INTRODUCTION

The United Nations-supported Principles for Responsible Investment (PRI) is the world’s leading initiative on responsible investment. The PRI has over 2100 signatories (pension funds, insurers, investment managers and service providers) globally with approximately US $83 trillion in assets under management.

121 of these signatories are currently based in Canada.

Responsible investment explicitly acknowledges the relevance to the investor of environmental, social and governance (ESG) factors in investment decision-making for the long-term health and stability of financial markets.

The PRI works with policy makers, regulators, investors and stakeholders to improve the sustainability of the financial system and address systemic market risks through policy change. The PRI has experience of responsible investment public policy reform in multiple markets, including the UK, Europe, US and China.

The PRI congratulates Canada’s Ministers for Finance and Environment and Climate Change (ECCC) on their appointment of the Expert Panel on Sustainable Finance, and their commitment to a more sustainable financial system in Canada and globally. The PRI warmly welcomes the Interim Report, and the opportunity to provide comment.

The PRI would welcome a follow-up call with the Expert Panel to discuss the Interim Report and our response. Our answers focus on areas where we have international experience. Our priority recommendations are:

- The Government of Canada should endorse the TCFD recommendations without delay. This should be part of a Canadian strategy on Sustainable Finance, which includes a disclosure framework consistent with the TCFD recommendations.

Department of Finance Canada clarify that fiduciary duties require ESG integration, and work with provincial regulators to update Pension Benefit Acts (or equivalent provincial pension regulation).

Department of Finance Canada ensure effective implementation, oversight and monitoring of responsible investment-related regulation.

Finally, the PRI recommends the mandate of the Expert Panel on Sustainable Finance is extended to ensure implementation of the Panel’s recommendations, perhaps similar in mandate to the European Technical Expert Group.

**PRI RESPONSE**

### 3.1 Clarity on Climate and Carbon Policy

*Would execution of the federal carbon pricing backstop and complementary regulatory actions to reduce emissions provide the policy clarity that private sector players need to make “rational” decisions reflecting the cost of pollution and carbon emissions in market pricing?*

Yes. Putting a price on carbon is a fundamental pillar of policies designed to mitigate the impact of climate change. The price signal acts as an incentive for businesses and investors to their investments, mix of inputs and innovate away from greenhouse gas intensive technologies.

Canada’s greenhouse gas emissions are currently on an upward trajectory and projected to increase by 6% ~ 28% of the 1990 baseline, yet to be in line with the Paris Agreement they will need to peak by the early 2020s and fall each year after that.

Altering this trajectory requires a policy response. Carbon pricing is central to the Pan-Canadian Framework on Climate Change. Effectively implementing it is critical to reducing emissions and putting Canada on a lower carbon pathway. That said, experience in other markets has shown there are risks in over-reliance on a single policy measure and that carbon pricing also need to be complemented with non-price measures, such as – carbon budgets, green investment banks, regulation, energy efficiency, integration of low carbon & resilience factors into national infrastructure plans.

International investors are looking to governments, including in Canada, to stay the course on the Paris Agreement and effectively implement key policy frameworks. The recent UN climate summit in Poland saw the largest ever joint statement from 415 institutional investors representing $32 trillion of assets under management, calling on governments to ratchet up their climate policy measures.

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3 Source Climate Action Tracker [https://climateactiontracker.org/countries/canada/](https://climateactiontracker.org/countries/canada/)

3.2 Reliable Information

Given the breadth of data needs across industries and roles, what critical areas of data would meet the widest need and should be prioritized? What are the best sources of that information today?

The PRI recommends the Government of Canada publishes reliable country-wide data on ESG issues, including climate change and GHG emissions, allowing investors to incorporate ESG trends and ESG issues in their investor decision-making. The data needs to be accessible for all investors, including smaller, less resourced pension funds.

3.3 Effective Climate-Related Financial Disclosures

What would accelerate adoption of the TCFD disclosure framework? Are there any critical enablers or barriers to adoption that have not been discussed?

The Interim Report highlights the need to balance adoption of the TCFD recommendations with costs on industry and financial institutions that are asked to prepare and publish related reports. In addition to regulation, further consideration could be given to the convening role of government and how this could be used to accelerate the maturity of the TCFD implementation and reporting process.

Recommendations include:

- **Build capacity.** Bring together preparers and users of climate-related disclosures in an annual conference to further identify barriers and potential solutions, serve as a platform for peer exchange.
- **Institutionalise the Expert Panel on Sustainable Finance** under a leading financial industry body. This will help maintain momentum and act as a central convening hub for sustainable finance initiatives in Canada. Part of the role of this new committee or institution could be a workstream or pilot on climate disclosure.
- **Establish a government-backed group on climate disclosure** to pilot the TCFD recommendations. Participants would develop a multi-year action plan, which would be published, and then report progress annually against this plan, with the intention that each year would build on the last. The above mentioned annual conference could be used to identify key issues that the pilot would address.

As well as, regulatory steps:

- **Publish formal guidance.** In accordance with the recommendations in the Canadian Securities Administrators’ report on climate risk, the CSA and other relevant policy authorities, should issue formal guidance on the business risks, opportunities and potential financial impacts of climate change.
- **Clarifying the materiality of ESG risk factors, including climate change.** Where a risk is financially material, issuers under existing securities law are required to disclose it. The CSA and other relevant policy bodies should clarify that climate change is a material risk factor and adopt a disclosure framework consistent with TCFD to assist companies to understand the
scope of their disclosures and to integrate climate risk awareness into their businesses and existing (or developing) reporting systems. These were the key recommendations from the PRI – Baker McKenzie Canada Country review of the TCFD recommendations⁵.

Should the Government of Canada become an official supporter of the TCFD?

Yes, the Government of Canada should endorse the TCFD recommendations without delay. This should be part of a Canadian Strategy on Sustainable Finance, which includes a disclosure framework consistent with the TCFD recommendations and a range of policy measures to raise awareness of the business risks and opportunities of climate change.

Is there a need for climate-related disclosures to be included in mainstream financial statements, or is that not necessary so long as other conditions are met (i.e. robust oversight and governance of the reporting process and quality)?

Yes, in addition to TCFD, the PRI recommends the Department of Finance Canada and Canadian Securities Administrators (CSA) clarify ESG reporting requirements, including climate change, 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 (the PRI has developed guidance with other investor groups⁶ on quality of reporting, available here).
- ESG disclosures include additional company-specific ESG risks and opportunities.

Is there a need for further guidance on the relationship between climate-related risks and materiality? How can the understanding of what is material be improved?

Multiple publicly-available empirical studies published by both academics and practitioners demonstrate that ESG issues, including climate change, are materially linked to both equities and fixed income financial performance. The studies demonstrate that attractive investment opportunities can be achieved through the use of ESG integration, with the degree of financial materiality varying across individual sustainability factors, fundamental profiles and industry groups.

The PRI recommends that the government convene industry associations to incorporate ESG-related content in training programs, scale ESG-training programs, and where appropriate, align content (see section 3.5). This could include evidence on ESG materiality.

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⁶ With contributions from Ceres, CFA Institute, GIIN, GSIA, UNEP FI, ICGN and PRI.
Experience in other markets suggests that clarification in public policy and regulation is the most effective way to clarify that ESG issues, including climate change, are financially material, and therefore, a core component of investment decision-making.

What is the role of a board - and specifically the audit committee - in overseeing climate-related financial disclosures? Are there any other standards that could be combined with the TCFD to reduce reporting burden?

A key recommendation from the TCFD is for issuers to describe the board’s oversight of climate-related risks and opportunities. This includes whether the board or board committees have discussed climate-related issues and consider it when reviewing strategy, major plans of action and risk management policies. As well as, how the board oversees progress against agreed goals and targets for addressing climate-related risk and opportunities. As the CSA report on climate change notes, the incorporation of climate risk into corporate governance should be a near term priority.

3.4 Clear Interpretation of Fiduciary Duty

Is there a need to more clearly define the scope of fiduciary duty with respect to the evaluation of climate-related or broader ESG factors in financial decision-making in Canada? What would be the best ways to effect change, and who are the key stakeholders in facilitating this change?

Yes, clarifying fiduciary duties is a priority recommendation as part of our Fiduciary Duty in the 21st Century project with UNEP FI and The Generation Foundation. The project finds that: “Failing to consider all long-term investment value drivers, including ESG issues, is a failure of fiduciary duty.” A dedicated Canada Roadmap was published in January 2017.

The PRI recommends that the Department of Finance Canada, in collaboration with provincial pension regulators, clarify that fiduciary duties require:

- ESG integration, consistent with the time-horizon of the obligation.
- The understanding and integration of client ESG preferences.
- Disclosure of ESG processes.

This should be clarified in provincial Pension Benefit Acts, or equivalent pension regulation.

There are two international examples the Panel could consider:

Example 1:

The UK Department for Work and Pensions (DWP) has clarified that ESG issues, including climate change, are financially material, and so trustees should consider ESG issues, including climate change, including in the default fund. The Statement of Investment Principles (SIP) must disclose how trustees consider ESG issues, including climate change.

7 See www.fiduciaryduty21.org
8 See https://www.unpri.org/download?ac=1387
Example 2:

Clarification of fiduciary duties was a priority recommendation for the EU High Level Expert Group in their final report, published in January 2018. It recommended that the clarification of investor duties should reflect the following principles:

- Asset owners and investment intermediaries shall examine the materiality of risks and value drivers, including ESG factors, consistent with the timeframe of the obligation to the client or beneficiary/member. Where financially material risks and value drivers stemming from ESG factors are identified, these shall be acted on in the investment strategy, consistent with:
  - The best interests of the clients and/or members and beneficiaries.
  - The investment timeframe of the clients and/or members and beneficiaries.

- Pension funds should ensure that they have a sound understanding of the broad range of interests and preferences of their members and beneficiaries, including ESG factors. They should also ensure that their investments are consistent with time horizon of their members and beneficiaries.

- Asset managers shall ensure that they have a sound understanding of the broad range of interests and preferences of their clients, including ESG factors, and that they provide clear information to their clients about the potential benefits and risks, including the effect on the prospective return of the investment strategy.

- For institutional clients, this should be consistent with the institutional client’s long-term obligations to their members and beneficiaries (including under IORP II), policyholders (for insurance undertakings under Solvency II) or customers (for insurance intermediaries and insurance undertakings under IDD).

- Asset owners and investment intermediaries shall disclose their investment approach to clients and/or beneficiaries in a clear and understandable manner, including how preferences are incorporated into the scheme’s investment strategy and the potential risks and benefits of doing so.

- Whether financially material or not, the preferences of clients, members and beneficiaries shall be pro-actively sought and incorporated into investors’ investment decision-making and the demands that they, in turn, make on the asset managers and other participants with which they interact to deliver their obligations to clients.

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9 The EU uses the term investor duties, applicable to both common and civil law jurisdictions.
What is the best way to incorporate ESG into rules or regulations that govern Canadian financial institutions?

To ensure ESG-issues are effectively incorporated in financial regulation, the PRI recommends:

- Clarifying ESG integration and disclosure requirements in pension fund regulation (as articulated in response to section 3.4).
- Clarifying ESG requirements in corporate disclosure and endorsement of the TCFD recommendations (as articulated in sections 3.2, 3.5 and 3.6).
- Introducing a stewardship code, which includes ESG principles and signatory reporting requirements. In Spring 2019, the UK FRC is expected to consult on amendments to the UK stewardship code on how signatories to the code must integrate stewardship within their investment decision-making and demonstrate how they take into account material ESG factors, including climate change. Other international examples include Japan’s Stewardship Code, Hong Kong’s Principles for Responsible Ownership, the European Shareholder Rights Directive and Australia’s Asset Owner Stewardship Code.

The PRI recommends the following good-practice principles in introducing ESG-related policy:

- Build the evidence base on investor practice to understand how capital markets currently contribute to, or undermine, sustainable development.
- Strengthen policy design – tentative drafting, comply or explain, and easy opt-outs mean responsible investment policy is often easy to disregard.
- Improve monitoring and communicate the impact – clarify how provincial pension and securities regulators’ mandates contribute to sustainable development.

In particular, provincial pension and securities regulators should:

- Communicate how they interpret their mandate in relation to ESG issues;
- Build capacity (people and skills) for monitoring responsible investment implementation.

This is a priority recommendation for PRI.

What are the responsibilities of investment agents and advisers for identifying and acting in accordance with the preferences of clients regarding sustainability issues? What is the most effective manner for these preferences to be identified and communicated?

In 2018, the PRI published extensive research on the role of investment consultants, including dedicated research on the Canadian market. The PRI proposes a series of solutions across market structure, investment practice and policy and regulation. In particular, the PRI recommends that the Expert Panel work with investment consultants to improve:

- Investment strategies and beliefs – For example, the way that consultants and their clients publish investment strategies and beliefs, implement investment beliefs throughout the

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10 See [https://www.unpri.org/download?ac=5167](https://www.unpri.org/download?ac=5167)
organisation and include ESG performance as a standard agenda item at performance review meetings.

- Asset allocation and portfolio construction – For example, the way ESG risks and opportunities can be integrated into funding assumptions, asset allocation and portfolio construction, and how the service offering needs to evolve.
- Fund ratings – For example, the inclusion of ESG questions in due diligence questionnaires and assessment of responses. All clients should be presented with ESG fund options.
- Reporting – For example, client reporting and inclusion of ESG performance reporting as standard.
- Fiduciary management – For example, full incorporation of ESG issues in fiduciary management, including in stock or fund selection, stewardship and active ownership, voting and reporting.

What is the most effective method for delivering board education on climate risk and ESG/sustainability issues? Does education need to include guidance on effective governance and committee modeling for ESG oversight?

All trustee and fiduciary on-boarding procedures should embed skills and awareness of ESG issues as part of the core competencies of trustees and plan fiduciaries – and be set out as a requirement in fiduciary education. Trustee boards and plan fiduciaries should annually review their balance of skills and competencies; familiarity with ESG methodologies should be a fundamental part of that assessment. Investment consultants should advise their clients as to ESG risks and analysis.

3.5 A Knowledgeable Financial Support Ecosystem

Given the breadth of climate-related considerations and diverse needs across industries, what professional services are most critical today? What are the crosscutting challenges and opportunities that they should focus on first?

The Department of Finance Canada should lead efforts to change market views on ESG issues by making sustainability an integral part of professional training and professional codes of ethics in, for example, CFA or actuarial exams. It could also work with these bodies to ensure that ESG issues are an integral part of continuous professional development (CPD) requirements for chartered professionals in these areas.

What catalysts might accelerate investment in building the necessary capabilities and capacity?

As noted above, government agencies and / or leading business associations can play an important role in raising awareness and help accelerate the maturity of frameworks like TCFD through their unique role as a convener.

Institutionalising the Expert Panel, setting up a working group on disclosure, holding an annual conference, and so on, are all measures that have been used in other markets (China, EU, UK, France) to build local capability and capacity.
In self-regulated segments of the financial support ecosystem, can associations effectively deliver necessary education and awareness amongst constituents? If so, should relevant authorities ask that associations develop plans for effecting change among their constituents? Would mandatory training programs on key topics be effective?

Yes, associations are key representatives of the industry, and serve as important access points and continuing professional development for constituents. As such, the PRI recommends that the government convene associations to incorporate ESG-related content in training programs, scale ESG-training programs, and where appropriate, align content.

Should ESG aspects be integrated into university curricula to build competency and awareness among future professionals prior to entering the workforce?

Yes, in addition to incorporating ESG issues in professional training and professional codes, we recommend ESG aspects are integrated into school, college and university curricula.

The PRI is aware of some efforts already underway. For example, Education for a Sustainable Future (LST / LSF)\(^1\) aims to work in collaboration with teachers, students, parents, government and the community, as well as business leaders to integrate the concepts and principles of sustainable development into education policies, school curricula, teacher continuing education in Canada.

3.6 Relevant and Consistent Financial Regulations

What expectations, if any, should stock exchanges place on issuers regarding ESG disclosure?

The TSX should introduce mandatory ESG disclosure as a listing requirement. The TSX should also update its Primer for Environmental & Social Disclosure\(^2\), in line with the SSE's Model Guidance on Reporting ESG Information to Investors. The PRI recommends the TSX join the SSE initiative. It is the only major exchange not to do so. As of January 2019, there are 17 stock exchanges with ESG listing standards and 42 with ESG guidance\(^3\).

4.2 Sustainable Infrastructure

How can Canada promote the systematic incorporation of climate resiliency and energy emissions measures in infrastructure development across the country? What role can sustainable finance play in that?

The PRI recommends that:

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\(^1\) See http://www.lsf-lsf.ca/
\(^2\) See https://www.tsx.com/resource/en/73
\(^3\) See here
Clear and consistent sustainability standards (both environmental and social, and based on international best practice) are applied to the design, planning, procurement and operation for all infrastructure projects, whether owned at federal, provincial or municipal levels.

The CIB, or related body, develop a national infrastructure strategy/investment plan in order to build a viable project pipeline, updated on a regular basis, both for greenfield and brownfield projects that align with the PCF.

A standard reporting framework on the sustainability performance and outcomes of infrastructure projects is established to create a dataset of consistent and comparable ESG data for investors to take into account in their investment processes.

A working group of key stakeholders – for example, public pension funds, CIB, federal and provincial treasuries, research bodies, infrastructure industry – be established to help create realistic and resilient financial mechanisms and regulatory environment that support the flow of private capital into public infrastructure.

4.4 Innovation in the Oil and Gas Industry

*When thinking about the opportunities for low-carbon innovation in the oil and gas sector, what are the most effective and far-reaching early measures?*

An important early measure, would be to assess the impact of a carbon tax, prolonged sub-$50 price of oil, or shift in demand from consumers could have on the business and its ability to deliver financial returns. Stress testing the business under different-to-usual conditions would allow companies and investors to identify sectors and investments at risk.

*What would have the highest impact in encouraging or financing transition-oriented innovation while enhancing the long-term financeability of the sector and reducing the systemic risk of sector decline (maximized capital cost allowances for related projects? Additional cleantech R&D subsidies? Redirected carbon tax proceeds?)?*

Policy certainty on the energy transition is vital for sending a clear signal to business. Governments can provide this through a short, mid and long-term plan for reducing emissions, combined with a suite of policy measures that will help to achieve this goal.

The government could consider public sector funding for related R&D and early-stage technology investing. By taking the role of the “cornerstone investor”, governments can further attract private sector capital.

Finally, the PRI encourages the Panel to review PRI’s work on a Just Transition for workers and communities as Canada’s economy transitions to low-carbon energy sources.14

4.6 Sustainable Asset Management

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What would create the necessary imperative for asset managers to objectively evaluate material ESG or transition-related issues in strategic planning, risk management, and investment research?

The PRI recommends the Department of Finance Canada, in collaboration with provincial regulators, introduce regulation similar to the European Commission’s Proposal for a regulation on disclosures relating to sustainable investments\(^{15}\). The European regulation will introduce obligations on institutional investors and asset managers to disclose how they integrate ESG factors in their risk processes, including requirements to integrate ESG factors in investment decision-making processes. Asset manager ESG disclosures should also be systematically included in management reports sent to clients.

For investment products that actively pursue sustainable objectives, the European Commission regulation proposes that the way in which these objectives are incorporated into investment decisions would also need to be disclosed. The information disclosure and reporting requirements would be more stringent for those financial products that claim to be sustainable investments than for conventional products. This is a position PRI supports.

Does benchmark composition need to capture climate considerations? If so, precisely how? How do we prevent transitioning companies from exclusion?

Many investors rely on benchmarks for portfolio allocation and measurement of financial performance. While index providers have been developing a wide range of indices considering climate change, their significance for overall portfolio allocation remains limited. This is a major subject of the European Commission Action Plan for Financing Sustainable Growth.

The lack of transparency on benchmark methodologies has made it difficult for investors to compare the various types of low-carbon or climate-related indices and to use them to assess the performance of low-carbon portfolios.

As such, the majority of portfolios are still benchmarked against conventional indices. Conventional indices may not align with the objective of limiting global warming to below 2°C pursuant to the Paris Agreement (rather, they are likely to be in line with a 3 to 4°C increase scenario). The European Commission identified varying methodologies and levels of transparency among indices pursuing low-carbon or climate-related strategies\(^{16}\).

The PRI recommends developing a set of minimum requirements, including methodology disclosure requirements, for low-carbon indices.

Should clients, plan constituents and investors be afforded further information or input into their exposures to climate risk and opportunity led by the investment strategy or portfolio composition of their asset managers?


Yes. Currently, ESG-related research and advice is often provided only at additional cost to clients. This reinforces the perception that it is additional, and not integral to investment practice. It also creates a real barrier to asset owner clients requesting or accessing this research and advice. This applies across the whole range of fee models that we see in the investment industry.

This is a legitimate business issue. The development of ESG capabilities, research products, and the provision of ESG-related advice, can involve additional costs. It is often seen as a bespoke service offering, not necessarily as something that can be replicated for more resource-constrained asset owners.

The PRI recommends that the Expert Panel develop a view on what a core (or universal) ESG service might look like.

*Should defined contribution pension plans be encouraged to offer an ESG alternative as a default fund in their programs?*

The PRI recommends that all default CAP plans should integrate ESG issues consistent with their fiduciary duties.

*Would it be feasible or helpful to have a disclosed measure and labeling of carbon intensity and/or climate exposure for institutional investment portfolios, ETFs, and other funds? Should disclosure of such a measure be mandatory for funds that are marketed in Canada?*

Maintaining the integrity of green financial products is critical to their continued growth. Standards and labels can help build confidence in these products and help reduce search costs for institutional and retail investors. Where such funds are marketed as “green” it is recommended that the issuers publish the methodology used for the calculation and impact of the fund. (As mentioned above), to improve transparency in Europe, regulators are looking to establish methodologies for two new categories of benchmarks:

1. A low carbon benchmark. A lower carbon mirror of a standard equity index
2. A positive carbon impact benchmark. Where the underlying stocks are selected on account of having carbon savings that exceed the stocks’ residual carbon footprint.

The technical report on the methodologies is due to be published in 2019. This could provide a form of reference for regulators in other markets.

*Is there a leadership role for the Bank of Canada to play along with other central banks in addressing the systemic financial risks associated with climate change?*

Yes. As the first report of the Central Banks and Supervisors Network for Greening the Financial System (NGFS) states “climate-related risks are a source of financial risk. It is therefore within the mandates of Central Banks and Supervisors to ensure the financial system is resilient to these risks.”

understanding of these risks, developing new analytical and supervisory approaches and in some cases playing an active role in scaling up the greening of financial flows.

4.7 Green and Transition-linked Financial Products

*Is there mainstream interest in a green bond market in Canada?*

Evidence to date shows that green bonds are being priced flat to the yield curve, that is that credit ratings and the business reputation of the issuer are still decisive factors for investors in green bonds. However, there have been some reports of tighter spreads in the secondary market, as investors tend to buy and hold these bonds\(^\text{18}\). This could suggest investors do value the additional social benefit of the bond being earmarked “green”. As such, it is reasonable to anticipate mainstream investor interest in green bonds issued by institutions from a G7 country like Canada.

*Are existing taxonomies appropriate in the Canadian context? Do any further conditions or key elements need to be put in place?*

Institutional investors and asset managers are currently identifying sustainable economic activities and sustainable investable assets in-house and on a voluntary basis. This can be time consuming and costly, and consequently, for some investors, too burdensome.

The PRI recommends the introduction of a sustainable taxonomy to define sustainable economic activity, possibly developing work underway by the European Commission\(^\text{19}\). The proposed European regulation establishes the conditions and the framework to create, over time, a unified classification system (or taxonomy) on what can be considered environmentally sustainable economic activities. This is widely seen as an important enabling step in the overall effort to allocate investments into sustainable economic activities. The PRI’s experience is that it is important to distinguish between those activities which contribute only partially or in a transitional way to environmental objectives with those that contribute in a substantial and sustainable way, which may influence Canada’s approach to existing Taxonomies.


\(^\text{19}\) The PRI is taxonomy rapporteur of the European Technical Expert Group.