

## Green Funds

Investors around the world are becoming increasingly interested in environmental, social and governance (ESG) investing. In particular, with the effects of climate change being a live issue, focus must turn to the "E" aspect of ESG.

Green funds have existed overseas for several decades, but it is only in recent years that investors, particularly institutional investors, have paid increasing attention to green investments.

In New Zealand, the Guardians of New Zealand Superannuation has led the way in green investing, by moving its global passive equity portfolio into low-carbon investments. A number of New Zealand fund managers have established funds which incorporate ESG factors into their investment selection, but few have focused on the environmental aspect.

### What is a green fund?

There is no legal definition of a green fund, but a green fund is typically a fund that invests in companies that operate in environmentally sustainable ways. This includes companies engaged in renewable energy production, low-emission commercial premises and transport, pollution control, and other investments with a focus on environmental sustainability. While green funds have mostly invested in equities, the increased availability of green bonds provides an opportunity for green funds to further diversify their investments.

The key driver for the increase in this type of investment is growing investor demand. With increased attention on climate change related issues, there has been a significant increase in the number of investors – institutional and individual – who are seeking investments in exclusively green equities. Surveys in the United States show that a strong majority report interest in sustainable investing, particularly among millennials.

### Approaches to green investing

There are some difficulties relating to green funds, which largely flow from the fact that this type of investing has qualitative as well as quantitative objectives. It can be difficult to explain to investors a fund which is concerned with non-financial factors, as well as the core objective of generating a financial return.

Unlike green bonds, which have international published standards, there is significant ambiguity around what qualifies or can be classified as a green fund. There are many different approaches to green investing, such as the application of exclusionary criteria, the integration of ESG criteria or sustainable impact investing, and no single approach has ascendancy. Funds may be advertised as "ethical" or "sustainable", yet understanding exactly what this means and how it translates into an investment policy can be difficult.

There is also confusion regarding the regulation of green funds. Given the difficulty of classifying exactly what is "green" in this context, it is difficult for regulators to take any effective action to police what can be offered as a green fund.

## Standards for green funds

Having standards for green funds may help to alleviate some of the difficulties mentioned above. For example, the Responsible Investment Association Australasia has developed a certification that assesses and verifies that an investment product has taken ESG or ethical considerations into account along with financial returns. However, this has a broad focus on ESG as opposed to green investing.

In April this year, the Guernsey Financial Services Commission released a consultation paper on the world's first green fund rules. The proposed rules:

- set out certain criteria which must be met by a fund before it can be designated as a "Guernsey Green Fund";
- require appropriate disclosures to be made to investors; and
- impose continuing obligations to confirm the criteria are met,

thus providing a transparent and consistent approach for investors.

## Disclosure for green funds

Product disclosure statements for KiwiSaver schemes are currently required to contain a statement as to whether the scheme takes responsible investment, including environmental, social, and governance considerations, into account in the investment policies and procedures of the scheme.

There is no requirement to describe how the scheme takes these considerations into account, and no requirement for non-KiwiSaver funds to make such a statement. While a fund manager could, if it wished, include such information as part of the description of the investment in the product disclosure statement, consideration would need to be given to whether the fund could be labelled a "green fund".

## Green funds in New Zealand

Earlier this month the Ministry for the Environment introduced consultation on the Zero Carbon Bill. As the success of our action on climate change will depend in part on where the financial markets direct capital, there is an opportunity to consider how we can encourage green investing. Considering criteria for determining when a fund constitutes a "green fund" and can be referred to as such, and what disclosures green funds should make, would be a good starting point.