



CERTIFIED BY RIAA

RESPONSIBLE INVESTMENT STANDARD

ASSESSMENT NOTE

P3: Avoiding significant harm Minimum requirements

Revision	Rationale	Date
Added manufacture of nicotine alternatives	Recommendation of the World Health Organization to broaden consideration of 'harms' from new forms of nicotine delivery	19/10/2021 Effective 1/1/2022
Added nuclear weapons	Changing norm; alignment with the UN Treaty on the Prohibition of Nuclear Weapons	19/10/2021 Effective 1/1/2022

What does the RI Certification Standard say about avoiding significant harm?

The RI Certification Standard requirement P3 specifies that a RIAA certified product must:

'Avoid significant harm: can detail how the responsible investment product strategy results in a product for investors that, as a minimum avoids significant harm'

What is the intent of this requirement?

The intent of this requirement is:

- to mitigate the risk that consumers find certified products containing holdings that are principally in the business of activities that inflict significant harm on people, animals and the environment; and
- to reduce harm to people, animals and the environment by directing capital away from companies that produce goods and services and behave in ways that systematically undermine respect for human rights, environmental protection and economic stability (through unsound corporate governance as an example).

What does this mean in effect?

As per the RI Certification Standard Criteria 2 for *Minimum Product and Service Inclusions* and Requirement P3 Avoiding Significant Harm:

it is expected that, at a minimum, products exclude producers of tobacco, manufacture of nicotine alternatives and tobacco-based products, controversial weapons and nuclear weapons from their portfolio.

The statement above expresses an absolute minimum expectation of a product's exclusions. Outside of this, the Standard is not explicit about a minimum level of 'harm avoidance' - but it is incumbent upon the applicant to demonstrate that this has been considered in the design and execution of the product's responsible investment strategy.

In its marketing of the Responsible Investment Certification Symbol, RIAA must be able to maintain that *certified products do not have direct exposure to companies involved in the production of tobacco, manufacture of nicotine alternatives and tobacco-based products, controversial weapons and nuclear weapons.*

Tobacco, nicotine alternatives and tobacco-based products

The scope for excluding companies (and their subsidiaries and investments) are as follows:

The company is involved in the production of tobacco, manufacture of nicotine alternatives and tobacco-based products.

Nicotine alternatives and tobacco-based products include:

- Electronic nicotine delivery systems (ENDS) as defined by the US Food and Drug Administration (e.g. 'vaping' devices, e-cigarettes) alternatively described as nicotine vaping products (NVP)

- Dissolvable and non-combustible tobacco products (e.g. nicotine pouches, snuff)
- Shisha and water pipes

The issue of tobacco principally arises in a portfolio's consideration of equities and corporate issuances involvement in their production and distribution.

At a minimum, exclusions must cover companies (and their subsidiaries and investments) involved in the production of tobacco and manufacture of nicotine alternatives and tobacco-based products. This does not currently include parts of the supply chain like packaging, transport, machinery, or retail.

The minimum exposure considered is based on a company's revenue from the excluded activity. An effective threshold of 0% revenue should apply to companies (and their subsidiaries and investments) involved in the production of tobacco, manufacture of nicotine alternatives and tobacco-based products.

Controversial weapons

The scope for excluding companies is as follows:

The company is involved in the development and production of biological and chemical weapons, depleted uranium ammunition/armour, anti-personnel mines or cluster munitions/sub-munitions and their key components.

This scope does not require the exclusion of

- civilian firearms (except in jurisdictions where it is legally required to do so)
- military investors

The issue of controversial weapons principally arises in a product's handling of equities and corporate issuances involvement in their production and distribution.

At a minimum, excluded companies must cover those (and their subsidiaries and investments) involved in the manufacture of controversial weapons (being involved in the development and production of biological and chemical weapons, depleted uranium ammunition/armour, anti-personnel mines or cluster munitions/sub-munitions and their key components).

The minimum exposure considered is based on a company's revenue from the excluded activity. An effective threshold of 0% revenue applies to companies involved in the manufacture of controversial weapons.

Nuclear weapons

When determining whether to exclude companies (and their subsidiaries and investments) involved in the development, production and maintenance of nuclear weapons, the minimum exposure considered is based on a company's revenue from the excluded activity.

An effective threshold of 0% revenue should apply to companies involved in the prohibited activity.

It is expected that delivery systems such as missiles that are specifically developed for nuclear tasks, are excluded, but not delivery platforms such as bombers and submarines.

It is expected that other services to nuclear weapons production that are materially significant also be excluded.

The scope for excluding companies is based on the UN Treaty on the Prohibition of Nuclear Weapons, which entered into force on 22 January 2021 [and includes state-party signatories such as New Zealand and The Holy See (Vatican)].

Products offered in NZ – special note

Registered default KiwiSaver products must adhere to the additional level of exclusions required under their contracts; this ensures compliance by entities with the Standard's Criteria 1, Products must be current and legally trading.

Ownership screening disclosure

RIAA accepts that varying revenue calculation methodologies to determine exposure are in place is not prescriptive in what can and cannot be used. However, RIAA requires that the methodology and any resulting exceptions to the exclusion screen, that would be expected by a typical investor, be clearly disclosed.

The following provides guidance on how you may adequately disclose the methodology applied around ownership screening to your current or prospective clients.

Depth of ownership screening: Is this what a reasonable consumer would expect from any claims made by the product?

If the fund's company assessment methodology results in an exposure that a reasonable consumer would NOT expect from the claims, explicitly the exclusion screens, it is a requirement that:

- a. the issuer provides a clear, legal signal in the Product Disclosure Statement (PDS) or equivalent (fact sheet) to ensure the screening methodology clearly articulates how an issuer's equity investments (e.g., subsidiaries, accounting policies, ownership structure) are considered. The legal signal must also show what is therefore not included. For example, 'A parent company and its subsidiaries (equal to or greater than 50% ownership) are considered for screening purposes, however a company's minority investments (less than 50% ownership) are not.'; and
- b. exposure does not exceed a reasonable level on a full look-through basis, as determined by the application of the Quality and Thresholds Test (most likely to be 5% revenue exposure). This applies to both full (0% revenue thresholds) and partial (>0% revenue thresholds) exclusions; and
- c. the issuer provides to RIAA the strategy in place to mitigate the current and ongoing risk of exposure (e.g. divestment, shorting position or a plan to work with the index provider to adjust methodology); and
- d. the issuer deploys at least one, and preferably a second line of defence such as hardcoded pre-trade screens or periodic checks that the portfolio constituents are not inconsistent with the exclusion screens that a reasonable consumer would expect as published in the PDS or equivalent.

FAQ

1. How does this differ to the requirements of Tobacco Free Portfolio's Stamp of Approval?

The RIAA certification exposure revenue threshold is set at effectively 0%, whilst Tobacco Free Portfolio's Stamp of Approval is set at 5% for excluded companies found in holdings.

2. I have a multi-asset product and I am not confident that a tobacco and controversial weapons screen is applied across certain asset classes such as cash. What is the allowable product coverage to satisfy RIAA certification, i.e. multi-asset products?

The scope of exclusionary screening shall depend on the composition of the product but should include as much of a portfolio as practicably possible and be in-step with the intent of the requirement, – i.e. RI strategies should apply to asset classes reasonably considered to be suitable for screening and holdings directly held and managed.

Generally, RIAA requires that multi-asset products have a minimum of 75% of the total FUM compliant with the Responsible Investment Standard and that coverage applies to asset classes reasonably considered to be suitable for screening.

Where RIAA may make exceptions (to the 75% FUM coverage guide) is, for example, providing assessment over a conservative product comprising more than 30% of asset classes in categories such as Cash or Other in the next section. In this event, RIAA would assess the product based on the issuer's application of the RI strategies across the balance of the asset classes listed following.

Where certain asset classes are not covered by the RI strategies, it is a requirement to:

- a) indicate the allowable allocation to the uncovered proportion of the total product in legal and marketing documentation;
- b) explain why this asset class is not covered by RI strategies; and
- c) provide in writing to RIAA the formal steps in place to manage exposure to significant harms such as the producers of tobacco, tobacco-related products and manufacturers of controversial weapons in this uncovered asset class.

Giving consideration to the style and nature of the product as well as the Quality & Thresholds Test, RIAA shall have discretion to determine whether the scale of the exclusion and explanation provided are reasonable and steps in place to manage the risk of exposure to excluded holdings, is prudent.

Refer to the Guidance Note for Multi-asset Products for additional disclosure and/or management requirements pertaining to multi-asset funds.

3. How should assets managed by underlying fund managers be treated?

The investment mandate existing between the RIAA certified product issuer and the underlying fund manager must codify the screen applied as relevant to tobacco, tobacco products and controversial weapons producers. It may be a requirement that this investment mandate be made available to RIAA to verify the RI process is formalised and can be consistently applied. It will still be a requirement of RIAA certified products to have controls in place (at least first and preferably a second line of defense) to check for portfolio constituents as per the investment mandate. The same rule applies to issuers of RIAA certified products whose portfolio contains passively held holdings.

4. What is expected to be in the legal documents to reflect compliance with this requirement?

Where there is a statement about the exclusion applied across the RIAA certified product with respect to scope and exposure threshold, that statement cannot be inconsistent with the strategy applied in practice. For example, if a fund excludes companies involved in tobacco production, then the PDS, investment mandate or equivalent legal document cannot include a revenue threshold above 0%.

For products where the effective 0% threshold on the required exclusions under this Assessment Note is a given due to a combination of fund type, investment philosophy, investment process and underlying index (where relevant), a statement on these exclusions is not expected to be in the legal documents, however the above rule applies, that where there is a statement about the exclusions, it cannot include a revenue threshold above 0%.

5. If a passive strategy portfolio holding is in breach of RIAA's Avoid Significant Harm requirement between rebalancing dates, does RIAA expect immediate divestment to retain certification?

RIA understands that the constituents of an index are subject to periodic review, and constituents are unlikely to change between reviews. New data and information, including corporate actions, may mean a constituent no longer fulfils the index product's ESG criteria. These include, but are not limited to, mergers and acquisitions of companies involved in restricted business activities or controversies, changes to businesses' strategies, new sanctions or changes to regulations.

- Compared with active managers, a passive strategy product manager may not be able to divest between rebalancing and reconstitution. As such, a product provider must clearly explain the limitations in reacting to the latest data, and communicate the reasonable timeframe within which an investor should expect to see action taken,
- In cases where an error in data is discovered, the product provider must explain the process of exclusion, any changes to weightings or other measures to be implemented, and the reasonable timeframe an investor should expect for such procedures to be complete.

6. Financial products usually outsource part of the RI process or data sourcing to a third party for ASH Screening. Does RIAA assess this outsourcing relationship and those processes?

RIAA does not currently test the due diligence a product provider conducts on the index or data provider it uses to develop and monitor the product. In due course this may be incorporated as part of RIAA's assessment. This principle also extends to other products that rely on third-party data providers to carry out negative screening and positive screenings as well.

Notwithstanding increased regulatory scrutiny in this area¹, a financial product provider must not promise exclusions or claims they cannot guarantee. Such promises or claims are the responsibility of the product provider, not the third-party data provider. If a claim may not be delivered or if there are limitations to methodologies used in the delivery of those claims, these must be disclosed with an outline of measures and procedures in place to address those circumstances. The Quality and Thresholds Test may be exercised in determining if explanations and timeframes are reasonable.

Future developments

Based on analysis of international norms, expectations of consumers, investors and NGOs, definitions should be broader. Most ESG research firms also take a broader view than expressed in the scope statements herein. Furthermore, additional minimum expectations may be added such as for fossil fuels producers.

If and when this occurs, impacted stakeholders shall be engaged as RIAA works to revise scope statements so that they achieve stronger outcomes.

¹ Report REP 791 ASIC's interventions on greenwashing misconduct: 2023–2024