



Highlights- CCLI Submission to the Department of Finance on Sustainability of Pension Funds

In January 2021, we submitted a letter to the Financial Sector Policy Branch, Department of Finance Canada as part of its public consultation on Strengthening Canadian's Retirement Security – Proposals to Support the Sustainability of and Strengthen the Framework for Federally Regulated Private Pension Plans. We share some highlights of our submission below.

On behalf of the Canada Climate Law Initiative (CCLI), a collaboration of faculty from the law schools at the University of British Columbia and York University, together with a nationwide network of 67 corporate and pension law experts and affiliated research scholars, we are making this submission on an important aspect of your current consultation on strengthening the sustainability of federally-regulated private pension plans, the embedding of environment, social and governance (ESG) factors in pension plan administration. We propose specific recommendations and discuss the underlying rationale and growing domestic and international support for our views.

1. Require the statement of investment policies and procedures of federally-regulated pension plans to include ESG in line with the TCFD framework

We recommend that the federal government amend regulations under the *Pension Benefits Standards Act (PBSA)*¹ to require disclosure of ESG factors, including climate-related disclosure, using the framework recommended by the G20 Financial Stability Board Taskforce on Climate-related Financial Disclosures (TCFD).² The TCFD framework focuses on climate-related financial risks, but has been endorsed globally as a helpful framework for effective governance of ESG risks. The TCFD recommends four areas for disclosure that represent the core elements of how organizations operate: governance, strategy, risk management, and metrics and targets.³ Requiring disclosure of how ESG risks and opportunities are identified and managed would considerably enhance the administration of federally-regulated pension plans; will encourage them to embed these factors in their investment strategies and risk management; and will allow

¹ *Pension Benefits Standards Act*, 1985, RSC 1985, c 32 (2nd Supp), as amended (*PBSA*). Pension Benefits Standards Regulations, 1985 (SOR/87-19), as amended 2017.

² Taskforce on Climate-related Financial Disclosures, *Final Report, Recommendations of the Task Force on Climate-related Financial Disclosures* (2017), available at <https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf> (hereafter *TCFD Final Report*).

³ *TCFD Final Report*, note 2 at v.

pension trustees and plan administrators to meet their fiduciary obligations to plan members and retirees.⁴

The *PBSA* governs private pension plans linked to federally-regulated areas of employment, such as banking, telecommunications, inter-provincial transportation, and navigation and shipping, as well as private sector employment in Yukon, the Northwest Territories, and Nunavut, and employment at certain federal Crown corporations.⁵ About 7% of private pension plans in Canada are federally regulated.⁶ Amending the regulations would enhance governance of these pension funds and provide leadership to other parts of Canada regarding more effective pension fund governance.

The Department of Finance's current consultation process observes that establishing a governance policy could enhance administrators' fulfillment of obligations under the plan and enhance communications and transparency with plan members. We agree. Effective pension plan governance is critically important to trustees and plan administrators meeting their fiduciary duties to act in the best interests of the plan, its members, and beneficiaries. It assists in establishing a framework that clearly sets out the duties and responsibilities for each aspect of governance of fund assets and embeds accountability and transparency mechanisms.⁷

Our view is that the governance policy and SIPP should be submitted annually to the oversight regulator, the Office of the Superintendent of Financial Institutions (OSFI), so that it is able to assess the effectiveness of management and compliance with the *PBSA* solvency and going-concern funding rules.

Disclosure of ESG factors in the plan's SIPP would allow beneficiaries, union officials, financial oversight bodies, and relevant Ministry personnel to determine the seriousness with which pension fund trustees, plan administrators, and asset managers are incorporating ESG into their governance, strategy, risk management, targets, and metrics. This transparency would allow plan members access to information on how the pension fund is balancing the intergenerational interests of plan members and retirees. It would allow younger contributors to evaluate the risks to their future financial security from how their current pension contributions are being managed. It would also elevate the issues regarding the financial risks of climate change within the asset management community, and potentially energize the engagement teams within asset management firms to take up climate change discussions with portfolio companies with renewed seriousness of purpose.

⁴ Janis Sarra, *From Ideas to Action, Governance Paths to Net Zero* (2020, Oxford University Press) at 83-89 (hereafter Sarra, *From Ideas to Action*).

⁵ Department of Finance, *Strengthening Canadians' Retirement Security - Proposals to Support the Sustainability of and Strengthen the Framework for Federally Regulated Private Pension Plans*, (November 2020), (hereafter Department of Finance) available at <https://www.canada.ca/en/department-finance/programs/consultations/2020/strengthening-canadians-retirement-security-proposals-support-sustainability-strengthen-framework-federally-regulated-private-pension-plans.html>.

⁶ Department of Finance, note 5.

⁷ Ronald B Davis, *Democratizing Pension Funds, Corporate Governance and Accountability* (Vancouver: UBC Press, 2008).

2. Canadian institutional investors and organizations support our recommendations

Our proposed amendments align with the recommendation of the Expert Panel on Sustainable Finance that the federal government should require federally-regulated pension plans to disclose in their SIPP whether and how climate issues are considered, including the rationale for any non-consideration,⁸ and its recommendation that pension regulators harmonize provincial and federal regulatory approaches in line with the TCFD framework.⁹

Canadian institutional investors are also calling for increased transparency in respect of ESG risk management. In November 2020, the Chief Executive Officers of the eight largest pension fund investment managers in Canada, representing \$1.6 trillion in assets, issued a statement seeking standardized ESG disclosure from portfolio companies, including TCFD climate-related disclosure, so that they have the information necessary to contribute to a post-pandemic sustainable economy recovery.

Ontario pension law has already adopted regulation and has been successful in drawing pension funds' attention to the need to measure and disclose management of ESG factors.¹⁰ To align with the Ontario regulation s 78(1)-(3), Regulation 909 of the Ontario *Pension Benefits Act*¹¹, we believe that the SIPP of federally-regulated pension funds should include consideration of ESG factors as an important mechanism to align plan administrators' duties to pension plan members and beneficiaries. Consideration of such factors can enhance performance of investment portfolios over the medium and long term.¹²

Implementing this recommendation also aligns with recent federal government initiatives. The government conditioned short-term liquidity assistance to companies under the COVID-19 Large Employer Emergency Financing Facility on mandatory annual disclosure according to the TCFD recommendations.¹³ In Budget 2019, the federal government expressed its support for the TCFD framework and encouraged phased-in adoption by major Canadian companies and federal crown corporations.¹⁴ In December 2020, the federal government announced that it is encouraging its crown corporations to publicly disclose their greenhouse gas emissions annually, encouraging adoption of the TCFD recommendations where appropriate and relevant to the crown corporations' business activities.¹⁵

⁸ Expert Panel on Sustainable Finance, *Final Report of the Expert Panel on Sustainable Finance - Mobilizing Finance for Sustainable Growth*, (2019), at 21, available at <https://www.canada.ca/en/environment-climate-change/services/climate-change/expert-panel-sustainable-finance.html> (hereafter Expert Panel).

⁹ Expert Panel, note 8.

¹⁰ RRO 1990, Reg 909: General, under *Pension Benefits Act*, RSO 1990, c P 8, as amended, s 78(3).

¹¹ RRO 1990, Reg 909, note 15.

¹² For example, in a meta-study of 2,200 empirical studies on ESG and financial performance, Friede, Busch and Bassen found that the large majority report positive corporate financial performance when the companies integrate ESG considerations, and for 90% of the total, there was at least a non-negative relationship between ESG and corporate financial performance, Gunnar Friede, Timo Busch and Alexander Bassen, 'ESG and financial performance: aggregated evidence from more than 2000 empirical studies' (2015) 5:4 *Journal of Sustainable Finance and Investment* 210-233, DOI. See also, Janis Sarra and Cynthia Williams, *Time to Act* (2019, CCLI), at 22-23, available at [Time to Act: Response to Questions Posed by the Expert Panel on Sustainable Finance on Fiduciary Obligation and Effective Climate-Related Financial Disclosures \(ubc.ca\)](#).

¹³ Government of Canada, <https://www.cdev.gc.ca/leeff-factsheet>.

¹⁴ Government of Canada, *Budget Plan 2019, Government of Canada*.

¹⁵ Treasury Board of Canada Secretariat, *Greening Government Strategy: A Government of Canada Directive*, (3 December 2020), available at <https://www.canada.ca/en/treasury-board-secretariat/services/innovation/greening-government/strategy.html>.

The Bank of Canada’s 2019 Annual Financial System Review discussed climate change as a vulnerability to both Canada’s economy and its financial system.¹⁶ It has initiated a multi-year research plan to better assess the risks from climate change relevant to its mandate, and has joined the Network of Central Banks and Supervisors for Greening the Financial System.¹⁷ In 2020, the Bank of Canada and OSFI jointly launched a pilot project to use climate-change scenarios to better understand the risks to the financial system related to a transition to a low-carbon economy.¹⁸

Most recently, in January 2021, OSFI issued a discussion paper asking for policy recommendations regarding governance of Canadian financial institutions to better protect their safety and soundness, including consideration of whether climate risks should be embedded into assessment of capital adequacy requirements, risk assessment processes, and OSFI’s prudential oversight of climate-related risk management.¹⁹

3. International developments support our recommendations

In addition to support within Canada for our recommendations, there is considerable support internationally. The United Kingdom (UK) and New Zealand have announced that TCFD disclosure will become mandatory for companies subject to their jurisdiction.²⁰

In 2020, the UK Chancellor of the Exchequer announced that TCFD-aligned disclosure will be mandatory across the UK economy as of 2025, going beyond a comply or explain approach, and covering “listed commercial companies, UK-registered large private companies, banks, building societies, insurance companies, UK-authorized asset managers, life insurers, FCA-regulated pension schemes, and occupational pension schemes.”²¹ The UK Financial Conduct Authority (FCA) is requiring, effective 1 January 2021, that companies listed on the London Stock Exchange disclose information consistent with TCFD on a comply or explain basis.²²

¹⁶ Bank of Canada, *Financial System Review 2020*, Vulnerability 5, Climate Change, (14 May 2020), available at <https://www.bankofcanada.ca/2019/05/financial-system-review-2019/#Vulnerability-5-Climate-change> (hereafter *Financial System Review*).

¹⁷ *Financial System Review*, note 16.

¹⁸ Bank of Canada, Press Release, *Bank of Canada and OSFI launch pilot project on climate risk scenarios*, (16 November 2020), available at <https://www.bankofcanada.ca/2020/11/bank-canada-osfi-launch-pilot-project-climate-risk-scenarios/> (hereafter Bank of Canada and OSFI).

¹⁹ OSFI, *Navigating Uncertainty in Climate Change: Promoting Preparedness and Resilience to Climate-Related Risks* (January 2021), available at [Navigating Uncertainty in Climate Change - Promoting Preparedness and Resilience to Climate-Related Risks \(osfi-bsif.gc.ca\)](https://www.osfi-bsif.gc.ca/en/uncertainty-in-climate-change).

²⁰ Ministry for the Environment, Government of New Zealand, *Climate Related Financial Disclosures*, (21 September 2020), available at <https://www.mfe.govt.nz/climate-change/climate-change-and-government/mandatory-climate-related-financial-disclosures>; HM Treasury, *Chancellor sets out ambition for future of UK Financial Services*, (9 November 2020), available at https://www.gov.uk/government/news/chancellor-sets-out-ambition-for-future-of-uk-financial-services?utm_source=POLITICO.EU&utm_campaign=f1fb3a3a16-EMAIL_CAMPAIGN_2020_11_09_05_28&utm_medium=email&utm_term=0_10959edeb5-f1fb3a3a16-190626680 (hereafter New Zealand government).

²¹ HM Treasury, *Chancellor sets out ambition for future of UK Financial Services*, (9 November 2020), available at https://www.gov.uk/government/news/chancellor-sets-out-ambition-for-future-of-uk-financial-services?utm_source=POLITICO.EU&utm_campaign=f1fb3a3a16-EMAIL_CAMPAIGN_2020_11_09_05_28&utm_medium=email&utm_term=0_10959edeb5-f1fb3a3a16-190626680.

²² Nikhil Rathi, Financial Conduct Authority, *Green Horizon Summit: Rising to the Climate Challenge*, speech, (12 November 2020), available at <https://www.fca.org.uk/news/speeches/green-horizon-summit-rising-climate-challenge>.

The Government of New Zealand Ministry for the Environment announced plans to make climate-related financial disclosures mandatory for publicly-listed companies and large insurers, banks and investment managers, in line with the TCFD recommendations.²³ The New Zealand Parliament will amend the *Financial Markets Conduct Act 2013*,²⁴ an amendment that the Cabinet has approved.²⁵ Financial entities will be required to make disclosures as early as 2023.

New European Union rules on ESG sustainability disclosure requirements in the financial services sector take effect in March 2021, affecting institutions such as pension funds, banks, insurance companies, and investment firms. The European Union (EU) Non-financial Reporting Directive (Directive 2014/95/EU) requires large companies to disclose, as part of their annual reports, information on how they operate and manage social and environmental issues, for the benefit of investors, consumers, policymakers, and other stakeholders.²⁶ The Directive is complemented by the European Commission's (EC) integration of TCFD recommendations in its 2019 *Guidelines on Reporting Climate-Related Information*.²⁷

4. Given the financial materiality of ESG and climate change risks, consideration of these risks is an important component of plan administrators' fiduciary duties

The fiduciary duties of plan administrators, pension fund trustees, and asset managers require these fiduciaries to evaluate and incorporate ESG and climate factors into portfolio construction and risk management, as they would any factor that may pose a material financial risk to the pension plan assets.²⁸ The fundamental obligations of pension fiduciaries arise from common-law standards,²⁹ incorporated into the *PBSA*, as discussed above. The federal government should affirm these obligations by issuing a public statement that consideration of ESG factors is firmly within the remit of pension administrators' and trustees' fiduciary duty.

The links between climate change and financial risk are becoming increasingly evident and inextricable.³⁰ The understanding of climate change has evolved from a purely ethical or 'environmental externality' to an issue that poses foreseeable financial risks and opportunities for Canadian pension funds and the financial system across short-, medium-, and long-term

²³ New Zealand government, note 20.

²⁴ *Financial Markets Conduct Act 2013*, Public Act, 2013 No 69 (New Zealand).

²⁵ New Zealand government, note 20.

²⁶ European Parliament, Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, available at [DIRECTIVE 2014/95/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL - of 22 October 2014 - amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups - \(europa.eu\)](#), <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0095>.

²⁷ European Commission, *Guidelines on Reporting Climate-Related Information*, available at https://ec.europa.eu/finance/docs/policy/190618-climate-related-information-reporting-guidelines_en.pdf

²⁸ See United Nations Principles for Sustainable Investment, *Fiduciary Duties in the 21st Century*, (September 2015), available at <https://www.unpri.org/fiduciary-duty/fiduciary-duty-in-the-21st-century/244.article>.

²⁹ *Hodgkinson v Simms* [1994] 3 SCR 377, [1994] 3 RCS 377, discussed in Edward J Waitzer and Douglas Sarro, 'The Public Fiduciary: Emerging Themes in Canadian Fiduciary Law for Pension Trustees' (2012) 91:1 *Can Bar Rev* 163 at 169-175. See also Sarra, *From Ideas to Action*, note 4, chapter 4.

³⁰ For an example of the linkage between climate risk and effective governance, see the CCLI, *Audit Committees and Effective Climate Governance, A Guide for Boards of Directors* (December 2020), available at [CCLI-Guide-for-Audit-Committees-on-Effective-Climate-Governance.pdf](https://www.ccli.ca/CCLI-Guide-for-Audit-Committees-on-Effective-Climate-Governance.pdf) (ubc.ca).

horizons.³¹ Indeed, the impacts of both a changing climate and efforts to decarbonize the global economy to address climate change present some of the most significant and complex risks facing organizations today.³²

Climate change poses financial risks across three key pathways:

- *physical risks* arising from both acute catastrophic and gradual onset impacts, including more frequent and intense extreme weather events, sea level rise, and biodiversity loss;
- *economic transition risks* arising from the transition towards a net-zero emissions economy, and associated shifts in the regulatory, technological, and stakeholder landscape within which business operates; and
- *litigation exposures* stemming from the attribution of climate change to a company's activities or the failure to manage the impacts of climate change on the business.³³

Given these physical, transition, and litigation risks across the Canadian and global economies, pension plan administrators must be equipped with adequate information on ESG and climate exposures of portfolio companies, where actively investing, and throughout the fund when developing strategy and risk management approaches. Moreover, the processes administrators use to evaluate and incorporate that information can best be supervised by OSFI if there are clear disclosure requirements set out for plan administrators and trustees.

5. Conclusion

In conclusion, we believe that it is both timely and important that ESG factors be embedded in the governance of pension plans, in the investment decisions of their administrators and asset managers, and in their disclosures. The momentum created by the TCFD framework means that Canada can further align pension governance with developments nationally and internationally and take a leadership role for the rest of Canada.

For more information on the Canada Climate Law Initiative, see ccli.ubc.ca or follow us on [Twitter](#) and [LinkedIn](#).

³¹ Our sincere thank you to our partner, Ellie Mulholland, Director, Commonwealth Climate and Law Initiative, Oxford University, for her substantial contribution to this part of our submission. For information about the Commonwealth Climate and Law Initiative, see [Commonwealth Climate and Law Initiative \(ox.ac.uk\)](http://Commonwealth Climate and Law Initiative (ox.ac.uk)). This assessment is shared by, for example, the US Commodity Futures Trading Commission report “[Managing Climate Risk in the US Financial System, Report of the Climate-Related Market Risk Subcommittee](#)”, (9 September 2020); the Network for Greening the Financial System, [The Macroeconomic and Financial Stability Impacts of Climate Change](#) (June 2020); Patrick Bolton, Morgan Despres, Luiz Awazu Pereira da Silva, Frédéric Samama, and Romain Svartzman, Bank for International Settlements, [The green swan: Central banking and financial stability in the age of climate change](#) (January 2020); and TCFD *Final Report*, note 2.

³² TCFD *Final Report*, note 2. See also the [TCFD: 2019 Status Report](#) (June 2019).

³³ Bank of England Prudential Regulation Authority, *The Impact of Climate Change on the UK Insurance Sector*, (September 2015), available at [The impact of climate change on the UK insurance sector \(bankofengland.co.uk\)](http://The impact of climate change on the UK insurance sector (bankofengland.co.uk)).