PRI RESPONSE

CANADIAN ASSOCIATION OF PENSION SUPERVISORY AUTHORITIES (CAPSA) DRAFT PENSION PLAN RISK MANAGEMENT GUIDELINE

September 2023

To inform this briefing, the following investor groups have been consulted: PRI Global Policy Reference Group and RIA Policy Stewardship Group. This consultation is not an endorsement or acknowledgement of the views expressed in this briefing.

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An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

ABOUT THE PRI

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a range of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research. The PRI welcomes the invitation to provide comment to the Canadian Association of Pension Supervisory Authorities' public consultation on revisions to its draft Guideline for Pension Plan Risk Management.

ABOUT THIS CONSULTATION

On June 28, 2023, the Canadian Association of Pension Supervisory Authorities (CAPSA) released its revised draft Guideline for Pension Risk Management.

The revised Guideline is intended to better support plan administrators in understanding and fulfilling their fiduciary duties, including the appropriate consideration of their applicable standard of care.

The new document covers foundational risk management concepts associated with the good administration of pension plans, regulatory expectations, and risk-specific sections, including the consideration of Environmental, Social and Governance (ESG) issues.

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SUMMARY RESPONSE

The PRI is encouraged to see that CAPSA has incorporated many of the stakeholder recommendations from the 2022 consultation period into the revised Guideline on Pension Plan Risk Management. Building on the detailed response submitted last year, the PRI welcomes this new opportunity to provide additional comment on the revised Guideline.

Most investors are exposed to financial risks (and opportunities) associated with undiversifiable, system-level sustainability issues such as climate change, biodiversity collapse or social instability. The revised Guideline clearly articulates that the legal duties of pension plan administrators require them to take into consideration any factors which are relevant to their legal purpose to provide a pension, and to act accordingly.

This position largely aligns with the findings of A Legal Framework for Impact (LFI), a joint research project between by the PRI, UNEP FI, the Generation Foundation, and Freshfields Bruckhaus Deringer. The research finds that across the 11 jurisdictions studied, including Canada, *investors are broadly permitted, and in circumstances may be required, to consider pursuing sustainability goals where this would contribute to their financial return objectives*.

To better reflect the findings of the LFI research in CAPSA's Guideline on Pension Plan Risk Management, the PRI proposes the following actions.

KEY RECOMMENDATIONS

CAPSA should consider:

- Revising the phrase in Section 2.1 to include: "Plan administrators are encouraged to adapt their risk management practices reflecting their plan's *investment beliefs*, specific circumstances and the risks being assumed". Investment beliefs are foundational to how administrators understand the fulfilment of their fiduciary duties; they influence the development and execution of a fund's overall investment strategy, policies and risk appetite.
- Including the action of goal setting in Section 6.3.5 so that investors consider identifying and pursuing sustainability impact goals at the portfolio level to inform setting targets, limits or standards for investment decisions and ownership activities. Commitment to sustainability impact goals, such as aligning with the Paris Agreement, should reflect the fund's investment beliefs, and should be required in cases where doing so would reduce financial risk and improve returns over time.
- Adding the action of reporting on any assessable progress made toward sustainability impact goals and interim targets set by the fund to the description of annual minimum disclosure in Section 6.3.6.

DETAILED RESPONSE

All investment activity has consequences in the real world, positive or negative, intended or unintended. Governments, as well as investors, increasingly recognise that long-term financial returns depend, to a large extent, on the viability of environmental and social systems. Most investors are exposed to financially relevant system-level sustainability risks, but many are not yet acting decisively to address these challenge that may impede their ability to achieve their financial objectives.

INCLUDE INVESTMENT BELIEFS IN SECTION 2: SCOPE

Investment beliefs are foundational to how administrators understand the fulfilment of their fiduciary duties and how they manage all relevant risk to financial objectives. As such, the PRI recommends that CAPSA include investment beliefs in the phrase outlining risk management practices in Section 2.1 to reflect that investment beliefs are relevant beyond ESG risk management; rather, they influence the development and execution of a fund's overall investment strategy, policies and risk appetite.

The investment beliefs of the plan should be balanced and reflect actual circumstances without compromising what is understood to be appropriate for the plan and in the best interests of plan members.[1]

IDENTIFY GOAL SETTING AS APPROPRIATE ACTION TO ACHIEVING FINANCIAL RETURN OBJECTIVES

Investor portfolios are exposed to financially material risks linked to system-level sustainability issues, such as climate change, biodiversity collapse or social instability. By definition, these risks cannot be mitigated simply by diversifying portfolio holdings. Investors can try to address the drivers of these risks (and promote long-term value creation) by setting and pursuing positive sustainability impact goals. If an investor concludes, or on the available evidence should conclude, that certain sustainability issues pose a material risk to achieving its financial investment objectives, it will generally have a legal obligation to consider what it can do to mitigate that risk and to act accordingly. The PRI has outlined in its Canada LFI report a key recommendation to all relevant Canadian regulatory authorities of pension plans to clarify the cases in which pension administrators can or should consider setting and pursuing sustainability impact goals.[2]

Pension administrators can use individual stewardship, collaborative engagement and asset allocation to pursue positive sustainability impact goals to influence the relevant sustainability issues or the assets' exposure to them; and to do so in ways that reduce the investment risk.

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[1] Deciding your funding approach | DB pension | Trustees | The Pensions Regulator
[2] A Legal Framework for Impact Canada: Integrating Sustainability Goals Across the Investment Industry, p. 14

Pension administrators should identify and articulate any sustainability impact goals in relation to their fiduciary duties, the financially relevant risks and opportunities they need to manage, and their core values. They can consider:

- their existing sustainability commitments, a top-down assessment of the most material sustainability risks, or a bottom-up evaluation of investment-linked outcomes;
- using relevant global sustainability goals and thresholds as a reference to ensure adequate levels of ambition.

ADD REPORTING ON GOAL PROGRESS TO ANNUAL MINIMUM DISCLOSURE

The revised Guideline outlines best practice on annual minimum disclosure regarding relevant ESG information as it pertains to risk management, roles and responsibilities and stewardship activities of the fund. Following on the recommendation above to include sustainability impact goal setting as possible action to address potential risks to financial returns, the PRI recommends that annual minimum reporting should include reporting on any assessable progress made toward sustainability impact goals and interim targets set by the fund. CAPSA should include this in the description of annual minimum disclosure in Section 6.3.6 of the revised Guideline.

The PRI has experience in contributing to public policy on sustainable finance and responsible investment across multiple markets and stands ready to support the work of CAPSA *in its objective to ensure the fulfilment of fiduciary duties by Canadian plan administrators.*

Please send any questions or comments to policy@unpri.org.

More information on www.unpri.org