Leanne Hubmann

From: Alex Carr
Sent: Tuesday, 4 April 2023 3:56 pm
To: [redacted]
Subject: RE: Integrated Financial Products
Attachments: CFA IFP presentation.pptx

Hi [redacted]

Thanks for your patience on my response. I'm glad you enjoyed the presentation. Very happy to provide the slides to you under the OIA.

Warm regards

Alex

From: [redacted]
Sent: Thursday, 30 March 2023 4:13 pm
To: Alex Carr <Alex.Carr@fma.govt.nz>
Subject: Integrated Financial Products

Hi Alex, enjoyed the IFP session with CFA this week. Were the slides going up on the sight by chance I wanted to give a summary to the board on the topic.

Kind Regards

[redacted]

[redacted]

MARCH 2023

Integrated Financial Products – moving forward

Alex Carr, Manager, Investment Management

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Investing into managed funds that are integrated financial products

- **Hard to know what you're getting**
- **Hard to know what the fund manager will do**
- **Hard to check if you're getting what you think you should get**

What we’ll cover

- Why the FMA undertook the review and made the changes; what concerned us about the situation in NZ and what do we want to see for the future.
- What did the review find?
- How has the report been received by the industry and are any changes anticipated based on feedback?

Firstly – what is an Integrated financial product?

‘Integrated financial products’ refers to financial products incorporating non-financial factors alongside financial factors. Our choice of the term ‘integrated financial product’ (IFP) reflects that other terms for the concept, while commonly used, do not have commonly shared meanings (including the terms ‘ethical’, ‘responsible’, ‘sustainable’, ‘green’ and ‘Environmental, Social and Governance’ (ESG)).

Includes other types of funds – like religion focused funds or even funds that aim towards conventionally negative outcomes.

At the core – a financial product that tries to do more than just give you a financial return.

What was the subject matter?

Managed funds, including KiwiSaver managed funds

Our focus was on managed fund products that are labelled or marketed as being integrated financial products (e.g. sustainable fund, ethical fund, green fund)

Managed funds are the most popular financial products that New Zealander’s invest in, with the widest level of uptake.

Why did the FMA look at this?

A host of issues

- Growing consumer demand = growing supply of managed funds that are integrated financial products
- Unclear language
- Impossible to compare funds
- “Race to the bottom”
- Concerns about greenwashing

Why does the fund information matter?

Guiding choice and maintaining trust

- The FMA's research indicates that investor due diligence is still brief and formal disclosure may not currently be assisting investors find the investment that is right for them.
- The lack of close engagement by investors reinforces the information advantage fund Managers have over investors and presents a significant challenge for New Zealand fund Managers.
- The fund management industry needs to provide accurate, well-placed and high-quality information to explain and support any claims that their products incorporate non-financial factors.

What did we do?

Staged approach to ‘raising the bar’

December 2020 the FMA published guidance Disclosure framework for integrated financial products (the IFP Guidance)

July 2022 - Review of offer and scheme documents (PDS, OMI, SIPO) and website information – sample of 14 MIS (including 4 Kiwisaver funds) that use IFP labels – either in product name or description.

- Tested whether:

– products that are labelled as “integrated financial products” comply with FMA guidance;

– If there are fair dealing, disclosure, or value for money concerns that the FMA should address.

Information on exclusions

Exclusions were unclear

In terms of justification for labelling or presenting their funds as IFP Funds, Managers need to do more to clearly explain what investments their IFP Funds will exclude and why.

IFP Funds we reviewed often failed to adequately explain the scope of the exclusion and relevant thresholds. Most managers failed to explain how incidents (like Russia's invasion of Ukraine) would result in exclusions.

Example – unclear exclusions

On close examination, the scope of the exclusion would elude the average investor

Unconventional oil and gas

Companies that generate more than 10% of their revenue from the extraction of unconventional oil and gas. This includes revenues from oil sands, oil shale (kerogen-rich deposits), shale gas, shale oil, coal seam gas, coal bed methane.

Our growth asset fund manager generally excludes companies (where possible) involved in:

- Controversial weapons
- Nuclear weapons
- Thermal coal production and power generation
- Tar sands production
- Tobacco producers
- Civilian firearms producers and retailers
- UN Global Compact violators

Information on positive investing strategies

Unclear and confusing

- IFP Funds using a “positive screening” approach (where an IFP Fund ‘tilts’ investment toward activities it regards as contributing to positive non-financial outcomes) they need to do more to explain how the fund will select investments consistent with their approach.
- The main shortcoming was the language used to describe the positive screening approach was so broad and non-specific as to leave the investor none-the-wiser about what the approach was supposed to achieve, or how it worked. Another issue with positive screening funds was a lack of clarity about weighting between financial and non-financial outcomes or between competing non-financial outcomes.

What would you want?

What would you expect from your fund manager?

- A manager has realized it has investments in Russia – should it sell them? If so, when?
- A manager evaluates that a company its fund invests in is about to go bankrupt, tanking the value of the investment but greatly lowering it's carbon emissions – should it hold the investment or sell?
- Should a manager invest in a company that is already "green" but has little room for improvement? Or a carbon producing company that could now more easily invest in technology to reduce their carbon impact?
- An ethical fund invests in a bank that lends to a landmine company – does the manager need to sell their shares in the bank?
- The director of a listed company makes sexist remarks in a personal capacity – should the manager sell their share in the company?
- Following Russia's invasion of Ukraine, should a manager invest in gas infrastructure that supports the Ukranian war effort?
- A fund managers has investments in private companies in Myanmar. Should it sell them in light of human rights abuses by the government of Myanmar?

What did we find?

Access

We noted that it is difficult for investors to make a decision on which IFP Fund to select, because relevant information is scattered across different sources and what information that is provided often doesn't give a complete picture or lacks sufficient detail.

Breaches and reporting

Consequences of breaches, measurement of performance and reporting were all areas where a significant majority of IFP Funds we reviewed failed to provide adequate information. Investors would find it difficult to understand what a fund would do if it identified that one of its investments were no longer appropriate under its exclusion policy.

What did we find?

- Based on this review's assessment of the quality, utility and accessibility of the information Managers provide to investors we consider that fund managers have not developed mature approaches to disclosure of the features, risks and benefits of IFP Funds.

- Our review found deficiencies in both the information that IFP Funds provide to investors, and the way in which that information is presented. These deficiencies mean that it is difficult, or in some cases impossible, for an investor to fully understand the nature of the investment they are making.

- For funds we reviewed, all of them had weaknesses in information disclosure in at least one area. Most funds had multiple areas where improvement was needed. Managers need to act to improve the quality, utility and accessibility of the information they provide to investors about the IFP Funds they offer.

Initial responses

- Generally positive media feedback and responses
- Varying responses from fund managers/industry bodies
  - It's the FMA's fault – you should come up with rules for us; or
  - The FMA is going too far
- Some increasing exposure to groups pushing the FMA to do more in this space.

Summary

- New Zealanders are clearly seeking funds that match their ethics or values, but their due diligence is still brief. This reinforces the scale of the information advantage fund managers have over investors.

- We will continue to work with MIS managers to ensure they are also helping potential and existing investors with better quality information and disclosures.

- Longer term:
  - Managers have had time to improve
  - Managers need to start improving their disclosures
  - We're done talking now

- ESG type funds are moving to a different regulatory "life phase", both in NZ and in peer countries. NZ is not being left behind in that change.

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