

14 October 2021

Simon O'Connor, MP & Louisa Wall, MP
Co-Chairs of the New Zealand Inter-Parliamentary Alliance on China
By email: Jenny.Chang@parliament.govt.nz

Dear Simon and Louisa,

NZ SUPER FUND INVESTMENTS IN CHINA

Thank you for your letter of 23 September 2021 enclosing the Hong Kong Watch-authored report on *ESG, China & Human Rights*. We appreciate you bringing the report to our attention.

In the report, which was published internationally on 22 September 2021, Hong Kong Watch recommended that the NZ Super Fund should scrutinise and consider divesting from four categories of Chinese companies:

1. companies sanctioned by the United States Government;
2. surveillance companies “complicit in gross human rights violations against the Uyghurs”;
3. Chinese state banks; and
4. large technology companies with “problematic human rights records”.

I note that we explained our responsible investment approach at our recent appearance before the Foreign Affairs, Defence and Trade Select Committee.

As a reminder, we make exclusion decisions based on the clear processes and principles set out in our Responsible Investment Framework. Exclusions can occur in three different ways:

- By country (sovereign bonds of specific countries if they are included in New Zealand’s sanctions list)
- By product (companies involved in the production of certain products, by reference to New Zealand laws, international conventions that NZ has signed and significant policy positions of the NZ government). A list of product category exclusions can be found on our website.
- Poor corporate practices.

We do not engage with companies under the first two exclusion categories. In respect of the third category, we may engage with a company first in an effort to use our influence as a shareholder to help the company change its practices. Where companies have not responded to engagement, or we consider engagement is unlikely to be effective, we may choose to exclude that company from our portfolio.

Further detail in respect of the specific human rights concerns raised by Hong Kong Watch is set out below.

Companies subject to United States Sanctions

Based on our 31 December 2020 portfolio holdings report, Human Rights Watch identified 14 companies in the NZ Super Fund's investment portfolio that are subject to U.S. sanctions, specifically:

- Avic Xi'an Aircraft Industry Group
- China Aerospace Times Electronics Co
- China Avionics Systems
- China Communications Construction
- China Mobile
- China Railway Construction Corp
- China Spacesat
- China Telecom Corp
- China Unicom Hong Kong
- China United Network Communications
- Hangzhou Hikvision Digital Technology
- Inner Mongolia First Machinery Group
- Semiconductor Manufacturing International Corp
- Zhejiang Dahua Technology.

By way of background, there are two types of sanctions that are relevant here:

- United States investment into the first 13 companies is prohibited under 12 November 2020 Presidential Executive Order 13959, which was subsequently amended on 19 January 2021 and 3 June 2021.
- The 14th company, Zhejiang Dahua Technology, is subject to a U.S. export sanction, which means it is prevented from buying American products, but is not captured by the Executive Order prohibiting U.S. investment.

Hong Kong Watch identified these companies based on publicly available figures for NZ Super Fund portfolio holdings as at 31 December 2020. By 22 September 2021, however - the date Hong Kong Watch's report was released, ahead of you sharing their report with us, all of the thirteen companies prohibited under Executive Order 13959 had been removed from the Fund. We would have been happy to inform Hong Kong Watch of this if we had been aware of their report prior to publication; however, they did not check their facts with us.

To explain, the Fund's global equities portfolio tracks, as is common practice for institutional investors, investment indices developed by our supplier MSCI, which is an American company. As a result of Executive Order 13959, MSCI deleted securities impacted by this order from its global investable market indexes on 5 January, 8 January, 26 January and 26 July 2021. The thirteen securities noted above were in turn removed from the NZ Super Fund's portfolio. MSCI's most recent [Q&A](#) on the issue provides some background information on their processes.

The Fund continues to hold shares in Zhejiang Dahua Technology. MSCI does not remove companies subject to export bans from its indices. For further information on how we deal with potential breaches of our responsible investment standards by companies that are not captured by MSCI's sanctions process, and do not fall under either the country or product exclusion categories explained above, see below.

Should Executive Order 13959 be amended again in the future to include a different set of companies, under MSCI's and our current processes, the Fund's passive global equity portfolio holdings would be adjusted accordingly. More broadly, information concerning sanctions or concerns over human rights is incorporated into our responsible investment research process. The inclusion of a company on a country's sanctions list is a relevant data point but is not of itself definitive, particularly as sanctions can be driven by political considerations. It may be necessary to examine the reasons why the company was included and the evidence relied on as well as whether the EU or any other country has sanctioned the company.

Other companies of concern to Hong Kong Watch

In respect of the three other categories, Hong Kong Watch raised concerns about NZ Super Fund investments in a further 9 companies:

- Hangzhou Hikvision Digital Technology
- iFlytek
- Bank of China
- Agricultural Bank of China
- China Construction Bank Corp
- Bank of Communications Co
- Industrial & Commercial Bank of China
- Alibaba
- Tencent.

Zhejiang Dahua Technology Co (discussed above in respect of the US export ban) is also included by Hong Kong Watch in this group.

Of these companies, Hikvision is subject to the Executive Order noted above and is therefore no longer in MSCI's indices or the Fund's portfolio. The Fund remains invested in the other companies at the time of writing.

Our approach to potential breaches of RI standards by companies in the Fund's portfolio

Our Responsible Investment Framework, which sets out our engagement and exclusion processes, is in line with international principles and guidance, in particular the UN Global Principles for Business and Human Rights (UN GPs), the United Nations-based Principles for Responsible Investment (UNPRI) and related guidance such as the OECD guide for institutional investors.

These principles and guidelines set out that it is the companies that cause or contribute to the adverse impacts that must prevent or remedy these impacts. Minority shareholders in publicly listed companies are not considered to cause or contribute to the adverse impact but may be considered to be in a business relationship with the companies and therefore linked to the impact. In this case it is recommended that shareholders consider using leverage through engagement and/or voting actions to try and influence the companies to address the issue in line with the UN GPs. It has been further recommended that investors in large portfolios of companies should prioritise and focus efforts on a smaller list of companies, rather than try to address all human rights issues across the full universe. The UNPRI has well established guidance on how investors should engage with companies, including increasing leverage through collaboration.

The G20/OECD Principles for Corporate Governance set an appropriate context for how shareholders can interact with investee companies. The principles recognise that investors do not have operational control over the listed companies they invest in. They advocate that shareholders can exercise their rights through voting and engagement. OECD Guidance on Responsible Business Conduct for Institutional Investors provides guidance on how institutional investors should apply the OECD Guidelines for Multinational Enterprises, which the NZ government adheres to.

In line with the above, the Guardians has contractual arrangements with suppliers that will conduct environmental, social and governance (ESG) monitoring and research across the global universe of listed companies we invest in, including rating materiality of breaches of standards and of the companies ESG policies and practices. To prioritise our engagement efforts, we develop a focus list of companies based on a range of factors set out in our Responsible Investment Framework, such as:

- our understanding of the significance of the breach;
- the strength of grounds to believe a breach has occurred;
- potential effectiveness of engagement; and
- the materiality of a company's involvement.

The nature and degree of a company's involvement is important in determining if we conduct further research, engage, hold or exclude companies. We do not engage with every company facing controversy and, when we do, companies may remain on our focus list for some time. We believe that by engaging we are most likely to be able to make a difference and encourage companies to change their policies and practices. Exclusion is a last resort, in the sense that we typically only exclude where companies have not responded to engagement or where we consider engagement is unlikely to be effective.

We continue to devote significant resource to our engagement programme. This work programme includes:

- the global engagement specialist BMO engaging on our behalf;
- participation in a number of collaborative engagements alongside other leading global investors; and
- occasional direct engagements by our team.

We refer you to the recent High Court [decision](#) in which Justice Woolford said: "Guardians cannot be criticised for adopting widely accepted international standards in formulating its own policies, standards and procedures.... I do not consider that Guardians has fettered its judgement when it states that exclusion of investments will only be 'rare' and for 'severe breaches'. The setting of a high threshold is not a fetter. Engagement with a company with ESG issues may be more effective in changing a company's practices for the better than withdrawal of investment in the company altogether (exclusion)."

Guardians' engagement on human rights issues

Human rights is a priority theme within our engagement programme. Within this, we are addressing issues relating to technology and surveillance through global collaborative investor initiatives, given the global and sectoral nature of the issues.

For instance, we are aware of alleged supply chain issues relating to the treatment of minority groups in Xinjiang and have commenced engagement via an external service provider with companies that source from the region.

We have also joined a collaborative investor initiative comprising 50 global investors, representing more than US\$4.5 trillion in assets under management, to focus on facial recognition systems. This initiative is engaging with several companies included in our portfolio to address the risks raised by facial recognition technology products and services.

Engagement can be time consuming and resource intensive. If we consider that companies have not responded to engagement or we consider that engagement is unlikely to be effective, we may move to exclude the company from the Fund. It is unusual, however, for engagements to not result in any improvements by companies, and exclusion is rare.

Company engagements are conducted on a confidential basis and we do not, as a general rule, disclose the names of companies we are engaging with, nor the details of our engagement. This is to encourage the flow of information between the companies and ourselves / our engagement collaborators.

Comments on consistency of approach relative to our exclusion of companies involved in financing settlement activities within the Occupied Palestinian Territories

We are aware that this is an area of interest to you. As was touched on at the Committee, we did not engage with the five companies we excluded earlier this year, although we did advise them of our decision to exclude shortly before we announced it publicly and invited them to provide us with further information. As at the date of this letter, we have not received any response from the companies. We gave careful consideration about whether or not to engage with them. As the companies have continued their involvement in the Occupied Palestinian Territories in the face of international criticism over a long period and have reported that they believe their activity is legal, given our small shareholdings in the companies at the time, we concluded that engagement was unlikely to be effective and would therefore not be a good use of our resources. Other factors in our exclusion decision, which is outlined [here](#), included the strong position of successive New Zealand Governments and the United Nations General Assembly and Security Council on the illegality of the settlements under international law, and the critical nature of the funding provided by the companies to the construction of the settlements.

Further Information

Further information on our responsible investment and engagement activities is available in our 2020/21 Annual Report, which is available [here](#). We have also published an updated list of the Fund's [portfolio holdings](#) (we publish this on a six-monthly basis).

Invitation to Meet

I note your invitation to meet. We are happy to take you up on this offer. Please contact Catherine Etheredge (cetheredge@nzsuperfund.co.nz) to schedule this meeting, if you wish to go ahead. Given the current COVID alert level in Auckland the meeting will need to be held via Zoom.

Thank you for your interest in the NZ Super Fund. The Fund is \$58 billion dollars and a very significant asset for the New Zealand public. I can assure you that while responsible investment challenges will always emerge in such a large investment fund, we have a world-leading approach that gives appropriate consideration and weighting to human rights violations, and that the Board takes a keen interest in these issues.

Yours sincerely

A handwritten signature in black ink, appearing to read 'C. Drayton', with a stylized flourish at the end.

Catherine Drayton

Chair, Guardians of New Zealand Superannuation

CC Office of the Minister of Finance; Treasury; Matt Whineray; Catherine Etheredge.