PRI Principles for Responsible Investment

PRI RESPONSE TO THE CONSULTATION, STRENGTHENING CANADIANS' RETIREMENT SECURITY - PROPOSALS TO SUPPORT THE SUSTAINABILITY OF AND STRENGTHEN THE FRAMEWORK FOR FEDERALLY REGULATED PRIVATE PENSION PLANS

January 14, 2021

INTRODUCTION

The Principles for Responsible Investment ("PRI") welcomes the opportunity to respond to the Consultation, Strengthening Canadians' Retirement Security - Proposals to Support the Sustainability of and Strengthen the Framework for Federally Regulated Private Pension Plans.

The PRI is the world's leading initiative on responsible investment.[1] It works to understand the investment implications of environmental, social, and governance (ESG) factors and support its international network of over 3,000 investor signatories in incorporating these factors into their investment and ownership decisions. Launched in New York in 2006, the PRI's signatories manage over $100 trillion in AUM.[2] In Canada, there are 179 investment manager, asset owner and service provider signatories to the PRI,[3] 30 of which are either federal or provincial pension plan providers.

The Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice.[4] The Principles that signatories set out to achieve include incorporation of ESG issues into investment analysis and decision-making processes; engagement with companies around ESG factors; and seeking issuer disclosure on ESG factors. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system. They have attracted a global signatory base representing a majority of the world's professionally managed investments.

Signatories to the PRI aim to integrate all financially material factors, including ESG factors, into their investment processes. This is a risk management strategy, as evidence shows factors such as climate change and human capital management have a material economic impact on asset prices, especially

[1] Principles for Responsible Investment (PRI), What are the Principles of Responsible Investment? available at: https://www.unpri.org/pri/an-introduction-to-responsible-investment/what-are-the-principles-for-responsible-investment.
[2] As of March 30, 2020.
[3] As of January 12, 2021.
[4] PRI, About the PRI available at: https://www.unpri.org/pri/aboutthe-pri.

when taking into account the risks that long-term, universal investors like pension plans face. Therefore, the PRI will focus our comments on the consultation's Plan Governance and Administration subsection on environmental, social and governance factors.

COMMENTS ON CONSULTATION

5) 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?

For pension plans to properly consider ESG factors and weigh the risks and opportunities for retirement savers, financially material ESG information from issuers must be available. The PRI advocates for ESG reporting data that is comparable, accessible and consistent, and believes the most decision-useful ESG information for investors stems from a combination of quantitative and qualitative disclosures. For example, the PRI strongly supports the Ontario Capital Markets Modernization Taskforce initial consultation report's recommendation to require ESG information, including forward-looking information, for TSX issuers.[5] Increased public transparency and disclosure of material ESG risks could add value to Canadian pension plan participants' and beneficiaries' investments, and could encourage pension plans to incorporate ESG factors as part of their investment practice as well.

ESG factors may be made part of investment practice in a variety of ways. Examples include:

- **ESG Integration**. Integration of ESG issues entails the use of qualitative and quantitative ESG information in investment processes with the objective of enhancing investment decision-making. Integration of ESG issues can be used to inform economic and industry analysis. It can be used at the portfolio level, by taking into account ESG-related trends such as climate change, or at the individual investee level.
- **Sustainability-themed investments.** Sustainability-themed investments cover passive funds investing in companies linked to specific themes (e.g. indices focused entirely on environmental and social themes such as clean technology, microfinance and impact investing).
- **Screening.** Screening may include the use of indices constructed from an eligible universe based on the ESG characteristics of a company or country, but in which ESG issues do not play a part in the weighting of those companies or countries within the index.
- **Active ownership.** Active ownership is the use of the rights of ownership to influence the activity or behavior of investees. For listed equities, it includes both engagement and voting (including filing shareholder resolutions). Engagement may take different forms for other asset classes (e.g. fixed income).
- **Engagement.** Engagement refers to interactions between the investor and current or potential investees (which may be companies, governments, municipalities, etc.) on ESG

[5] See PRI, Response to Ontario Capital Markets Taskforce initial consultation report (September 2020), available at: https://www.unpri.org/Uploads/x/u/o/priresponse_ontariotaskforcerecommendations_sept72020_957650.pdf.

issues. Engagements are undertaken to influence, or identify the need to influence, ESG practices and/or improve ESG disclosure.

These investment practices may be conducted in isolation or in combination with other ESG strategies.[6]

The PRI recommends using the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD).[7] Investors are increasingly adopting the TCFD recommendations as they provide a global framework for translating climate risks and opportunities into financial metrics and disclosing that information to investors and the public.[8] Climate disclosures are every bit as suitable for disclosure as forward-looking economic projections, and they are critical to provide investors a complete understanding and plug material omissions in those economic projections.

In our response to the Expert Panel on Sustainable Finance's Interim Report,[9] we recommended, in addition to using the TCFD, the Department of Finance Canada and Canadian Securities Administrators (CSA) clarify ESG reporting requirements, including climate-related disclosures, in mainstream financial statements such that:

- ESG disclosures, including climate change, are a requirement of annual reporting, consistent with the other outputs of conventional accounting practice, with clear links between ESG issues and the company's business model and risk factors.
- ESG disclosures are subject to assurance, as with other financially material reporting.
- ESG disclosures use common performance metrics to allow for comparability, in particular, by industry, portfolio and across time-series.
- ESG disclosures include additional company specific ESG risks and opportunities.

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[6] PRI, PRI Reporting Framework Main Definitions 2018 (November 2017) available at: https://www.unpri.org/download?ac=1453. There is no definitive list for ESG issues, however, the PRI Reporting Framework includes main definitions of ESG issues to help guide signatories in identifying factors that may be financially material in their investments.

[7] This year, PRI signatories were required to report against the TCFD Framework with voluntary option to publicly disclose. All 2097 signatories reported on the climate indicators (strategy and governance and risks and opportunities). 20% signatories chose to disclose their responses to at least one of the indicators. 20% of Canadian signatories chose to publish at least one of their responses. We have noticed that mandatory reporting likely contributed to an increase in practices such as Board oversight on climate. (538 signatories reported Board oversight on climate in 2020, that had not done so in 2019). In 2021, all TCFD disclosures are mandatory, except for the metrics and targets, which will be mandatory in 2022. See PRI, TCFD-based reporting to become mandatory for all PRI signatories in 2020 (February 18, 2019) available at: https://www.unpri.org/newsand-press/tcfd-based-reporting-to-become-mandatory-for-pri-signatories-in-2020/4116.article.

[8] TCFD, TCFD Supporters (as of February 2020, "support for the TCFD has grown to over 1,027 organizations, representing a market capitalization of over $12 trillion.") available at: https://www.fsb-tcfd.org/tcfd-supporters/. Support does not indicate that these organizations are reporting against the TCFD in a uniform manner. See also PRI, PRI FAQ on mandatory climate reporting for PRI signatories, available at: https://www.unpri.org/reporting-for-signatories/faq-on-mandatory-climate-reportingfor-pri-signatories/5356.article. The PRI required signatories to report against the TCFD Framework this year.

[9] See PRI, Interim Report of the Expert Panel on Sustainable Finance Consultation Response (January 2019), available at: https://www.unpri.org/Uploads/q/b/k/priresponseexpertpanelonsustainablefinance_523917.pdf.

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

The PRI supports the concept that fiduciaries are obligated to integrate all material considerations, including ESG factors, into their investment actions. As stated in our response to the Interim report, the Department of Finance Canada should clarify that fiduciary duties require ESG integration.[10]

The PRI has conducted extensive research into the application of fiduciary duties in major global economies as part of the Fiduciary Duty in the 21st Century program.[11] Through that analysis, we have determined that ESG integration is an increasingly standard part of the regulatory and legal requirements for institutional investors. In major global economies, the fiduciary duties of investors require them to:

- Incorporate ESG issues into investment analysis and decision-making processes, consistent with their investment time horizons.
- Encourage high standards of ESG performance in the companies or other entities in which they invest.
- Understand and incorporate beneficiaries' and savers' sustainability-related preferences, regardless of whether these preferences are financially material.
- Support the stability and resilience of the financial system.
- Report on how they have implemented these commitments.

There are three main reasons why the fiduciary duties of loyalty and prudence require the incorporation of ESG issues: i) ESG incorporation is an investment norm; ii) ESG issues are financially material, iii) policy and regulatory frameworks are changing to require ESG incorporation.

The Canada Roadmap recommended, among other items, that Canadian pensions regulators should require pension plans to disclose ESG integration practices, and Canadian Securities Administrators should conduct a comprehensive review of the reporting of material ESG factors, following which it should expand its reporting framework and guidance.[12]

Experience in other markets suggests that clarification in public policy and regulation is the most effective way to define that ESG issues, including climate change, are financially material and therefore, a core component of investment decision-making. In order to protect Canadian pension plan participants and beneficiaries, and increase transparency for all capital markets participants, the Department of Finance Canada and Canadian Securities Administrators should define ESG reporting requirements, and the Department of Finance Canada should clarify that fiduciary duties require ESG integration.

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[10] See PRI, Interim Report of the Expert Panel on Sustainable Finance Consultation Response (January 2019), available at: https://www.unpri.org/Uploads/q/b/k/priresponseexpertpanelonsustainablefinance_523917.pdf.
[11] See Fiduciary Duty in the 21st Century Programme, available at: www.fiduciaryduty21.org.
[12] See Fiduciary Duty in the 21st Century, Canada Roadmap (January 2017), available at: https://www.unpri.org/download?ac=1387.

In addition, the PRI would encourage consistent regulation on these topics across federal and provincial governments.

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