



Investment Policy and Investment Duties of Pension Fiduciaries

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Fiduciary Requirements: Summary

Integrating ESG considerations into an investment analysis so as to more reliably assess or predict financial performance is clearly permissible and is arguably required.

Fiduciary Requirements:

1. Use as a “lens” **allowed**
 - If relevant (and available), must consider
 - If not relevant, must not consider
2. Use as “tie-breaker” **allowed**
3. Use as a negative “screen” **depends**
 - Authorized by plan documents **(yes)**
 - Authorized by SIPP only **(doubtful)**
 - Beneficiary wishes/survey **(doubtful)**

Fiduciary Requirements: Summary

Not a contest:

- Desire to take into account environmental, social and governance factors
- vs.
- Duty to act in best financial interest of plan members

Should be: an integration of ESG factors into business value analysis to enable investment practices that respond to the best financial interests of plan members

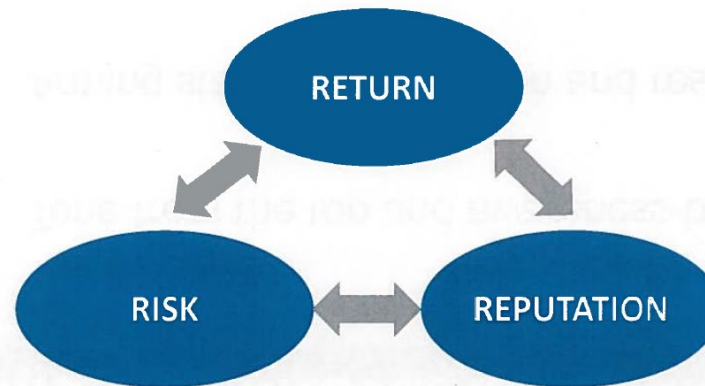
Therefore:

- Draw clear links between ESG factors, sustainability, financial performance and strategy
 - Build expertise and knowledge on how ESG factors affect intrinsic value (risk and return)
 - Use both quantitative and qualitative data
 - Ask questions (administrator, investment advisor or mutual fund operator)
- Document conclusions (process matters)
- Comply with disclosure obligations

ESG Factor Integration

Ontario Teachers' Approach

Responsible investing is about achieving long-term sustainable returns for members



Plan maturity makes it even more important to manage risk carefully

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Building Mindset and Culture

- 1 Tone from the top and awareness-building
- 2 Arming staff with education and resources
- 3 Framework for application

We have a common vision of responsible investing

Investment Policy Development

A brief explanation of the approach:

- “shall take into account the extent to which portfolio managers are able to take ESG factors into account”
- “shall take reasonable and proper care to consider ESG opportunities and risks when making direct investments”
- “engage corporate management to seek information and understanding of the corporate decision and its effect on ESG issues”

Investment Policy Development

Scope of application of ESG factors:

“Our ESG policy serves as an overlay to the Plan, and is applied across all asset classes. The Plan is updated through internal staff analysis and recommendations to our Board. Our board then uses independent fiduciary counsel and fiduciary consultants to ensure alignment of the Plan with our fiduciary duty to our beneficiaries.”

-California State Teachers Retirement System (CalSTRS)

Investment Policy Development

ESG: Sample SIPP – **DC** Plan:

In selecting investment options that consist of collective or aggregated funds such as pooled funds, mutual funds, ETFs, hedge funds, segregated funds or closed-end funds, the Administrator shall take into account the extent to which fund managers are able to consider environmental, social and governance (ESG) factors for investment purposes. One or more investment funds that expressly take into account ESG factors shall be provided. The Administrator shall otherwise monitor and evaluate all funds in accordance with the standards applicable to all other investment options.

Advanced Legal Considerations

1. Disclosure

- (a) Investment policy
- (b) Member statements

2. Owner Engagement

- (a) Continual learning and education
- (b) Seeking Disclosure
- (c) Collaboration -- Meetings/discussion
- (d) Proxy voting
- (e) Selling
- (f) Suing

Engagement:

- Post-investment monitoring
- Used to potentially increase value of assets and to mitigate risk
- Scale of engagement: light, medium or heavy

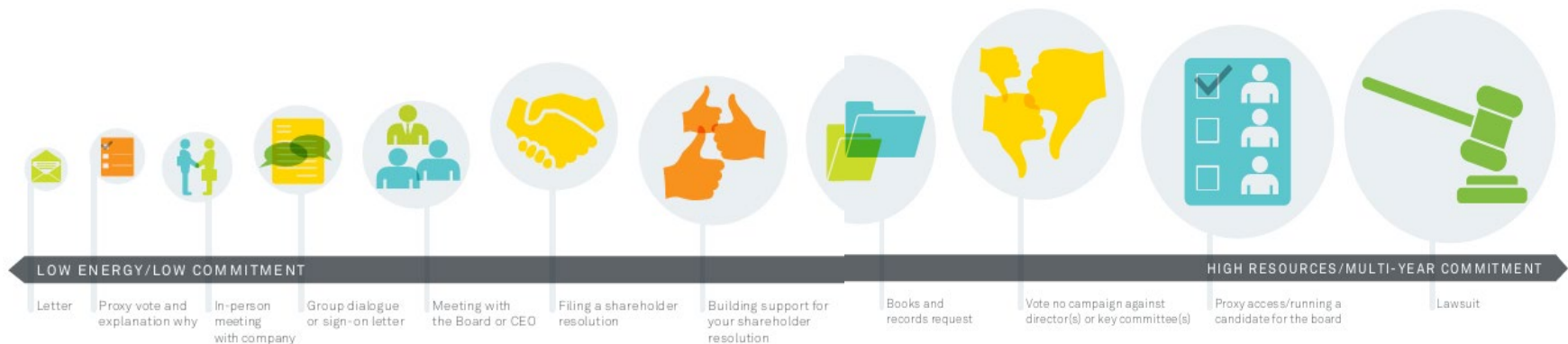


Chart: Ceres.org

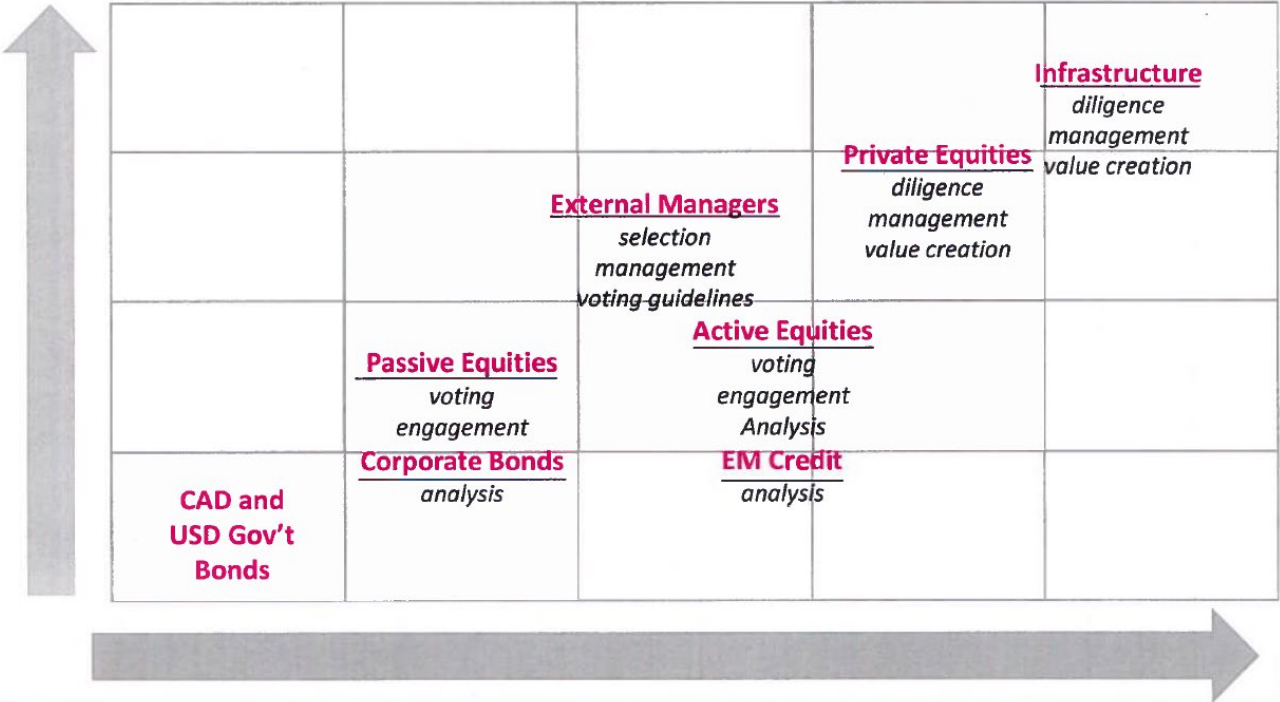
Engagement Policy -- Sample

Depending on the value of the ownership interest of the plan and the nature of the issue, before selling the plan's interest or terminating the portfolio manager, the administrator should actively engage with the investee or manager to address ESG issues that could affect the value of plan assets by considering and if appropriate proceeding with activity to mitigate loss, such as:

- Engage in a constructive dialogue with management;
- Letter writing or meetings
- Collaborate with other investors
- Proxy voting (consistent with proxy voting policy)
- Collaborate with advocacy groups
- Media campaign
- Sell the asset or terminate the portfolio manager, with appropriate transition provisions to avoid any loss to portfolio return or increase in risk
- Commence legal proceedings to compensate for any loss, such as loss of value or reputation

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Tailored Approach



We take a practical, balanced approach based on the level of risk and opportunity

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We Are Engaged Owners

Ownership and Influence

Low

High

- As a public company shareholder
 - Ownership stakes are small
 - Limited access to board
 - Use engagement and voting to influence
- As a private company investor
 - Ownership stakes can be large
 - May have board seats
 - Can directly influence or implement good practice

We tailor our approach and manage expectations

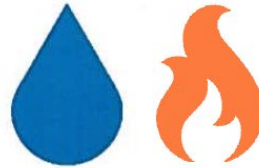
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Managing Risk and Opportunity

IDENTIFICATION



DILIGENCE



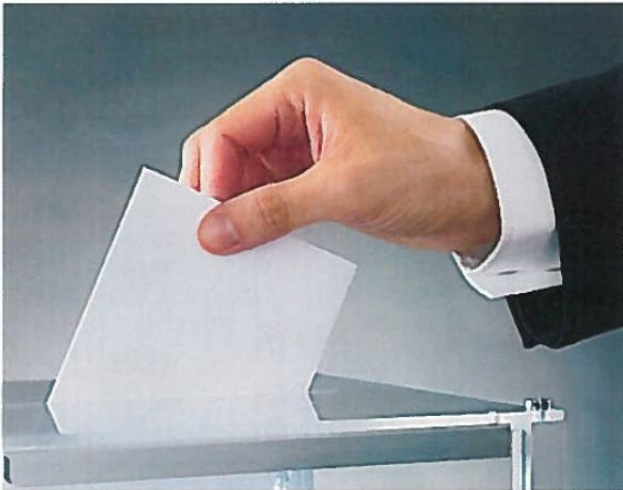
VALUE CREATION



ESG factors are considered throughout the investment process

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Voting Our Shares



- We vote about 2,000 shareholder meetings every year
- Guided by our Corporate Governance Principles and Proxy Voting Guidelines
- Case by case assessment to make a balanced, pragmatic thoughtful voting decisions
- Post all our votes and provide commentary when we vote against management
- Voting against management creates an opportunity to engage with the company

The most important role as a shareholder is to vote

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Engagement Objectives

- 1 Gain greater transparency on a company's strategy and risk management practices
- 2 Identify best practices to share with other companies
- 3 Evolve our thinking and approach as we learn

Successful corporate engagements benefit the company and the investor

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Engagement Approaches

- Low Touch
 - Letter and email correspondence with companies
 - Typically for smaller holdings, lower risk
- High Touch
 - Face-to-face meetings and phone calls
 - Greater effort and cost, but maximizes our influence



Face-to-face meetings are more effective

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RFIs Are Just the Tip of the Iceberg



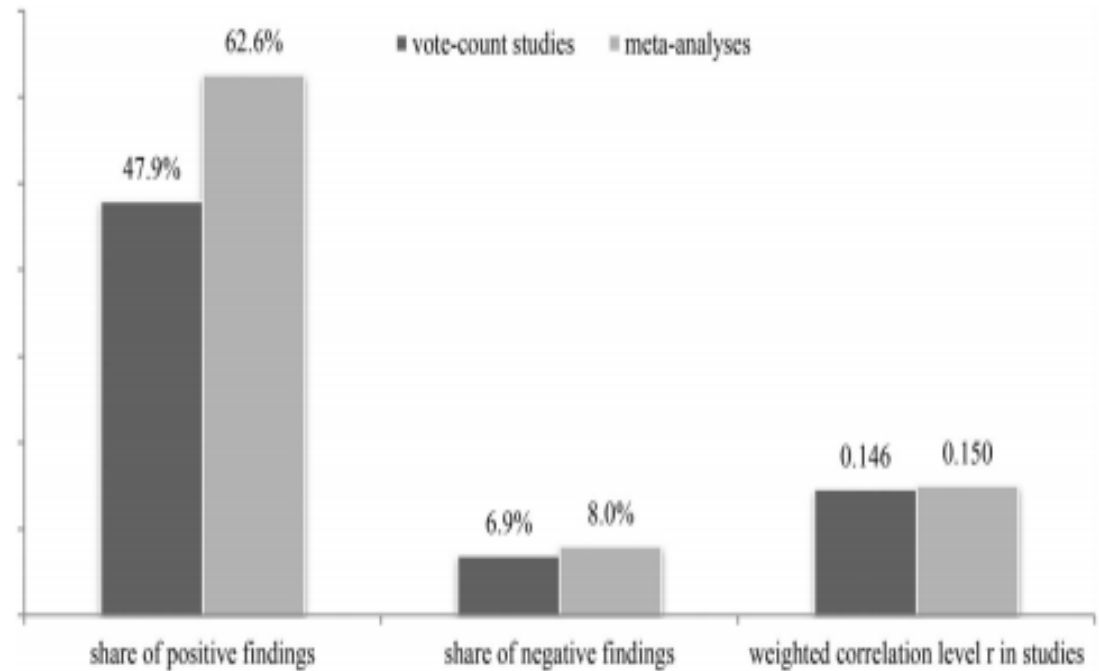
- What are your ESG policies? What is the governance around ESG integration at the fund?
- How do ESG considerations impact investment beliefs? What is the organizational culture around ESG?
- How do you identify material ESG risks? How might they impact the investment decision-making process? How do you monitor companies?

Engagements with managers can help to uncover hidden risks

Empirical evidence – Where do we stand?

Majority of studies reported a positive correlation

- Roughly 90% of the researched studies found a non-negative relationship between ESG and corporate financial performance (predominantly measured by stock returns)



Source: Gunnar Friede, Timo Busch and Alexander Bassen; Journal of Sustainable Finance & Investment, 2015

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