SEPTEMBER 2024

Ethical investing disclosure insights

This document provides an update on the Financial Markets Authority – Te Mana Tātai Hokohoko (FMA)'s supervision of ethical investment disclosure.

Background

Ethical investing is a high-trust relationship. When investors place their money in investment products that make ethical claims, it is with the expectation of an outcome that aligns with their values, and delivers an appropriate level of return.

The underlying activities and approaches taken by issuers to demonstrate the ethical nature of their products can be complex and varied. Our research shows investors do not necessarily investigate the claims being made by issuers or the underlying details, such as which assets are in which funds. Investors rely on issuers to do what they claim to be doing.

In 2020 we released our Disclosure Framework for Integrated Financial Products, which provides guidance around advertising and disclosure expectations for ethical investments. In 2022 we published findings from a thematic review of how the 2020 guidance was applied by selected managed investment scheme (**MIS**) managers. Other FMA guidance, such as our advertising guidance, also applies to ethical investing disclosure.

Monitoring market participants' ethical investment practices is now part of our supervision approach. Our supervision and guidance apply to all market participants making ethical claims for their products or services, not only to products that use ethical labelling.

Fair dealing

The fair dealing provisions in Part 2 of the Financial Markets Conduct Act 2013 (**FMC Act**) set out the standards of behaviour that those operating in the financial markets must comply with.

The fair dealing provisions prohibit:

- misleading or deceptive conduct, including conduct that is likely to mislead or deceive;
- false, misleading or unsubstantiated representations;
- offers of financial products in the course of unsolicited meetings.

Additionally, specific provisions apply to disclosures for regulated offers of financial products under Part 3 of the FMC Act. Information disclosed must not be materially false or misleading, or likely to mislead, or omit material information.

These provisions apply to issuers offering ethical investment products. Further detail around the FMA's approach to fair dealing is available on our website.

What we have seen

Since the 2022 thematic review we have done further targeted work with MIS managers about their ethical investment practices. We have not identified any situations where an issuer deliberately used ethical labelling or marketing with no intention of implementing an ethical investment strategy.

Below is a summary of some of our recent review work, which falls into the following three categories. Our engagement with managers covered some or all of these categories, depending on the issues we identified.

1. Reviewing product disclosure statements (**PDS**), statements of investment policies and objectives (**SIPO**) and other material information (which includes responsible investment policies or similar), and providing feedback to assist managers with improving the information they give to investors, including better aligning this information with how they manage their investment products by addressing the matters raised in our guidance.

   These reviews related to both existing schemes and new schemes pre-registration. We did not review all offer documentation for all schemes, but focused on offers by new issuers, and novel or complex offers.

   Confusing, unclear and inconsistent disclosure around ethical investing remains common. Of the 10 MIS schemes we reviewed, we provided feedback to all of them on disclosure issues we identified, including:

   - Using an ethical label but not providing any detail about what ethical strategy was applied.
   - Claiming to use an ethical scoring system to help make decisions about where to invest, but not explaining how that system was applied. For example, whether the score was only one factor considered along with others, or if it solely determined the available investment pool.
   - A lack of detail about what steps the manager would take when it determines an existing asset no longer complies with the investment policy, or the timeframe in which investors could expect those steps to be implemented.

   We also saw good practices including:

   - Clearly stating that what is provided in a PDS is not necessarily the full detail, and including clear cross-references to the SIPO or other material information where that detail can be found.
   - Providing the full strategy in the documents on the Disclose register, and making it clear exactly what strategy currently applies (and how the strategy may have changed) and that any related content on the MIS Manager's website only summarises the strategy and does not introduce additional information.

2. Considering whether advertising and reporting by MIS managers was misleading or deceptive, or likely to confuse investors. This covered advertising in all media (television, radio, internet etc) as well as the content on managers' websites. Reviews were either in response to complaints we received, or a result

of findings from our reviews of offer documentation (see 1 above) or assets in MIS funds (see 3 below). We observed issues including:

- Advertising around ethical investing strategies not aligning with the contents of the SIPO and responsible investing policy.
- Unclear or no reporting on planned activities such as carbon offsets and engagement with companies where investments are held.
- Managers claiming they had carbon net-zero targets but not reporting on progress being made towards those targets on a regular basis.

We engaged with managers, which led to advertising being voluntarily withdrawn and reporting being improved to make it clearer what practical steps managers have taken towards their claims and targets.

We also saw good examples designed to increase transparency for investors such as:

- MIS managers having on their website a list of companies that they do not invest in, so investors do not have to make their own judgements about the scope of any exclusion rules being applied.
- Where a manager claims to engage in shareholder voting as a part of their strategy, they report on what votes they have cast and the themes of their reasons for voting.

3. Reviewing the assets in certain MIS funds[1] to determine whether they complied with the MIS manager's sector exclusion policies (e.g. tobacco, controversial weapons, fossil fuels).

   Our reviews focused on funds with sustainable labelling or claiming third-party certification. However, we consider all funds that claim to use ethical criteria to select investments need to understand the companies they invest in and ensure those investments match the representations made by the fund.

   Where we saw potential issues we engaged with MIS managers and asked them to explain how the specific assets held were consistent with the exclusion policies. In the majority of instances the MIS manager was able to provide adequate explanation.

   It can sometimes be difficult to determine the exact nature or extent of a company invested in by the fund's involvement in an excluded sector, and different data providers can provide different information. Some managers we engaged with voluntarily elected to divest doubtful holdings to avoid any potential risk or doubt.

Future focus

Ongoing supervision

We will continue to review ethical investing practices, both proactively and in response to any complaints received. Our primary objective is to work with issuers to improve the quality of disclosure.

[1] MIS managers are required to publish the assets in each fund they are managing on the Disclose register every six months. Information on the Disclose register is free and publicly available.

We recognise that good practice in ethical investing disclosure is evolving. There is still a lack of standard practice and consistency. We consider this is best addressed through engagement, education and feedback, to support issuers to provide investors with clear and meaningful information.

We will consider exercising our regulatory powers where we believe that:

- conduct or advertising is clearly misleading or deceptive under the fair dealing provisions;
- any disclosure is materially false or misleading, or likely to mislead;
- advertising for products or services is likely to confuse investors; or
- there is a material omission under the offer disclosure provisions.

We have a range of tools within financial markets legislation to influence better outcomes or hold firms to account.

Green, social, sustainability and sustainability-linked bonds

In response to market demand for a more efficient route to market for green, social, sustainability and sustainability-linked (**GSSS**) bonds, we consulted publicly on a proposed class exemption to allow certain bonds of this type to be issued without the full disclosure required (provided they are otherwise identical to other quoted vanilla bonds already available in New Zealand). Under the proposal, issuers will have to disclose the basis on which the bond is described as GSSS. We are considering the consultation responses to determine whether a class exemption is appropriate. If we decide to grant the exemption, we expect it to be finalised in 2025.

Climate-related disclosures

The FMA is the regulator of the new climate related disclosures (**CRD**) regime. The first climate statements were lodged in April 2024 for CREs with a December year-end. We are taking a broadly educative and supportive approach to monitoring and enforcement of the CRD regime in the early years, which includes reviewing filed climate statements, and providing feedback and guidance to climate reporting entities (**CREs**) to improve disclosure in future reporting periods. This feedback will be provided through individual engagement with CREs where necessary and in a monitoring report to be published in November 2024.

Regulatory trends

There is a trend nationally and internationally towards clearer definition and standardisation of what constitutes a ‘sustainable’, ‘ethical’ or similar investment. We will be watching those developments and considering how they may impact the investment market in New Zealand. We will be taking account of any material developments that arise from the Sustainable Finance Taxonomy[2] currently under development by the Ministry for the Environment, which would help investors to identify sustainable activities.

[2] Sustainable finance taxonomy for New Zealand | Ministry for the Environment