

### **3.2A What did the financial services entity do that amounts to misconduct or conduct falling below community standards and expectations?** (Maximum 400 words)

Over recent years this sector, Ethical and Socially Responsible Investment (SRI) has emerged as one of the fastest growing sectors within funds management. Yet there is little regulation within this sector governing exactly what can be marketed as an Ethical or SRI product.

The Responsible Investment Association of Australasia (RIAA) estimates that A\$622 billion of Australian investment assets were invested under Responsible Investment principles in 2016, of which A\$64.9bn was invested under “core” screened funds (up 62% from 2015).

Funds are able to create their own highly selective SRI definitions, with the investor left the bewildering task of trying to differentiate between them, much like insurance products of old. Further, the majority of products manifestly fail to meet true SRI considerations and accordingly operate well below what would constitute community standards and expectations.

This submission intends to draw attention to this shortcoming within the sector and the need for governing rules of practice for those fund managers offering products within Australia that claim to operate within Ethical, SRI, or Environmental, Social & Governance (ESG) parameters.

While RIAA imposes rules on its members in relation to investing standards and seeks to validate those claims made by fund managers, they are not resourced to oversee or monitor the extent to which claims made by those offering such products, actually match their practices. This represents an area of significant weakness within a sector attracting more and more ordinary investors.

In 2014, the Australian Securities and Investments Commission (ASIC) introduced guidelines which stipulated, “...where...environmental, social or ethical considerations are taken into account, the PDS must tell consumers which matters are taken into account....and where such matters are not taken into account.” However, there is no requirement for disclosures beyond a listing of the top-10 holdings.

As the demand for SRI products continues to grow, there is a significant risk that the expectations of peer-matching performance may cause investment managers to blur the lines between ethical or SRI portfolios with their more mainstream counterparts, creating further investor confusion.

To compound the issue, many fund managers operating ethical and SRI funds within Australia include international investments where the underlying investments are rarely household names, creating potential to mislead Australian investors seeking to diversify their portfolios.

We therefore believe there is a need for a uniform and identifiable classification system where Ethical, SRI or ESG credentials can be standardised, enabling consumers to make more informed choices.

### **3.6 What culture or governance practices and other practices (including risk management, recruitment and remuneration practices) of the entity are of concern and why? (Maximum 400 words)**

While some investment managers are strongly committed to the principles of SRI, as demand has grown it has become increasingly difficult to isolate the specific sustainable and non-sustainable measures being utilized within the current range of investments.

We believe that the investment industry trend towards a focus on short-term metrics, and their use in evaluating KPI's and 'performance' for many large institutions could lead to either deliberate, or unintended, misleading of investors seeking appropriate sustainable investment options.

Furthermore, many funds which were originally conceived and developed by specialist ethical fund managers (e.g. Australian Ethical, Hunter Hall) with clear ethical or socially responsible mandates, are now being offered by mainstream retail and industry superfunds in which the same Chief Investment Officer presides over conventional fund allocations as well as ethical funds.

Should the growth in funds purporting to 'screen' their investments in one form or another continue on its present trajectory, the majority of funds will soon be able to claim some form of 'responsible' screening mechanism. Unless clear definitions and guidance are also introduced, then this 'lowering the bar' of what constitutes screening creates a significant potential for mis-leading investors.

This will be especially so as the weight of public sentiment increasingly moves to favour ESG and sustainable investment options, and mainstream operators, driven by the attractions of volume and profit, move progressively into this space, badging products as ethical, sustainable or responsible without regard for any underlying ethos.

A recent example of such behavior was the much-trumpeted announcement by AMP, on 16 March 2017, of their decision to divest from Tobacco and Cluster Munitions. While this was reported as a great step forward, existing investors were in utter disbelief that AMP still held such investments.

Despite this example, screening appears more effective in traditional areas such as alcohol, tobacco and gambling, however, it is inconsistently applied in other areas such as; fossil fuels, nuclear power, environment and gender equality.

The AMP Responsible Leaders fund presents a further example of the sorts of disingenuous behaviour that could become common as funds seek to build business through tapping into to the prevailing investment SRI popularity.

If each fund is allowed to simply develop and present its own unique definition of 'sustainable' or 'responsible' investment, we believe this will degrade the quality of the investment proposition being offered to investors who seek to invest in accordance with their personal values.

### **3.7 How effective are the mechanisms for consumer redress and how could they be improved? (400 words)**

Methods for redress are the same as any financial product, primarily through initial complaint to the product provider and then, if dissatisfied, through further appeal to the Financial Ombudsman. However, the context of such a complaint would require significant clarification as the current complaint mechanisms are most commonly associated with claims for redress for poor, misleading or corrupt advice and are generally associated with financial loss, not with ethically unconscionable or misleading information.

Funds offering products that claim to offer ethical or sustainable investment options currently have no significant compliance requirement in relation to the ethical nature of their offering, other than to meet the broadly generic wording outlined within their PDS. Since this wording can differ widely from fund to fund this can render them incomprehensible to ordinary members of the community seeking to invest ethically. Such product claims can also change in both substance and form between successive updates of PDS documentation following the initial investment.

### **3.8 What changes would you like the Royal commission to recommend? (400 words)**

With the exception of a few specialist Ethical fund managers, the funds management industry has so far failed to live up to, what we consider to be, community expectations for the provision of Ethical and Socially Responsible offerings. It has done so lawfully, aided by a lack of regulation and no physical redress system to avoid deceptive conduct.

We therefore recommend the following changes to improve the transparency for consumers:

1. Mandating those fund managers wishing to claim Ethical or SRI status to fully disclose all holdings on a quarterly or six-monthly basis. The US regulator requires full disclosure of investments on a quarterly basis detailing all stocks held and relative percentage make up within the portfolio.
2. Create definitions and minimum conditions for funds claiming to be either Ethical, Socially Responsible or having ESG principles applied.
3. Standardisation of stock screening nomenclatures which form part of a PDS. For example, where a fossil fuel screen is claimed - the fund must not invest in any company that derives more than 5% of its revenue from fossil fuel sales.
4. Where companies exclude or screen out certain activities (i.e. nuclear weapons, animal testing) this is not made a "review point", instead funds must screen out that activity or disclose clearly on its website and marketing materials the levels of flexibility employed within such screens.
5. While the RIAA has a role to play in helping develop the above framework, it is to some extent beholden to those Fund managers who sit on its Board and provide the majority of its funding. We would therefore recommend the establishment of an independent board or Committee, under ASIC, with the capacity to review these requirements on an ongoing basis and to make recommendations to ASIC for change. Participants could be drawn from; ASIC, The Responsible Investment Association, Academia, and the Ethical Advisors Cooperative, reflecting the unique skills and specific expertise of their respective organisations.

### 3.9 Other comments (400 words)

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