Mindful Money

Inside the Black Box of New Zealand Investment Funds

Mindful Money research report on progress towards Ethical Investment

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Inside the Black Box of New Zealand Investment Funds

This research report provides a snapshot of the portfolio holdings of all KiwiSaver and New Zealand retail investment funds, categorised according to issues that the New Zealand public would like to avoid. It forms part of larger report on The State of Ethical Investing[1] in New Zealand to be released later in 2020.

Executive Summary

Mindful Money has brought transparency to investment. For the first time, New Zealand investors in all forms of managed funds have access to information about how their money is invested. Mindful Money is unique in providing information to the public on which companies they invest in, categorised according to the types of companies they want to avoid.

Across KiwiSaver funds and retail investment funds, greater transparency has contributed to higher ethical standards applied by managers of KiwiSaver schemes and retail investment funds. As a result, there has been a significant decrease in the investments that New Zealand retail investors would like to avoid.

This has been particularly significant in some of the most controversial issues such as gambling, weapons and fossil fuels. For example, the proportion of KiwiSaver funds invested in fossil fuels declined by 23% over the past year to end March 2020. There has been a fall in the proportion of investment across all issues of concern[2] as more funds have deepened their ethical policies and practices.

Even so, $6.4 billion of retail KiwiSaver and investment funds are still invested in companies that most New Zealanders would like to avoid. These are particularly concentrated in Animal Welfare issues (measured by non-pharmaceutical products tested on animals), Human Rights violations and Fossil Fuels. These issues are amongst the most serious concerns for investors.

Exclusions are not the only measure of ethical management and the Mindful Funds include providers that primarily use strategies of managing Environmental, Social and Governance (ESG) risk. This entails avoiding the worst companies, rather than excluding the sector, and engaging with other companies to improve their performance. There has been a huge rise in ESG practices internationally and in New Zealand, and there are good examples of how New Zealand investment funds are using engagement to positively influence company practices.

However, analysis of the data shows that claims of ESG management are not always reflected in the composition of portfolios. Fund providers that claim to use ESG management often have companies that behave badly and are resistant to change, as shown by Exxon-Mobil being included in the portfolios of 126 KiwiSaver funds. It is important that claims of using ESG management are backed up by reporting on the outcomes of engagement with companies, and externally verified.

The analysis of drivers shows there is a revolution happening in investment. The traditional approach to balancing risk and returns is being supplanted by the inclusion of impact as the third axis. The public is demanding that their funds are invested ethically, and they are now being presented with more choice in the form of a wider range and a deeper commitment to ethical standards.

This first wave of progress towards a more integrated view of investment in society is gathering pace in New Zealand. It is primarily focused on avoiding damage from investment using negative screening and ESG management. Yet to come are viable options for investment in positive environmental and societal impacts, and a wider process of integrating social and environmental issues into the core of sustainable finance. These would contribute towards improved well-being, the Sustainable Development Goals and a safe climate.

Driving Change Towards Ethical Investment

The growth in ethical investment can be tracked by membership of the Principles for Responsible Investing (PRI). It now includes organisations with $110 trillion of funds under management. While this is a significant proportion of global funds under management (around 40%), the example of PRI also illustrates that signing up to a policy does not mean it is fully or consistently implemented.

There are diverse motivations for investing ethically and a range of drivers for growth.

Ethical alignment – the history of the ethical investment movement started with exclusions, often demanded by religious organisations, covering issues that were inconsistent with their moral principles such as slavery, usury and apartheid. Now a broader ethical consumerism movement is on the rise and consumers are demanding more transparency and higher ethical standards for the products they buy. Similarly, avoiding investments in companies that do not align investors' values is important to many individuals, charities and religious organisations.

Managing risk – analysing and managing risk is at the heart of financial management. Risks related to Environmental, Social and Governance (ESG) factors are now significant (or 'material') to most businesses. There have been many celebrated cases of companies that have suffered massive financial losses or bankruptcy because they failed to manage ESG risks, including Enron, Arthur Anderson, BP, Volkswagen and Wirecard. Legal opinion suggests that not only should investors consider ESG risks as part of good practice, they are failing in their fiduciary duty if they do not do so.

There is growing evidence that sound ESG management not only manages risk, but also provides returns that, on average, are at least as high as conventional funds. Funds that under-weight declining sectors such as fossil fuels have benefitted from

[1] Throughout this report, the term ethical investing is used, rather than responsible, green or sustainable investing. There are definitions of these terms that point to substantive differences, but those definitions and the standards that underlie them, are not widely understood or accepted. Therefore, the term ethical investing is used throughout, reflecting the report's focus on retail investing, and the fact that ethical investing is the term most recognised by the public for investment that takes social and environmental issues into account.

[2] Issues of concern are the sectors or types of companies that investors would like to avoid, according to annual surveys. Further detail is in the Methodology Annex.

higher returns. International and New Zealand comparative analysis showed that ethical funds out-performed their comparator indexes during the initial months of the COVID crisis.

Improving impact – in addition to managing risk, there are other reasons for investors to take environmental and social issues into account. Some company impacts, for harm or good, are not reflected in financial costs or benefits. Many companies, individual investors and investment funds aim to have a positive impact in society. Perhaps the most significant change to thinking on investment practice has arisen from the recognition that company practices result in a range of impacts, ranging from serious harm through to transformative benefits.

This has been given prominence by annual letters from Larry Fink, CEO of BlackRock, the world's largest investment manager, in which he calls on companies to have a positive business purpose with regard to their impacts on society. The impact responsibility of investors has also taken on urgency in the context of the climate emergency. Therefore, the impact of a company is increasingly recognised as the third axis for investment management, alongside risk and return.

Active stewardship – proper governance of corporations requires shareholders to be active in holding management to account. However, with the increased concentration of shareholdings in institutional investors, this duty has been neglected. Engagement in the policies and practices of companies with regard to ESG factors is now considered part of active stewardship and good practice for institutional shareholders.

Regulation – there is a growing willingness for some governments to provide a regulatory framework that promotes ethical investing. This has been seen in the framework for public finance institutions such as the Norges Bank (Norway's Superannuation Fund) and the New Zealand Super Fund, but also in broader frameworks. The EU's Sustainable Finance Action Plan is one of a number of plans in various stage of formation, including the roadmap being developed through the Sustainable Finance Forum in New Zealand.

Ethical Investment in New Zealand

Ethical investing has remained a niche in the New Zealand investment market until recently. There was a public outcry in 2016 over KiwiSaver investments in tobacco and weapons like cluster munitions, and as a result most funds excluded companies in those categories. This increase in negative screening for tobacco and controversial weapons was reflected in a rapid increase in ethical investment reported in annual benchmark reports from the Responsible Investment Association of Australasia (RIAA).

The annual survey of the New Zealand public's attitudes to ethical investing, undertaken by Mindful Money and RIAA, has shown an increase in the proportion of respondents expecting their fund provider to behave ethically and responsibly from 72% in 2018 to 83% in 2019.

However, most funds did not extend their exclusions beyond tobacco and controversial weapons to include other factors that the public want to avoid, as described in this report. Many fund providers have remained sceptical about whether the public really cares about ethical issues and the impact of their investments.
This has created a gap between the offerings of most providers and an increasing demand for ethical investment funds as a result of higher social and environmental awareness.
The reasons why more members of the public have not proactively invested in ethical funds was revealed in the annual public surveys – principally it is because they lack objective information, they have no time to do the research and compare options, and they doubt the credibility of funds of offer. Mindful Money's online platform was designed to address these barriers.

Over the past year, Mindful Money has contributed to the increased demand and activity. In terms of direct impact on consumer demand, investors with funds totalling $10 million have shifted into 'Mindful' KiwiSaver funds in the first year. Mindful Money has set a target of $50 million for year two. Anecdotal evidence from investors and fund providers suggests that the value of funds shifted is far higher, since many investors undertake the research on Mindful Money's website and then go directly to the provider to invest.

Interviews reveal that these changes have already contributed to a significant impact on the sector. What gets measured gets managed. The transparency that Mindful Money's public disclosure brings is changing the practices of investment providers.

These factors, and the broader range of drivers above, are changing the investment approaches of individuals, institutions and fund providers. A number of New Zealand fund providers are now implementing more stringent responsible investment policies and portfolio management practices and have applied for their funds to be included on the Mindful Money platform. A wave of change is sweeping through the New Zealand investment sector.

KiwiSaver Portfolio Analysis

There has been a sharp drop in the proportion of KiwiSaver funds invested in companies of concern, from 7.3 to 6.3% in a single year This is a positive development, showing the benefit of transparency – what gets counted (and put into the public domain) gets managed.

By way of explanation, the analysis of KiwiSaver funds below includes all unrestricted funds (available to members of the public) and restricted funds where data is available (e.g. Christian KiwiSaver, Medical Assurance Society). The portfolio holdings include securities that funds invest in directly and securities they invest in indirectly through funds and Exchange Traded Funds.
The companies are categorised into ten types of companies that the public are concerned about, and would like to avoid, as shown in annual surveys. Further details of the methodology are provided in Annex 1.

Analysis of KiwiSaver funds by issues of concern to the NZ public

NZ$000	March 2019	September 2019	March 2020	% total KiwiSaver
Issues of concern:				
Tobacco	14,356	17,148	16,346	0.03%
Alcohol	428,457	489,017	424,851	0.66%
Gambling	262,420	254,712	157,052	0.24%
Adult Entertainment	0	6	0	0.00%
Subtotal Sin Stocks	*705,233*	*760,884*	*598,249*	0.93%
Fossil Fuels	1,155,446	1,261,694	961,334	1.50%
Weapons	183,668	166,402	123,690	0.19%
Human Rights and Env.	730,382	772,707	762,029	1.19%
Animal Welfare	1,425,798	1,623,497	1,466,639	2.28%
Palm Oil	9,088	10,535	6,281	0.01%
GMOs	143,585	149,893	150,328	0.23%
Issues of concern	**4,353,201**	**4,745,611**	**4,068,551**	6.33%
Total KiwiSaver funds	59,304,558	66,025,480	64,268,809	
% Issues of Concern	7.34%	7.19%	6.33%	

Key Insights From the KiwiSaver Data

Although KiwiSaver funds invested in issues of concern has only dropped by 6.5% in value, there has at the same time been an increase in the value of overall KiwiSaver investments. The fall in proportion of funds that are in issues of concern is a significant fall of 13.7% in a single year. In particular, the declines have occurred through divestment from companies in gambling, weapons and fossil fuels. These are important issues for New Zealand investors, as shown in annual surveys.

It is even more significant given the increase in ETFs and passive funds which follow the market averages and include relatively high proportions of issues of concern. New Zealand fund providers are increasingly seeking out the ETFs and passive funds that exclude not only tobacco and controversial weapons, but also a range of other issues that are important to their clients.

KiwiSaver providers on the Mindful Money platform are Amanah Ethical, AMP Responsible Investment, Booster SRI funds, CareSaver, Christian KiwiSaver, Kiwi Wealth, Mercer, QuayStreet SRI, Simplicity and SuperLife Ethica.

Managed Retail Investment Funds Portfolio Analysis

The analysis of retail investment funds includes all unrestricted funds (available to members of the public) and some restricted funds (not available to all members of the public) where data is available (such as Medical Assurance Society and Whai Rawa).

Analysis of retail investment funds by issues of concern to the NZ public

NZ$000	September 2019	March 2020	% of Funds
Issues of concern:			
Tobacco	35,163	42,442	0.09%
Alcohol	234,082	197,434	0.40%
Gambling	241,895	132,668	0.27%
Adult Entertainment	39	63	0.00%
Subtotal Sin Stocks	*511,179*	*372,607*	0.76%
Fossil Fuels	838,134	622,848	1.26%
Weapons	88,825	82,693	0.17%
Human Rights and Env.	407,957	446,427	0.91%
Animal Welfare	727,011	740,158	1.50%
Palm Oil	7,347	5,387	0.01%
GMOs	78,148	76,124	0.15%
Issues of concern	**2,658,601**	**2,346,244**	4.76%
Total KiwiSaver funds	48,427,170	49,287,349	
% Issues of Concern	5.49%	4.76%	

Note: the total fund value for September 2019 is an estimate, using March 2020 data because September 2019 data is not available.

Key Insights From Retail Investment Funds Data

Some implications from the data for retail investment funds as a whole are as follows:

- The proportion of overall investment in companies of concern is lower than for KiwiSaver funds. There are several reasons:
    - This reflects the greater diversity in fund types and approaches for managed investment funds. Compared to KiwiSaver schemes, there is a far lower concentration in a few large funds that have high levels of issues of concern
    - This may also reflect the ethical expectations of High Net Worth clients and institutions like trusts or charities

- Over the past six months, there has been a fall in the value and proportion of funds invested in companies of concern. This reflects two major factors that are at least partly related to Mindful Money's advocacy for ethical investing and transparency about portfolio holdings:
    - Funds are reducing their involvement to avoid public scrutiny and adverse comment over their high levels of investment in companies the public wants to avoid
    - More funds are deliberately reducing their investments in companies that have ESG risks, as they deepen their understanding of ESG management

- There are other reasons related to the current downturn:
    - In an environment of uncertainty, funds are holding a higher proportion of cash and government bonds, rather than company equity and bonds that have higher ESG risks. Analysis of changes in asset mix show this is not a major factor.
    - Some of the high risk sectors are in decline – most notably fossil fuels. A number of fund managers have targets for allocations to sectors like energy and have maintained the target level during fossil fuel share price declines. Without these targets the fall in fossil fuel investments would have been larger.
    - Managed fund providers on the Mindful Money platform are Amanah NZ, AMP Capital Ethical Investment Leaders funds, Booster SRI funds, Kiwi Wealth, Mercer, Pathfinder, QuayStreet SRI, Salt Carbon Fund, Simplicity and SuperLife Ethica.

Sector-Related Issues

Tobacco: Surprisingly, investments in tobacco producers and retailers have risen, especially for retail investment funds. This results mainly from the inclusion of tobacco companies in passive funds and ETFs, and the rise of passive investments as a proportion of total funds under management. This is especially the case for managed investments.

The effect of adverse publicity over tobacco investments in 2016, focused on the KiwiSaver scheme, is reflected in the lower proportion of tobacco investments as a total of KiwiSaver funds. Analysis of the data shows there are a number of providers that have a policy of excluding tobacco that have not fully done so.

Alcohol: Investment in alcohol for KiwiSaver funds has not fallen to the same extent as other sectors. A recent Mindful Money online seminar heard evidence of serious alcohol harm in New Zealand, especially amongst Māori communities. The seminar also looked at the international structure of the alcohol industry, including the use of multiple brands by the major corporations, and examined investment approaches to reduce alcohol harm.

Gambling: Investments in gambling have fallen sharply, in both KiwiSaver funds and retail investment funds. This reflects both a current decline in activity and company value during the COVID crisis, but also the decision by many New Zealand funds to reduce gambling exposure or divest completely.

Fossil fuels: Managed investment funds are progressively reducing their investments in fossil fuels, either selling the most risky and polluting companies or divesting from the sector as a whole. Those being selective are often using a staged approach of selling producers of dirty fuels, such as thermal coal, tar sands, oil from the Arctic or shale oil. They are also exiting companies that are not making a transition to renewable energy.

Other fund managers are choosing not to divest but to engage with the companies that are committed to making progress. There are good examples of some oil and gas companies that are investing heavily in renewables, but they remain a small minority of companies. The active engagement by fund managers is encouraging fossil fuel companies to make promises and set targets, but the pledges are not all they seem to be. Most of the sector remain wedded to an emissions-intensive business model. The oil majors spent only 1% of their budgets on renewable energy in 2018. This is not the transition that a climate emergency needs.

It would be expected that the rise in use of ESG management by New Zealand fund managers would mean that energy portfolios would include more of the best performers. However, most investment still goes to the oil majors that have a business model that is resistant to change through engagement.

Companies such as Exxon-Mobil have not only been slow to switch to clean energy, but they also have a record of funding climate deniers and lobbying against climate regulation. They still attract most investment in the energy sector – 126 KiwiSaver funds have investments in Exxon-Mobil. Given the poor record of the fossil fuel sector in renewables investment and the continued dominance of the oil majors in portfolios, it is unsurprising that a large number of investors would prefer to divest.

Although there are varied reasons for fund managers to take action on fossil fuels, the financial risks of continued fossil fuel production have become even more prominent over the five years since warnings by then Bank of England governor Mark Carney and others. Analysis shows fund returns would have been higher for New Zealand funds without the negative returns from fossil fuel companies resulting from collapse in their value.

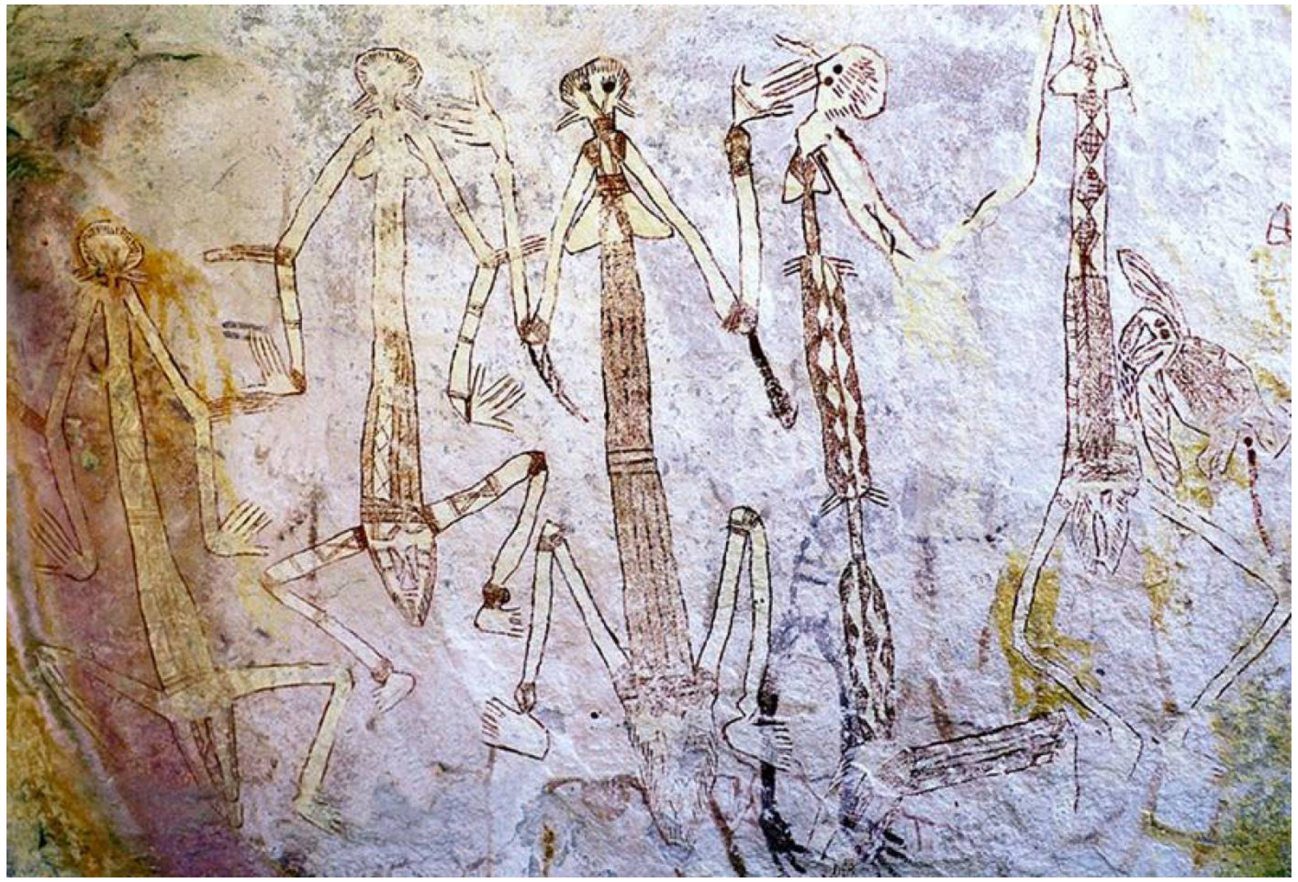
The global divestment campaign is still building internationally. Institutions managing nearly $15 trillion of financial assets have committed to divest, together with 42 faith leaders, cities, universities and others. The campaign in New Zealand has recently been influential in the decision by the ACC to partially divest, along with universities and city councils. There is a growing list of KiwiSaver and investment funds that have a policy of divestment . Funds with recently adopted policies include Mint Asset Management, NZ Funds and Hunter Investment. It is likely that new government regulations on KiwiSaver default funds will make fossil free portfolios a norm for many KiwiSaver providers.

Weapons: Investments in weapons companies have fallen, particularly in KiwiSaver funds. As with tobacco, KiwiSaver funds with investments in cluster munitions and other controversial weapons were highlighted in 2016. In the wake of the Christchurch shootings there has been a move by fund providers to expand their definitions for exclusion of weapons, from solely controversial weapons to include firearms and, in many cases, to exclusion of all weapons.

Even so, there is still significant investment, even in controversial companies. Mindful Money's analysis, using March 2019 data, showed that $100 million of KiwiSaver funds is invested in companies that derive at least 10% of their revenues from nuclear weapons manufacture.

Human Rights and Environmental violations: As well as sectors of concern, the public wants to avoid companies that contravene international norms by violating human rights and causing environmental damage. The annual surveys show that this is one of the areas of greatest concern to the public, including issues such as slave labour, child labour, deforestation and breaches of cultural and indigenous rights. The categorisation of companies into this category is reserved for those companies that are repeat offenders and fail to rectify problems when they emerge.

There has been a recent increase in New Zealand funds invested in companies engaged in human rights violations and environmental damage. This has been primarily driven by the inclusion of Rio Tinto in the list of companies, after ongoing controversies including the knowing destruction of sites of significance to indigenous Australian peoples, with 46,000 year old cave paintings. There are 150 retail investment funds with investments in Rio Tinto and 69 KiwiSaver funds.



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Animal welfare: There are different measures for animal welfare. The most available measure for categorisation of global companies is the companies that test products on animals. The definition that Mindful Money uses does not include testing for pharmaceutical products, recognising the potential benefits for human health. The non-pharmaceutical category is dominated by cosmetic products that are tested on animals, often for regulatory requirements, such as for the Chinese market. In the light of evidence showing harmful effects, a growing number of companies have chosen not to sell to China and stop testing products on animals. Annual surveys show that animal welfare is one of the highest issues of concern to the New Zealand public.

There is only one provider that excludes animal testing – Pathfinder Asset Management/CareSaver. Other funds are undertaking research and are likely to extend their exclusions to include animal testing in future. Mindful Money has launched a research programme to develop a broader range of measures for animal welfare than animal testing.

Annex 1: Methodology

Mindful Money's online platform, with analysis of 280 KiwiSaver funds, was launched in late June 2019 and extended to include all 390 retail New Zealand managed investment funds in August 2020.

Mindful Funds

The website provides research and information on ethical investing, enables users free access to find out what companies of concern are in any New Zealand KiwiSaver or investment fund, and matches users with Mindful Funds that most closely match those criteria. Mindful Funds are those that meet the criteria for using ethical investing strategies, primarily:

- Negative screening or Exclusions - avoiding sectors or types of companies; and/or
- Environmental, Social and Governance (ESG) management (avoiding some companies and working to improve ESG performance of others, primarily through governance engagement)

Verification is crucial. The Financial Markets Authority has launched an inquiry into misleading advertising of ethical, responsible, green and other credentials. Mindful Money has the evidence to be able to verify exclusions directly, but verifying ESG management is more difficult, especially as most fund providers claim to practice some form of ESG analysis and management. Mindful Money recognises the certification process undertaken by the Responsible Investment Association of Australasia (RIAA) as a current form of credible certification. There are likely to be others in future. Further information on this process is on Mindful Money's website.

Portfolio Analysis

The website provides transparency about fund investments in companies that investors want to avoid (and in future, about the types of companies that investors want to invest in). The categories of these companies are drawn from annual surveys of the New Zealand public undertaken by Mindful Money and RIAA. More than 63% of the public want to avoid investing in the 10 sectors/types of companies profiled on the website and in the following analysis.

Mindful Money undertakes primary and secondary research to develop a robust list of global companies in each of these categories, including sources such as Sustainalytics, Norges Bank (Norwegian sovereign wealth fund) and the New Zealand Superannuation Fund. The list is formed using clear definitions for scope and level of materiality (e.g. proportion of business involvement in a sector). These are described on Mindful Money's website.

Portfolio information for each KiwiSaver and managed fund is sourced from 6 monthly filings with the Disclose register of the Companies Office. Mindful Money undertakes primary research to find the full portfolio listings for indirect funds- as well as investing directly in securities, most funds have investments in other managed funds and Exchange Traded Funds.

Accessible Information

This analysis, incorporating a full portfolio view and a categorisation of portfolio holdings related to the public's issues of concern, is unique. It is not available to investors through any other source. Nor is it available in any other country. Mindful Money makes it available for free to members of the public.

The most important outcome from this data analysis is that the information is used for investment decision-making. Feedback and analysis of user experience has been used in website design to make the information easily understood and relevant to investors and potential investors. The website is laid out to make the process as simple and intuitive as possible for users of varying degrees of familiarity with investment.

The website is not only a form of radical transparency but is a tool to help Kiwis find a fund that fits their needs. The fund finder tool provides a way for users to be able to enter their criteria – their values, preferred investment approach and risk category. The website algorithm matches these criteria with the attributes of mindful funds and provides a list of funds that are the best fit. A growing number of Kiwis are using the website to switch their KiwiSaver, and from the launch of managed funds, to find a retail investment fund.

Mindful Money is currently undertaking research to provide information on how retail investors can participate in impact investing – investments with an intentional and measurable positive impact on well-being, sustainability and climate stability.

Annex 2: Mindful Money

Mindful Money is an independent charity that aims for positive social and environmental outcomes through an increase in the availability of ethical investment and through the integration of sustainability into the finance system. Mindful Money's long term aim is to shift investment away from pollution, exploitation and inequality towards a low emissions, sustainable and inclusive economy.

The initial focus is on raising awareness about the benefits of investing ethically, and empowering New Zealanders to be responsible for how they invest their savings. Research from Mindful Money and RIAA in 2019 found that 83% of New Zealanders want to invest responsibly but only 8% proactively invest in a fund that aligns with their values. The survey identified barriers to investing responsibly, including a lack of objective information, not enough time to research and compare options, and a lack of credibility for ethical claims.

Mindful Money's online platform aims to remove these barriers, offering radical transparency about what is in investors' portfolios and providing them with research on options that match their criteria. Mindful Money launched the platform with analysis of 280 KiwiSaver funds in June 2019 and extended it to include 390 managed funds in August 2020. The online platform is part of a broader campaign that aims to re-align the financial system towards sustainability. Mindful Money's programme includes:

- Public engagement and education through conferences and weekly online seminars
- Engagement with workplaces to encourage workers to consider ethical KiwiSaver funds
- Dialogue and collaboration with investment providers and the broader financial sector to deepen their ethical investment practices
- Engagement with government to promote government policies and regulations that support a more sustainable and inclusive financial system.

Mindful Money has a work programme to extend the online platform to include information on companies that provide positive social and environmental benefits. This is important to many investors who have discretionary funds that they are prepared to commit to investments that may be risky, but which create public benefit.

Mindful Money is a registered charity (a programme of Sustainable Initiatives Aotearoa CC#51919), founded by Barry Coates. He has experience across corporate strategy and civil society, a Masters in Management from Yale University and was involved in the establishment of the UK's ethical investment network. Mindful Money now includes a strong core team of staff, advisors and allies.

Mindful Money's funding for establishment has been provided by Barry Coates and a small number of committed donors. When investors use Mindful Money's online platform to switch to an ethical fund, the fund pays a small fee to Mindful Money. This currently provides only a small contribution to ongoing costs but is forecast to increase as awareness and website traffic grows.

Mindful Money currently does not receive any government funding, although the Retirement Commissioner's three year review of retirement policy recommended funding for Mindful Money to support continued transparency on investment.