Canadian Institute of Actuaries | Institut canadien des actuaires

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

The Canadian Institute of Actuaries (CIA) is pleased to provide our comments on this consultation.

The CIA congratulates CAPSA for the issuance of this draft guideline on environmental, social and governance (ESG) considerations in pension plan management and we support the guideline for the reasons outlined in this submission. The importance of ESG factors has grown considerably in recent years as extreme climate effects become more frequent and human capital management issues take a centre stage in the public space.

A February 2021 study by the NYU Stern Center for Sustainable Business and Rockefeller Asset Management examined the relationship between ESG and financial performance in more than 1,000 research papers from 2015 to 2020. It found a positive relationship between ESG and financial performance for 58% of the "corporate" studies focused on operational metrics such as ROE, ROA, or stock price, with 13% showing neutral impact, 21% mixed results (the same study finding positive, neutral, or negative results), and only 8% showing a negative relationship.

This type of study reinforces the crucial need for pension plan administrators to appropriately consider ESG factors as part of their fiduciary duties, as is clearly outlined in the draft guideline.

Actuaries are often involved in helping plan administrators assess and manage risks. Accounting for climate-related factors in investment decisions was part of the CIA's 2019 *Time to Act* statement, which called on investors and business leaders to include ESG factors in their decision making. The proper integration of ESG factors into the investment process of a pension plan could lead to improved risk adjusted returns. We can expect these factors will only continue to grow in importance over time and that plan administrators have a lot to gain from incorporating them into their risk management framework.

While we support the draft guideline, we offer some recommendations that we believe will improve its use by pension plan administrators. It is important to emphasize the systemic risk posed by climate change on pension plans and on the capacity of plan sponsors to meet their long-term goals and obligations. The Bank of Canada and the Office of the Superintendent of Financial Institutions quantified the risks financial institutions face in their seminal January

2022 report, *Scenario Analysis to Assess Climate Transition Risk*, as we transition to a net-zero economy. These transition risks will also affect pension funds and plan sponsors.

While transition risks are more short term in nature, each year of delayed transition to a net-zero economy adds to the uncertainty of the physical risks we will face collectively. In turn, physical risks will put pressure on the investment income required by pension plans to meet lifetime retirement income goals and obligations. A consideration not addressed in the draft guideline is that climate change may also affect longevity and how long pensions are paid. Incorporating ESG considerations in pension plan management is vital for the plan's assets and liabilities.

Recommendation 1 – CAPSA should consider including a section in the guideline on how ESG factors should be taken into consideration on the liabilities side of the balance sheet. Climate change may impact longevity of pensioners and, by extension, the capital adequacy of pension plans.

A second consideration not addressed in the guideline is whether pension plans should have a duty to promote sustainability beyond their fiduciary duty to secure retirement benefits. The Principles for Responsible Investment define a sustainability goal as "the ability of plan boards and managers to be responsible investors, active stewards, and allocators of capital to economic activities with desirable social and environmental outcomes." Some larger Canadian pension plans have adopted a secondary goal of investing in a stable, healthy world for members to retire into in addition to the primary goal of securing lifetime income to its beneficiaries.

Recommendation 2 – CAPSA should comment in the guideline about the allowance for dual objectives for pension plans: security of benefits and sustainability of the environment in which the plan exists.

Canada's pension landscape is broad and diverse. The CIA appreciates the principles-based approach set out in the draft guideline and finds the three principles support its overall objectives. The expectations placed on plan administrators should be proportional to their capacity to act. While Canada's largest public-sector pension plans have taken a position in favour of greater integration of climate risks in pension management and improved disclosure of climate-related risks, many smaller pension plans are unsure where to start. The CIA hopes that the clarity provided by this guideline will motivate more plans to take steps in the right direction, such as strengthening their governance and risk management practices related to ESG considerations or requesting more detailed disclosure from their asset managers or outsourced chief investment officer providers.

Globally, ESG standards are evolving. We believe that plan administrators should not wait for legislation to seek best practices and that this draft guideline provides a good foundation towards the continuous improvement of sound pension management. We encourage pension associations and regulators to work together to help standardize best practice and to build a common framework across Canada's pension systems.

Disclosure has been the area of focus of many initiatives as it is fundamental to informed decision making. As mentioned in the draft guideline, there is a growing international shift toward mandatory climate-related disclosure. We suggest that plan administrators should be more than just encouraged to keep pace with disclosure developments and to prepare for their eventual requirements.

We note that scenario analysis is not mentioned as a tool to incorporate climate-related risks in the investment decision process. Large pension plans have used climate scenario analysis as part of requirements to report risk in accordance with the Task Force on Climate-related Financial Disclosures (TCFD) framework as well as for strategic decision making. We believe that scenario analysis can help to:

- provide meaningful insight into how a plan fares under various climate pathways;
- identify potential transition or physical risks associated with them; and
- guide sponsors on courses of action to mitigate or adapt to these risks.

Recommendation 3 – CAPSA should add wording in section 3.2 to the effect that climate scenario analysis can provide meaningful insight into how a plan fares under various climate pathways and identify potential transition or physical risks and opportunities associated with them. Plans could adopt a qualitative or quantitative approach to climate scenario analysis taking proportionality principles into consideration.

Recommendation 4 – Examples of E, S, and G
What falls under the ESG umbrella is evolving. It might be helpful to provide some examples at the beginning of the document especially in respect of “S” and “G” (climate change is used as an example of “E”). Alternatively, this could be covered off in a Q&A section.

Recommendation 5 – ESG and the fiduciary duty of plan administrators
The first and third principles are strong, making use of the word “should” in the consideration of ESG characteristics and the disclosure of investment policies in relation to those ESG considerations, whereas the second principle only indicates that plan administrators need “to assess” whether their practices are sufficient. In the first paragraph of 3.1 it is stated that plan administrators “should ensure” that proper structures and processes are in place. We suggest the use of stronger wording in the second principle to align with the other principles and to be consistent with wording in section 3.

Recommendation 6 – Implementing ESG considerations in plan activities
The last paragraph of section 3 states that plan administrators should request companies that they invest in to disclose their ESG policies. We note this wording is similar to the second part of principle 3 in section 4, which directly follows but which starts the phrase “Where appropriate.” We suggest removing the reference from section 3.

Recommendation 7 – Disclosure
The use of the word “should” in principle 3 makes it a strong statement, however the supporting text that follows would seem to somewhat weaken this principle. Specifically, it says that *if* the plan administrator takes ESG factors into account then it is best practice to acknowledge that fact in the statement of investment policies and procedures. We suggest that it is best practice for plan administrators to acknowledge whether and how ESG factors are considered and if they are not, explain why.

At the end of this section, plan administrators are only encouraged to ensure they are keeping pace with disclosure developments and industry best practices. Given the Prime Minister's mandate letter to Minister Freeland to work with provinces and territories to move toward mandatory climate-related financial disclosures based on the TCFD framework, we believe that plan administrators should prepare for mandatory climate-related financial disclosures. There is an acknowledgement of "the growing international shift toward mandatory climate-related disclosure." Perhaps there could be an example provided in the Q&A section to illustrate that point (i.e., disclosure requirements following TCFD for UK pension schemes with assets over £1B.)

The CIA appreciates the opportunity to provide feedback on these issues, and we would welcome further discussion with you throughout this process. We would like to note that CAPSA has recently released several consultations at the same time and with a relatively short review period and similar due dates. In order for our volunteers to provide appropriate feedback, we kindly request that consultations are released with more time and throughout different times of the year as much as possible.

If you have any questions, please contact Chris Fievoli, FCIA, Actuary, Communications and Public Affairs, at 613-236-8196 ext. 119 or chris.fievoli@cia-ica.ca.

Sincerely,

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