



SOCIAL INVESTMENT ORGANIZATION

The Canadian Association for Socially Responsible Investment

184 Pearl St. 2nd floor
Toronto, Canada M5H 1L5
416-461-6042 t
416-461-2481 f
www.socialinvestment.ca

November 10, 2008

Bill Black, Chair, Pension Review Panel
c/o Department of Labour and Workforce Development
Policy Division
PO Box 697
Halifax, NS
B3J 2T8

Dear Mr. Black:

Re: Brief to the Nova Scotia Pension Review Panel

I am writing on behalf of the members of the Social Investment Organization, the national association for socially responsible investment. Our members include about 40 investment funds, financial institutions, investment consultants, asset managers, credit unions, and institutional investors, as well as more than 100 investment advisors across Canada. Our members serve more than a million Canadian depositors and investors.

With this letter, we are responding to your request for comments on issues regarding pensions in Nova Scotia. We welcome the opportunity to contribute to this debate and give you permission to post this brief on your website.

On behalf of our members, who manage billions of dollars of retirement savings for Canadians, we want to confine our remarks in this brief to investment issues. In this brief, we make some specific recommendations for regulations that would help to provide a higher level of transparency to plan members on the investment policies and practices of their pensions.

Environmental, social and governance (ESG) factors in investment

There is a growing consensus in the investment community that environmental, social and governance (ESG) factors are an important component of prudent risk management and a source of portfolio value. The emerging view is that investment fiduciaries must incorporate ESG analysis in order to ensure that they are meeting the highest standards of due diligence. Yet, in spite of the evidence about the importance of social and environmental factors, and the growing responsibility of fiduciaries to account for ESG factors, pension plan members still have no access to information on how their plans incorporate – or fail to incorporate – such strategies. This is an important deficiency in pension plan accountability and transparency.

The current financial crisis in world capital markets has been caused, in part, by lack of attention to ESG factors. As we now know, the widespread use of collateralized debt obligations and credit default swaps with poor underlying asset quality was a root cause of the recent failure of financial markets. While inadequate financial risk controls were certainly a part of the failure, it is also essential to understand that investment banks and financial advisors selling these instruments were not aware of the social risks of these instruments. The capital markets did not consider and price-in the social risk posed by borrowers of sub-prime and predatory loans under significant economic and interest rate pressure. Some SRI investors – including faith-based investors motivated by the issue of poverty – as well as SRI research firms had identified this risk, but their warnings were not widely disseminated to analysts, rating agencies and investment advisors.

This is a concrete example of the potential consequences of lack of attention to ESG factors. But there is also a growing body of evidence indicating that long-term investment returns can be enhanced through the incorporation of non-financial criteria.

For example, numerous socially responsible stock indexes, including the Domini Social Index in the US (www.kld.com) and the Jantzi Social Index (www.jantziresearch.com) in Canada, have matched or outperformed their conventional benchmarks.

Research studies have also found that there is no sacrifice for investing in a socially responsible way. In fact, some research has found that attention to climate change and other ESG factors can result in portfolio outperformance. In October 2007, Mercer and the Asset Management Working Group (AMWG) of the United Nations Environment Program Finance Initiative released a major analysis of 20 academic and 10 broker studies on the issue of SRI and financial performance. The analysis, entitled *Demystifying Responsible Investment Performance* (http://www.unepfi.org/fileadmin/documents/Demystifying_Responsible_Investment_Performance_01.pdf), found that 10 of the 20 academic studies established a positive relationship between ESG factors and performance. Two of the studies concluded that the relationship is neutral-positive, while four indicated a neutral relationship, one established a neutral-negative relationship, and three discovered a negative relationship. Of the 10 broker studies, three yielded a positive relationship; the rest were neutral.

Clearly, the traditional view that attention to ESG factors will result in negative performance is not correct. In fact, there is some evidence to show that such strategies will reduce risk and enhance return.

Furthermore, the legal environment for investment fiduciaries on the consideration of ESG factors is rapidly changing. The traditional view of the legal community is that consideration of strictly “non-financial” factors in investment analysis is not permissible, and may even leave fiduciaries open to liability. However, just in the last three years, the legal consensus has changed dramatically.

A comprehensive legal analysis published in 2005 conducted by the prestigious UK law firm of Freshfields Bruckhaus Deringer found the traditional consensus to be untrue. The study found that, contrary to widespread belief that incorporation of ESG factors is prohibited by fiduciary obligation, the law permits the integration of ESG issues and, arguably, requires such integration. (http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf)

ESG and pension policy

Around the world, numerous jurisdictions are recognizing the importance of ESG integration. Governments and securities commissions are coming to the view that SRI disclosure represents an important new form of consumer protection for investors and pension plan members.

In July 2000, the UK Pensions Act was amended to require trustees of occupational pension plans to disclose their policy on socially responsible investment as part of their Statement of Investment Principles (SIP). Before this amendment, pension fund trustees were under no obligation to inform their members of their SRI stance. Since then, France, Germany, Belgium and Sweden have adopted similar regulations.

Pension plan members have a vital interest in knowing that their pension plans are being properly managed – including knowledge of the important long-term non-financial factors that could increase the risk to their pension assets or future added value. Pension plan members have a right to access such information.

We also believe that investment committees, administrators and managers of pension funds would be prompted to review their investment policies if such disclosure was required. Such a review would help to bring all pertinent long-term investment policies under consideration, leading to stronger investment policy-making.

Proxy Voting Policies and Records

Many institutional investors – including a substantial number of pension funds – fail to understand the importance of their power as shareholders. In spite of direction from federal regulators, many pension funds fail to vote their shares, or routinely support management on shareholder resolutions. According to two studies of major Canadian mutual fund companies conducted by the Social Investment Organization (<http://www.socialinvestment.ca/documents/ProxyVoting.pdf>) and the Shareholder Association for Research and Education and FundVotes (http://www.share.ca/files/MutualFund_Voting_Report_0607.pdf), the majority of mutual fund companies vote with management on significant shareholder proposals. While no equivalent study has been done on Canadian pension fund proxy voting, we suspect the results would be similar to the mutual fund industry.

The Canadian Securities Administrators (CSA) have recognized the principle that proxy voting is an important part of good asset management by mutual funds, and that mutual funds have a fiduciary duty to vote their assets on behalf of their unitholders. Further, the CSA has determined that unitholders have a right to know what policies are being used to determine how these votes are cast, and have a right of access to the records of these votes to determine for themselves whether the funds are following their policies. In the CSA's National Instrument 81-106 and Companion Policy 81-106CP, the CSA established new rules requiring mutual funds to disclose their proxy voting policies, and to keep records on how they have voted their shares in the companies held in their portfolios, and that they provide these records to unitholders. These rules are similar to rules put in place for US mutual funds and investment advisors by the Securities and Exchange Commission.

In Canada, according to the *Guideline for the Development of Investment Policies and Procedures for Federally Regulated Pension Plans*, published by the Office of the Superintendent of Financial Institutions, proxies are to be considered important plan assets. The Guideline states:

Plan administrators should not ignore the value of voting rights acquired through plan investments... Failure to describe in the investment policy how these rights will be used leaves plan administrators open to charges of either negligence or arbitrary action, possibly in violation of the standard of care requirement. Investment policies should describe and require the use of voting rights, whether directly or through proxy.

(Section 1.6.6, Appendix 1, endnote 4, Guideline for the Development of Investment Policies and Procedures for Federally Regulated Pension Plans, OSFI)

Our members believe that it is important to have full transparency across all institutional investors. The fiduciary duty that pensions have to cast their votes appropriately is only meaningful if it is accountable, and the accountability mechanism is through the trustees that oversee the plans. Without disclosure of voting policies and records, pension plan members and their trustees have no way of knowing if plans are in fact acting according to their fiduciary duty when voting their shares. Transparency on voting policies and records is essential.

Recommendations

The SIO has two broad recommendations. We recommend that Nova Scotia Pension Benefits Regulations be amended to provide information to plan members on the extent that environmental, social and governance considerations are taken into account in the investment management process; and to require pension funds to disclose their proxy voting policies and records directly to plan members upon request, or publicly through their websites.

1. ESG Disclosure

Specifically, we recommend that pensions under regulations of the *Nova Scotia Pension Benefits Act* be required to include “a statement on the extent (if at all) to which environmental, social and governance (ESG) issues are taken into account in the selection, retention and management of investments, including the policies of the pension fund with regard to the voting of its proxies.”

Such a statement would require trustees to consider their ESG and proxy voting policies and, if they choose to adopt such policies, to include them in the statement of investment policies and procedures (SIPP). If no such policies are adopted, the SIPP would have to note this.

Furthermore, we recommend that disclosure of the ESG and proxy voting provisions of the SIPP, and, in fact the SIPP itself, should be made available to members through the internet. The SIPP should be available on the website of each pension plan. If plans do not have websites, they should be required to provide their SIPPs to plan members on request.

2. Proxy Voting Policies and Records

In terms of proxy voting and policies, we recommend that the pension administrator or a manager delegated by the administrator be required to keep records on the voting of proxies on all shareholder votes in which the pension plan would receive materials as a securityholder. The records would include information on the name of the company, a description of the matter voted and whether the pension plan voted its shares for or against or abstained on the proposal.

We recommend that pension funds be given the choice of providing records on request or through their websites to discourage frivolous requests, to aid in fuller disclosure and to reduce the waste of paper. The costs of this proposal are minimal given the fact that pensions are already under a fiduciary duty to vote their holdings on behalf of plan members. Whatever mechanisms are already in place to ensure due diligence in the voting process will not change under our proposal. Pension funds will simply be required to report to their members about their policies and their voting records.

For pension funds that are not now voting their shares, or are routinely voting with management, these recommendations may lead to some additional costs. However, such pension funds are now operating outside of current best practices on fiduciary duty and need to update their proxy voting activities in any case.

Conclusion

Our proposals would ensure that pension funds regulated under the Nova Scotia Pension Benefits Act would be required to disclose whether they take into account critical long-term, non-financial factors into their risk management and value-added strategies. Proxy voting disclosure would require pension funds to review their policies on their voting obligations, to keep records on their votes and to disclose those records to their plan members.

We have made similar recommendations to the federal consultation on defined-benefit pension plans that was held in 2005, and the Ontario Expert Commission on Pensions. We are hopeful that these jurisdictions will adopt similar rules at some time in the near future, and believe that federal-provincial harmonization of such policies would be in the national interest.

Such disclosure would provide important new information to plan members about the long-term management of their pension assets. As well, it would provide a level of transparency that would enhance the practice of ESG assessment and proxy voting through the investment community in Canada. This would result in better risk management in the future and improve long-term pension fund returns.

Sincerely,



Eugene Ellmen
Executive Director