

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

About this consultation

This consultation seeks issuer and investor input on green bonds and other responsible investment products that expressly take into account environmental, social, and/or governance considerations.

Submissions will initially be used to help us develop guidance for issuers. We will also publish separate material on our website covering matters that may be relevant for investors, including questions they should ask of product and service providers, and examples of different kinds of responsible investing products and their features and risks.

This consultation, and the resulting guidance and investor information, will be particularly relevant for:

- issuers of green bonds (wholesale and retail)
- managers of managed investment schemes (MIS), including KiwiSaver schemes, that are labelled as 'responsible' or have responsible investment objectives
- retail and wholesale investors in these products
- financial advisers
- any other financial service provider or issuer promoting itself or its financial products or services as responsible.

Next steps

The final day to make a submission on this consultation is **Thursday 24 October 2019**. After we consider all submissions, we intend to finalise our guidance and publish it on our website.

Document history

This version was issued in September 2019 and is based on legislation and regulations as at the date of issue.



Draft guidance	3
Consultation questions	7
Feedback form	8

Draft guidance

Introduction

There is a growing demand for responsible investment products. In response, issuers are now offering an increasing array of products. While the FMA supports the development of the market for these products, there are associated risks and issues to consider. These largely arise from the lack of common understanding of what makes an investment 'responsible'.

We are keen to benchmark what good conduct and good disclosure look like in the context of responsible investment, to ensure issuers focus on meeting investor needs.

The objectives of this guidance are:

- to promote and facilitate development of the broader responsible investment market by providing greater clarity for issuers about the FMA's expectations.
- to ensure investors have a clear understanding of what they are being offered and the risks involved, and are then able to make informed and deliberate choices.

Throughout this paper we use the term 'responsible investment product' to refer to any product that expressly takes into account environmental, social and/or governance (ESG) considerations.

Risks and issues

Responsible investment adds a layer of complexity to the investing landscape. Approaches to product design vary, and there are no agreed standards for what makes something green, ethical or responsible.

It can be difficult for investors to determine how responsible a financial product is. Without adequate disclosure it is difficult to tell whether an issuer has extensively validated their product's features, or is overstating the greenness of their product ('greenwashing') to take advantage of market hype and investor demand.

There is also risk of a mismatch between what investors think is meant by 'green', 'ethical', or 'responsible', and how issuers use those labels.

The challenge for issuers of responsible investment products is ensuring that investors are not likely to be misled by the labels used. Issuers also need to ensure that the nature, characteristics, suitability and associated risks of their particular responsible investment products are adequately explained to investors.

Legal context

Other than for KiwiSaver, there are no requirements in New Zealand financial services legislation specifically aimed at green, ethical or other responsible investment products or services.

Section 129 of the KiwiSaver Act requires all KiwiSaver providers to include in their product disclosure statements (PDS) a statement about whether the scheme takes responsible investment, including ESG considerations, into account in its investment policies and procedures. It is up to providers to decide the extent to which those matters are taken into account and what responsible investment means.

However, the absence of specific requirements does not mean the existing law cannot accommodate new financial products.

All regulated offers, including those of responsible investment products, must explain features, benefits and returns to investors in accordance with Part 3 of the FMC Act and the related Regulations. All types of responsible investment products and services are also subject to the overarching fair dealing provisions in Part 2 of the FMC Act. These provisions prohibit misleading or deceptive conduct, false or misleading representations and unsubstantiated statements in relation to all offers of financial products (retail and wholesale) and services, made to all types of investors, regardless of where they are located.

Like all provisions of the FMC Act, Part 2 applies despite any purported disclaimers (which in themselves would be misleading).

Complying with fair dealing requirements

Important points for providers of responsible investment products and services to consider in the context of Part 2 include:

- whether claims made in relation to the responsible investment product or service are substantiated
- what might need be included in information provided to investors and customers to ensure that people are not misled about the nature, characteristics, or suitability of the financial product or service
- what the overall impression is (ie, could what has or hasn't been said or done leave a misleading impression, even if everything said is absolutely true and verifiable?).

These are overarching considerations in the provision of financial products and services. They apply not only to the terms and conditions of the financial product or service, but to all promotional material – including online and in social media posts, and to both acts and omissions.

What makes something green, ethical or responsible?

We are not proposing to set out prescriptive definitions of 'green', 'ethical', or 'responsible'. We are keen to work with issuers and investors to benchmark what good conduct and good disclosure look like.

As a starting point, we expect issuers to substantiate and explain labels attached to their products. We also expect issuers to have appropriate governance measures in place to ensure their products are fit for purpose and true to label, both at the point of sale and on an ongoing basis.

In the case of green bonds, substantiating that something is 'green' includes making it clear whether the 'greenness' relates to a specific asset or project of the issuer (eg proceeds from the issue are used to develop a specific green asset such as a sustainable, solar-powered building), or to the issuer's entire business. While both these types of 'greenness' can make positive contributions to a sustainable financial sector, they could be quite different from an investor's perspective.

More generally, we consider that, in the context of the Part 2 fair dealing requirements, disclosure for a responsible investment product should include consideration of the following questions:

- What makes the financial product green, ethical or otherwise responsible? For example:
 - Is the product labelled as green, ethical or otherwise responsible solely by virtue of the intended use of proceeds towards self-selected qualifying projects with no independent assurance?

- Is the product independently certified as green, ethical or responsible, or benchmarked against recognised standards or sector exclusion lists? If so, why has that certification, set of standards or sector exclusion list been selected?
- Is there any independent third-party validation or ongoing assurance of what makes the product green, ethical or otherwise responsible?
- What are the consequences for the issuer/recourse for investors if there is a failure to maintain what makes the product green, ethical or otherwise responsible? For example, in the case of a bond, is there any contractual right of review or repayment, or limitations on the redeployment of funds to different projects? In the case of managed investment products, are the features that make the product green, ethical or otherwise responsible reflected in the Statement of Investment Policy and Objectives (SIPO) for the scheme? In each case, if not why not?
- In the case of green bonds –
 - Does the ‘greenness’ relate to a specific asset or project, and if so how does that relate to the overall greenness of the issuer?
 - Is anything preventing the issuer from trading away this greenness through the use of derivatives, such as virtual asset swaps, or the sale of emissions units or carbon offsets?
 - Can the payment obligations under the bond be met from non-green sources (noting that while that is likely to be positive in terms of the credit quality of the bond, it could compromise the claim of greenness)?

We will develop this section of our guidance, using specific examples, after we have received further input and considered submissions made in response to this consultation.

Review of KiwiSaver Default Provider Arrangements

The Government’s current [review of KiwiSaver Default Provider Arrangements](#) includes consideration of the extent to which responsible investment requirements should apply to default funds. The consultation paper notes that there is no standard understanding of what constitutes responsible investment. There is also no standard practice, but common practices include positive screening through ESG criteria, or negative screening through sector-exclusion policies. The paper notes that:

... KiwiSaver providers (including default providers) have faced criticism for their responsible investment performance. Particular points of contention have been not further developing their socially-responsible criteria and poor transparency with members regarding where their money is being invested.

The guidance we propose should help KiwiSaver providers fill in those gaps.

The key questions about responsible investment in the default provider review are:

- Whether default schemes should have mandatory exclusions, either in relation to specific sectors, by reference to recognised exclusion standards, or by requiring certification.
- Whether default providers should follow a standard method of disclosing responsible investment criteria.
- Whether to maintain the status quo, leaving it up to providers to decide how those matters are taken into account and what responsible investment means.

The outcomes of that review may be relevant to our guidance.

2019 Review of Retirement Income Policies

The Retirement Commissioner is currently carrying out a [Review of Retirement Income Policies](#). The terms of reference for that review include consideration of the public's perception and understanding of ethical KiwiSaver investments.

The outcomes of that review may also be relevant to our guidance.

Consultation questions

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:
 - 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?

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: _____ Number of pages: _____
 Name of submitter: _____
 Company or entity: _____
 Organisation type: _____
 Contact name (if different): _____
 Contact email and phone: _____

Question number	Response

Feedback summary – if you wish to highlight anything in particular

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.