January 14, 2021

Financial Sector Policy Branch
Department of Finance Canada
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Submitted via email to: FIN.Pensions-Pensions.FIN@canada.ca

Re: Consultation -- "Strengthening Canadians' Retirement Security - Proposals to Support the Sustainability of and Strengthen the Framework for Federally Regulated Private Pension Plans"

The Responsible Investment Association (RIA) is pleased to comment on the Department of Finance Canada's Consultation Paper, "Strengthening Canadians' Retirement Security - Proposals to Support the Sustainability of and Strengthen the Framework for Federally Regulated Private Pension Plans."

The RIA is a network of over 130 institutions and 300 individuals who support our mandate to drive Canada's adoption of responsible investment, which refers to investments that incorporate environmental, social and governance (ESG) factors. Our individual members include financial advisors, consultants and others, while our institutional members are mainly asset management firms and asset owners, including pension funds, who collectively manage over $20 trillion in assets.

Our comments are related to the consultation paper's Plan Governance and Administration section, in particular the subsection on "Environmental, social and governance factors" and related questions 5 and 6.

Canadian Responsible Investment Trends

We concur with the statement in the paper that "growing international consensus is emerging related to the financial nature of ESG factors."

For context, we present the current state of play in Canada for responsible investing, which we define as "the incorporation of environmental, social, and governance factors (ESG) into the selection and management of investments." Our recent 2020 Canadian Responsible Investment Trends Report notes how responsible investing has become well-established in Canada, and this goes hand-in-hand with the growing recognition among investment professionals that:

- ESG factors can have a material impact on the risk and return potential of an investment, and
- Considering material ESG factors in their investment analysis and decision-making is consistent with their fiduciary duty.

Of note, the research revealed that:

- Responsible investment represents 62% of Canada's professionally-managed assets under management;

- The top reasons for considering ESG factors are: (1) minimizing risk over time, (2) improving returns over time, and (3) fulfilling fiduciary duty; and
- The ESG frameworks most often used by survey respondents in their investment analysis are: (1) Task Force on Climate-related Financial Disclosures (TCFD); (2) United Nations' Sustainable Development Goals (SDGs); and (3) Sustainability Accounting Standards Board (SASB).

With this context, our comments are provided below.

Q5) In light of the growing international focus on ESG factors in investing, what would be an appropriate approach to encourage pension plans to consider ESG factors?

In our view, the approach to encourage pension plans to consider ESG factors should be based on four key considerations: (1) clarifying the scope of fiduciary duty in the context of material ESG factors; (2) requiring pension plans to disclose their ESG policies and practices in their Statement of Investment Policies and Procedures (SIPP); (3) a phased-in approach to allow smaller pension plans time to implement changes to their policies and processes; and (4) encouraging the adoption of consistent regulations across federal and provincial regulators in Canada. We elaborate on these considerations below.

First, we believe it is important to clarify that considering material ESG factors alongside financial factors is consistent with fiduciary duty. While in our view this practice (often referred to as ESG integration) is compatible with fiduciary duty, there exist lingering doubts and confusion among some fiduciaries concerning the extent to which ESG factors can and should be considered in their investment decision-making. Therefore, codifying the compatibility of ESG integration with fiduciary duty would provide meaningful clarity for pension plan fiduciaries and stakeholders. In this regard, the RIA supports recommendation number six from Canada's Expert Panel on Sustainable Finance, which is to clarify the scope of fiduciary duty in the context of climate change. For this consultation, we recommend that other material ESG factors be referenced alongside climate change as a particular, urgent example.

For further details on our views related to fiduciary duty, please see our response to Q6 below.

Second, to ensure they are fulfilling their clarified fiduciary duty, pension plan fiduciaries would become required to consider material ESG factors in their investment decision-making. Fiduciaries should demonstrate how they incorporate ESG factors in their investment decision-making by providing appropriate disclosures about their ESG incorporation policies in their SIPP. ESG incorporation should be addressed throughout all levels of pension plan governance, starting with its governance structure and policy-setting, continuing through to strategic asset allocation and risk management decisions, in the implementation of investment strategies and manager selection, and in monitoring and reporting processes.

Among ESG factors that should be considered by pension plan fiduciaries, the risks and opportunities of climate change present an urgent and pressing concern. Climate change represents a systemic risk with material implications for the short, medium and long-term horizons for pension plans. We suggest that any regulation related to the incorporation of ESG factors by pension plan fiduciaries should encourage a holistic approach that encompasses all material ESG factors rather than a narrow focus on climate-related factors. However, we think it is reasonable that regulation specifically addresses incorporating climate change in pension plans' investment decision-making, as an initial step.

Fiduciaries should also be required to file the plan's SIPP annually with the pension regulator, Office of the Superintendent of Financial Institutions (OSFI). This is similar to the approach taken in Ontario under section 78(3) of Regulation 909 under the Pension Benefits Act. We also recommend that OSFI review, monitor and report on plans' SIPP disclosures related to ESG practices.

Third, we note that in 2017, FSCO published their Report on Ontario Pension Plan Filings of Statement of Investment Policies and Procedures Information Summaries, which revealed that just 36% of pension plans in Ontario indicated they incorporated ESG factors. ESG incorporation increased with asset size, with 66.7% of plans with assets over $1 billion indicating they incorporate ESG factors.

We suggest that regulation must be feasible for smaller pension funds, who tend to lack dedicated investment resources and expertise. Therefore, phasing in the enhanced ESG disclosure requirements over time, in particular for funds under $1 billion, would allow pension plan fiduciaries to build their understanding and implement changes to their governance processes.

Lastly, although outside of the scope of this consultation, we recommend a consistent approach be adopted across all federal and provincial pension plan regulatory jurisdictions, to clarify the scope of fiduciary duty and to encourage all Canadian pension plans to consider ESG factors, including the risks and opportunities related to climate change, in their investment decision-making.

Q6) What are your views on the relationship between ESG factors and a pension plan administrator's fiduciary duty?

The RIA concurs with the consultation's statement that "factoring ESG issues into pension investment analysis is increasingly considered to align with plan administrators' fiduciary duties." As noted above, the RIA's position is that the consideration of material ESG factors alongside financial factors is consistent with fiduciary duty. ESG information is additive to conventional financial information and facilitates more thorough investment analysis. Furthermore, our position is well-supported by current investment industry practices.

Several references are provided below. Please note this is not an exhaustive list, but it includes indicative and global perspectives on the evolved understanding of the role ESG factors have relative to fiduciary duty in investments.

- *Fiduciary Duty in the 21st Century* by the PRI, UNEP FI, UNEP Inquiry and UN Global Compact. The report concluded that "Failing to consider all long-term investment value drivers, including ESG issues, is a failure of fiduciary duty."
- CFA Institute — In *Positions on Environmental, Social, and Governance Integration*, the CFA Institute notes the duty of CFA charterholders to factor in all material information, including material ESG factors, into investment analysis. The policy paper notes that such factoring is consistent with an investment manager's fiduciary duty.
- Expert Panel on Sustainable Finance — In its final report, *Mobilizing Finance for Sustainable Growth*, the Expert Panel urged that "fiduciary duty today does not preclude the consideration of relevant climate change factors. In fact, evolving sustainability principles and international best practice increasingly require such considerations." (The report also advised the inclusion of "other material ESG factors," which were outside the Panel's remit.) The RIA supports the findings of the Expert Panel, and of particular relevance for this consultation, *Recommendation 6: Clarify the scope of fiduciary duty in the context of climate change*.

- The UN-convened Net-Zero Asset Owners Alliance (NZAOA) now has 33 asset owner members representing $5.1 trillion in assets under management who have committed to transitioning their investment portfolios to net-zero GHG emissions by 2050. In order to meet their fiduciary duty to manage risks and achieve target returns, the NZAOA notes that "this Commitment must be embedded in a holistic ESG approach, incorporating but not limited to, climate change, and must emphasize GHG emissions reduction outcomes in the real economy."
- From a pension regulatory perspective, we have already noted the Ontario regulations related to the disclosure of ESG practices in a pension plan's SIPP. In addition, we refer you to the International Organization of Pension Supervisors (IOPS). The *IOPS Supervisory Guidelines on the Integration of ESG Factors in the Investment and Risk Management of Pension Funds* state that the explicit integration of ESG factors into pension fund investment and risk management process is in line with the fiduciary duties of the pension fund's governing body or asset managers.

It is important to note that the ability of pension fund fiduciaries to incorporate ESG factors into their investment decision-making is largely reliant on the availability and quality of data from investee companies regarding these factors. Investors require timely, consistent, comparable, and material information from companies to be able to accurately assess the risks and opportunities related to the relevant ESG factors.

While outside the scope of this consultation, the RIA advocates for mandated, enhanced disclosures of material ESG information from companies. In our submission to the Ontario Capital Markets Modernization Taskforce, we recommended mandatory disclosures in alignment with the frameworks developed by the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) and the Sustainability Accounting Standards Board (SASB). The TCFD covers climate-related financial information while SASB covers a broader range of material ESG factors across sectors. Both the TCFD framework and SASB standards have been increasingly adopted by leading investors and companies worldwide. We call upon all Canadian securities regulators and stock exchanges to mandate consistent, enhanced, ESG disclosures.

Concluding Remarks

In closing, we commend Finance Canada for seeking input on this important topic. We believe pension plan fiduciaries and beneficiaries—as well as the capital markets and society as a whole—will benefit from increased transparency around why and how ESG factors are incorporated into pension plans' investment decision-making.

We would be happy to discuss the matters raised in this submission in more detail. Please note, the RIA consents to the disclosure of our comments in whole or in part.

Sincerely,

Mary Robinson, CFA
Director of Research, Policy & Collaboration
Responsible Investment Association

Copy to: Dustyn Lanz, Chief Executive Officer, Responsible Investment Association