CANADIAN CAPITAL STEWARDSHIP NETWORK
RÉSEAU CANADIEN D'INTENDANCE DU CAPITAL

October 5, 2022

Leah Fichter, Chair, CAPSA
Tamara DeMos, Chair, CAPSA ESG Committee
Canadian Association of Pension Supervisory Authorities
16th Floor – 5160 Yonge Street
Toronto, ON M2N 6L9
Delivered via email: capsa-acor@fsco.gov.on.ca

Dear Ms. Fichter and Ms. DeMos:

Re: CAPSA Guideline – Environmental, Social and Governance Considerations in Pension Plan Management

The Canadian Capital Stewardship Network (CCSN) welcomes the opportunity to comment on the Canadian Association of Pension Supervisory Authorities' (CAPSA) proposed Guideline No. 2202-0.3: Environmental, Social and Governance Considerations in Pension Plan Management ("The ESG Guideline"). The CCSN is an action-oriented movement of trade union representatives and labour-nominated pension fund trustees. The movement came together through a shared conviction that workers' deferred retirement savings can and should be invested to build and contribute to a just and secure economy for workers, their families and their communities. The CCSN is housed at the Shareholder Association for Research and Education (SHARE), a national non-profit dedicated to shareholder advocacy responsible investing.

The two constituencies of the CCSN, pension fund trustees and trade unions, are interested in ensuring that workers' retirement savings contribute to a just and secure economy for workers, their families and their communities. Pension fund trustees, including funds that CAPSA Members regulate, have important responsibilities regarding ESG investment stewardship by virtue of their role on governing boards. Trade unions are also impacted by the growing interest in ESG investing, as they often provide training and capacity building for union-nominated trustees to fulfill their duties as fiduciaries.

In this submission, we formulate recommendations based on our review of the ESG Guideline Plan. Our recommendations and observations are the following:

- A standalone ESG Guideline
- Providing additional context behind the growth of ESG investing

- Welcoming the link between ESG and fiduciary duty
- Drawing attention to reputational risks related to ESG for pension plans
- Clarifying the role of stewardship in investment decision-making
- Calling for additions to asset manager accountability mechanisms
- Clarifications in the cadence of disclosures
- Promoting the inclusion of the ESG Guideline in relevant legislation and regulation

Furthermore, we include a set of questions that pension fund trustees would benefit from having answers to in the FAQ proposed by CAPSA.

1) A Standalone ESG Guideline is Preferred

While the CCSN understands the desire to streamline guidelines, it believes that the proliferation of information around ESG investing in recent years warrants the a standalone ESG Guideline publication by CAPSA. A Guideline on ESG that is well connected to the Risk Management Guideline would direct a higher level of attention toward ESG considerations from pension plan administrators (either directly or through their delegates). Given that the attention toward ESG considerations in investments is a relatively novel phenomenon, there is a gap in expertise among pension plan administrators – both at the trustee board and among agents, such as pension plan executives and investment consultants. A standalone ESG Guideline could remedy this by promoting improved training and allocation of resources toward ESG considerations at the fund level and across the investment chain.

2) Adding Context Behind the Growth of ESG Investing

Section 1.1 of the ESG Guideline gives a definition of ESG factors and it lists a set of ESG issues "that may have the potential to affect risk and return". We urge CAPSA to add context explaining how ESG issues have come to play an important role around the globe in recent years. For instance, CAPSA could cite the seminal UNEP-FI 2005 report entitled "A legal framework for the integration of environmental, social and governance issues into institutional investment" (also known as the Freshfields report), the 2015 Paris Agreement on Climate Change, growing recognition around the importance of sustainable development and the application of international norms and frameworks, such as the OECD Guidelines for Multinational Enterprises, to institutional investors.

We also note that the Net Zero pledges of large Canadian pension funds (e.g., Ontario Teachers' Pension Plan, La Caisse de dépôt et placement du Québec) go beyond a pure calculation of risk and return – and point to a recognition of these entities' roles as important economic actors who have a responsibility to tackle urgent problems of the 21st century, like climate change. As a result, we would welcome a reference to the "responsibility" of pension funds to consider ESG issues.

3) Welcoming the Link Between ESG Factors and Fiduciary Duty

In section 2.1, we welcome the ESG Guideline's clear indication that ignoring or failing to consider ESG factors that may be potentially material to the fund's financial performance could be a breach of fiduciary duty.

Furthermore, we welcome the inclusion of "stewardship activities such as engagement and proxy voting" as a deciding factor that plan administrators can consider when deciding between otherwise equivalent investment options.

4) Drawing Attention to Reputational Risks Related to ESG for Pension Plans

The recent proliferation of investment products that boast specific claims around ESG are creating a newer type of risk for pension plan administrators: reputational risk. Two components of reputational risk should be added to "Section 3.2 Risk Management – Framework". On the one hand, pension plan administrators face increased reputational risks from inaction when it comes to managing ESG risks. Reputational risk to fiduciaries could arise from increasing expectations from beneficiaries and other stakeholders as it relates to mitigating investment exposure to carbon intensive industries. On the other hand, administrators also need to grapple with the risks of fraudulent claims or "greenwashing" when it comes to ESG products.

The risks of investing in products making fraudulent ESG claims have grown in tandem with the recent development in the ESG investing industry. According to Canada's Responsible Investment Association, assets in Canada being managed using one or more responsible investment strategies increased from $459.5 billion in 2006 to $3,166.1 trillion in 2019.[1] However, there is a wide disparity in the practices used across the industry when it comes to applying ESG labels to market investment products. In recent months, authorities in Germany and the USA have undertaken investigations and are taking regulatory and legal action in response to asset managers' possible exaggerations in the ESG credentials of certain products, also known as "greenwashing". The risk of greenwashing and fraudulent ESG claims may also exist in Canada.

Section 3.2 should thus acknowledge that ESG considerations have created two types of reputational risks for pension plan administrators: risk related to inaction around ESG issues and risk related to the use of ESG products that make fraudulent claims. The CCSN recommends that CAPSA provide clarity on how to assess and manage these risks.

5) Clarifying the Role of Stewardship in Investment Decision Making

Stewardship activities, including engagement and proxy voting at companies, is the key mechanism which allows investors to use their voice once they hold an ownership stake in a company. Asset managers may market ESG products in public equities to pension funds, based on a) specific ESG investment screens (e.g., a low-carbon investment fund), b) ESG stewardship credentials (e.g., carrying out shareholder engagement and proxy voting to promote fundamental labour rights) or c) a combination of both.

We note that the assessment by plan administrators of "whether and how ESG considerations are integrated into the investment decision-making process of any third-party managers", in section 3.3.2, is not a simple, straightforward task. We recommend that more granular details around the examination of ESG considerations be provided. The following text could be considered:

"the plan administrator should consider the following transparency practices of any third-party manager around ESG considerations:

- *Disclosure of ESG policies and practices at the firm level*
- *Disclosure of ESG policies and practices at the financial product level*
- *Disclosure of ESG practices in periodic client reports*

[1] https://www.riacanada.ca/responsible-investment/ (accessed on 26 September 2022)

This is broadly consistent with the approach taken in the European Commission's Sustainable Finance Disclosure Regulation.[2]

Secondly, noting that CAPSA lists engagement – alongside proxy voting – as key ESG stewardship activities in section 2.1, paragraph 3, and in section 3.3.3, paragraph 2. Indeed, shareholder engagement has become a standard practice in effective ESG stewardship. For these reasons, we recommend that a reference to shareholder engagement be added to section 3.3.3, paragraph 3, on documenting stewardship expectations in public equity investments.

Finally, given the growing role of private market investments (e.g., private market investments in real estate, infrastructure) in pension portfolios, we would welcome the addition of a paragraph indicating ESG stewardship tools that can be used by pension plans in private markets.

6) Adding to Asset Manager Accountability Mechanisms

Plan administrators can use their commercial clout as a tool in their ESG strategy. An important accountability mechanism for many pension plans is their ability to set expectations for asset managers. This can include the ability to "hire and fire" specific asset managers when pension plans rely on external asset managers, or the ability to influence the investment approach of internal (or embedded) asset managers. To strengthen the link between ESG expectations by pension plans toward their asset managers, we recommend adding the following text to section 3.3.3, paragraph 5:

- *"Articulate and document the plan's ESG stewardship expectations in the service provider agreement"*

Building on the current language around "collective stewardship activities" in paragraph 5, the CCSN would welcome the inclusion of a principle on collective asset owners' action for prudent investment delegation around ESG stewardship, in section 3.3.3, paragraph 6. In recent years, asset owners have come to recognize the sizeable influence of some external asset managers when it comes to shareholder engagement and proxy voting at specific

[2] The EU SFDR sets specific transparency requirements for asset managers at the "entity level", "financial product level" and more. For additional details, see here: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2088&from=EN (accessed on 26 September 2022)

companies. This has led to the development of collaborative asset owner-centred initiatives. Examples include the UN-Convened Net Zero Asset Owner Alliance and the Global Unions' Committee on Workers' Capital's Asset Manager Accountability Initiative. A fourth bullet point could be added as follows:

- *"Consider joining collective asset owner-led activities aimed at monitoring or improving ESG stewardship considerations of investment managers"*

7) Clarifying the Cadence of Disclosures

We are generally supportive of the recommendations found in section 4 of the ESG Guideline. We would welcome more prescriptive language around the cadence of ESG disclosures by pension funds. We recommend adding the following language in section 4, paragraph 3:

"If ESG factors are considered for risk management and investment purposes, best practice suggests the plan administrator make the following minimum disclosures in describing how ESG factors are considered, <u>and that those be updated on an annual basis</u>:"

8) Promoting the Inclusion of the ESG Guidelines in Relevant Legislation and Regulation

The CCSN encourages CAPSA members to embed clauses from the ESG Guideline into regulation where appropriate. The CCSN will monitor opportunities to weigh into legislative reviews of relevant provincial and federal pension acts. Enshrining clauses from the ESG Guideline into regulation and legislation would provide an additional basis for CAPSA members to track the quality of compliance with the ESG Guideline and could provide a basis for its enforcement.

Proposed Questions to add in FAQ section

Finally, we would like to propose questions for the FAQ section to help pension plan administrators approach specific ESG issues:

- *What are the responsibilities of Canadian pension funds under the OECD Guidelines for Multinational Enterprises?*
- *Does the adoption of net-zero portfolio targets for pension funds align with fiduciary duty?*
- *What is the role of pension funds and their investment in helping attain the 2050 net-zero target adopted by the Government of Canada?*
- *What is double materiality and how does it apply to Canadian investors interested in ESG?*

Thank you for offering the opportunity to comment on the draft ESG Guideline. Should you wish to discuss any of the matters raised in this submission, please feel free to contact Hugues Létourneau by email at hletourneau@share.ca or by phone at 604-695-2038.

Sincerely,

Hugues Létourneau
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CCSN Secretariat