riaa Responsible Investment Association Australasia

Responsible Investment Benchmark Report

2018 New Zealand

SUPPORTING ORGANISATIONS

australianethical

AXA Investment Managers

PENGANA CAPITAL

NZSUPERFUND Te Kaitiaki Tahua Penihana Kaumātua o Aotearoa

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Australian Ethical

Australian Ethical is Australia's leading ethical wealth manager, providing investors with products that align with their values and investments without compromise.

With over $2.8 billion in funds under management across superannuation and managed funds, Australian Ethical has invested according to its Ethical Charter since its inception in 1986. The Charter not only guides its investment approach but also underpins all elements of the business. Since 2014, the company has maintained its B Corp 'Best for the World' status, ranking it in the top 10% of 1,800 B Corps globally. Ten percent of Australian Ethical's annual profits (before bonus) fund its Community Grants programme. To date, more than $2.5 million has been granted to charitable organisations and social impact initiatives through this programme. Since 2016, Australian Ethical Super has been one of the fastest growing super funds in Australia.

AXA Investment Managers

AXA Investment Managers is an active, long-term investor. From equities, fixed income and real assets to alternatives and multi-asset, we marry innovation and risk management in a bid to deliver long-term value for clients. We are responsible investors; we believe that responsible investment not only delivers sustainable, long-term value for clients, it also makes a positive impact on society. This is why we incorporate environmental, social and governance considerations into our investment decisions. We are committed to making investing easier – we want to help investors cut through the noise and empower them to make the right investment choices. We are bringing to bear the power of big data and technology not only to improve our investment offering but to enhance the ways in which we engage with our clients. We manage $1,145 billion* on behalf of our clients, with 771 investment professionals in 21 investment centres around the world.

* as at 31 December 2017

Pengana Capital Group

Pengana Capital Group (ASX: PCG) is a listed diversified funds management group specialising in global and Australian equities, with distinct investment strategies that aim to deliver superior risk adjusted returns to investors. They offer a range of investment solutions that allow investors to align their portfolios with their principles without compromising their investment returns, including sustainable impact investments, negatively screened managed funds and a listed investment company.

Pengana is committed to best practice in ethical and sustainable impact investing. They are a member of RIAA, a signatory to the UN's Principles for Responsible Investment, source ESG company research from a specialist provider, and undertake an annual audit by an independent research house focused on ESG analysis.

New Zealand Super Fund

The NZ$35 billion New Zealand Superannuation Fund invests globally to help pre-fund the future cost of universal superannuation in New Zealand. The Fund is managed by an Auckland-based Crown entity, the Guardians of New Zealand Superannuation. The Guardians believes that environmental, social and governance (ESG) factors are material to long-term investment returns, and is committed to integrating ESG considerations into all aspects of the Fund's investment activities. A founding signatory of the United Nations Principles for Responsible Investment, the Guardians also provides responsible investment services to the Accident Compensation Corporation and the Government Superannuation Fund Authority and is a member of the New Zealand Corporate Governance Forum.

Research support from:

ABOUT THIS REPORT

This report is the 4th annual New Zealand Responsible Investment Benchmark Report prepared by the Responsible Investment Association Australasia (RIAA). The report details industry data on the size, growth and performance of the New Zealand responsible investment (RI) market over the 12 months to 31 December 2017 and compares these results with the broader New Zealand financial market.

Through this report RIAA aims to support the ongoing growth of the responsible investment industry consistent with our objective of both broadening the uptake of RI whilst increasing the positive impact of investments on society and our environment. By providing clear and transparent data on the development of the market and the implementation of RI strategies, RIAA aims to support more investors undertaking a responsible approach to investment. Furthermore, by identifying the key drivers of increased RI, assets under management (AUM) and the barriers to uptake, RIAA works to increase the adoption and quality of RI strategies.

KPMG was commissioned by RIAA to undertake the data collection and analysis for this 2018 report. KPMG developed and delivered a survey to investment organisations across New Zealand, compiled the data derived from this primary research, undertook secondary research on publicly available data, undertook the ESG integration assessment based on RIAA's framework and analysed the data to deliver the size, performance and growth of the responsible investment industry.

The report was designed by Loupe Studio.

ABOUT THE RESPONSIBLE INVESTMENT ASSOCIATION AUSTRALASIA

RIAA is the peak industry body representing responsible, ethical and impact investors across Australia and New Zealand. RIAA is a growing active network of over 220 members managing more than $9 trillion in assets, including superannuation funds, fund managers, consultants, researchers, brokers, impact investors, property managers, banks, community trusts and financial advisers. In NZ, RIAA has 30 member investment organisations cross funds management, asset owners through to financial advisers.

RIAA's goal is to see more capital being invested more responsibly; shifting more capital into sustainable assets and enterprises and shaping responsible financial markets to underpin strong investment returns and deliver a healthier economy, society and environment.

RIAA does this through:

1. Acting as the member hub of timely and relevant environmental, social, corporate governance (ESG), ethical and impact investing information to strengthen the capacity of the finance and investment industries through regular events, webinars, conference calls and working groups, industry research and;

2. Growing the awareness and demand for responsible investments through communications and marketing work, media activity, as well as by operating the world's first and longest running fund Certification Program and the consumer online tool Responsible Returns.

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BACKGROUND

Each year since 2002, the Responsible Investment Association Australasia (RIAA) has commissioned research into the size and growth of responsible investment across Australasia. This 2018 report is the fourth stand-alone New Zealand report, a companion report to the 2018 Australian Responsible Investment Benchmark Report. The aim of this research is to gather data on the various forms of responsible investment and to present analysis of growth in the sector. The New Zealand Responsible Investment Benchmark Report charts the ongoing growth of responsible investing strategies, whilst also identifying the key drivers of increased capital flows towards responsible investment (RI) and the barriers to uptake with the intention of increasing the adoption and quality of RI strategies.

This report details industry data on the size and growth of the New Zealand responsible investment market over the 12 months to 31 December 2017.

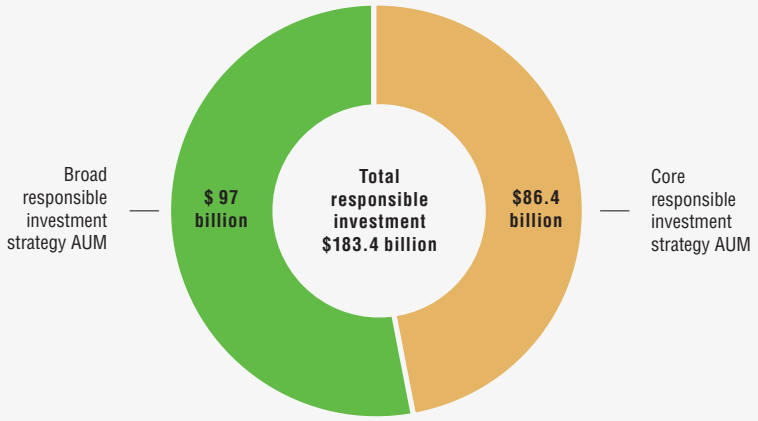
KEY FINDINGS

This Responsible Investment Benchmark Report reinforces that a responsible approach to investing– one that systematically considers environmental, social and governance (ESG) and/or ethical factors across the entire portfolio – is now the expected minimum standard of good investment practice in New Zealand.

Importantly an emerging understanding that ESG factors are a driver of value across a portfolio has significantly shifted more of the investment industry towards a responsible investment approach.

1. As at 31 December 2017, responsible investment constituted $ 183.4 billion assets under management (AUM), up a significant 40% from $131.3 billion AUM in 2016.
2. Survey responses identified that a key driver of growth in RI funds was the further desire by clients to align investments to mission with the second most cited driver being the understanding that ESG factors impact on investment performance.
3. The Survey identifies a massive growth in Core responsible investments – primarily negatively screened funds – for the second year running, growing by 102% reaching $86.4 billion.
4. Broad responsible investments – those integrating ESG considerations – grew by 9% to reach $97.0 billion AUM.
5. Core responsible investment funds are outperforming equivalent New Zealand equities and multi-sector balanced funds over all time horizons.
6. There continues to be a massive increase in the use of negative screens in NZ in the last year, with increased frequency of tobacco and controversial weapons screens.

FIGURE 1 Responsible investment AUM split into two distinct categories based on their strategy: Broad responsible investment or Core responsible investment



BROAD RESPONSIBLE INVESTMENT

Broad RI approaches – whereby ESG integration is the principle RI strategy – continue to make up the largest portion of total responsible investment AUM, with $97.0 billion in AUM.

These organisations span community trusts, investment managers and asset owners including crown financial institutions.

CORE RESPONSIBLE INVESTMENT

In 2017 Core responsible investment strategies - and specifically the use of negative screens - have emerged as a significant part of the total responsible investment AUM, jumping up substantially for the second year running to $86.4 billion AUM. This increase is due primarily to the inclusion of additional funds in this year's survey, either from new entrants or large managers screening tobacco and controversial weapons investments.

Core responsible investment approaches apply at least one of the following primary strategies: negative, positive or norms based screening; sustainability themed investing; or impact investing and community finance.

The vast majority of Core responsible investment involves **screened investments which at $ 85.9 billion constituted 99.5% of the total Core RI (up from $42.3 billion AUM in 2016)**. The major screened issues included tobacco, controversial weapons, but also nuclear power and gambling.

Sustainability themed investments remained constant at $0.4 billion ($0.4 billion in 2016).

Impact investing is an emerging responsible investment strategy having gained in momentum in the last year, however as at 31 December 2017, still accounted for only a small amount of investments.

PERFORMANCE

For the first time this report has looked at the performance of Core responsible investment funds against relevant benchmarks.

This report found very strong performance results from Core responsible investment funds:

- Core responsible investment **New Zealand share funds** outperformed the relevant benchmarks across all time periods.
- Core responsible investment **international share funds** outperformed their relevant benchmarks over the three and ten year time horizons.
- Core responsible investment **multi-sector growth funds** (balanced funds) outperformed their equivalent benchmarks over all time horizons.

It is recognised that the above analysis is drawn from a small sample of performance data, especially for the New Zealand share funds. However, analysis performed in Australia, over larger samples produced a consistently similar outcome[1].

KEY DRIVERS AND DETRACTORS OF RI GROWTH

For the second year the survey asked investment organisations to identify the key drivers of RI growth and key factors that have deterred RI growth. The top three responses were:

TOP DRIVERS

Key Driver	% of respondents
Alignment to mission	56%
ESG factors impact on performance	50%
Growing awareness of ESG risks impact on value	36%

TOP DETRACTORS

Key Driver	% of respondents
Lack of demand from retail investors	40%
Lack of awareness by members of the public	27%
Lack of demand from institutional investors	27%

Alignment to mission, indicating a growing interest by clients to align their investments with Mission/values, continues to be the primary identified driver of growth in NZ, demonstrating the demand side interest continues strongly in the Kiwi market. The second and third drivers relate to the positive impact of ESG on investment performance either as a predictor of growth or the avoidance of risk.

On the flip side, it was very clearly communicated that a lack of demand and awareness by both retail and institutional clients continues to hold back ever greater growth in RI.

OUTLOOK

The elevated public focus on the underlying investment holdings of the KiwiSaver market in 2016 caused a massive shift in the industry towards negative screening of funds, which has effectively caused an entire industry to switch to a base level of responsible investment practice in an incredibly short period of time. There is an increasing understanding, at least within the investment community, that in addition to negative screening, RI strategies are also an increasing component of driving better investment outperformance.

More work is needed to build retail awareness of the availability and the relative performance of RI Core funds versus equivalent mainstream funds and to engage stakeholders and influencers.

1 See Responsible Investment Benchmark Report 2018 Australia Report

ABOUT RESPONSIBLE INVESTMENT

All businesses, and therefore all investments, have an impact on people and the planet, both positive and negative. Responsible investing seeks to minimise the negative effects generated by business and promote positive impacts, ultimately delivering a healthier economy, society and environment and underpinning a stronger investment outcome.

Responsible investing, also known as ethical investing or sustainable investing, is a holistic approach to investing, where social, environmental, corporate governance (ESG) and ethical factors are considered alongside financial performance when making an investment.

Responsible investing considers a broad range of risks and value drivers as part of the investment decision-making process, beyond and in addition to reported financial risk. It is a systematic approach that takes ESG and ethical issues into account throughout the process of researching, analysing, selecting and monitoring investments. It acknowledges that these factors can be critical in understanding the full value of an investment.

RESPONSIBLE INVESTMENT STRATEGIES

There are many different ways to engage in responsible investment, as outlined in RIAA's Responsible and Ethical Investment Spectrum, and investors often use a combination of strategies.

As responsible investment becomes an increasingly sophisticated component of the financial sector, it is guiding the investment approach of a broad range of products

FIGURE 2 **RIAA's Responsible and Ethical Investment Spectrum**

	TRADITIONAL INVESTMENT	RESPONSIBLE & ETHICAL INVESTMENT						PHILANTHROPY
		ESG INTEGRATION (including shareholder engagement & voting)	NEGATIVE SCREENING (& norms based)	POSITIVE OR BEST-IN-CLASS SCREENING (& norms based)	THEMATIC/ SUSTAINABILITY THEMED INVESTMENTS	IMPACT INVESTING		
						MARKET RATE	CONCESSIONARY RATE	
FOCUS	Limited or no regard for environmental, social and governance factors	Consideration & analysis of environmental, social and governance (ESG) factors as part of investment decision making	Industry sectors or companies excluded/ divested from to avoid risk or better align with values	Investments that target companies or industries with better ESG performance	Investments that specifically target sustainability themes eg clean energy, green property	Investments that target social and environmental impact and deliver market rate financial returns	Investments that target social and environmental impact and deliver below market rate returns	Grants that target positive social and environmental impact with no financial return
IMPACT INTENTION	Agnostic	Avoids harm		Benefits stakeholders				
					Contributes to solutions			
FEATURES	Delivers competitive financial returns							
		Manages ESG risks						
				Pursues ESG opportunities				
						Intentionality: delivery of impact is central to underlying asset/investment		
						Impact of investment is measured & reported		

** This spectrum has been adapted from frameworks developed by Bridges Fund Management, Sonen Capital and the Impact Management Project*

and services, from large investment managers who integrate ESG factors into their decision-making to so-called 'deep green' ethical investment funds that apply exclusionary screening criteria over investments, and impact investments that intentionally seek to deliver positive social and environmental outcomes. It includes superannuation funds that apply multiple RI strategies across all asset classes to banks that take an ethical and socially minded approach to lending.

Given the volume and variety of responsible investment and banking products available in New Zealand, individual investors are best positioned to determine the products and services most closely aligned to their values and beliefs. In other words, the determination of what constitutes adequate or appropriate ESG screening for a particular product is subjective and dependent on the individual investor's expectations. There is a high level of variability in the degree in which these factors are weighted, analysed and incorporated into investment decision-making.

To enable comparison of New Zealand's responsible investment market with those of other regions, this report has been prepared in line with the seven strategies for responsible investment as detailed by the Global Sustainable Investment Alliance (GSIA) and applied in the Global Sustainable Investment Review 2016[2], which maps the growth and size of the global responsible investment industry. These strategies are:

1. Negative/exclusionary screening
2. Positive/best-in-class screening
3. Norms-based screening
4. Integration of ESG factors
5. Sustainability themed investing
6. Impact and community investing
7. Corporate engagement and shareholder action

Full definitions of each responsible investment strategy can be found in the Glossary.

INTERNATIONAL CONTEXT

RIAA is a proud member of the GSIA, together with Eurosif (The European Sustainable Investment Forum), UKSIF (UK Sustainable Investment & Finance Association, US SIF (The Forum for Sustainable & Responsible Investment) and VBDO (Dutch Association of Investors for Sustainable Development).

CORE VERSUS BROAD RESPONSIBLE INVESTMENT

For the purposes of this report we distinguish between Core and Broad responsible investment. This allows us to differentiate the data to allow for an enhanced analysis of the responsible investment industry and the degree to which responsible investment strategies are integrated into products and services.

Core responsible investment approaches apply at least one of the following primary strategies: negative, positive or norms-based screening; sustainability themed investing; impact investing and community finance; or corporate engagement.

Core responsible investment approaches are made up in large part of those funds traditionally referred to as socially responsible investing (SRI) or ethical investments, as well as sustainability themed funds and impact investments.

Broad responsible investment approaches use ESG integration as the principle responsible investment strategy. This involves the systematic inclusion of ESG factors into traditional financial analysis and investment decision-making based on the acceptance that these factors are important drivers of risk and value in companies and assets. This strategy is often accompanied by a structured approach to corporate engagement and other active ownership and stewardship mechanisms.

RIAA and KPMG have undertaken a detailed desktop analysis of: all New Zealand asset managers that are signatories to the PRI (UN backed Principles for Responsible Investment); other asset managers that RIAA's database indicates as practicing ESG integration; and a selection of international asset managers with a strong presence in this market and strong ESG credentials that manage assets for local clients. In this case only assets specifically identified as managed for local clients were included in the assessment. Only those that score above 80% against the RIAA assessment methodology are included in the results. This approach has been used in the survey for the past four years. For more detail on the assessment methodology, please see the breakout box on 'How RIAA defines leading practice in ESG integration'.

The Broad responsible investment market is largely comprised of institutional funds that apply ESG integration as part of a mainstream investment offering. These products for the most part do not include an ethical, SRI or sustainability themed investment strategy selected by the investor – or where they do, these are not the primary responsible investment strategies – and are usually wholesale or institutional products.

As this report demonstrates, asset managers are increasingly applying multiple responsible investment approaches. For example, a fund may apply Broad ESG integration as well as Core responsible investment strategies such as negative or positive screening. In such a case, we have categorised the fund according to the primary responsible investment strategy being pursued. The primary strategy is identified by the organisation in their survey response. In addition to this, RIAA performs a review of all survey responses to ensure that strategies are categorised consistently across the cohort of responses and that investor responses are categorised consistently year on year.

It is important to note that this report aims to clearly and conservatively estimate the size of the value and volume of the responsible investment industry. Therefore, for the purpose of this report, AUM included under a Broad responsible investment strategy only includes asset managers demonstrating industry leading ESG integration practices as opposed to including all self-declared ESG managers.

It is noteworthy that RIAA sees the role of financial advisers as critical gatekeepers in the finance industry and are an integral part of the implementation of responsible investment. Although this report doesn't estimate the state of play of responsible investment in financial advice, RIAA continues to work to ensure advisers do understand their role in delivering responsible investment advice for clients.

2 Global Sustainable Investment Alliance, *Global Sustainable Investment Review 2016*, http://www.gsi-alliance.org/members-resources/trends-report-2016

HOW RIAA DEFINES LEADING PRACTICE IN ESG INTEGRATION

Over the past decade, responsible investment has grown to a point where a significant proportion of the investment industry has now committed to implementing a responsible investment approach. For large institutional investors, this has focused primarily on applying ESG integration practices to traditional investment decision-making.

Defining and measuring ESG integration practices is challenging due to limited disclosure and a broad variation in depth of integration – from systematic implementation embedded into investment valuation practices and company engagement, to more ad hoc approaches.

For the purposes of this report – to define the size of the responsible investment industry in New Zealand – RIAA aims to include only those assets managed by asset managers who are practicing a leading approach to ESG integration, rather than all assets managed by organisations who have self-declared that they are implementing responsible investment.

For the fourth year in a row, RIAA undertook a desktop review of asset managers who are self-declared responsible investors – either via their commitment to the PRI, or other public commitments – and rated each of these against a framework of leading practice to ESG integration.

This framework was developed by RIAA based upon global definitions and existing assessment frameworks for ESG integration practices, and remains the same as the framework used by RIAA in last year's report.

The framework acknowledges that although it is difficult to prescribe a single best practice process for the integration of ESG factors into investment decision-making, there are a number of leading practices and constituent parts of leading practice that can be identified. RIAA has established a framework drawing on the core pillars of leading ESG integration practices that assesses and scores:

- Publicly stated commitments to responsible investment;
- Responsible investment policy;
- Commitments to the transparency of processes and approach;
- Systematic processes for ESG integration as well as evidence demonstrating how this process is applied as part of traditional financial analysis;
- Evidence of activity in other areas of active ownership and stewardship including voting and engagement;
- Membership of a collaborative investor initiative; and
- Coverage of total AUM by responsible investment or ESG practices.

These pillars were weighted to ensure balance between evidence of systematic investment processes versus policies and public commitments. Using this framework, RIAA then assessed New Zealand and a selection of international asset managers who have an active presence in New Zealand based on their publicly available information including websites, PRI responsible investment transparency reports and all other available material. All asset managers were scored using these criteria.

Only those asset managers that scored more than 80% have been included in the Broad responsible investment category in this report. Some additional inclusions are made in the Broad responsible investment category where a fund manager or asset owner undertakes both ESG integration as well as negative screening.

METHODOLOGY

REPORTING BOUNDARY

This report covers the 2017 calendar year and where possible, data disclosed has been recorded as of 31 December 2017. Data from some asset managers was not available on a calendar year basis and in these cases data was taken from the closest available reporting date. All financial figures are presented in NZD.

The financial sector is a globalised industry. Responsible investment funds may be held in one country, managed in another and sold in a third, meaning that a level of estimation is applied in order to demarcate the boundary of the New Zealand market. This impacts on the accuracy/usefulness of reporting survey results as proportional to the market size as reported with Morningstar's statistics for TAUM. Morningstar's TAUM figures are limited in their coverage of the full investment market in New Zealand by covering only those assets managed by the New Zealand managed funds industry through retail and wholesale funds, discrete mandates and listed investments. Morningstar's TAUM does not capture overseas fund managers and direct investments. However, in the absence of a more appropriate measure, TAUM continues to be used for comparison purposes. This report is intended to inform readers of the range of responsible investment products that are available in New Zealand. As such it includes assets managed within the region, as well as assets managed outside the region where these are on behalf of New Zealand clients.

DATA COLLECTION

Data used to compile this report was generously provided and collected from the following sources:

- Directly supplied by asset managers as well as some asset owners;
- Morningstar statistics for total assets under management (TAUM) in New Zealand and the average performance of mainstream managed fund categories. Morningstar also provided a secondary source of AUM data for some of the funds listed;
- RIAA's database and industry contacts; and
- Desktop research of publicly available information regarding assets under management, performance data and investment strategies from sources including company websites, annual reports and PRI Responsible Investment Transparency Reports.

Where survey responses were not received, publicly available information was used where available. In total, this research managed to gather a comprehensive summary of the full responsible market in New Zealand.

Responses that identify the key drivers of RI and detractors were only taken from survey respondents.

No data has been extrapolated from its original source.

DATA ANALYSIS AND REPORTING

As many asset managers apply several investment strategies, the data collection survey required respondents to identify a single primary responsible investment strategy. The survey also requested to respondents to nominate any secondary strategies applied in order to determine the depth of responsible investment strategies applied, to identify any overlap of approaches and to assist in categorising funds. This approach was used in order to create an accurate depiction of the responsible investment environment in New Zealand.

Fund overlaps between survey respondents have been removed, where identified, from the reported figures. RIAA is continuously working to improve its data collection process to enhance the quality of reported figures and to ensure that all products in the New Zealand market are identified.

It is important to note that all information in this survey is 'self-reported' by respondents and only limited analysis is performed over statements made. There is no assurance of statements.

DATA COMPLETENESS

Many of the products in the New Zealand responsible investment market are not bound by any public reporting, disclosure requirements or independent review (assurance). This report includes both retail and wholesale investment products, and increasingly, institutional fund mandates, individually managed accounts, and separately managed accounts. Some investment custodians are reluctant to supply information for reasons of privacy or commercial confidentiality. Data pertaining to funds held outside of managed responsible investment portfolios was not accessible. For this reason, as well as matters identified in the Reporting Boundary section above, this report provides a conservative depiction of the responsible investment environment in New Zealand.

RESPONSIBLE INVESTMENT IN NEW ZEALAND

The responsible investment industry in New Zealand has grown significantly in 2017 for the second year in a row to make up an ever greater portion of the overall investment market in New Zealand. Our research reveals that $183.4 billion in AUM is managed under responsible investment strategies as at 31 December 2017, a growth of 40% since 2016.

When compared to the total professionally managed assets (TAUM) in New Zealand, reported by MorningStar as $80.9 billion, this represents a significantly larger figure. This figure surpasses the total value of professionally managed assets due to many of the assets captured in this report being managed outside of NZ on behalf of the institutional asset managers and owners in this study.

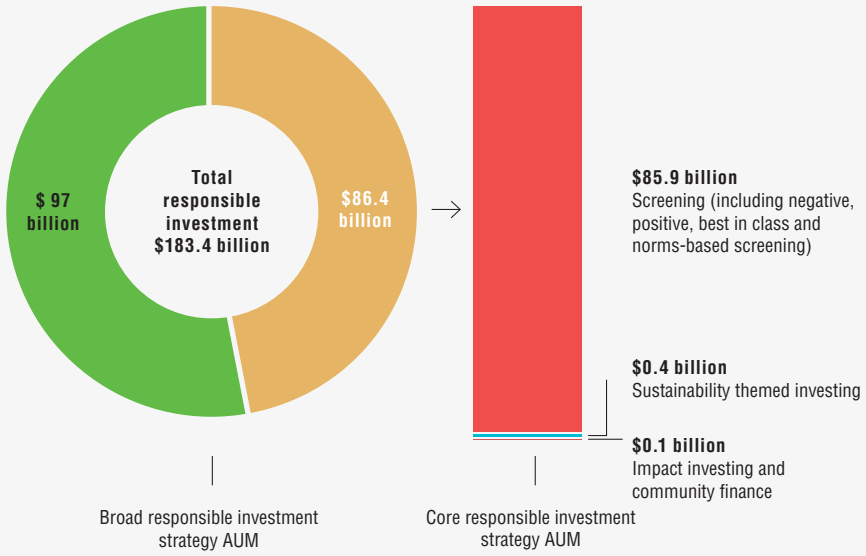
Of this total AUM just over half (53%) or $97.0 billion – is accounted for by asset managers and asset owners undertaking a Broad responsible investment approach, using ESG integration as their primary RI strategy. This demonstrates a growth of 9% year on year.

In 2017, Core responsible investment funds doubled from $42.8 billion to $86.4 billion AUM, constituting over 107% of New Zealand's TAUM. This staggering step up is due primarily to the continued incorporation of negative screening across tobacco and controversial weapons into mainstream fund offerings.

FIGURE 3 **Responsible investment AUM – totals by year**

Responsible investment approach	2016 Responsible investment AUM ($bn)	2017 Responsible investment AUM ($bn)	Change
Screening (including negative, positive, best in class and norms-based screening)	42.3	85.9	103%
Sustainability themed investing	0.4	0.4	4%
Impact investing and community finance	0.1	0.1	0%
Core responsible investment total	**42.8**	**86.4**	**102%**
Broad responsible investment total ESG integration	**88.6**	**97.0**	**9%**
TOTAL RESPONSIBLE INVESTMENT	**131.4**	**183.4**	**40%**

FIGURE 4 **Responsible investment by approach**



CORE RESPONSIBLE INVESTMENT

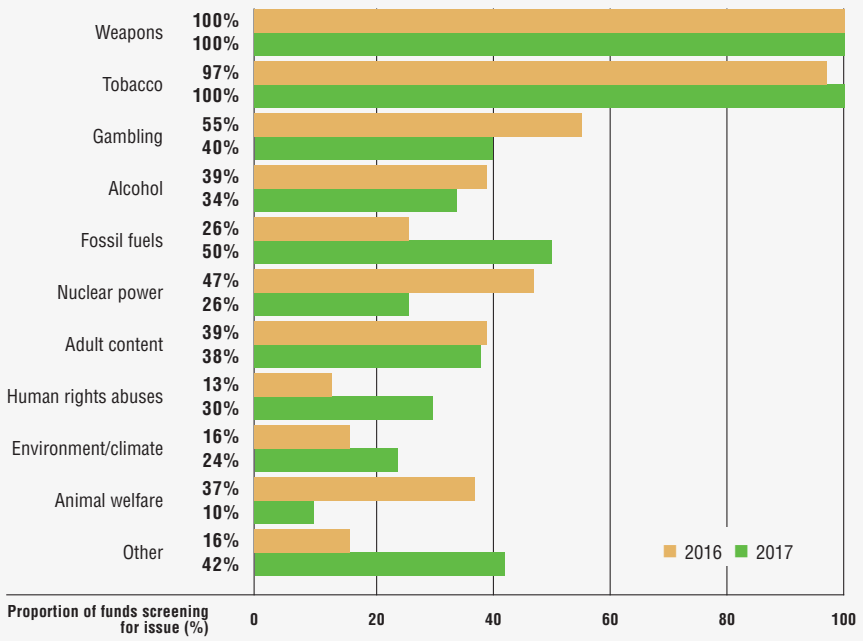
Core responsible investment funds grew significantly during 2017, increasing by 102% to $86.4 billion at 31 December 2017 compared with $42.8 billion for the previous year.

At $86.4 billion AUM, Core responsible investment funds represent 107% of the TAUM held in New Zealand, increasing from 61% of TAUM in 2016.

The $86.4 billion of Core responsible investment in New Zealand is held by 23 asset managers managing 79 products (an increase from 51 in prior year). A range of Core responsible investment strategies have been applied to these funds and the key trends in these strategies are detailed below:

Screening, primarily negative, is the RI approach applied to 99.5% of Core AUM. The use of screening has seen a significant amount of growth year on year with AUM increasing by 102% on 2016.

FIGURE 5 **Frequency of issues being screened**



In August 2016, news reports revealed that KiwiSaver funds had investment holdings in tobacco, cluster munitions, land mines and nuclear devices. This resulted in massive interest in the investment practices of KiwiSaver funds, and it rapidly became apparent that the average New Zealander was not content to have their KiwiSaver investments invested in such industries. This resulted in a very rapid response from the industry whereby the largest KiwiSaver providers put in place exclusions across these main industries.

This 2017 survey indicates that managers are continuing to put in place screening in portfolios, both labelled 'ethical' portfolios as well as mainstream portfolios. As shown below all Core funds included in the survey have screens over weapons and tobacco.

In addition, overall there was an increase in the number of issues screened, with significant increases in screens over fossil fuels and environmental and climate issues compared to the prior year.

Some funds have traditionally marketed themselves as being ethical or socially responsible funds, and typically include more than just a base level of screening across one or two issues. There continues to be both a growth in those funds marketed as SRI or ethical funds, as well as mainstream offerings incorporating a baseline of negative screens.

Furthermore, we are increasingly observing the incorporation of ESG integration, or broad responsible investment practices, with negative screens, as the market matures to reflect both consumer expectations as well as recognising the investment performance implications of ESG factors.

As noted in previous years, we see in the NZ market some very significant asset owners who incorporate screening into their funds, such as the Accident Compensation Corporation and New Zealand Superannuation Fund. These funds, for example, all incorporate screening across tobacco, controversial weapons (cluster munitions, nuclear explosive devices, anti-personnel mines) and whaling sectors, however, also incorporate an ESG integration approach across their investments. For these asset owners, we have included them under their primary RI strategy that we take to be Broad RI – ESG integration.

Sustainability themed investing remained consistent with the prior year at $0.4bn with the small change driven by organic growth in the two funds identified. Interestingly, this seems to indicate the market is still very much focused on both ESG as a investment value enhancer and negative screens as meeting client expectations, with only early moves to tap the client interest in more positively screened, more sustainably themed funds, as we're seeing emerge in other markets. We would expect to see this opportunity emerging as the next wave of responsible investing in NZ, as we have seen in other markets.

Impact Investment: Early stages of activity within the category of impact investment and community finance have now begun in NZ, with a small but significant early moves occurring in 2017. This year's report identified activities by community trusts and private foundations making allocations to impact investment, as well as a sizeable first green kauri bond issued by the International Finance Corporation. But in the months since the end of 2017, activity continues to ramp up in the NZ impact investment market, and we look forward to seeing more activity in this category in coming years.

THE GROWTH OF IMPACT INVESTING IN NZ

A focus on impact investment is truly taking off in NZ. There is now an active community combining investors, social enterprises, philanthropists, civil society and government who are working together to ensure capital is directed to support social and environmental outcomes along with financial returns.

This year's Responsible Investment Benchmark Report New Zealand again finds only small total value of assets invested as impact investments in 2017, however this masks the amount of activity underway in this market, and due to the nature of this study, likely misses smaller private investments and lending activities that are happening outside of the mainstream capital markets.

Community trusts, private foundations, angel investors, as well as major banks and asset managers have all now been actively seeking and making impact investments and lending with a diversity of approaches across New Zealand, pioneering the early stages of this market development.

The *Growing Impact in New Zealand Report*, launched by Akina, EY and JB Were in September 2017, maps out the current and emerging impact investment landscape in detail, highlighting the thriving activity underway across multiple sectors. Importantly, the report also estimates the future market potential for impact investing of NZ$5 billion based on the relative size of the NZ economy, charity sector and capital markets.

Progress is now well underway, and pleasingly capital is starting to flow towards investments that create positive social impact, connecting capital markets to social and environmental outcomes.

In the recently year, an Impact Investment Network has been formed bringing together the hive of activity and actors into one network to foster market development and activity, and as a community to share learnings to date. Furthermore, a New Zealand Impact Investment National Advisory Board has been established that will connect NZ with the Global Steering Group for Impact Investment, allowing the market to leverage the experience of other markets at this important emerging stage.

As we've seen in other markets, we anticipate that in future years there will be a rapid ramp up of activity and capital flowing to impact investments, from green bonds to social impact bonds, venture capital funds to private lending, micro finance to social infrastructure. NZ is now establishing a strong foundation for its impact investment activities.

PERFORMANCE OF CORE RESPONSIBLE INVESTMENT FUNDS- NEW ZEALAND

This report, for the first year, has assessed the performance of New Zealand Core responsible investment funds compared with their benchmark index and the average of equivalent mainstream funds.

The average performance in each time horizon has been determined using the asset-weighted returns (net of fees) as reported by each responsible investment fund within its category. Mainstream performance indices and fund comparison data were calculated by MorningStar using a comparable methodology.

Figure 6 shows a comparison of the performance of the principal categories of core responsible investment funds against the performance of mainstream funds over one, three, five and ten year time horizons.

The results of this analysis indicate:

- Core responsible investment New Zealand share funds outperformed their equivalent benchmarks for all periods.
- Responsibly invested international share funds outperformed their benchmarks in the three and ten year time horizons, but underperformed over the one and five year terms.
- Additionally, responsibly invested balanced portfolios outperformed the multi-sector growth fund average for all periods (with no benchmark data available for 10 year period).

This pleasingly reinforces global studies as well as our own Australian performance research that support the conclusion that responsibly invested funds provide similar or stronger risk-adjusted returns to their mainstream peers.

BROAD RESPONSIBLE INVESTMENT

Beyond Core responsible investment, ESG integration constitutes a major force in the mainstream investment industry today. As at this survey period 18 New Zealand asset managers and eight asset owners have declared their commitment to responsible investment by becoming signatories to the PRI. Signatories to the PRI commit to incorporating ESG considerations into investment analysis and decision-making processes and to publically report on their performance.

Combined, these investment organisations demonstrate that ESG integration is becoming a key consideration in mainstream investment strategies.

RIAA has always taken a conservative approach to estimating the value of AUM relating to funds that consider ESG factors. The AUM attributable to asset managers and

asset owners comprising the $97.0 billion AUM in this report was determined using a combination of approaches including RIAA's responsible investment survey results as well as a desktop assessment of eight asset managers who are self-declared responsible investors (primarily from PRI signatory lists).

As outlined in the earlier section on 'How RIAA defines leading practice in ESG integration', the asset managers were reviewed against a framework of leading practice in ESG integration as determined by RIAA, and based on global research, in order to determine those asset managers demonstrating a leading approach to ESG integration. Asset owners were included who also had in place extensive negative screening in addition to their ESG integration practices.

In this year's report, included in the Broad RI assets are:

- The largest NZ asset owners applying multiple RI approaches;
- Asset managers that apply an ESG approach coupled with screening (mainly for institutional mandates);
- Community trusts undertaking ESG integration through their external managers; and
- Asset managers demonstrating leading practice in ESG integration taken from our assessment.

To ensure no double counting, RIAA's survey asks asset owners to identify the underlying asset managers, and where there is overlap, those assets are removed from the total AUM.

FIGURE 6 Performance of Core responsible investments against benchmarks

NZ share funds	1 Year	3 Years	5 Years	10 Years
Average responsible investment fund (between 1-2 funds sampled depending on time period)	29.9%	17.3%	19.0%	10.0%
NZ OE Equity Region NZ	21.8%	14.6%	15.8%	8.8%
S&P/NZX 50 TR NZD	22.0%	14.7%	15.6%	7.6%

International share funds	1 Year	3 Years	5 Years	10 Years
Average responsible investment fund (between 2-8 funds sampled depending on time period)	14.2%	22.6%	10.5%	6.7%
Large-cap international share fund average	20.0%	12.8%	15.0%	5.9%
MSCI World ex-Australia Index	20.9%	11.5%	13.3%	4.9%

Multi-sector growth funds	1 Year	3 Years	5 Years	10 Years
Average responsible investment fund (between 6-17 funds sampled depending on time period)	14.7%	7.0%	10.4%	6.4%
NZ OE Multisector - Balanced	12.0%	6.3%	8.5%	

Over performance Under performance

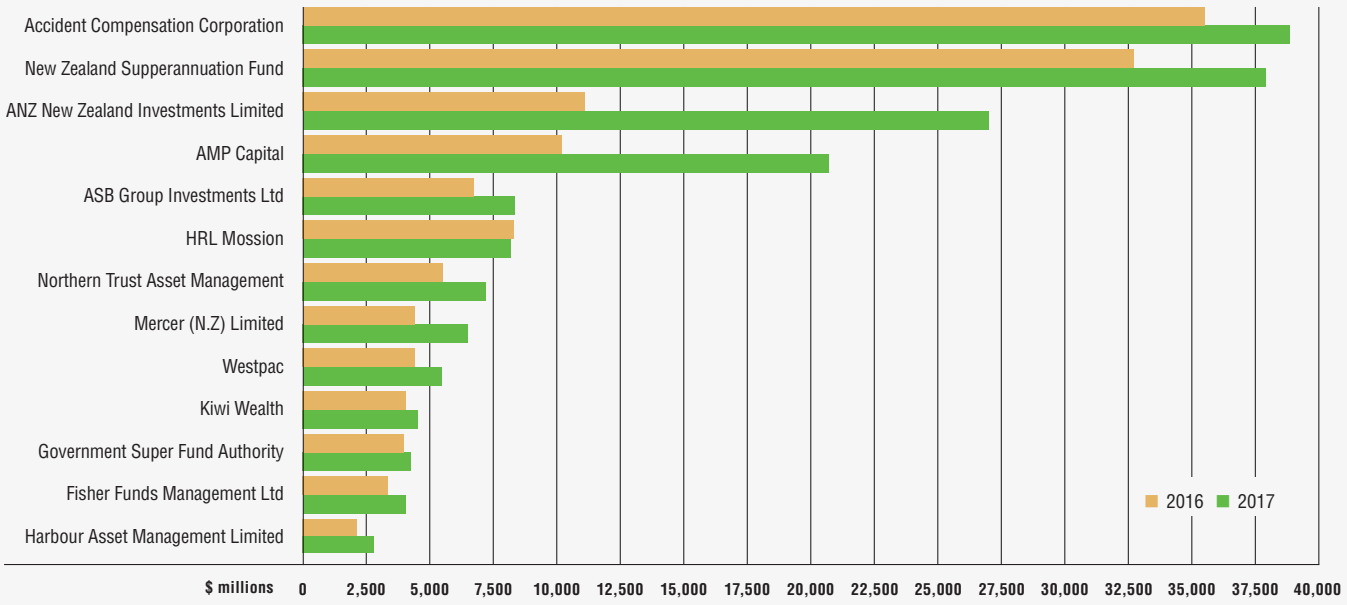
This assessment found that four domestic asset managers in New Zealand are applying a leading approach to ESG integration in their Broad responsible investment approach. These four managers are:

- AMP Capital
- Harbour Asset Management
- HRL Morrison
- Southern Pastures Management

These four asset managers were able to clearly demonstrate a systematic process to ESG integration in their investment process, through policies, clearly defined approaches to stewardship, active ownership that includes engagement and voting, and meaningful disclosure.

Where asset managers report some of their funds under Core RI, the Core RI fund value was excluded from the Broad RI to eliminate double counting.

FIGURE 7 Largest responsible investment asset managers and asset owners



MARKET DRIVERS AND FUTURE TRENDS

This survey clearly shows that there has been a significant increase in the number of products and strategies subject to responsible investment across the investment industry as well as an increase in AUM in those strategies driven by both by retail and institutional investors.

It is increasingly clear that appropriate and properly executed RI strategies can have a significant positive impact on the environment and society whilst at the same time generating sustainable financial returns that outperform comparable mainstream funds.

In order to gain insight into the factors behind the increased use of responsible investment strategies we asked respondents to identify and rank the key drivers of increased adoption of responsible investment strategies and AUM and the key factors in the market that have restricted growth.

KEY GROWTH FACTORS

56% of respondents attributed growth to the desire by underlying clients to align their investments with their organisational missions or values.

Half of respondents (50%) identified the impact of ESG factors on performance as a key driver of growth (again a significant increase on the prior year), and a further 35% identified the recognition of ESG risks as important to portfolio valuation. Asset managers now are seeing ESG as a value creating factor rather than solely one that is driven by client demand.

Key deterrents

In the previous year, the largest factor deterring additional growth was associated with concerns around the financial performance of responsible investments. This factor has significantly reduced this year (from 34% to 23%) and when coupled with performance being identified as the second biggest driver of growth, it appears that RI has reached a point of inflection with positive performance being increasingly attributed to RI funds.

A lack of demand from retail investors and an associated perceived lack of awareness of responsible investment by members of the public, identified by 40% and 27% of respondents respectively, were the two most common observations – pointing to a need for capacity building and education of retail investors as to the availability and performance benefits of RI products.

FIGURE 8 Key drivers of market growth by those surveyed

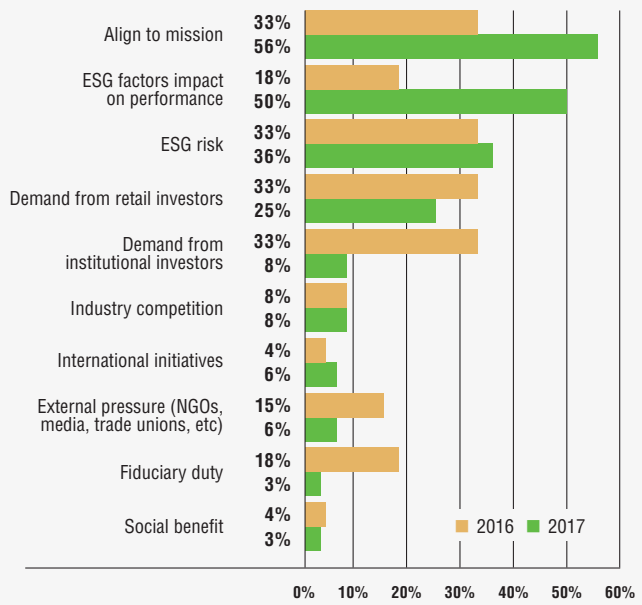
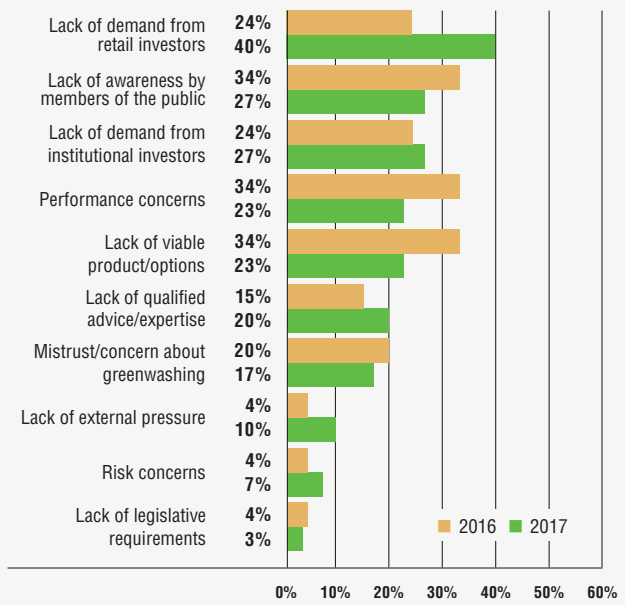


FIGURE 9 Key deterrents to RI market growth by those surveyed



MEASUREMENT OF PERFORMANCE

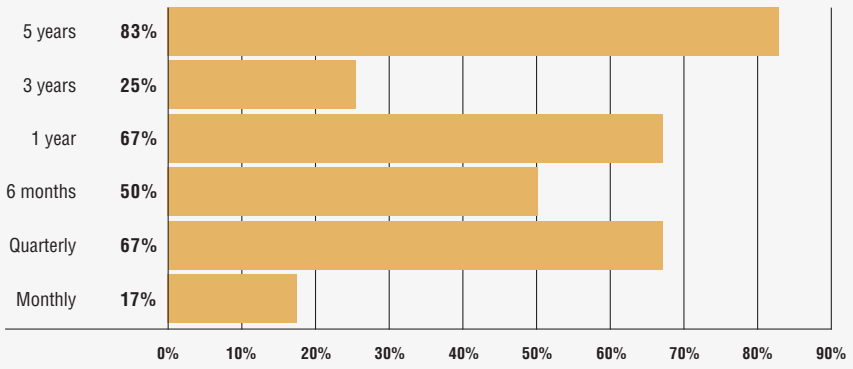
For the first time this year the survey asked respondents to report the time horizon over which performance is measured and rewarded. The responses are shown below in Figure 10.

Respondents reported that performance is measured over a number of time periods, the majority reporting a short term (less than one year and quarterly) and long term (five years or more) measurement period. Many respondents identified a number of time periods over which performance is measured.

It is good to see that the majority of asset managers' performances, at least in part, is measured over a period of five years.

More investigation is needed to understand the prioritisation of monitoring or focus of asset owners and investors.

FIGURE 10 The time horizon over which performance is measured and rewarded



APPENDIX A

GLOSSARY

AUM
Assets under management

ESG
Environment, social and governance

GSIA
Global Sustainable Investment Alliance

PRI
UN backed Principles for Responsible Investment

RIAA
Responsible Investment Association Australasia

TAUM
Total assets under management

DEFINITIONS OF RESPONSIBLE INVESTMENT STRATEGIES

Broad responsible investment – investment that applies ESG integration as the key responsible investment strategy.

Core responsible investment – investment that applies at least one of the following responsible investment strategies:

- screening of investments – negative, positive or norms-based screening;
- sustainability themed investing;
- impact or community investing;
- corporate engagement and shareholder action.

ESG integration – ESG integration involves the systematic and explicit inclusion of environmental, social and governance factors into traditional financial analysis and investment decision-making by investment managers. This approach rests on the belief that these factors are a core driver of investment value and risk.

Negative screening – screening that systematically excludes specific industries, sectors, companies, practices, countries or jurisdictions from funds that do not align with the responsible investment goals. This approach is also referred to as values-based or ethical screening. Common criteria used in negative screening include gaming, alcohol, tobacco, weapons, pornography and animal testing.

Positive screening – involves screening investment in sectors, companies or projects selected for positive ESG or sustainability performance relative to industry peers. It may also be referred to as best-in-class screening. It involves identifying companies with superior ESG performance from a variety of industries and markets.

Norms-based screening – involves the screening of investments that do not meet minimum standards of business practice. Standards applied are based on international norms such as those defined by the United Nations (UN). In practice, norms-based screening may involve the exclusion of companies that contravene the UN Convention on Cluster Munitions, as well as positive screening based on ESG criteria developed through international bodies such as the UNGC (United Nations Global Compact), ILO (International Labour Organisation), UNICEF (United Nations Children's Fund) and the UNHRC (United Nations Human Rights Council).

Sustainability themed investing – relates to investment in themes or assets that specifically relate to sustainability themes. This commonly involves funds that invest in clean energy, green technology, sustainable agriculture and forestry, green property or water technology. This category also includes multi-strategy portfolios that may contain a variety of asset classes or a combination of these themes.

Impact investing – targeted investments aimed at addressing social or environmental issues while also creating positive financial returns for investors. Impact investing includes community investing, which involves projects that have a defined social purpose, as well as environmental investing that typically aims to finance initiatives that address key environmental issues.

Corporate advocacy and shareholder action – refers to the employment of shareholder power to influence corporate behaviour. This may be conducted through direct corporate engagement such as communications with senior management or boards, filing or co-filing shareholder proposals and proxy voting in alignment with comprehensive ESG guidelines.

APPENDIX B

This table lists organisations whose data was assessed and/or is included in this report:

Organisation name	
Accident Compensation Corporation	New Ground Capital
ANZ New Zealand Investments Limited	New Zealand Anglican Church Pension Board
AMP Capital	New Zealand Methodist Trust Association
ASB Group Investments Ltd	New Zealand Superannuation Fund
BNZ	Northern Trust Asset Management
Booster Financial Services Limited	Otago Community Trust
Devon Funds Management	Pathfinder Asset Management
Fisher Funds Management Ltd	PIE Funds
Foundation North	QuayStreet Asset Management
Generate Investment Management Ltd	Salt Funds Management
Government Super Fund Authority	Simplicity
Harbour Asset Management Limited	Southern Pastures Management
HRL Morrison	SuperLife Limited
International Finance Corporation	The NZ Anglican Church Pension Board
Kiwi Wealth	The Tindall Foundation
Medical Assurance Society	Trust Management
Mercer (N.Z) Limited	Trust Waikato
Milford	WEL Energy Trust
Mint Asset Management	Westpac

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