November 15, 2016

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Financial Sector Policy Branch
Department of Finance Canada
James Michael Flaherty Building
90 Elgin Street
Ottawa, ON K1A 0G5

Sent via electronic mail to LegislativeReview-ExamenLegislatif@canada.ca

Re: Supporting a Strong and Growing Economy: Positioning Canada's Financial Sector for the Future

To whom it may concern:

We have reviewed the above-referenced consultation document for the review of the Federal Financial Sector Framework, and thank you for the opportunity to provide our comments.

The Responsible Investment Association (RIA) is Canada's membership association for Responsible Investment (RI). Our members, representing over $1 trillion in assets under management, include financial institutions, asset management firms, mutual fund companies, advisors, investment research firms, pension funds, foundations and others. The RIA's members believe that the integration of environmental, social and governance (ESG) factors into the selection and management of investments can provide superior risk adjusted returns and positive societal impact.

The review of Canada's federal financial sector legislative and regulatory framework is an opportunity to reflect on the purpose of Canada's financial sector and the role it must play in the development of a sustainable, low-carbon, climate-resilient and egalitarian society.

The Department of Finance's consultation document notes significant changes occurring in the financial services sector, including a section on emerging risks such as climate and environmental change. The RIA supports this approach and wishes to provide feedback on how Canada's financial sector can help position Canada strategically to seize future opportunities and create sustainable economic growth.

Q1. What are your views on the trends and challenges identified in this paper? Are there other trends or challenges that you expect to significantly influence the financial sector going forward?

While the trends and challenges identified in the consultation paper are important, we have identified five additional issues, trends and opportunities we believe will significantly impact the financial sector in the future and should be addressed in the government's policy paper moving forward:

- The growth of responsible investment in Canada and beyond
- Emerging expectations on responsible business conduct of financial institutions
- The role of the financial sector in sustainable development
- The role of the financial sector in the transition to a low-carbon economy
- Diversity within senior executives and boards

Growth of responsible investment

Responsible investment, in which environmental, social and governance (ESG) factors are incorporated into investment practices, is growing significantly both globally and in Canada. Over 1,500 investment institutions, representing more than US$60 trillion in assets under management, including 86 Canadian financial institutions, are signatories to the United Nations-supported Principles for Responsible Investment (PRI).[1] This global collaboration aims to advance the practice of responsible investment and support signatories incorporating ESG factors to their investment processes.

Further, as of December 31, 2013, Canada's responsible investment market had increased from $600 billion to more than $1 trillion of assets under management within two years, representing 68% growth.[2] 31% of the Canadian investment industry has espoused responsible investment in some form.

We believe this trend presents an opportunity to advance federal economic, social and environmental objectives. The financial sector framework review should explore ways to further stimulate the growth of responsible investment in Canada.

Emerging expectations on responsible business conduct of financial institutions

As well as taking into account ESG factors that may impact the value of an investment, there is an emerging expectation that financial institutions should also avoid causing environmental and social harm. Adopted in 1976, the OECD Guidelines for Multinational Enterprises (the Guidelines) are a comprehensive set of recommendations on corporate responsibility backed by over 40 countries, including Canada. The Guidelines cover many aspects of responsible business conduct, including employment and industrial relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition, and taxation. Adhering governments must set up a National Contact Point (NCP) to act as a grievance mechanism in cases where companies are alleged to have breached the Guidelines. The Guidelines were last updated in 2011, taking into account the adoption of the UN Guiding Principles on Business and Human Rights (the UNGPs).

According to the UNGPs, all companies have the "responsibility to respect" human rights, and a human rights due diligence approach is promoted. Under the Guidelines, enterprises are encouraged to conduct due diligence to prevent and mitigate adverse impacts that are directly linked to their operations, products or services, including through their supply chain and business relationships. An emerging issue is the question of how this concept applies to investors (including minority shareholders). In the period 2011-2015, 17% of grievance instances raised with NCPs related to the financial sector, compared with only 8% in the period 2000-2010[3].

The OECD has been undertaking a multi-stakeholder process to develop guidance on due diligence approaches for application of the Guidelines in the financial sector.[4] The outcomes of this process should be considered within the financial sector framework review.

[1] https://www.unpri.org/about

[2] RIA (2015). 2015 Canadian Responsible Investment Trends Report https://riacanada.ca/wp-content/uploads/2015/01/RI_Trends_Report2015_EN.pdf

[3] OECD (2015). Implementing the OECD Guidelines for Multinational Enterprises: the National Contact Points from 2000 to 2015. https://mneguidelines.oecd.org/15-Years-of-the-National-Contact-Points-Highlights.pdf

[4] We submitted comments on a discussion paper circulated as part of this process. NEI (2016) Organization for Economic Cooperation and Development (OECD): Responsible Business Conduct for institutional investors

The role of the financial sector in sustainable development

The consultation paper does not explore the potential for the financial sector to contribute positively to federal social and environmental objectives, as well as economic objectives. This potential was highlighted in the recently-published Federal Sustainable Development Strategy 2016-2019, which recognizes that "a strong economy and a clean environment must go hand in hand in the modern world." In addition, investors are identified as one of the key partners in sustainable development "*by taking environmental, social and governance factors into account in investment decisions and by engaging with companies to encourage sustainable practices*". [5] In this context we would also highlight emerging discussion of the role of finance in the achievement of the United Nations Sustainable Development Goals[6].

The United Nations Environment Programme inquiry into the *Design of a Sustainable Financial System* was established in 2014 to advance policy options to "deliver a step change in the financial system's effectiveness in mobilizing capital towards a green and inclusive economy".[7] The Inquiry calls for a realignment of the financial system; it identifies short-termism as an issue, and suggests government and governance structures be re-calibrated to align with long-term outcomes. Financial policy makers and regulators need to take steps to integrate sustainable development such as guiding principles, regulator mandates, and performance measurement.

The role of the financial sector in the transition to a low-carbon economy

Climate and environmental change are rightly presented as factors increasing the potential for losses from catastrophic events (p28), and as a specific risk for property and casualty insurers (p14). Climate change is widely accepted in economic circles as a key global threat.[8] However, the challenge to financial sector stability extends beyond catastrophic risk to encompass the risks and opportunities for the financial sector in navigating the transition to a low-carbon economy.

In 2015, the Financial Stability Board (FSB) established an industry-led Task Force on Climate-related Financial Disclosures to develop guidelines for consistent climate-related financial risk disclosures by companies for use by investors, lenders, insurers and other stakeholders, and contribute to understanding of the financial sector's exposure to climate-related risk, both at the level of the individual firm and at a systemic level.[9] **We urge that the Task Force's final recommendations, expected in late 2016, should be taken into account in the review of the financial sector framework**.

Further consideration should also be given in the review to ways in which the financial sector policy framework can better support innovation and clean technologies that take advantage of opportunities presented by the transition to a low-carbon economy, in line with the government's vision of a "Clean Growth Economy."[10] For example, this may include supporting innovative climate financing mechanisms from commercial financial institutions.

[5] Government of Canada (2016). Achieving a sustainable future. A federal sustainable development strategy for Canada 2016-2019. https://www.ec.gc.ca/dd-sd/CD30F295-F19D-4FF9-8E03-EAE8965BE446/3130_FSDS_Eng_FINAL.pdf

[6] For example: Dialogues at the PRI level involving global stock exchanges, institutional investors and policy makers on the role of private sector in UNSDGs https://www.unpri.org/press-releases/exchanges-policymakers-and-investors-share-views-on-supporting-the-united-nations-sustainable-development-goals

[7] *"The Financial System We Need",* UNEP Inquiry Report, October 2015

[8] For example: World Economic Forum (2016). 2016 Global Risk Report. http://www3.weforum.org/docs/Media/TheGlobalRisksReport2016.pdf

[9] FSB. Task force on climate-related financial disclosures https://www.fsb-tcfd.org/

[10] Government of Canada (2016). Chapter 4 - A Clean Growth Economy http://www.budget.gc.ca/2016/docs/plan/ch4-en.html

We note the growing market (and support) for green bonds and climate bonds, both within Canada and globally[11]. We believe green bonds can play a growing role in stimulating the energy transition and encourage the Government of Canada to explore deeper involvement in this area. In 2014 Ontario issued the first provincial green bond, which was strongly embraced by investors, being more than four times oversubscribed. However, retail investors had limited access to this offering, consistent with the global experience for green and climate bonds. The secondary market for green bonds is decidedly shallow. Despite the rapid growth of the green and climate bond market, it is still relatively difficult for investors to get exposure to this asset class. The Federal Government has a role to play in both increasing the access to high quality green bonds and in ensuring that standards around green bond issuance are credible, robust and transparent. In this context, we would highlight that investors representing US$2.2 trillion in AUM have signed the *Green Bonds Statement*[12] calling on governments to support issuance of bonds that address climate change based on clear standards.

Diversity within senior executives and boards

There is a strong business case for higher levels of gender diversity on boards of directors and among executive officers than currently exists. A growing body of evidence links diverse leadership with stronger financial performance compared with more homogenous boards and executive teams. A recent working paper from the International Monetary Fund[13] examined the link between gender diversity in senior corporate positions and financial performance of two million companies in Europe. It found companies with a higher share of women in senior positions had a higher return on assets, especially for firms in sectors that employ significantly more women in their labour force and have greater demand for higher creativity and critical thinking.

In addition, companies in the MSCI World Index with strong female leadership had a 36.4% higher return on equity as well as a 12.8% higher price/book value compared with companies without, according to a recent MCSCI report.[14] A 2015 report released by McKinsey & Co.[15] also found that there was "a statistically significant relationship between a more diverse leadership team and better financial performance." In its analysis of hundreds of companies in the U.K., Canada, Latin America and the U.S., organizations with higher gender diversity were "15% more likely to have financial returns that were above their national industry median. Companies in the top quartile of racial/ethnic diversity were 35% more likely to have financial returns above their national industry median."

4. What (other) actions could be taken to strengthen the financial sector framework and promote economic growth, including with respect to the identified themes? How should those actions be prioritized?

Pension fund disclosures: Require federally registered pension plan administrators to disclose to their members and publicly whether and if so how the consideration of environmental, social and governance factors is reflected in the plan's investment policy and practice.

[11] Investor Statement re: Green Bonds & Climate Bonds (2014). https://www.neiinvestments.com/documents/PublicPolicyAndStandards/2014/Investor%20Statement%20on%20Green%20Bonds%20and%20Climate%20Bonds%2020141211.pdf

[12] The Paris Green Bonds Statement (2015).http://www.climatebonds.net/files/files/Paris_Investor_Statement_9Dec15.pdf

[13] IMF Working Paper, *Gender Diversity in Senior Positions and Firm Performance: Evidence from Europe,* March 2016 (https://www.imf.org/external/pubs/ft/wp/2016/wp1650.pdf)

[14] MSCI ESG Research, *Women on Boards: Global Trends in Gender Diversity on Corporate Boards*, November 2015 (https://www.msci.com/documents/10199/04b6f646-d638-4878-9c61-4eb91748a82b)

[15] Hunt, V., Layton, D., Prince, S., *Diversity Matters*, February 2015 (http://assets.mckinsey.com/~/media/857F440109AA4D13A54D9C496D86ED58.ashx)

We believe there is a necessity to develop and implement mandatory climate change related disclosure requirements. Canada lags behind other countries in terms of national regulation on ESG (environmental, social, governance) disclosure for pension funds. The United Kingdom, Australia, France, Sweden and Germany, among others, require ESG disclosure by pension administrators. Federal policy on ESG disclosure has not kept abreast with changes at the provincial levels. In 2014, Ontario adopted regulations explicitly requiring ESG disclosure by pension administrators (PBA909). At the same time, federal leadership on ESG disclosure could prompt action among those provinces that have thus far been slower to act.

5. What other actions should be taken to ensure the financial sector framework remains modern and technically sound?

In order to better anticipate and position Canada to leverage systemic change, we need to define a vision of a sustainable Canadian financial system. Key federal officials, provincial regulators, the Bank of Canada, as well as the banking, asset management and insurance sectors should be engaged in this undertaking.

The United Nations' Inquiry has researched financial and monetary policies, regulations, standards, disclosure requirements, credit ratings, listing requirements and indices, analyzing the effectiveness of each in helping to align financial systems with sustainable development. Canada can benefit from this work to assess the policies best suited to support the government's mandate and meet its climate commitments.

We call on government to bring together a small group of key government and business leaders, sustainable finance experts and the heads of the UN Inquiry to explore the development of a roadmap for Canada; doing so would be a positive first step.

We thank you for the opportunity to provide comments. Should you have any questions regarding this letter, please do not hesitate to contact me.

Sincerely,

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