



ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 41

Socially responsible investing disclosure guidelines

December 2002

Your comments

You are invited to comment on the issues raised, or any other aspect of this discussion paper.

Comments are due by Friday, 28 February 2003. and should be sent to:

**Ms Delia Rickard
Deputy Executive Director, Consumer Protection
ASIC
GPO Box 9827
CANBERRA CITY, ACT 2601**

or to delia.rickard@asic.gov.au

All submissions will be treated as public documents unless they are clearly marked as confidential.

Executive summary

- 1 We ask whether ASIC should produce guidelines on the new requirement that all products with an investment component that have a product disclosure statement (PDS) will now need to disclose the extent to which labour standards or environmental, social or ethical considerations are taken into account in the selection, retention or realisation of the investment. We refer to such disclosure by its common name, socially responsible investing (SRI). We also invite comments on the appropriate content of any such guidelines should they eventuate.
- 2 Socially responsible investing (SRI) is a new and growing area of the investment market. Good disclosure practices are essential if consumers with SRI related goals are to be in a position to make informed choices between products.
- 3 We outline arguments for and against ASIC producing guidelines on SRI disclosure in product disclosure statements (PDSs).

The main arguments for ASIC guidelines are:

- providing industry with greater certainty about how it can meet this new disclosure obligation; and
 - providing consumers with better disclosure to enhance their ability to ensure that the product they purchase matches any SRI goals they may have.
- 4 In looking at what such guidelines could cover, we have been influenced by our informal consultations to date with over 20 industry, government and community sector organisations.
 - 5 We have sought to suggest an approach that will foster meaningful disclosure for consumers without being commercially unrealistic or exposing product issuers to unreasonable levels of risk. It is not in the interests of anyone to have the disclosure obligations set in such a way that funds avoid having regard to SRI considerations in order to avoid potential liability.
 - 6 All investment products will need to address SRI issues in their PDS to some extent, even if it is only to say that they don't take SRI issues into account. Our view is, however, that the more a product promotes itself as taking into account labour standards and environmental, social or ethical considerations, the more detailed the PDS disclosure will need to be.
 - 7 However, too much disclosure can be as counterproductive as too little. We think it would be acceptable to refer consumers to a secondary information source, once the minimum content

requirements for PDS have been met, ie if the PDS has sufficient information to enable target consumers (reasonable consumers of the class to whom the PDS is directed) to make a decision whether or not to acquire the product.

- 8 Against this background, we argue that the disclosure obligations also apply to a multi-investment option product.
- 9 Where a product claims to take into account labour standards and environmental, social or ethical considerations, disclosure must also cover its approach to monitoring the ongoing compatibility of its investments to its stated strategy, and what it will do when an investment no longer fits its disclosed SRI approach.
- 10 The diversity of investment products on the market and the broad spectrum of SRI approaches mean that while guidelines may be helpful, it won't be possible to set down definitive rules about what to say when.
- 11 Product issuers should always ask themselves:
 - (a) Is anything I'm saying, or not saying, likely to give rise to a misleading or deceptive impression about the SRI characteristics of my product?
 - (b) Am I providing my target consumers with sufficient information to allow them to clearly understand my approach to SRI issues and to determine whether or not it meets any SRI goals they may have?
- 12 We welcome your feedback on the paper, including to our questions in Section 7 of it.
- 13 Finally, in a policy proposal paper recently released by ASIC, *Licensing: Financial product advisers - Conduct and disclosure*, we query whether there are any circumstances where an adviser preparing and providing personal advice on investment products would not have to inquire about a client's views on labour standards or environmental, social or ethical considerations (see Appendix 3). You may also wish to comment on that paper.

Glossary

the Act	Corporations Act 2001
FSR	Financial services reform
PDS	Product disclosure statement
SRI	Socially responsible investing
target consumers	Reasonable members of the class of consumers to whom the PDS is directed

Contents

Executive summary.....	3
Section 1: Legislative and policy context.....	7
Section 2: Market context.....	9
Section 3: Should ASIC produce SRI guidelines?.....	11
Section 4: Preliminary legal issues.....	13
Section 5: What should any ASIC guidelines cover?	21
Section 6: Administering the guidelines	27
Section 7: Your feedback.....	29
What happens next	30
Appendices	31

Section 1: Legislative and policy context

Impact of the FSR Act

1.1 Due to the Financial Services Reform Act, which commenced on 11 March 2002, product disclosure statements (PDSs)¹ for products with an investment component must include disclosure of ‘the extent to which labour standards or environmental, social or ethical considerations are taken into account in the selection, retention or realisation of the investment’: s1013D(1)(l) of the Corporations Act 2001 (the Act). Similar requirements now exist in some overseas jurisdictions.²

1.2 The reforms also gave ASIC the power to ‘develop guidelines that must be complied with where a PDS makes any claim that labour standards or environmental, social or ethical considerations are taken into account in the selection, retention or realisation of the investment’: s1013DA of the Act.

This discussion paper examines whether ASIC should produce such guidelines and, if we should, what they should contain.

1.3 The law does not require ASIC to specify the labour standards or environmental, social or ethical considerations that may be taken account of, or the methodologies that should be used, and we do not intend to do so.

1.4 While the legislation does not use the term ‘socially responsible investments’ or SRI, we have used it in this paper, as it is commonly used to refer to these types of investment considerations.

The full text of the main SRI disclosure requirements in the *Corporations Act 2001* and in the *Corporations Regulations 2001* is set out in Appendix 1.

We will consider Policy Statement 168

1.5 In developing any SRI guidelines, we will take into account the good disclosure principles in our Policy Statement 168 *Disclosure*:

¹ A PDS provides key information to enable a consumer to make a decision whether or not to acquire a financial product. Usually, a PDS is required to be given to a consumer prior to the acquisition of a financial product.

² A July 2000 amendment to the UK Pensions Act requires trustees to state “the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention or realisation of investments” and “their policy in relation to the exercise of rights (including voting rights) attaching to investments”. Similar legislation also exists in other parts of Europe.

Product Disclosure Statements (and other disclosure obligations) [PS 168].

In brief, these principles state that disclosure should:

1. be timely
2. be relevant and complete
3. promote product understanding
4. promote comparison
5. highlight important information.
6. have regard to consumers' needs.

1.6 Readers should consult [PS 168] for a more detailed discussion of the implications of each of these principles.

1.7 We have also been influenced by our informal consultations to date, with over 20 industry, government and community sector organisations.

Section 2: Market context

2.1 An increasing range of investment products are marketed as having regard to appropriate labour, environmental, social and ethical practices when their choice of investments was selected. Depending on the product, this may be done because of the type of world some investors may want, their perceived impact on the financial worth of investments or for both these reasons. An increasing number of consumers are considering such matters in their choice of investments.

2.2 While traditional investment strategies have sometimes considered the impact of some environmental, social, ethical and labour considerations on the investment, these newer products are developing specific methodologies to measure and reflect the values they promote themselves as having. Such products or funds are becoming known as ‘socially responsible investments’ or SRI products.

Main SRI methodologies

2.3 Most funds use one or more of six main methodologies in developing their products. Many also use some type of preliminary financial screen to ensure that investments are financially sound. The main SRI methodologies are:

- (a) **Engagement** approaches where the fund undertakes to actively conduct dialogues with companies and use its voting rights and other sources of influence to exert pressure on the company to do, or not do, particular things.
- (b) **Negative screens** where the fund does not invest in companies involved with certain named activities. Common negative screens include tobacco, gambling, uranium, arms and animal testing.
- (c) **Positive screens** where funds seek to invest in companies that engage in what the fund sees as desirable practices. Positive screens include reducing greenhouse gas emissions; offering paid maternity leave or reinvesting in the communities in which they operate.
- (d) **Preference strategies** where fund managers work to a list of guidelines or criteria that companies invested in should meet. This approach can involve elements of a number of the other methodologies.
- (e) **Best of sector** approaches where the fund invests in companies that are the best performers in their sector as measured against a range of specified indicators.

- (f) **Index based** approaches that construct portfolios using established indices of environmentally and socially responsible companies.³

SRIs in Australia

2.4 The size of the SRI market in Australia is growing. A recent survey of SRI investments in Australia by Deni Greene Consulting showed that as at 30 June 2002, \$13.9 billion was invested in SRI-style products, an increase of 32% from the \$10.5 billion invested at the same time the year before.

2.5 Of that amount, \$1.8 billion was invested in SRI managed funds, an increase of 31% on the \$1.3 billion invested the year before.⁴

2.6 Despite the growth in SRI investments, they still represent a small percentage of the total market for investment products. The Australian Bureau of Statistics (ABS) figure for the value of assets held by managed funds as at 30 June 2002 was \$154 billion.⁵ (The ABS and Greene surveys, however, have defined managed funds slightly differently and, adjusting the Greene figures for those differences, the comparable figure for SRI managed funds is around \$868.73 million.)

2.7 The Greene survey also showed that the number of SRI managed funds in 2002 was 74, an increase of 61% over the 46 in 2001.⁶ There are now also specialist SRI research houses and indices to support such funds.

2.8 Even with this growth though, recent survey research by ASSIRT suggests that most Australian investors are not aware of SRI products though many investors would consider them if they were aware of them.⁷

³ For discussions of key methodologies see for example: Deni Greene Consulting Services, *A Capital Idea: Realising value from environmental and social performance*, Aug 2001, at <http://www.ea.gov.au/industry/sustainable/finance/pubs/capital-idea.pdf>; Karen Eldridge, 'Taking social and environmental factors into account in the investment decision-making process: What can fund managers do to meet clients' needs' *Journal of Pensions Management*, Vol 6 Number 2 January 2002.

⁴ Deni Greene Consulting Services, *Socially Responsible Investment in Australia – 2002: Benchmarking Survey Conducted for the Ethical Investment Association*, September 2002. A copy of the survey is available from Environment Australia's website at: www.ea.gov.au/industry/sustainable/finance/publications.html. The \$13.9 billion figure is made up of: \$1.8 billion in managed SRI funds; \$124 million in private SRI portfolios managed by financial advisers; \$6.7 billion in investments by religious organizations; \$116 million invested by charitable trusts using SRI criteria; \$5 billion in employer superannuation funds using SRI overlays and \$164 million in community finance investment.

⁵ Reserve Bank of Australia Statistical Table B15 – Managed Funds.

⁶ The Investment & Financial Services Association's *Key Industry Statistics Survey 2002*, conducted by Price Waterhouse Coopers also suggests that the prevalence of SRI products will continue to grow (p.11).

⁷ The ASSIRT April 2002 Proactive Investor survey found that less than one-third of all proactive investors (defined as adult Australians with investments outside their

Clearly there is a need for more consumer education in this area by industry, government and other interested organisations. ASIC plans to include some basic investor education on SRI on its consumer website www.fido.asic.gov.au. We are happy to discuss this proposed initiative with interested stakeholders.

Section 3: Should ASIC produce SRI guidelines?

Arguments for

3.1 We took part in a number of forums focusing on the SRI disclosure reforms and consulted informally with representatives from over 20 organisations. These included:

- key industry associations
- industry players that offer SRI funds
- industry players that don't offer such funds
- representatives of non-government or not-for-profit organisations with an interest in this issue, and
- other government agencies.

The majority of those we talked with favoured ASIC producing such guidelines.

3.2 There are two main arguments for ASIC guidelines:

- (a) providing greater certainty for *industry* about how it can meet its SRI disclosure obligations; and
- (b) providing consumers with better disclosure to enhance their ability to ensure that the product they purchase matches any SRI related goals they may have.

3.3 Arguments in favour of providing industry with greater certainty included:

compulsory superannuation contributions or primary residence) have an understanding of ethical investments although younger investors had a higher awareness. Fewer than one in ten have had ethical investments discussed by their financial planner. When informed about the meaning of socially responsible investing, and given the choice between ethical or 'other investments', nearly 40 percent would favour ethical products according to the ASSIRT survey.

- (a) greater clarity about the exact nature of the disclosure requirements is needed, especially given the potentially serious consequences if disclosure is defective
- (b) existing SRI disclosure in the marketplace suggests that there is room for improvement in how SRI disclosure is being handled
- (c) many product issuers find themselves in the middle of a transitional period which offers a good opportunity for more detailed guidance for SRI disclosure with less potential for disruption than if guidelines were issued later; and
- (d) guidelines that take a sensible and commercially realistic approach could help quell the concerns that have been expressed about the new disclosure requirements exposing product issuers to unreasonable legal risk or unreasonable burdens.

3.4 Arguments put to us that supported consumers being provided with further improved SRI disclosure included:

- (a) It is currently very hard for a consumer to know with some SRI-labelled products, what they are really getting. It has been suggested to us that some products claim they are SRI but really do nothing, or very little, to reflect this in their investment strategy.
- (b) Guidelines would promote clear, concise and effective disclosure that is sensible and is both meaningful and useful to consumers.
- (c) Guidelines would help improve product comparability. On this argument we would note that while guidelines could go some way towards aiding comparability, market forces are also likely to be important here. The current displeasure of some industry participants at being required to respond to multiple questionnaires from financial services providers and research houses about their corporate activities, along with growing international consensus around standards such as those in the Global Reporting Initiative,⁸ are likely to help develop common considerations and standards.

Arguments against

3.5 A number of arguments against producing guidelines, either in the short or long term, were raised in our consultations and internal discussions.

- (a) A case can be made for waiting until the law has been operational for some time, and then doing a study of PDSs in the marketplace to see how the new law has been interpreted and whether any further guidance is needed.

⁸ <http://globalreporting.org>

- (b) Concern was expressed that guidelines may introduce a level of prescription that is not justified or consistent with the flexible nature of the FSR PDS regime.
- (c) Concerns have also been expressed about the costs for those funds that have already issued PDSs, where their disclosure, while not misleading and deceptive, doesn't fully comply with ASIC guidelines (see paras 6.5 – 6.8 of this document).
- (d) Another argument put to us was that industry associations should provide the guidance, not ASIC. While we recognise a legitimate place for industry guidance, no one industry body represents all those covered by the new disclosure requirements. Many organisations we consulted, especially in the not-for-profit sector, preferred ASIC to give the guidance, which may also provide greater comfort to consumers and some other industry players. We have also been given a very specific power to make guidelines.

Section 4: Preliminary legal issues

4.1 The issues below were raised in our consultations with stakeholders.

Our guideline-making power is limited

4.2 ASIC must exercise its guideline-making power under s1013DA of the Corporations Act in a way that is consistent with Part 7.9 of the Act (in particular, section 1013D). While it is clearly Parliament's intention for ASIC guidelines to further direct what goes into the PDS, we could not impose a requirement outside the scheme proposed by Parliament.

Who is the relevant consumer for the purposes of determining the content of a PDS.

4.3 Section 1013D(1) provides that:

‘ . . . a Product Disclosure Statement must include the following statements, and such of the following information as a person would reasonably require for the purpose of making a decision, as a retail client, whether to acquire the financial product’.

4.4 So how much SRI information does a retail consumer reasonably require? The answer to this question is important to determine what must

be in a PDS (the primary information source) and when it is acceptable to refer consumers to a secondary information source.

4.5 Just how much information a consumer would reasonably require involves asking who that consumer is. Consumers may vary from those with no SRI interest, to those with a general desire to ensure their investing does some good or does not harm, to those with a passionate commitment to certain issues.

4.6 As the law does not envisage product issuers, when preparing PDS, knowing potential clients' particular circumstances, it is reasonable to assume that the requirements refer to a reasonable person in the class to which the product is aimed — here, we'll call them 'target consumers'.

4.7 As ASIC Policy Statement 168 on Product Disclosure Statements notes:

When considering what information will be relevant and useful to a consumer for the purposes of decision making, a product issuer should have regard to:

(a) the information needs of reasonable consumers of the class to whom the PDS is directed. [PS 168:46]

4.8 Just who these reasonable consumers are will depend on the investment product in question. For example, if a fund is only open to members of an environmental lobby group, it would be reasonable to expect it to contain a higher level of information about environmental considerations and the methodology for dealing with them, than an SRI fund aimed at the general population.

When is it acceptable for issuers to refer consumers to a secondary info source?

4.9 It is **only** acceptable to refer consumers to a secondary source once the minimum requirements for what must be in a PDS have been met. The mere availability of information elsewhere does not justify its non-inclusion in a PDS if it is information that must be in the PDS.

What should be in a PDS?

4.10 Certain statements and information must be included in a PDS if a potential retail client would reasonably require them for the purpose of making a decision whether to acquire the financial product: s1013D(1) of the Act.

4.11 With certain exceptions, a PDS must also contain any other information that might reasonably be expected to have a material

influence on the decision of a reasonable retail client whether to acquire the financial product: s1013E.

SRI issues could be in a separate document as part of PDS

4.12 Before looking at secondary sources beyond the PDS, it should be noted that the law provides that a PDS can be made up of one or more documents that are given to the client at the same time: s1013L(1).

When can a secondary info source be used?

4.13 In our view, once a PDS fulfils the law's requirements, referring consumers to a secondary, non PDS, source for more information on a fund's SRI approach is permissible. Indeed, we believe that good disclosure principles suggest that this will sometimes be the desirable approach, given that too much disclosure can be just as ineffective as too little.

4.14 Part 7.9 of the Act clearly intends that secondary sources may sometimes be required. For example:

- (a) s1017A obliges issuers to give additional information on request, including information that 'might reasonably influence a person's decision, as a retail client, whether to acquire a financial product to which the statement relates'.
- (b) s1013C(1)(b)(ii) specifically allows a PDS to 'refer to other information that is set out in another document.'

4.15 So when is it acceptable to refer people to a secondary source or, to put it another way, how much information does a person reasonably require to make a decision whether to acquire a product?

4.16 The answer will depend on:

- the target consumers the product is aimed at
- the extent to which SRI factors are a feature of the product, and
- the complexity of the SRI methodology used.

4.17 For example, an SRI fund which markets itself to the public would need to provide consumers with enough information for them to know the main labour standards and/or types of environmental, social and ethical considerations that it takes into account and the general methodology used in doing this.

4.18 It is reasonable to expect though that some consumers considering such a fund may want more detail about the precise nature of the considerations and methodology used. Such information should be easily available and we would recommend that, subject to PDS content

complying with the law, the PDS should contain cross-references to other sources such as websites or other documents, plus a phone number for consumers who don't have internet access.

Are multiple investment options subject to SRI disclosure requirements?

4.19 This issue was raised because of industry concerns about the potential for lengthy and complex disclosure as a result of the need to address SRI issues at an investment option level.

4.20 Where the financial product (eg a superannuation product) enables the holder to choose from a number of investment options or choices, the SRI disclosure requirement applies so that appropriate information is provided about each investment strategy or choice. This 'drilling down' approach is required by the law,⁹ in particular, the requirement for information in a PDS to be determined by what a retail client would reasonably require to make a decision whether to acquire the financial product.

4.21 The amount of SRI disclosure required for each investment option or choice will be affected by:

- (a) the exact nature of the investment arrangement and investment decision making within the arrangement; and
- (b) how far the option is marketed as an SRI option and other factors relevant to the materiality of the information.

4.22 Also, when 'drilling down' to the investment options or investment choices level, the Act envisages that a PDS can be made up of more than one document: section 1013L(1). For example, if desired, one part of the PDS could address common issues across the investment options with a separate PDS document given at the same time that addresses SRI issues particular to each investment option.

Custodial arrangements

4.23 In the case of some investment options, SRI information will not be required, depending on whether the options are offered by a custodial arrangement within the meaning of s1012IA.¹⁰ Generally, the operator of

⁹ In the superannuation context, there are also specific obligations on trustees of superannuation funds for disclosure at the investment option level. See, in particular, Regulation 4.02 of the Superannuation Industry (Supervision) Regulations which requires a trustee of a superannuation fund to give a member all the information the trustee reasonably believes a person reasonably needs for the purpose of understanding the effect of, and any risk involved in, each investment strategy offered by the fund.

¹⁰ A custodial arrangement is an arrangement between a person (the provider) and another person (the client) under which the client can give an instruction that a particular financial product or a financial product of a particular kind is to be acquired. Other elements of a custodial arrangement are set out in section 1012IA. Where a

a custodial arrangement may often not be required to make extensive SRI disclosures. If SRI factors were not considered in developing the investment options, the operator can just state this.

4.24 This is because the operator does not itself issue financial products (in which case there is no requirement for the operator to produce a PDS) or because it will not usually take SRI factors into account when offering those options (eg an IDPS-like scheme with a large range of investment choices). This is because SRI factors will often be a matter for the client to consider rather than for the operator of the custodial arrangement. In this situation, SRI information for each investment option is more likely to be required in the PDS for the underlying investment product or fund.

What disclosure will be reasonable?

4.25 *Materiality of information* is relevant to determining the extent of SRI disclosure requirements for a PDS. This suggests that the more a product is marketed as an SRI investment product, the more material is information about the SRI approach adopted.

4.26 The Corporations Act requires information to be included in the PDS only to the extent to which the requirement is applicable to the financial product. The PDS does not need to indicate that a particular requirement is not applicable to the financial product: s1013D(3).

4.27 But despite anything in section 1013D or 1013E,¹¹ information is not required to be included in a PDS if it would not be reasonable for a retail client considering whether to acquire the product, to expect to find the information in the Statement: s1013F

4.28 The Act also lists matters relevant to when it is/is not reasonable for a person to expect to find information in a PDS: s1013F(2). These matters include:

- (a) the nature of the product
- (b) the extent to which the product is well understood by the kinds of persons who ordinarily acquire products of that kind as a retail client
- (c) the kinds of things such persons may reasonably be expected to know

custodial arrangement exists, the provider is required to give a PDS to the client about the financial product the client wants the provider to acquire before it is acquired. This is in addition to any PDS required for the custodial arrangement itself.

¹¹ Section 1013E is a requirement to include other information in a PDS that 'might reasonably be expected to have a material influence on the decision of a reasonable person . . . to acquire the product'.

- (d) the way in which the product is promoted, sold or distributed, and
- (e) any other matters specified in the regulations.

4.29 The regulations (see Appendix 1) make it clear that all investment products will need to address SRI issues to at least some extent – even if it is only to say that they do not take them into account.

4.30 That said, the materiality of information provisions are likely to be relevant in determining what SRI information must be provided. They are particularly relevant to those products that do not market themselves as SRI products but may consider the impact of labour standards and/or environmental, ethical and social considerations on investment returns.

What disclosure applies to product providers that devolve investment decisions to others?

4.31 It has been argued that for some products, the product issuer does *not* consider SRI issues because fund managers or other participants deal with them. Therefore, it is argued, the SRI disclosure requirements are not triggered beyond saying that these matters are left to others.

4.32 Simply put, positive SRI disclosure is required whenever SRI issues are taken into account in selecting, retaining or realising investments.

4.33 SRI issues might be taken into account in a number of ways including one or more of the following:

- (a) in formulating the investment objectives and/or investment strategy of a product or investment options offered by a product
- (b) in choosing investment managers or investment advisers
- (c) in any direct investments selected or disposed of directly by product issuer
- (d) in the investments made by investment managers, and
- (e) in formulating risk management strategies or other governance arrangements.

4.34 Where SRI issues are not considered for a product, this needs to be disclosed under s1013D(1)(l). But our view of s1013D(1)(l) is that where SRI issues are taken into account in the total ‘makeup’ of a product’s investment arrangements, more expansive SRI disclosure is triggered.

4.35 It does not matter for the purposes of s1013D(1)(l) *who* does the taking into account of the SRI issues.

4.36 An exception to this is where *the client* makes the decision to select, retain or realise an investment. For example, in a non-

superannuation custodial arrangement, the operator will not be required to provide SRI disclosure. In issuing any PDS for the custodial arrangement, the product issuer would need to disclose whether, and if so how far, SRI factors were considered in framing the list of investments. SRI information might also be required in the PDS for the underlying investments offered by the operator of the custodial arrangement.

4.37 The level or type of disclosure will vary, depending on the nature of the investment arrangements, who takes SRI factors into account and how these factors are taken into account.

What are the potential consequences for breaching any ASIC guidelines?

4.38 A range of remedies and sanctions potentially apply to the new SRI disclosure requirements, including a breach of any ASIC guidelines.

4.39 Section 1013DA, the guidelines making power, does not contain any specific reference to penalties or sanctions for breach of the guidelines.

4.40 Despite this, it is ASIC's view that a breach of any guidelines could result in a court finding that the Product Disclosure Statement is defective and potentially may give rise to criminal penalties under Division 7 of Part 7.9 of the Act where the defect was made deliberately or recklessly. Should this occur it could result in criminal penalties of up to 200 penalty units¹² or imprisonment for up to 5 years or both¹³.

4.41 What constitutes defective disclosure is outlined in section 1021(B)(1). It includes disclosure which contains:

- (a) a misleading or deceptive statement (s1021B(1)(a))
- (b) in the case of a PDS, omission of material required by section 1013C, other than material required by section 1013B or 1013G (these latter two sections deal only with the title and date of a PDS).

being a statement or omission that is, or would, be materially adverse from the point of view of a reasonable person considering whether to proceed to acquire the financial product concerned.

4.42 Section 1013C(1) requires that a PDS include:

- (a) A statement or information required by section 1013D

¹² A penalty unit is currently worth \$110 (see section 4AA of the Crimes Act 1914).

¹³ See section 1311 and Schedule 3 of the Corporations Act 2002 for more details about potential penalties. A fine in respect of a body corporate can be five times that for an individual (section 1312 of the Corporations Act 2002).

- (b) Information required by section 1013E (other general information which might influence a person's decision), and
- (c) Information required by *other provisions of this subdivision* (our emphasis) being Subdivision C. Section 1013DA (the guidelines making power) is a provision of Subdivision C and requires information to be given by virtue of the fact that it provides a power to make guidelines which 'must be complied with'.

4.43 Apart from possible criminal penalties, a range of other remedies may be triggered if a PDS is defective because of non-compliance with s.1013DA guidelines. For example, a contravention of the Act provides grounds for an application for an injunction and other orders under sections 1323 and 1324. It may also provide the basis for issuing a stop order under section 1020E for a defective PDS.

4.44 In addition, both the ASIC Act 2001 and Corporations Act 2001 contain prohibitions on misleading and deceptive conduct. (See, for example, s.12DA of the ASIC Act 2001 and section 1041E of the Corporations Act 2001.)

Are deposit products 'financial products with an investment component'?

4.45 The SRI disclosure obligations only apply if the product has an investment component: s1013D(1)(1). Section 1013D(2A) provides that:

For the purposes of paragraph (1)(1), products with an investment component include superannuation products, managed investment products and investment life insurance products.

4.46 An issue raised with us is whether deposit products are products with an investment component. While the legislation does not specifically address this question, ASIC's initial view is that deposit products will not usually be caught by the new requirement. This is because it is not usually an express term of the product that either the issuer invests an amount equivalent to some or all of any deposit, or that the return to the investor is in some other way dependent on an investment held by the issuer. Issuers should obtain their own legal advice in relation to their particular products.

Section 5: What should any ASIC guidelines cover?

No definitive list of labour standards, environmental, social or ethical considerations, or prescribed methodology

5.1 We do not intend to produce a definitive list of labour standards or environmental, social or ethical considerations, nor prescribe the SRI methodology. Why?

- (a) Such standards, considerations and methodologies are in a permanent state of flux and evolution.
- (b) Ethical considerations are inherently subjective and no list would attract universal agreement.
- (c) No-one that we have consulted thus far has supported us taking such an approach.

5.2 But the Act does expect product issuers to clearly define what they mean when they say that they take such standards and considerations into account and to clearly describe the methodologies they employ.

Examples of labour standards or environmental, social or ethical considerations

5.3 It has been suggested that we provide a non-exhaustive list of what may be considered to be labour standards or environmental, social or ethical considerations, as part of the guidelines. We are conscious of potential pitfalls of such an approach, given the evolving and/or subjective nature of some of these areas. We also recognise though that some people might find such illustrations helpful. We are particularly interested in receiving your views on this issue.

5.4 If we provided such lists, we currently think we would base them on:

- (a) the Global Reporting Initiative (the GRI)¹⁴ and possibly
- (b) on the work being done by Environment Australia and the Federal Department of Family and Community Services to translate the GRI to an Australian context and encourage triple bottom line reporting here.¹⁵

¹⁴ <http://globalreporting.org>.

¹⁵ See *Indicators and Methodologies for Public Environmental Reporting: An Australian Guide*, Exposure Draft, Environment Australia, November 2002 at <http://www.ea.gov.au/industry/sustainable/per/indicators.html>. A similar exposure draft

5.5 The text accompanying any such lists would emphasise that:

- the lists were illustrative only and non-exhaustive
- ethical considerations are clearly subjective and impossible to fully define, and
- some considerations will be more relevant to some industries than others.

Examples of GRI-related standards and considerations

5.6 **Labour standards** may look to indicators relevant to such matters as:

- Health and Safety as measured by standard injury, lost time and absentee rates and the number of work related fatalities
- Employee benefits beyond those legally mandated (eg paid maternity leave)
- Training and Education as measured by the average hours of training per year per employee or the existence of programs to support the continued employability of employees.

5.7 **Environmental considerations** could include indicators relating to:

- energy use
- water use
- greenhouse gas emissions, and
- waste produced.

5.8 Common **social considerations** could include indicators to measure:

- policies to manage impacts on communities in areas affected by the business
- diversity and opportunity as indicated by EEO policies and/or the composition of senior management, including corporate governance bodies
- customer health and safety as indicated by polices to protect health and safety and breaches of relevant health and safety legislation.

covering social considerations is expected to be published by the Department of Family and Community Services in the near future. As each of these documents is focused on Triple Bottom Line reporting, rather than SRI disclosure, use of them may in some instances require some minor adjustment of the words used.

5.9 Common **ethical considerations** could include indicators relevant to:

- adherence to Human Rights as enunciated in UN conventions, including in the selection of suppliers and contractors
- Policies to combat bribery and corruption such as meeting the OECD Convention on combating bribery, and
- non-involvement in industries objectionable to fund members.

Spectrum of investment products

5.10 The spectrum of investment products for SRI purposes will be wide and fluid. They form a continuum. For the purposes of developing possible guidelines, however, we have grouped the arrangements into 3 very broad categories:

1. those products that don't consider SRI issues
2. those products which consider SRI issues to the extent that they impact on the financial value of the investment (some of these will have clear SRI methodologies while others will have a more ad hoc approach), and
3. those products marketed as having a clear SRI focus as part of their design (though the weight given to SRI issues within this group will vary greatly).

5.11 But in drawing this pragmatic distinction between the second and third groups:

- (a) we recognise that the second product group may sometimes put significant weight on SRI type considerations because of their implications for investments, and.
- (b) we do not mean to imply that products in the third group don't focus on the interrelationship between SRI factors and the financial bottom line.

5.12 Taking this approach allows us to give general illustrations along the spectrum at points which we hope will be useful to as many product issuers and consumers as possible. The main point is that the more a product markets itself as an SRI product, the more detailed the SRI disclosure requirements.

5.13 Views about whether we should include examples of good disclosure practices in guidelines, and about where in the SRI spectrum examples would be most useful, are welcome.

How much detail is required on the standards and considerations?

5.14 The regulations are clear that, where a product issuer says they do take labour standards and/or environmental, social or ethical considerations into account, the PDS *must* include a statement outlining:

- (a) The standards that the product issuer considers to be labour standards for that purpose (Reg 7.9.14C(c)(i)), and
- (b) The considerations that the product issuer regards as environmental, social or ethical considerations for that purpose (Reg 7.9.14C (d)(i)).

5.15 So it is not sufficient for the product issuer just to say that it takes labour standards and/or environmental, social or ethical considerations into account without some further elaboration.

Ad hoc consideration of SRI issues

5.16 What if a fund only considers SRI issues from time to time as they become aware of them, for their impact on the financial value of an investment? In such instances, our initial view is that disclosure should make the lack of a formalised approach clear. In doing so they may want to indicate the types of matters that have been taken into account in the past or are most likely to be relevant in the future (eg the exposure to litigation or damage to reputation arising from environmental damage).

More systematic consideration of SRI issues

5.17 Where a product does explicitly and systematically take labour standards and/or environmental, social and considerations into account, it should list these standards and considerations. In some instances, there will be no difficulty in doing this.

5.18 In other instances though it could be more difficult, especially where the fund has a headline outcomes-focused goal, such as good labour relations. In these cases the fund will usually have underlying criteria/indicators to measure how far the outcomes-focused goal is being met (eg number of strike days, above award conditions).

5.19 How far down disclosure should list the indicators relevant to the desired outcome is something that must be assessed on a case by case basis. But our initial view is that at least some of the criteria or indicators looked at in determining compliance with the higher level goals are needed in the PDS. Due to the evolving nature of many of these areas, however, we understand it may not be possible to provide a definitive list of the criteria/indicators. We also recognise the complexity of the assessment processes used by some funds. To avoid unwieldy and ineffective disclosure, the issuer should refer the consumer to an easily

accessible secondary source (such as a website or phone number) for details not listed in the PDS.

5.20 We favour this approach because we believe that:

- (a) most consumers will want at least some detail about how a fund assesses compliance with the higher level outcomes they seek, and
- (b) these details will help consumers to determine the degree of rigour employed by a fund in implementing its SRI approach or to differentiate between SRI products.

5.21 Standards and considerations must also be listed in ways meaningful to the target consumer. This will usually mean not just giving the technical standard name such as ISO 14000 but also including its more descriptive title (Environmental Management Systems).

What does ‘the extent to which’ mean?

5.22 The law requires funds to disclose ‘the extent to which’ they take SRI matters into account. What this requires will depend upon how interested in SRI issues the target consumers are likely to be, either from a risk assessment or values perspective, and thus how much information they need to make their decisions.

5.23 We have been asked: does this disclosure involve qualitative or quantitative description? This depends on the methodology used by the fund.

Where SRI issues are considered only for their impact on investment value

5.24 For funds that only take account of SRI considerations to the extent to which they impact on the investment’s value, they need to make it clear whether they have a methodology for identifying relevant SRI issues or whether their approach is more ad hoc (ie they have no methodology).

5.25 If they do have a specific approach, a general description of that methodology should be provided. The amount of detail provided depends on factors already mentioned, eg

- the target consumer
- the importance of the SRI issues to risk assessment, and
- the complexity of the methodology used.

Where the approach is more ad hoc, this should be clear to the consumer.

Where the product is an SRI fund

5.26 Where the product markets itself as an SRI fund it will, at a minimum, need to describe its general methodology for assessing SRI standards and considerations. Such a general description will almost certainly need to be qualitative but may also include some quantitative information such as the relative weighting given to SRI versus more traditional financial measures.

5.27 The test of whether there is adequate disclosure on ‘the extent to which’ SRI considerations are taken into account is really whether it provides the targeted consumers with sufficient information to enable them to understand the approach taken by the fund. The more complex the approach, the more detailed explanation required.

5.28 The product issuer may want to include in a secondary source:

- very complex systems of weightings that vary for each industry sector
- other intricate details about that system that only some consumers may want.

5.29 With all methodologies, care must be taken to adequately define the terms used and to explain whether a policy is absolute or whether it is subject to any qualifications. Qualifications must be explicitly stated.

How are retention and realisation policies relevant to disclosure obligations?

5.30 The law says a product issuer not only needs to disclose their SRI policy for selecting their investments, they must also disclose it for retaining and realising those investments.

Again, how, much information needs to be disclosed will partly depend on the extent to which the product markets itself as an SRI product.

Where SRI issues are considered only for their impact on financial value

5.31 For these products, their disclosure needs to make it clear whether they monitor for particular events and whether they will look at selling investments if particular events occur which can be categorised as relevant to labour standards and/or environmental, social or ethical considerations. Where they have a clear policy about this (eg, a policy to sell down if after 6 months the concerns aren't rectified), the policy should be disclosed. If they do not have a set policy, but decide on a case by case basis, this too should be transparent.

Where the product is an SRI fund

5.32 These products need to disclose both:

- (a) what monitoring/review they undertake to ensure that an investment still conforms with their disclosed SRI investment policy, and
- (b) what action they will take once they are aware that an investment no longer matches their disclosed SRI investment policy and what time frame will apply to their actions if actions, such as disposal, are proposed. Any qualifications on the policy should also be stated explicitly.

5.33 If a product that considers SRI issues in selecting investments has no monitoring/review procedures and/or no policy on what it will do if an investment no longer meets its disclosed SRI investment strategy then this too must be disclosed.

Section 6: Administering the guidelines

Our approach to monitoring and enforcement of SRI disclosure

6.1 For our approach to monitoring PDSs and enforcing PDS requirements generally read our Policy Statement 168 *Disclosure: Product disclosure statements (and other disclosure obligations)*.

6.2 In brief, we intend to conduct selective compliance reviews of PDSs to determine whether they comply with the PDS requirements, including the SRI disclosure requirements and any guidelines on SRI disclosure that ASIC may issue. In particular, we may review PDSs that:

- (a) we categorise as open to compliance risk;
- (b) if we receive credible information from an external source about a PDS that warrants undertaking a review; or
- (c) at random.

6.3 In [PS 168] we note that where we detect, or are made aware of, valid prima facie disclosure concerns about a PDS, we may notify the issuer of our concerns before serving an interim stop order. However, if delay could be prejudicial to the public interest, we will impose an interim stop order without consulting the issuer, pending resolution of

our concerns at a hearing. We see that public interest in this context can encompass non- financial concerns.

6.4 In deciding whether to take enforcement action on a particular PDS, we will consider whether the PDS appears to:

- (a) be misleading or deceptive – including the overall impression given about the SRI status of the fund;
- (b) contain all relevant information; and
- (c) meet the other general and specific content requirements of Part 7.9, including any ASIC guidelines on SRI disclosure.

Transitional arrangements

6.5 We recognise that there are significant costs associated with producing PDSs. Some product issuers have already produced their PDSs, so we are considering whether to have in place transitional arrangements about how any eventual guidelines will apply to an already issued PDS.

6.6 Our initial thinking is that such guidelines would only apply to PDSs issued *after* the guidelines had been officially released.

6.7 For product issuers who issued their PDS before the guidelines, they would be given until the earlier of either:

- the next printing of their PDS, or
- 12 months from the date the guidelines were issued

to either:

- issue a wholly new PDS, or
- issue a supplementary PDS under s1014A – 1014F.

6.8 Any transition arrangements, however, would not stop ASIC taking action against misleading or deceptive PDS or PDS that did not comply with the disclosure requirements as clearly stated in the legislation.

Section 7: Your feedback

We invite your comments on the questions below, as well as on any other aspects of this discussion paper.

1 Should ASIC issue guidelines?

If we do issue guidelines:

2 Should they contain illustrative, non-exhaustive lists of what may constitute labour standards or environmental, social or ethical considerations?

3 If the guidelines include these lists, what standards and considerations should be included?

4 If ASIC produces guidelines, should they include disclosure examples?

5 If yes, we would welcome sample examples of what you consider constitutes good disclosure practices.

6 If they do include examples, at which points along the SRI spectrum of investment products would examples be most useful.

7 Within the confines of what ASIC is permitted to do in guidelines, are there areas of guidance not raised in the discussion paper that industry would find useful to provide greater clarity about their disclosure obligations.

8 Within the confines of what ASIC is permitted to do in guidelines, are there issues not covered in the discussion paper which should be covered in any guidelines to facilitate better disclosure for consumers?

9 Do any of the positions suggested in the discussion paper cause practical problems for industry? If so, please provide supporting information.

10 Should transitional arrangements apply? If yes, do you agree with the approach adopted or are there other options which might be preferable.

As noted in the Discussion Paper, ASIC plans to produce some basic consumer education material about socially responsible investing. We would be interested in receiving feedback on:

11 What should any ASIC SRI education material cover?

What happens next

ASIC will continue to meet with interested parties to discuss the need for guidelines and their possible content. Once submissions have been received and analysed we will hold bilateral and roundtable consultations where needed. When this has occurred, the Commission will make a formal decision whether or not to proceed with guidelines. If a decision were made to produce guidelines then at least one consultation draft, with a minimum of a 6 week consultation period, would be issued before any guidelines were completed.

Appendices

Appendix 1: Relevant legislative requirements

Part 7.9 Corporations Act 2001

Section 1013D(1) Subject to this section, subsection 1013C(2) and section 1013F, a Product Disclosure Statement must include the following statements, and such of the following information as a person would reasonably require for the purpose of making a decision, as a retail client, whether to acquire the financial product: . . .

- (l) if the product has an investment component, the extent to which labour standards or environmental, social or ethical considerations are taken into account in the selection, retention or realisation of the investment.

Section 1013D(2A) For the purposes of paragraph (1)(l), products which have an investment component include superannuation products, managed investment products and investment life insurance products.

Section 1013DA ASIC may develop guidelines that must be complied with where a Product Disclosure Statement makes any claim that labour standards or environmental, social or ethical considerations are taken into account in the selection, retention or realisation of the investment.

Corporations Regulations 2001

7.9.14C Labour standards and environmental, social and ethical considerations.

For paragraph 1013D(4)(c) of the Act, the more detailed information to be included in a Product Disclosure Statement about the extent to which labour standards or environmental, social or ethical considerations are taken into account in the selection retention or realisation of an investment is:

- (a) a statement that the product issuer does, or does not, take into account labour standards for the purpose of selecting, retaining or realising the investment; and
- (b) a statement that the product issuer does, or does not, take into account environmental, social or ethical considerations for the purpose of selecting, retaining or realising the investment; and
- (c) if the Product Disclosure Statement includes a statement that the product issuer does take into account labour standards for the

purpose of selecting, retaining or realising the investment – a statement outlining:

- (i) the standards that the product issuer considers to be labour standards for that purpose; and
 - (ii) the extent to which the product issuer takes those standards into account in the selection, retention or realisation of the investments; and
- (d) if the Product Disclosure Statement includes a statement that the product issuer does take into account environmental, social or ethical considerations for the purpose of selecting, retaining or realising the investment – a statement outlining:
- (i) the considerations that the product issuer regards as environmental, social or ethical considerations for that purpose; and
 - (ii) the extent to which the product issuer takes those considerations into account in the selection, retention or realisation of the investment.

Appendix 2: Acronyms

ABS	Australian Bureau of Statistics
ASIC	Australian Securities and Investments Commission
FSR	Financial Services Reforms
GRI	Global Reporting Initiative
ISO	International Standards Organisation
PDS	Product Disclosure Statement
SRI	Socially Responsible Investments

Appendix 3: Other relevant ASIC documents

PS 168 Disclosure: Product Disclosure Statements (and other disclosure obligations)

PPP: Licensing: Financial Product Advisers – Conduct and disclosure

Part 3 of this PPP deals with the preparation and provision of personal advice by advisers. This includes the obligation to make reasonable inquiries into a client's personal circumstances. It is noted that

determining a client's relevant personal circumstances and determining what amounts to 'reasonable inquiries' are factual questions that will depend on the facts and circumstances of each case. Against this background, we raised the question at C2Q3 in the PPP:

In what circumstances (if any) would an adviser providing personal advice covering products with an investment component not need to make inquiries about a clients views about labour standards or environmental, social or ethical considerations: see s1013D(1)(1)? Please give details.

A copy of the PPP is available from www.asic.gov.au. The closing date for submissions is 21 February 2003.