

Notes for presentation

Evolution of Public Policy: The Sustainable and Socially Responsible Investment of Canada's Pensions

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- Good afternoon, pleased to be invited to speak to you about this topic
- Before I begin I want to offer a word of caution
- The description of my talk circulated for this event may have overhyped both the change that pensions are experiencing and the impact of public policy on this change
- Certainly some pensions – not all -- are changing with regard to responsible investment, and public policy has played a part in this change
- But it is important to keep things in perspective – certainly in Canada, and around the world -- it is still very much business as usual for most public and private pensions

- I want to talk about three major themes this afternoon, and I welcome the discussion to follow

- First, I want to look at how the pension landscape has changed in Canada and around the world in the last few years

- Second, I want to examine the role of public policy in this change, and the role of the SRI community in fostering this new public policy

- Third, I want to talk about a broader vision of the public policy role for the responsible investment community. Not just what can be achieved to advance our own commercial purposes – but also what it means for the broader public good of the financial industry and the communities in which we live.

The Pension Landscape

- First, how has the pension landscape changed?

- I think it's fair to say that if you look at the very largest of the public sector funds in Canada – things have changed a lot

- Look at very recent developments

- At the Canada Pension Plan Investment Board, with nearly \$100 billion in assets – the Board issued a new responsible investment policy last fall, followed by agreement to sign the Enhanced Analytics Initiative in March
- And just a few weeks ago, CPPIB CEO David Denison appeared with UN Secretary General Kofi Annan in signing the UN Principles for Responsible Investment
- And, very soon, CPPIB will be appointing a new Manager for Responsible Investment, the first job of its kind at the CPPIB
- The Caisse de depot, currently the largest pension manager in the country, issued a responsible investment policy in January 2005 and also agreed to sign the UN Principles a few weeks ago
- The British Columbia Investment Management Corp., which manages about \$70 billion in public sector pension plans in BC, also signed on to the UN Principles
- Batirente, a pension manager for the CSN unions in Quebec, and I'm pleased to add, a member of the SIO, also signed on to the UN Principles
- Internationally, these Canadian signatories are in very impressive company – Calpers, Norwegian Government Pension Fund, State of Connecticut, among about 50 in total
- The UN now estimates that signatories manage more than \$4 trillion dollars in assets
- However, there were some funds conspicuous by their absence – a spokesperson for the Ontario Teachers, for example, was quoted as saying that the Principles “are not currently under consideration.”
- There also seems to be an absence of corporate pension signatories – surprising when the UN itself is encouraging greater corporate social responsibility through the Global Compact
- However, I think that almost everyone believes this is still early days for the Principles – certainly organizers of the initiative are planning to hit the road seeking to increase the number of signatories
- So, certainly the landscape for the very largest pension funds in Canada has changed – only a few years ago none of the very largest investment funds had responsible investment policies

- Yet there still seems to be largely silence from the corporate plans out there – even the plans representing employees at the companies branding themselves as good CSR companies
- And it's not for lack of knowledge of responsible investment – many members of the SIO have knocked on the doors of these pension funds trying to attract interest
- So we seem to have a situation where the very largest of public pension funds in Canada – I'll call them the elite funds – have endorsed the UN Principles and seem to be on their way to a responsible investment stance
- And yet even most of the medium sized and small public pensions have not joined this particular bandwagon – and almost complete absence of participation from the corporate sphere
- We at the SIO will be monitoring this – the UN Principles, if you read them carefully, are very much a process-based series of principles, not an outcome-based set of principles
- This means that it is possible for these signatories to sign on to these principles – backed by the integrity and credibility of the UN – and actually not change one dollar of their investment portfolios
- This can lead to a perception of change, rather than to real change itself
- SIO welcomes the UN Principles and believes it is a major development in the field of responsible investment
- But we also believe that without further pressure from stakeholders that this initial good start may not develop into anything further – that the normal pressures to return to business as usual will prevail
- It's important for everyone involved in this activity – the mainstream responsible investment community, the traditional SRI community and issue-specific NGOs to put the signatories on notice that they expect not only process changes but real changes in portfolio outcomes
- SIO will be doing its part in this. We will be doing an analysis for our regular Two-Year Review of Responsible Investment in Canada – to be published late this year. We'll take a look at the Canadian signatories to the agreement – and do an analysis of the actions that the Canadian signatories have taken with regard to the Principles. Over time, we'll also look at the question of real outcomes – the actual dollar difference in investment portfolios or socially responsible behaviour by corporations that can be attributed to changes brought about by the Principles.

- We believe that this kind of monitoring is essential to ensuring that the signatories realize the very ambitious goals established by the Principles

The Role of Public Policy in Changing this Landscape

- Now I want to turn to the role that public policy has played in changing this landscape
- I think when the history of responsible investment is written some decades in the future, historians will point to the change in British pension rules in the year 2000 as a major turning point in how pension administrators and trustees came to regard their own role in helping to shape the responsible investment activities of their pensions
- Most of you are already aware of this but in 2000, the British Labour government adopted rules requiring British pension funds to disclose how social, ethical and environmental policies are taken into account in the investment strategies and proxy policies of their pensions
- Similar rules have been put into force in Australia, France and Germany, and are pending in Italy
- UK Pensions Minister Stephen Timms has called this “light touch legislation”
- Let’s look at what the rules do
- First they require trustees to deal with the issue – because of the disclosure requirements, trustees are required to decide whether, in fact, they have a responsible investment policy. If they do, they have to sketch out the details of that policy.
- And second, they are required to disclose that policy. Whatever policy they choose will have to stand up against scrutiny by their plan members and their peers at other funds. In theory, plan members can use their existing governance mechanisms – pension committees, for instance, to make trustees answer to these policies.
- It may be light touch legislation – as Timms says – but it holds the potential to revolutionize how responsible investment is treated at British pensions
- So what have been the outcomes of this change in disclosure and accountability?

- Our sister organization in the UK, the UK Social Investment Forum has a project into this very issue entitled Just Pensions
- Just Pensions does research into this question in the UK and encourages British pension funds to become responsible investors
- While it's impossible to determine the exact role played by the disclosure rules, it is possible to conclude that, for whatever reason, there has been a change in how UK pension funds are invested
- For example, a survey of 79 UK pension trustees found that only two per cent of respondents said that their fund used negative screening a lot in 2003
- By 2005, this had increased to 11 per cent
- Similarly, on corporate engagement, 26 per cent of respondents said that their fund was using corporate engagement a lot in 2003
- By 2005, this had jumped to 40 per cent
- Large funds are much more inclined than smaller funds to use corporate engagement and proxy voting, and smaller funds are much more likely to use negative screening
- It appears by these numbers that the intention of the legislation – to encourage more responsible investment outcomes by UK pension funds – is on the way to being achieved
- Can we attribute this change to the pension legislation?
- Not completely. In fact, the Freshfields report on responsible investment law released last year has played a tremendous role in clarifying misconceptions about the law of fiduciary duty
- This revision of fiduciary duty has been coming for many years – in fact, it's something that Gil Yaron at the Shareholder Association for Research and Education (SHARE) has been saying for several years
- But I think that the useful role that the disclosure policy has played is to force trustees and managers to think about the issue
- If you look at another question posed by the Just Pensions study, trustees were asked:

To what extent do you agree that additional regulation or legislation is needed to require pension funds to report on the implementation of their SIPs in their report and accounts?

- 33 per cent of trustees strongly agreed with this statement, and 33 agreed – 66 per cent were in agreement overall.
- Only 9 per cent disagreed and 24 per cent were neutral
- I think what this shows is that, in most cases, trustees are only prepared to disclose their implementation if there is a requirement that they disclose
- This shows the importance of the disclosure rule in the first place, and the need to strengthen the disclosure rule over time
- Another interesting finding in the report – from my point of view anyway – dealt with the role of plan members in deciding social, ethical and environmental strategy
- Trustees were asked about the significance members, consultants, legal advisers and their own organization have in determining social, environmental and ethical strategy at their pensions
- In spite of the fact that pensions must now report to their members on their SEE policies, 53 per cent of trustees said the views of members had “no significance” in deciding these strategies, while 21 per cent said members had some significance and 13 per cent said they had great significance
- Surprisingly, to me, the stakeholder with the largest influence in this area, is consultants
- 43 per cent of trustees said advice from investment consultants had some significance and 39 per cent said consultants had great significance
- It appears that – even in 2005 – after years of publicly-required disclosure, that consultants are still very much in the driver’s seat on this issue, and for someone like me who believes strongly in democratic institutions, I’m disappointed that the views of members still don’t play a large role

- I think the conclusion we can reach from this research is that the disclosure rule has been effective in drawing trustees' attention to the issue of responsible investment, and it is more important than ever to strengthen these rules to ensure that proper disclosure is in place
- What this shows to me as well is that public policy needs to address the fundamental governance issues of our pension and institutional investment systems
- It's clear that on important issues such as environmental, social and governance issues, that pension plan members have little power in shaping the policies of their plans
- It's important that this lack of democracy in these institutions become a critical part of financial sector public policy in the future

Future Directions

- I'd like to use the last few remaining minutes of my presentation to sketch out some directions in public policy that we've been working on at the SIO in the last few years
- I'd also like to take this opportunity to announce that SIO will be working with the Pensions at Work Project to compile an international inventory of public policy on responsible investment. This report will look at major policy initiatives around the world, and analyse how Canada ranks in terms of the emerging global policy environment.
- We are hoping to have this report completed by June with a preliminary presentation on our findings at the next SIO conference in Montreal in May of 2007.
- Some of the themes I'd like to talk about now will be in this report.
- First, in terms of pensions, I'm sure many or all of you are aware of our Right to Know Campaign – which is a campaign promoted by the federal consultation on defined benefit pension funds launched last year

- We don't deny that funding issues – all of the controversial rules establishing the viability of our sometimes precarious pension plans – are the most important issue currently confronting the pension system
- But we also feel that the preoccupation with funding issues – to the expense of investment issues – is simply dealing with the immediate crisis of the system, without addressing the longer-term issues of investment risk and return
- We also feel that the government's consultation paper fails on the critical test of accountability to plan members – and does not provide adequate transparency on the critical issues of environmental, social and governance policies, or proxy voting
- That's why the SIO – as part of this consultation – has called for UK-style regulations to require pension plans to report to their members on their environmental and social investment policies
- We've also gone a step further, and are calling on federal regulators to require pension plans to make public how they vote their shares
- These echo similar recommendations that we made to the Canadian Association of Pension Supervisory Authorities on defined contribution plans and other capital accumulation plans
- Because most plans are within provincial jurisdiction, the federal consultation only affects a minority of plans in Canada, but we feel that these changes would help launch new attitudes toward responsible investment by trustees
- We also feel that these measures would help to empower pension plan members in asking for information on responsible investment from their trustees and administrators
- Just as institutional investors are demanding greater governance accountability from corporations in the last few years, SIO believes that investment institutions themselves need to figure out ways of becoming more accountable to the investors whose money they manage

- This is why we have successfully pressed for new mutual fund rules that will require mutual funds to report on their proxy voting records. Starting this fall, Canadian mutual funds – for the first time – will be required to disclose how they have voted their shares on all shareholder proposals that have come before them in the last year.
- Thanks to funding from Institutional Shareholder Services, SIO will be tracking this data and will be compiling an analysis late in 2006 or early next year
- Let me also briefly tell you about some of the other public policy initiatives that we have taken. We believe that increased corporate disclosure on environmental, social and governance factors is absolutely essential for investors to properly evaluate companies on non-financial factors.
- Increasingly, the SRI industry feels that we're only getting half the picture under current corporate disclosure rules – there is lots of financial information, but very little social and environmental disclosure
- We have been very interested in the reform of accounting guidelines, such as the Canadian Institute of Chartered Accountants guidelines on Management's Discussion and Analysis – encouraging the CICA to incorporate non-financials into MD&A guidance. CICA is also developing specific guidance on issues such as climate change – and we encourage CICA to become much more specific in the kinds of ESG risk to be included in annual reports.
- Similarly, we have called on the Canadian Securities Administrators – the umbrella organization for Canadian securities commissions – to require much fuller disclosure of social and environmental policies and risks
- We have also called for new forms of corporate governance that would embed social and environmental perspectives into the oversight and direction of corporations – by making audit committees responsible for social and environmental reports, for example
- Finally, SIO has been doing some very preliminary work with a group of environmental organizations called the Green Budget Coalition on the issue of sustainable investment and taxation

- We know that tax rules are often an important driver of investment decisions, so we want to ensure that Canada has a tax system that at the very least levels the playing field between fossil fuels and alternative energy, if not actually promoting alternative energy
- These are the kinds of issues that we want to look at in the coming year, and we appreciate the opportunity of working with Pensions at Work to make this happen
- Overall, our view on public policy is that we want to pursue public policy that is supportive of the responsible investment industry, but that also fulfills a larger public purpose
- We believe that if Canadians are given a real opportunity to choose between responsible investments and conventional investments – an opportunity through their pension plans, mutual funds and personal investments – that they will choose responsible investments
- We believe that the key is to empower investors
- By requiring corporations to improve their social and environmental disclosure
- By requiring pension funds and mutual funds to provide their unitholders and plan members with more information on their social and environmental policies, and their voting records
- And helping to create a tax system that levels the playing field between industries of the past and industries of the future
- We believe these measures will certainly help the SRI industry – our members have a competitive advantage already in these activities
- But they will also have untold benefits for our economy and society by using the levers of the capital markets to encourage companies to take responsibility for the social and environmental costs of their operations. These measures will also help to reward companies that are leaders in their industries on social and environmental issues.
- That's why governments are showing interest in this area of public policy. They are beginning to understand the larger policy goals that responsible investment can help to achieve.

- Thanks again for the opportunity to let me talk to you about this topic today