securities to be serviced by the assets which they have funded, we believe this would add a layer of complexity, cost and likely risk, such that it may discourage issuance and therefore not be supportive of furthering sustainability. This is all the more reason for investors to receive information about the responsible nature of the overall entity and not just the assets notionally backing the debt.

Green Bond Framework

Argosy

Use of proceeds	► The proceeds of the Offer are intended to be used to refinance existing bank debt that supports Green Assets.
External review	► EY has issued a reasonable assurance report to Argosy, advising that Argosy's pre-issuance process in relation to the Green Bonds (as described in the Green Bond Framework) meets the requirements of the Green Bond Principles in all material respects.
Monitoring & compliance	► The Green Bond Framework provides that an annual assurance process will be undertaken by an independent third party assurance provider.
Reporting	► The Green Bond Framework provides for Argosy to publish semi-annual use of proceeds reports and report on any changes to the Green Bond Framework.
Evaluation of Green Assets	► To be eligible to be a Green Asset under the Green Bond Framework, the project or building must be certified as obtaining or targeting: ► A Green Star "Built" rating of at least 4-Stars; or ► A NABERSNZ "Energy Base Building Rating" or "Energy Whole Building Rating" of at least 4-Stars.

You can find the Green Bond Framework located on Argosy's website here http://www.argosy.co.nz/investor-centre/greenbondframework/.

23 ► www.argosy.co.nz

Argosy Green Bond Offer, Investor Presentation 20 February 2019