Responsible Investment Association Australasia

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http://www.pc.gov.au/inquiries/current/superannuation/make-submission#lodge

Productivity Commission, Superannuation: Assessing Competitiveness and Efficiency

Submission by the Responsible Investment Association Australasia

The Responsible Investment Association Australasia (RIAA) welcomes the chance to make a submission to the Productivity Commission on Draft Report: *Superannuation: Assessing competitiveness and efficiency* and highlight the importance and benefits of Australia's superannuation capital being invested responsibly to create the Australia its members want to live in, retire into and leave behind.

About RIAA and our members

The Responsible Investment Association Australasia (RIAA) is the peak industry body representing responsible, ethical and impact investors across Australia and New Zealand. With over 220 investment organisation members managing more than $9 trillion in assets globally - including 21 Australian superannuation funds across industry funds, retail funds and public funds. Our super fund members constitute 15 of the largest 50 APRA regulated superannuation funds in Australia[1] (Another 7 additional largest APRA funds whereby our members manage most of the assets)[2].

RIAA works to shift more capital into sustainable assets and enterprises, and shape responsible financial markets to underpin strong investment returns and a healthier economy, society and environment.

RIAA's role is to build the capacity of the financial industry to better understand and incorporate considerations of environmental, social, corporate governance (ESG) and ethical issues into decisions about capital allocation and related activities.

We do this through research, events, working groups and other activities aimed at providing information to our members on issues of relevance to their investments. Areas of focus include communicating different approaches undertaken in responsible investment (including ethical and impact investment), benchmarking the size of the industry, and highlighting leading responsible investment practices.

We also work to increase awareness of responsible investing to the public, in particular through an investment product Certification Program, which verifies claims made for responsible investment strategies applied to investment products which are then promoted to members and non-members.

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[1] AustralianSuper, Colonial First State, First State Super, UniSuper, SunSuper, HESTA, CBUS, VicSuper, Care Super, Local Government Super, Catholic Super, Australian Catholic Superannuation and Retirement Fund, NGS

[2] AMP Capital for AMP Super; BT Financial Group for BT Funds Mgt; ANZ Wealth for OnePath; First State Super for State Services Financial Services; Mercer for Mercer Super; Russel for Total Risk Management; Perpetual for Perpetual Super.

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RIAA focuses solely on investments (and investment processes) rather than members' governance or operational arrangements. As such, the matters considered by this submission remain limited to our areas of expertise. Many other areas outlined in the opportunity for submission are all issues that we recognise as important, but fall outside of the scope and expertise of our organisation, hence we are not in a position to provide comment on those matters.

Overall feedback

RIAA's work aligns with the Productivity Commission's focus on the competitiveness and efficiency of the superannuation system with the ultimate focus being on improving outcomes for members.

In our view, delivering on better outcomes for members, factors relating to responsible investment – that is the systematic consideration of environmental, social and corporate governance (ESG) issues as well as ethical issues into investment decision making processes - needs to be a part of any response to continuing to improve the super system for Australians.

Outcomes for members: Underpinning investment performance:

Today it is ever more evident that to deliver on performance, a consideration of environmental, social, governance (ESG) and ethical factors in investments is critical to delivering strong performance outcomes to members.

Responsible investment (RI) considers the full suite of investment risks and opportunities - beyond merely those found in financial statements - to protect and enhance financial returns. Pleasingly, this is now well supported by evidence that the consideration of ESG issues through a systematic responsible investment approach supports strengthened risk adjusted returns. Along with RIAA's own research, these findings have now been supported by academic and industry research from across the world's most esteemed universities and institutions.[3]

It is for these reasons that we now have 1 in every 2 dollars invested in Australia invested under a responsible investment commitment,[4] and that 80% of the largest 50 super funds in Australia have made commitments to responsible investing.[5]

Indeed, of the top 10 performing super funds, 7 of these have strong commitments to responsible investment. By contrast, none of the worst performing funds have such commitments (based on analysis of 10-year returns).[6]

However, the ethical factors are also an important consideration in today's investment landscape because it's intractably linked with risks that arise from reputation and changes in consumer norms that can flow through to investment outcomes.

In light of this evidence, many countries are updating the concept of fiduciary duty to explicitly incorporate the considerations of ESG, as well as specific issues such as climate change risks. Our own APRA has signaled the importance of climate change risks - citing them as a prudential threat - and UK and EU have both recently recommended changes to clarify investor duties on this matter. [7]

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[3] Harvard Business School (2016) ESG Integration in Investment Management: Myths and Realities, *Journal of Applied Corporate Finance*; ESG for All? The Impact of ESG Screening on Return, Risk, and Diversification, *Journal of Applied Corporate Finance* (2016); Can ESG Add Alpha? An Analysis of ESG Tilt and Momentum Strategies, *Journal of Investing*, (2016); Classifying and Measuring the Performance of Socially Responsible Mutual Funds. *Journal of Portfolio Management*, (2016); ESG and financial performance: aggregated evidence from more than 2000 empirical studies. *Journal of Sustainable Finance & Investment* (2015); NAB, (2017) *SRI in Australia,* Australian Centre for Financial Studies

[4] RIAA (2017), Responsible Investment Benchmark Report Australia 2017

[5] RIAA (2018), Super Fund Responsible Investment Benchmark Report 2018

[6] Based on 10-year performance, analysis undertaken by RIAA on the list of top and bottom performing funds published in The Australian 30 May - https://www.theaustralian.com.au/business/wealth/poor-superannuation-funds-cost-you-dearly/news-story/a5dee3cf37658eba8f6e820b759597e3

[7] E.g. UK Government report in June recommended Trustees be required to state policies in relation to evaluating risks relating to sustainability and consider members ethical concerns – Department for Work and Pensions, "Consultation on clarifying and

For example:

- **European Commission Action Plan for Financing Sustainable Growth** has recently set out as one of the actions a plan to clarify how institutional investors should act in the best interests of their beneficiaries. Specifically the EC will table legislation “to clarify institutional investors’ duties in relation to sustainability considerations that will aim to explicitly require institutional investors to integrate sustainability considerations in the investment decision-making process and increase transparency towards end-investors on how they integrate such sustainability factors in their investment decisions, in particular as concerns their exposure to sustainability risks” (March 2018)[8].
- **UK Government Department for Works and Pensions** has released draft legislation to clarify and strengthen trustees investment duties (July 2018) with a particular focus on requiring pension fund trustees to explain “how they take into account of financially martial considerations including (but not limited to) those arising from environmental, social an governance (ESG) considerations, including climate change”. In addition the draft also will require trustees to have policies in relation to their stewardship of the investments including engagement and voting. Furthermore the draft requires trustees to produce a statement outlining their members’ views on these ESG and sustainability issues, and how they take account of these views.[9]

These significant international developments are not alone, and underscore the shifting nature of pensions investment, and how the consideration of a wider set of duties to beneficiaries is becoming a core consideration of delivering the best outcomes for members.

This underscores why for superannuation to deliver the best outcomes for members, consideration of environmental, social and governance risks and opportunities and the views of members must be hard-wired into our super system.

Outcomes for members: Meeting the needs and expectations of members

In order to deliver fully on the goal of strong “outcomes for members”, performance, fees and choice are critical, but equally consumer research shows us that so is investing in a manner consistent with the expectations of Australians - to enhance returns whilst also avoiding doing harm.

Australians are concerned about fees and performance, but they are increasingly concerned also about the outcomes of their investments on how their biggest investment is shaping the world they will retire into.

Our research and that of others has shown that the bulk of Australians expecting their super or other investments to be invested responsibly and ethically.

- with 9 in 10 Australians expecting their super or other investments to be invested responsibly and ethically.
- 7 in 10 (69%) Australians would rather invest in a responsible super fund that considers the environmental, social and governance issues of the companies it invests in and maximises financial returns, rather than a super fund which considers only maximising financial returns (31%). This attitude has increased by 27% since 2013.[10]

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strengthening trustees’ investment duties”; European Commission Action Plan for Financing Sustainable Growth recommended clarifying institutional investors duties in relation to sustainability considerations.

[8] EC Action Plan for financing Sustainable Growth, March 2018, Action 7 in the “Communication from the Commission to the European Parliament, the European Council, The Council , The European Central Bank, The European Economic and Social Committee and the Committee of the Regions”.

[9] UK Government, Department for Work and Pensions, Consultation on clarifying and strengthening trustees’ investment duties: the Occupational Pension Schemes (Investment and Disclosure)(Amendment) Regulations 2018, June 2018.

[10] RIAA Consumer Research, From values to riches: charting consumer demand and attitudes for responsible investing in Australia, Nov 2017 https://responsibleinvestment.org/wp-content/uploads/2017/11/From-values-to-riches-Charting-consumer-attitudes-and-demand-for-responsible-investing-in-Australia-2017.pdf ; Other research has also been communicated to us by 6 different fund manager and super fund members who have conducted their own internal polling delivering similar results.

This values and ethics of Australians is increasingly being communicated to super funds directly via calls and emails to the funds from their members. This clearer understanding that Australians expect that their retirement savings be invested in a way that does no harm has been part of the reason for the relatively recent move by many of Australia's largest super funds to decide to exclude tobacco investments from their portfolios – e.g. in the last 4 or so years, super funds have moved approximately $3.5 bill out of tobacco stocks.

In this way, a focus purely on the size of the super fund balance at the point of retirement is no longer adequate as the sole measure of delivering outcomes for members. Increasingly, as funds gain in scale, those capital allocation decisions behind that $2.6 trillion of assets in superannuation are increasingly shaping our economy and society within which our members live and will retire.

From this perspective, a considered and properly implemented responsible investing approach – one that considers this full range of investment risks, opportunities and outcomes - is critical for super funds to be truly delivering the best outcomes for members.

Current state of play:

Today in Australia, as mentioned above, many funds are well progressed in implementing detailed and robust responsible investment strategies. Our recent report the Super Fund Responsible Investment Benchmark Report (May 2018)[11] provides a detailed assessment of the responsible investment commitments and implementation of the largest 53 super funds in Australia (includes APRA regulated and non-APRA regulated funds who in combination manage $1.4 trillion in AUM). RIAA commends this report to the Productivity Commission to give a detailed insight into how the largest funds are implementing responsible investment strategies.

In short, we found that:

- 80% of the largest funds had in place commitments to responsible investment, with 74% having either stand alone policy commitments or having these commitments embedded in investment beliefs.
- Detailed means by which responsible investment is being implemented across funds, via external fund managers
- that all categories of super funds – retail, public, corporate and industry – see examples of strong approaches to responsible investment
- that in conclusion we found 13 super funds that could demonstrate a comprehensive approach to their responsible investment strategies, across policies, RI governance/accountability, implementation, outcomes and transparency.

Importantly, what has shifted dramatically over recent years is that responsible investment is no longer just about offering an ethical investment option, but rather this is embedded as an investment consideration across the full fund, all investments, and reporting to members. This acknowledges that the largest super funds have recognised and understand that responsible investment has become a core part of delivering strong investment outcomes for members.

In this way, responsible investment has become synonymous with best practice in superannuation.

Recommendations:

In this light, RIAA would like to propose a number of ways these points above can and should be implemented into any future recommendations of the Productivity Commission.

RIAA understands the Productivity Commission aims to propose a best in show list of super funds as well as a product dash board for super funds in some form.

[11] https://responsibleinvestment.org/superfund-benchmark-report/

It is our overarching recommendation that any such assessment of funds in a best in show list or other assessment of funds must require an assessment of their responsible investment approach, and that this assessment must be a critical component of their eligibility to any best in show list.

In our view, a fund should be required to be able to demonstrate their commitment ***and*** implementation of a responsible investment approach beyond merely having a public commitment or policy with no evidence of further implementation. In this way, it will be important that any eligibility criteria look beyond just having a responsible investment policy.

We would again commend our report mentioned above – *Super Fund Responsible Investment Benchmark Report 2018* - as an important source of information as to how to go about assessing the responsible investment approach of super funds. It's worth noting that this report, our second iteration of the report, is based on a methodology developed in conjunction with global investment organisations through our partners in the Global Sustainable Investment Alliance, who present the leading regional responsible investment organisations in all parts of the world.

The eligibility criteria may for example have multiple tiers that seek to assess:

- commitment – ie stand alone policy
- commitment embedded in investment beliefs
- a measure of the depth of implementation – self-declared, as per the likert scale proposed below for example
- and that funds include a link to their responsible investment reporting (ie stand along RI report, within annual reports, RI details on their website or other.

Furthermore, in relation to product dashboards, we do believe that responsible investment factors should be built in to dashboards to reflect both the member interest and the investment outcome importance of responsible investment.

On January 20, 2016, RIAA made a submission to the review of improved superannuation transparency (Superannuation Legislation Amendment (Transparency Measures) Regulation 2015).

In that submission, RIAA advocated for the addition of an indicator on the proposed dashboard that notes the way responsible investment and ESG factors are taken into account within the superannuation product. (We noted that this would be consistent with the Corporations Act that requires product issuers to disclose how labour standards or environmental, social or ethical considerations are taken into account in selecting, retaining or realising an investment, as well as responding to the surging interest by consumers in the way ESG factors and ethics are considered in investment products.[12])

RIAA sees a product dashboard as the key consumer-focused summary of the investment product, and as such as the best opportunity for superannuation funds to differentiate their approach to responsible investment. The inclusion of an additional requirement to summarise the product's approach to responsible investing would, we believe, strengthen these dashboards to be both more useful to consumers as well as emphasising the importance of a responsible investment approach to delivering outcomes for members.

RIAA proposed some approaches to how this may appear and we have included them again below for this submission by way of examples.

We note that important legislation that will assist on this point of disclosure has been deferred numerous times, and ASIC Product Dashboards along with the transparency portfolio disclosure requirements. (Superannuation Legislation Amendment (Transparency Measures) Regulation 2015 remain unlegislated.[13]

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[12] RG 65 Section 1013DA of the Corporations Act 2001, requires product issuers to disclose in their "Product Disclosure Statements how labour standards or environmental, social or ethical considerations are taken into account in selecting, retaining or realising an investment".

[13] https://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-165mr-asic-to-extend-start-dates-on-stronger-super-reforms/

Approach 1: Likert Scale

Degree of consideration for responsibility or ethics
The self-declared rating represents the extent to which a responsible investment approach – such as consideration of environmental, social, corporate governance or ethical considerations are taken into account in selecting, retaining or realising of this product. 1 Low________________2__________________3 High 1. (Low) We do not review environmental, social or governance and/or ethical factors 2. We occasionally review the potential significance of ESG and/or ethical factors and investigate them accordingly 3. (High) We systematically review the potential significance of ESG and/or ethical factors and investigate them accordingly.

Approach 2: Select boxes

Aspects of responsibility or ethics	
The self-declared assessment shows the aspects relating to how responsible investment – such as consideration of environmental, social, corporate governance or ethical - considerations are taken into account in selecting, retaining or realising of this product.	Select all that are relevant for this product
1. Negative/exclusionary screening 2. Positive/best-in-class screening 3. Norms-based screening (e.g. compliance with international conventions such as human rights and anti-terrorism) 4. Integration of ESG factors 5. Sustainability themed investing (e.g. clean energy, green buildings) 6. Impact/community investing 7. Corporate engagement and shareholder action	☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐

The above is included as one way that these issues could be reflected within such a dashboard. There are no doubt many other ways. For example, RIAA also has a Certification Program that verifies investment products – super fund options, managed funds and others – as being true to label in their delivering on their responsible investment commitment. This Certification Program has been in place over a decade, is the world's longest running program, and has certain criteria that must be met to ensure investment products are delivering responsible investment to the expectations of consumers – these include for example full portfolio holdings disclosure, clear and accurate descriptions of responsible investment strategy (ie exclusions, or other strategies).[14]

Portfolio holdings is a case in point where Australia falls well behind the rest of the world: Morningstar reports in their annual Global Fund Investor Experience Report that "Australia remains the only country in this survey [of 25 countries] that does not have any requirement to disclose portfolio holdings." The Morningstar data is very clear on what is leading practice in this area: "Sixty percent of the countries require portfolio holdings to be disclosed semi annually, and nearly all of the others require quarterly disclosure." They report that "ideally, complete portfolio holdings are published monthly in a centralised electronic format that makes it easy for either a retail investor or an institution to quickly locate and gather the information.".[15]

Hence we again reiterate that full portfolio holdings, as is required in our Certification Program, is an essential component of delivering a stronger superannuation system, and one where members can get access to the information they require for fully informed decisions.

Finally, we would add that where any eligibility criteria for the best in show list does relate to financial performance data, it is critical that this is assessed against appropriate time horizons, which in the case of superannuation should be longer term performance over 5 or 10 year returns, not 1 or 3 year returns.

We thank the Commission for the opportunity to provide this submission.

Simon O'Connor
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[14] RIAA's Certification Program information can be found here: https://responsibleinvestment.org/program-overview/get-certified/
[15] Morningstar, Global Fund Investor Experience Study 2017, https://www.morningstar.com/content/dam/marketing/shared/pdfs/global-fund-investor-experience/GlobalFundInvestorExperienceReport2017.pdf