A LEGAL FRAMEWORK FOR IMPACT

CANADA
INTEGRATING SUSTAINABILITY GOALS ACROSS THE INVESTMENT INDUSTRY

February 2023
Disclaimer

The information contained on this document is meant for the purposes of information only and is not intended to be investment, legal, tax or other advice, nor is it intended to be relied upon in making an investment or other decision. All content is provided with the understanding that the authors and publishers are not providing advice on legal, economic, investment or other professional issues and services. PRI Association (UNEP FI, and the Generation Foundation as project partners) are not responsible for the content of websites and information resources that may be referenced. The access provided to these sites or the provision of such information resources does not constitute an endorsement by PRI Association, UNEP FI, and the Generation Foundation of the information contained therein, PRI Association, UNEP FI, and the Generation Foundation are not responsible for any errors or omissions, for any decision made or action taken based on information on this document or for any loss or damage arising from or caused by such decision or action. All information is provided “as-is” with no guarantee of completeness, accuracy or timeliness, or of the results obtained from the use of this information, and without warranty of any kind, expressed or implied.

Content authored by PRI Association, UNEP FI, and the Generation Foundation

For content authored by PRI Association (UNEP FI, and the Generation Foundation as project partners), except where expressly stated otherwise, the opinions, recommendations, findings, interpretations and conclusions expressed are those of PRI Association (UNEP FI, and the Generation Foundation as project partners) alone, and do not necessarily represent the views of any contributors or any signatories to the Principles for Responsible Investment (individually or as a whole). It should not be inferred that any other organisation referenced endorses or agrees with any conclusions set out. The inclusion of company examples does not in any way constitute an endorsement of these organisations by PRI Association or the signatories to the Principles for Responsible Investment, UNEP FI, or the Generation Foundation. While we have endeavoured to ensure that information has been obtained from reliable and up-to-date sources, the changing nature of statistics, laws, rules and regulations may result in delays, omissions or inaccuracies in information.

Content authored by third parties

The accuracy of any content provided by an external contributor remains the responsibility of such external contributor. The views expressed in any content provided by external contributors are those of the external contributor(s) alone, and are neither endorsed by, nor necessarily correspond with, the views of PRI Association or any signatories to the Principles for Responsible Investment, UNEP FI, or the Generation Foundation other than the external contributor(s) named as authors.

Map disclaimer

The designations employed and the presentation of the material on this map do not imply the expression of any opinion whatsoever on the part of the PRI concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries. Every effort is made to ensure this map is free of errors but there is no warrant the map or its features are either spatially or temporally accurate or fit for a particular use. This map is provided without any warranty of any kind whatsoever, either express or implied.
## CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>EXECUTIVE SUMMARY</td>
<td>5</td>
</tr>
<tr>
<td>KEY TERMS</td>
<td>6</td>
</tr>
<tr>
<td>THE CASE FOR SUSTAINABILITY IMPACT GOALS</td>
<td>8</td>
</tr>
<tr>
<td>SUMMARY LEGAL ANALYSIS</td>
<td>11</td>
</tr>
<tr>
<td>THE CASE FOR POLICY REFORMS</td>
<td>13</td>
</tr>
<tr>
<td>POLICY RECOMMENDATIONS</td>
<td>14</td>
</tr>
</tbody>
</table>
ACKNOWLEDGEMENTS

We thank Osler, Hoskin & Harcourt LLP for the legal review of this document.¹

We are also grateful for the support and assistance of investment industry leaders and senior representatives of non-governmental organisations with expertise in a broad range of relevant subject areas. In particular, we would like to thank our project partners – the United Nations Environment Programme Finance Initiative and the Generation Foundation – and our signatories who have provided valuable input for this policy report.

- Amr Addas
- Jesica Andrews
- Maria Elena Anker
- Tanya Carmichael
- Caisse de dépôt et placement du Québec
- Grace Eddy
- Delaney Grieg
- Laxmi Kumar
- Will Martindale
- Mark Miness
- Brian Minns
- Andrea Moffat
- Alison Paton
- Julie Segal
- Rosalie Vendette
- Ed Waitzer

¹ The document was reviewed by Andrea Boctor, Partner and Chair of Pensions and Benefits, and Jon Wypych, Associate in Pensions and Benefits.
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. As a result, there has been a dramatic increase in sustainable finance policy reforms around the globe, intended to align financial flows with sustainability goals. Still, most investors and other financial actors are not yet playing their full role in addressing evolving sustainability challenges.

The extent to which legal frameworks enable investors to do so is examined in a 2021 report, A Legal Framework for Impact (LFI), authored by Freshfields Bruckhaus Deringer and commissioned by the PRI, the United Nations Environment Programme Finance Initiative and the Generation Foundation.

The report finds that in the 11 jurisdictions analysed, including Canada, investors are broadly permitted to consider working towards positive sustainability impacts where this would contribute to their financial return objectives. Specifically, the extensive legal analysis concludes that:

- financial return is generally regarded as the primary purpose for investors;
- investors generally have a legal obligation to consider pursuing sustainability impact goals where that can help pursue their financial objectives;
- in some circumstances, investors can pursue sustainability impact goals for reasons other than achieving financial return goals (i.e., as an ultimate end);
- investors are legally required to pursue improved sustainability impacts if the objective of the financial product obliges them to do so.

The LFI report finds that Canadian law does permit and may even require investors to consider pursuing positive sustainability impacts – or investing for sustainability impact – as a way to achieve financial returns and protect financial value (so-called instrumental IFSI2), though Canadian law limits the pursuit of positive sustainability impacts as an end in itself (ultimate ends IFSI3).

Our own analysis shows that many Canadian investors may be interpreting their legal duties in ways that discourage them from considering sustainability impact goals, even where pursuing such goals can help them discharge their duty to achieve financial returns. Others may be reluctant to change established practices and allocate resources to the pursuit of sustainability impact goals.

The main reason for this lies in a lack of legal clarity about investors’ duties and insufficient action by policy makers to encourage and enable responsible investment, rendering Canada a low-regulation jurisdiction by international standards. For example, sustainability-related reporting and disclosure of stewardship activities by Canadian investors remain overwhelmingly voluntary. Making these disclosures mandatory could result in greater awareness of ESG factors among investors and deeper engagement with investee companies.

Building on the LFI report, this paper argues that policy changes are required if investors are to contribute fully to Canada’s long-term environmental and social sustainability. We examine the relevant aspects of the Canadian legal and regulatory framework and identify areas where more clarity and guidance are needed.

We then recommend reforms that would enable investors to consider sustainability risks and pursue sustainability impact goals, in particular where these are relevant to financial returns. A number of our recommendations are based on the Final Report of Canada’s Expert Panel on Sustainable Finance.

Our proposals include suggested changes to legal duties – due to the complexity of the Canadian legal framework, we make recommendations specific only to pension funds. Other recommendations in this paper apply to all institutional investors.

**POLICY RECOMMENDATIONS**

1. Clarify when sustainability impacts can or must be considered by pension administrators in discharging their legal duties
   - Clarify in which cases fiduciary duties permit or require pension administrators to consider pursuing sustainability impact goals
   - Introduce implementation requirements and guidance regarding sustainability risks and impacts

2. Facilitate consideration of climate-related risks and opportunities via legislation and regulatory guidance

3. Introduce sustainable finance tools that enable investing for sustainability impact
   - Sustainable finance taxonomy
   - Stewardship
   - Sustainability-related disclosures

4. Explore measures to encourage consideration of retail investors’ views

---

2 See Box 1 for further details.
3 See Box 1 for further details.
4 PRI (2022), Review of trends in ESG reporting requirements for investors (p.22-23)
The following key terms are used in this report:

- **Sustainability factors**: a catch-all term for sustainability impacts and sustainability risks.
  - **Sustainability impacts**: the impacts of investors’ actions on the environment and society. These impacts manifest themselves as the sustainability impacts of investments and can be positive or negative. Positive sustainability impacts are those aligned with global sustainability goals, such as the goals of the Paris Agreement and the UN Sustainable Development Goals (SDGs), as well as with the UN Guiding Principles on Business and Human Rights and the International Bill of Human Rights.
  - **Sustainability risks**: sustainability-related threats to investments’ financial performance, such as those arising from climate change and social unrest.
  - **Sustainability impact goals**: goals set by investors to achieve positive sustainability impacts through their investments.
  - **System-level risks**: a catch-all term for systematic risk and systemic risk, both of which have implications for investment performance.
    - **Systematic risk**: risk, transmitted through financial markets and economies, that affects aggregate outcomes, such as broad market returns. The term is interchangeable with “market risk” or “market-wide risk”. Because systematic risk occurs at a scale greater than a single company, sector or geography, it cannot be hedged or mitigated through diversification. One example of a sustainability-related systematic risk is the risk of reduced global economic growth due to sustained physical impacts of climate disruption; another is the opportunity cost associated with failing to meet the SDGs.
    - **Systemic risk**: the risk that an event at a particular point in time or a chronic economic condition destabilises the financial system or leads to its collapse. An example of a systemic risk materialising would be a number of “too-big-to-fail” financial institutions defaulting on obligations to their creditors or investors. An example of a sustainability-related systemic risk would be a sudden repricing of assets across the fossil fuel sector, resulting in cascading defaults that destabilise financial markets – this is sometimes referred to as a potential “climate Minsky moment”.

---

**KEY TERMS**
A Legal Framework for Impact, a report published by Freshfields Bruckhaus Deringer in 2021 and commissioned by the PRI, the United Nations Environment Programme Finance Initiative and the Generation Foundation, introduced the concept of “investing for sustainability impact”. The concept is not a legally defined expression and is not used in the report as a term of legal art. Instead, it is used in the report’s legal analysis to catch, broadly, any activities that involve an investor intentionally attempting (through investment decisions, stewardship or engagement with policy makers) to bring about assessable behaviour changes among investee companies, policy makers or other third parties aligned with positive sustainability outcomes.

The report distinguishes between two types of investing for sustainability impact based on the investor’s objectives:

- **instrumental investing for sustainability impact**, where achieving the relevant sustainability impact goal is “instrumental” in realising the investor’s financial return objectives;
- **ultimate ends investing for sustainability impact**, where achieving the relevant sustainability impact goal is a distinct goal, pursued alongside the investor’s financial return objectives but not wholly as a means of achieving them.

**Figure 1: Investing for sustainability impact (IFSI). Source: Adapted from the Legal Framework for Impact report**

**Investing for sustainability impact** involves a perspective and a set of practices that extend beyond traditional impact investing. Impact investing has tended to mean directing funds towards activities that have a specific sustainability goal and which would not exist without that targeted capital. In contrast, **investing for sustainability impact** involves investing in larger, more mature and diversified businesses and pursuing relevant sustainability impacts, with an emphasis not just on capital allocation but on stewardship and policy engagement as well.

Traditionally, impact investing has been conducted through specialist impact investing funds or strategies, whereas **investing for sustainability impact** is increasingly seen as a core investment approach that can be applied to broader portfolios. Still, impact investing is an example of one action institutional investors might take in a broader investment approach to achieve sustainability impact goals.
THE CASE FOR SUSTAINABILITY IMPACT GOALS

GLOBAL CONTEXT
The world is facing environmental and social emergencies – for example, the crossing of planetary boundaries – which pose material risks to the basic quality of life for current and future generations.

Alongside climate change and biodiversity loss, social issues such as human rights, modern slavery, working conditions, and diversity, equity and inclusion are gaining prominence. The COVID-19 pandemic has exacerbated existing economic inequalities, increased economic insecurity, disrupted supply chains and caused global educational crises. Over time, all of these issues will affect social stability, economic performance and, therefore, investors' financial returns.

Governments are taking action to address these sustainability challenges. All countries in the world have now joined the Paris Agreement, which lists among its main aims aligning finance flows with a shift towards low greenhouse gas emissions and climate-resilient development. A likely acceleration of policy responses by governments and international bodies to climate change and related sustainability issues, such as a just transition and biodiversity loss, could increase investment risk for those who remain unprepared, while creating opportunities for those who have positioned themselves to benefit from the policy actions.

Investors have been drawn into the growing efforts to tackle sustainability challenges through a wave of sustainable finance regulation, at both the national and multilateral levels. But investors themselves are increasingly concerned by the threats that social and environmental crises pose to economies and are facing calls for action from clients and beneficiaries. As a result, there has been a significant rise in responsible investment activity in recent years. However, responsible investment practices still need to be adopted much more widely, across a greater share of investments and with the specific intention to reduce the negative impacts of investment activities and achieve positive outcomes for society and the environment.

SYSTEM-LEVEL RISKS AND FINANCIAL MARKETS
The World Economic Forum has identified inaction on climate change, human-induced environmental damage, biodiversity loss, erosion of social cohesion and livelihood crises as some of the most severe global risks. Similarly, the International Corporate Governance Network has stated that environmental risks (such as climate change, water scarcity and pollution), social risks (including human rights violations and income inequality) and governance risks (such as corruption) pose significant systemic threats to the stability of the global financial system.

Institutional investors, tasked with securing long-term financial returns, have a responsibility to consider whether such system-level risks are relevant to their ability to meet their legal obligations and objectives and, if so, how they can mitigate these threats. Reduced system-level risks – which can be referred to as “better beta” – could improve financial outcomes over the long term.

Diversification, a core tenet of the popular modern portfolio theory, does not address such risks to investors’ portfolios. A more effective approach investors might take is to work towards improving the sustainability impacts of their investments (or to invest for sustainability impact in the terminology of this report). They can do this through investment decisions, stewardship and engagement with policy makers, acting individually as well as in collaboration with other investors.

---

5 See the United Nations Treaty Collection.
6 See the Inevitable Policy Response project.
7 See the PRI’s regulation database.
8 The PRI’s recent actions in support of responsible investment include the launch of Advance, an initiative facilitating collaborative stewardship by institutional investors on social issues and human rights.
9 World Economic Forum (2022), The Global Risks Report 2022
10 International Corporate Governance Network (June 2019), Investor Framework For Addressing Systemic Risks
12 Hawley, J., Lukomnik, J. (2019), Modernising modern portfolio theory.
Many investors are already taking this approach. One example is more ambitious stewardship driven by sustainability concerns. As noted in the Legal Framework for Impact report, the global Climate Action 100+ initiative, led by investors, is increasingly focusing on the outcomes of companies’ decarbonisation commitments. A number of its investor members are also setting emission reduction targets for their investee companies. A similar Canadian initiative, Climate Engagement Canada, was launched in October 2022. Its aim is to promote a socially just transition to a net-zero economy by engaging with the country’s top corporate emitters. Investors that engage with investees in order to address the financial threats arising from climate change are likely practising instrumental investing for sustainability impact (IFSI).

CANADIAN CONTEXT

A failure to mitigate climate change will come at a cost to Canada’s economy. That cost ranges from $2.773 trillion in lost GDP between 2015-2100 under 2°C warming to $5.520 trillion under a 5°C temperature rise, according to an April 2022 report by the Institute for Sustainable Finance and Queen’s University.

At the same time, as a country rich in oil, coal and natural gas, Canada faces particular challenges in the transition to a net-zero economy compared with its G7 peers. Its CO2 emissions per capita are the highest among G7 nations and, since Canada signed the Paris Agreement in 2016, its overall emissions have actually risen. While Canada’s economy is largely based on services, the extractive industry has an outsized influence over the government.

Still, Canada has started taking steps to address climate change. As required under the Paris Agreement, the Canadian Net-Zero Emissions Accountability Act has set legally binding emission reduction targets, although reaching these is made harder by lavish exemptions from the country’s carbon tax. The federal government has also established the Net-Zero Advisory Body, an independent group of experts tasked with advising the government on ways to achieve net-zero emissions by 2050.

For its part, Canada’s prudential regulator, the Office of the Superintendent of Financial Institutions (OSFI), has stressed the need for “sound climate risk management” in the country’s financial system.

FINANCIAL AND NON-FINANCIAL FACTORS

It has become common in discussions about the role of sustainability factors in investment decision-making to assess whether they are “financial” or “non-financial”.

Deciding whether a particular sustainability factor is financial or not is not always easy, and the financial relevance of at least some sustainability factors is not universally understood. For example, a factor traditionally seen as non-financial may have an impact on an investee company’s reputation, business model or governance and thus its value – and therefore could be considered a financial factor. In fact, the key question for an investor is whether a given factor has a bearing on its investment objectives, defined in accordance with applicable law and which are likely to be financial but may also include other objectives. From that perspective, the issue is not simply whether the factor is “financial” but whether it is relevant to achieving the investment objectives. Sustainability factors should therefore be considered based on their relevance to the investor’s proper purpose.


14 Climate Engagement Canada (October 2021). Financial community launches Climate Engagement Canada to promote a just transition to a net-zero economy

15 The Legal Framework for Impact report explains: “What is a proper purpose will be shaped by the terms of the particular investment arrangement, and especially the investment objectives that the asset owner or investment manager is legally required or permitted to pursue.”

16 The losses are the result of physical damage caused by climate change. To project Canada’s GDP, the authors used a model that incorporates capital, productivity and population. See data from the World Bank.

17 The Commissioner of the Environment and Sustainable Development, and the Auditor General of Canada (2021). Lessons Learned from Canada’s Record on Climate Change

18 For example, in 2019 The Narwhal reported that industry and related groups, primarily from the oil and gas industry, met with government officials 945 times over a 12-month period to discuss Bill C-69, which introduced new rules on environmental impact assessments. In contrast, environmental and Indigenous groups accounted for only 69 meetings in total.

19 The Office of the Honourable Rosa Galvez (2022), White Paper: Aligning Canadian Finance with Climate Commitments (p.18-19)

20 Corporate Knights (2022), Canada’s biggest emitters are paying the lowest carbon tax rate

21 Office of the Superintendent of Financial Institutions (June 2022), Remarks by Superintendent Peter Routledge at the Responsible Investment Association Virtual Conference, June 7, 2022
However, Canada still lacks the kind of economic policies that would signal to investors its long-term commitment to an equitable transition to a low-carbon economy. It also lacks a comprehensive sustainable finance policy that would enable investors to manage the risks and opportunities arising from climate change and contribute to national sustainability objectives.23

Managing these risks and opportunities, as well as other sustainability risks, is an integral part of the duties that long-term institutional investors owe their clients and beneficiaries. Such investors must act as responsible stewards of capital and generators of sustainable financial returns within social and planetary boundaries. Therefore, Canada's policies should enable institutional investors to take into account not only the traditional risk and return, but also the sustainability impacts of their investments. Canadian investors should be able to consider how their individual and collective actions can lead to positive, assessable changes in the behaviour or circumstances of investees. This, in turn, can reduce system-level risks, creating conditions for greater economic stability and boosting financial performance over the long term.

23 The PRI classifies Canada as a low-regulation jurisdiction in the August 2022 report, Review of trends in ESG reporting requirements for investors.
The Canada section of the Legal Framework for Impact (LFI) report examines the common law and statutes (or civil law in Quebec) relevant to investor decision-making and which are in force as of 31 January 2021.

Box 2: Relevant Canadian regulators, government departments, umbrella organizations and self-regulatory bodies

**FEDERAL BODIES**
- Office of the Superintendent of Financial Institutions
- Canadian Securities Administrators
- Canadian Association of Pension Supervisory Authorities
- Investment Industry Regulatory Organization of Canada
- Mutual Fund Dealers Association of Canada
- Department of Finance Canada

**PROVINCIAL BODIES**
- Alberta Superintendent of Pensions
- Ministry of Treasury Board and Finance (Alberta)
- Alberta Securities Commission
- Alberta Superintendent of Insurance
- Financial Institutions Commission (British Columbia)
- British Columbia Securities Commission
- Pension Commission of Manitoba
- Manitoba Securities Commission
- Financial Institutions Regulation Branch (Manitoba)
- Financial and Consumer Services Commission (New Brunswick)
- Consumer and Financial Services Division (Newfoundland and Labrador)
- Pension Benefit Standards Division (Newfoundland and Labrador)

Canada is composed of 10 provinces and three territories; lawmaking is shared across federal, provincial and territorial jurisdictions, resulting in a complex regulatory landscape.

The LFI report concludes that Canada’s legal framework limits investors’ ability to pursue positive sustainability impacts as a distinct goal (ultimate ends IFSI) but does permit and in some circumstances likely require investors to consider pursuing such impacts as a means to achieve financial returns and protect financial value (instrumental IFSI). For example, in relation to pension funds, the LFI report states: “Where wider societal objectives are relevant to the administrator’s stated financial objectives, they must be considered.”

In relation to asset owners more broadly, the report also says they should monitor and manage the financial risks generated by the negative sustainability impacts of their investments.

Below are the key findings from the Canada section of the LFI report, supplemented by additional legal analysis commissioned as part of the LFI project.

---


PENSION FUNDS

The analysis in the LFI report is focused on those Canadian pension plans where investments are directed by administrators (who retain ultimate responsibility for the investment of plan assets and must monitor and evaluate the investment manager).

Canada’s pension standards legislation does not expressly prohibit or permit investing for sustainability impact, but considering sustainability factors and pursuing sustainability impact goals are actions compatible with pension plan administrators’ statutory and common law duties where such factors are relevant to the fund’s financial performance/where such pursuit can improve financial performance. The LFI report confirms that it is “well-established” in Canadian law and practice that asset owners may take into account ESG factors in their investment decisions where relevant to fund performance and that such factors are increasingly viewed as relevant. Moreover, failing to consider ESG factors that may be potentially material to a given pension fund’s financial performance could be a breach of fiduciary duties, according to a draft guideline issued by the Canadian Association of Pension Supervisory Authorities (CAPSA) in June 2022.

Pension administrators owe fiduciary duties to plan beneficiaries under common law. They also have statutory duties akin to fiduciary duties under the relevant pension standards legislation. These statutory duties include a standard of care known as the “prudent person” standard.26

The standard means that investment decisions (on investment strategy, asset allocation, stewardship and policy engagement) must be made with consideration given to the overall risk in the investment portfolio.

Common law fiduciary duties and some pension legislation also exact a duty of loyalty and a duty to invest plan assets in the best interests of the plan’s beneficiaries. In the case of pension funds, the ruling in the case of Cowan v. Scargill (issued well before climate change became a global concern) has been interpreted to mean – and at least one Canadian statute explicitly states – that the “best interests” of beneficiaries are “financial best interests”. However, it is increasingly understood in public discourse that fiduciaries acting in the best interests of beneficiaries should also consider the preservation of social and environmental systems relevant to the quality of life for present and future beneficiaries upon retirement.27

MUTUAL FUNDS

The analysis in the LFI report covers the most common type of regulated mutual funds in Canada and excludes alternative mutual funds, exchange-traded mutual funds, as well as other retail investment funds and quasi-retail funds, such as closed-end funds, flow-through funds, labour sponsored investment funds, scholarship plans and private mutual/investment funds.

Every mutual fund must have an investment fund manager, and fiduciary duties are generally owed by the investment fund manager to the fund rather than to individual fund beneficiaries/unitholders. Investment fund managers are generally not subject to a duty to invest for sustainability impact, but where sustainability risks are financially material it may be appropriate for managers to consider investing for sustainability impact. A mutual fund is legally required to invest for sustainability impact where the fund’s marketing states that its investment objectives include pursuing sustainability impact goals. Where IFSI investments align with duties of mutual funds that are not marketed as investing for sustainability impact, these investments are permissible as long as sustainability impact goals do not take precedence over financial returns. The LFI report also finds that passive or quantitative investment strategies may not be compatible with any duty to consider non-financial factors.

INSURERS

Insurance companies/societies are subject to a statutory “prudent person” standard28 in relation to the investment of their assets, but they are not fiduciaries to their policyholders nor obliged to assess their views. Unless policy terms are specifically related to investing for sustainability impact, there is no obligation to prioritise sustainability objectives alongside or over financial objectives. Under the Insurance Companies Act, large insurers must publish annually a Public Accountability Statement to communicate their contribution to wider societal objectives in Canada, such as community development, but this does not require investing for sustainability impact.

---

26 The LFI report states that the standard requires a pension administrator to apply the level of prudence in dealing with pension assets as one would apply in dealing with the property of another.
28 Under the Insurance Companies Act, federally incorporated insurers and foreign branches must “adhere to investment and lending policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments and loans to avoid undue risk of loss and obtain a reasonable return”. Similar requirements apply to provincially incorporated insurers.
THE CASE FOR POLICY REFORMS

The **Legal Framework for Impact** report identifies impediments to **investing for sustainability impact**, which include investors' uncertainty about their legal duties. These are not static: the way institutional investors understand their duties has evolved over time and those duties now increasingly entail taking into account the systemic implications of investment decisions.  

The authors of the LFI report find that Canadian investors are in fact legally allowed, and in some cases likely required, to consider pursuing sustainability impact goals where doing so could help achieve their legal purpose (which is in most cases primarily to achieve financial returns). However, the law is not explicit on this point.

As a first step, therefore, policy makers should clarify investors’ duties. Policy interventions are also necessary in the areas of investment processes and sustainable finance tools, such as disclosures by companies and investors.

**Figure 2: Areas for policy intervention to align the investment industry with sustainability goals**

Canada’s authorities should provide clear guidance on how investors should go about incorporating sustainability factors into their decision-making and stewardship processes, and how they should report on their progress towards any sustainability goals they may have set.

There are currently no consistent regulatory requirements for sustainability reporting that apply to all investors and issuers across Canada. Such requirements should be introduced. They should be underpinned by a taxonomy based on science-based criteria for determining what constitutes a sustainable economic activity. Without such a tool, the risk of greenwashing by issuers is high; investors may also be led to believe they are investing responsibly when they are not.

Canada also needs an investor stewardship code backed by a regulator, as is the case in the UK, for example. So far, the Canadian Coalition for Good Governance has developed a set of **Stewardship Principles** for institutions investing in Canadian public equities, which have been endorsed by market participants.

In the absence of clearer regulation and direction from regulators, Canadian asset owners and asset managers will remain hesitant to use investment decisions, stewardship and policy engagement to pursue positive sustainability impacts – even if doing so is in line with their duty to prioritise investment returns. They will also struggle to contribute to Canada’s sustainability goals, such as those linked to the SDGs, the Paris Agreement and the United Nations Declaration on the Rights of Indigenous Peoples.

To initiate the reforms recommended below, the federal government should publicly emphasise its commitment to pursuing national sustainability goals and to cooperating with provincial, municipal and Indigenous governments in that pursuit.

---


30 The LFI report states: “Where sustainability risks such as climate change are determined to be financially material to the performance of an investment, and if ISI approaches can be effective in helping to achieve an investor’s financial goals (i.e., instrumental ISI), there would likely be a requirement to consider using them and act accordingly, which may be especially relevant in circumstances where there is a longer-term investment horizon.”
POLICY RECOMMENDATIONS

1. CLARIFY WHEN SUSTAINABILITY IMPACTS CAN OR MUST BE CONSIDERED BY PENSION ADMINISTRATORS IN DISCHARGING THEIR LEGAL DUTIES

CLARIFY IN WHICH CASES FIDUCIARY DUTIES PERMIT OR REQUIRE PENSION ADMINISTRATORS TO CONSIDER PURSUING SUSTAINABILITY IMPACT GOALS

Pension administrators are required to adhere to a prudent person standard (or similar duties of care, diligence and loyalty). The relevant regulatory authorities should:

- Clarify in regulations and guidance that, under that standard, legal duties require pension administrators to consider investing for sustainability impact where it is relevant to achieving their proper purpose to provide retirement income. This would ensure investors are aware of the full scope of their duties and powers.

- Clarify the scope of fiduciary duties in relation to climate change and other sustainability risks and impacts that could affect the financial performance of the fund – particularly where sustainability impacts are linked to system-level risks.

Pension administrators must also exercise investment powers for their proper legal purpose (often described as investing in the “best interests of beneficiaries”). Relevant authorities should update regulation and guidance to:

- Clarify that, as part of purpose-related requirements, administrators must take into account sustainability risks and to consider pursuing positive sustainability impacts where either action is relevant to their proper purpose, e.g., achieving financial returns and providing a pension for members and beneficiaries.

INTRODUCE IMPLEMENTATION REQUIREMENTS AND GUIDANCE REGARDING SUSTAINABILITY RISKS AND IMPACTS

Relevant regulators should:

- Require pension administrators to incorporate the assessment of sustainability risks and impacts relevant to their proper purpose into their investment policies and processes. This will encourage them to consider pursuing sustainability impact goals where this could help achieve their proper purpose, including their financial objectives.

- Stipulate that a pension plan’s statement of investment policies and procedures, or SIPP, must include information on how and to what extent the administrators take into account relevant sustainability risks and impacts when investing plan assets in line with applicable duties.

- Provide implementation guidance and examples of good practice to specify the actions investors can take to address sustainability risks and pursue sustainability impact goals. Regulators should clarify that the actions available to investors are not limited to asset allocation decisions and should encourage the use of stewardship, including collaborative engagement, by investors.

- Provide evidence on the relevance of system-level risks – including but not limited to climate change – to pension plans’ financial performance.

- Support and encourage efforts by the investment industry to develop their own examples of good practice and evidence base in these areas.

31 In the case of federally regulated pension funds, the Office of the Superintendent of Financial Institutions, under the direction of Canada’s finance minister, should provide a formal clarification on section 7.4 (1) of the Pension Benefits Standards Act, 1995. The section describes administrators’ duties. For its part, the Quebec regulator, Retraite Québec, should clarify section 101 of the Supplemental Pension Plans Act, and section 1306 in Division II of the Québec Civil Code. Lastly, the Ontario regulator, the Financial Services Regulatory Authority of Ontario, should clarify section 22 (1-2) of the Pension Benefits Act, R.S.O. 1990 c P.8.

32 This is based on recommendation 6 in the Final Report of Canada’s Expert Panel on Sustainable Finance. The recommendation includes the following detailed recommendations among others: issue a public statement from Canada’s finance minister articulating that the consideration of climate factors is firmly within the remit of fiduciary duties, and establish climate-related disclosure legislation for federally regulated pension plans and encourage provincial regulators to consider similar requirements.

33 For example, the Quebec regulator, Retraite Québec, should update section 1309 of the Québec Civil Code. The section states: “An administrator shall act with prudence and diligence. He shall also act honestly and faithfully in the best interest of the beneficiary or of the object pursued.”

34 One example would be the sustainability impact of fund investments in the communities in which beneficiaries live.
CAPSA should also provide guidance for pension plans on assessing the relevance of social and environmental goals in deciding how to invest in beneficiaries' best interests. This would help pension schemes assess whether achieving broader societal and environmental goals may improve the quality of life for beneficiaries into retirement – if so, these goals may be relevant to their best interests and hence to the scheme's purpose. In such cases, these goals would also be relevant to the pension plan's investment policies and procedures. At the same time, pension plan administrators need to consider all relevant issues. Responsibility for investment decisions rests ultimately with the plan's administrators.

2. FACILITATE CONSIDERATION OF CLIMATE-RELATED RISKS AND OPPORTUNITIES VIA LEGISLATION AND REGULATORY GUIDANCE

In 2021, the Supreme Court of Canada ruled that global warming is an issue of national concern, stating that climate change poses a grave threat to the future of humanity. Considering the implications of climate change for a pension fund is consistent with, and likely required by, an administrator's fiduciary duties. Specifically, the duty of prudence coupled with the duty of loyalty requires an administrator to consider factors that are financially relevant to fund performance and its ability to provide pensions. Given the many credible voices pronouncing that climate change will have broad and dramatic implications for the natural world and economies which depend upon it, an administrator should be able to conclude that climate change is financially relevant to fund performance and its ability to pay pensions.

Relevant regulators should:
- Specify that climate change is per se relevant to a pension fund's long-term financial performance.
- Phase in a requirement to report in line with recommendations by the Task Force on Climate-Related Financial Disclosures (TCFD) and with the climate disclosure standard currently being developed by the International Sustainability Standards Board (ISSB). In the initial phase, the requirement should apply to large pension funds (i.e., those with more than Can$5 billion in net assets).

Requiring such reporting will both improve the funds' governance and encourage action by pension administrators to identify, assess and manage climate risk. Specifically, pension administrators in scope should be required to:
- Implement the governance measures recommended by the TCFD – namely, disclosure of governance around climate-related risks and opportunities.
- Publish the governance disclosures annually on their website as part of a full TCFD report.

The TCFD recommendations comprise four pillars: governance, risk management, strategy, and metrics and targets. In relation to pension funds:
- The governance pillar allows those interested in a pension fund's future (e.g., beneficiaries, regulators) to understand whether its board/corporate trustee and investment managers are paying sufficient attention to climate change.
- The strategy pillar helps pension administrators identify the opportunities created or increased by climate change.
- The risk management pillar concerns the precise methods by which pension administrators identify, assess and manage climate-related risks.
- The metrics and targets pillar requires pension administrators to disclose certain climate-related information and the metrics they use to assess climate-related risks and opportunities in line with their strategy and risk management process.

Together, these pillars provide a framework for pension administrators to meet their climate-related obligations as fiduciaries.

---

35 Supreme Court of Canada (2021), Case in Brief: References re Greenhouse Gas Pollution Pricing Act
36 The duty of loyalty implies that future generations of beneficiaries should be left no worse-off than current ones. See Waitzer, E.J., Sarro, D. (March 2020), Fiduciary duty and sustainable finance: Clarifying the legal concepts.
Pension administrators should also be required to do the following, as far as they are able:\textsuperscript{37}

- Undertake scenario analysis, taking into account the potential impact of climate change on the fund’s assets and liabilities and the resilience of the fund’s investment strategy and any funding strategy.
- Obtain data on the Scope 1, Scope 2 and Scope 3 greenhouse gas emissions attributable to the fund’s assets and use the data to identify and assess climate-related risks and opportunities.
- Set a target for the fund in relation to a chosen climate change metric, and measure the performance of the fund against that target. The metric could be a measure of absolute emissions, for example.

The “as far as they are able” qualification reflects the fact that there may be gaps in the data pension administrators are able to obtain about their funds’ invested assets. Investors regularly report to the PRI that a lack of decision-useful corporate sustainability data is a substantial barrier to their responsible investment practices. The PRI is working with its global network of signatories to advocate for meaningful and globally comparable sustainability-related disclosures by companies, alongside other financial data.

OSFI has already taken a step in line with the above recommendations: it has proposed the Climate Risk Management Guideline B-15, which incorporates elements of the ISSB’s climate disclosure standard. Among other things, the guideline requires banks and insurers to disclose climate-related risks. The Canadian Sustainability Standards Board (CSSB) and provincial regulators should collaborate to develop similar reporting requirements for all other institutional investors, including pension funds.

3. INTRODUCE SUSTAINABLE FINANCE TOOLS THAT ENABLE INVESTING FOR SUSTAINABILITY IMPACT

Addressing system-level sustainability risks and achieving positive sustainability impacts in support of financial objectives and the wider best interests of beneficiaries and society should be a common goal for institutional investors and necessitates a whole-of-industry response. Investors should be supported by a comprehensive sustainable finance policy framework that does not only permit investing for sustainability impact but also provides investors with the tools they need to do so.

Canada’s finance minister, guided by the Sustainable Finance Action Council (SFAC), should ensure the following sustainable finance tools and practices are developed and introduced:

SUSTAINABLE FINANCE TAXONOMY

A sustainable finance taxonomy is a classification system to help investors and other stakeholders understand whether an economic activity is environmentally or socially sustainable. It should be aligned with national sustainability objectives and interoperable with sustainable finance taxonomies in other jurisdictions. The criteria for determining whether an activity qualifies as green or transitional should also be science-based and not reliant on currently uneconomic or unproven technologies.

Sustainable finance taxonomies generally comprise three elements:

1. Clearly defined objectives
2. Activity lists, which detail economic activities that can contribute to the objectives of the taxonomy
3. Performance criteria, which determine whether such activities make a significant contribution to one of the taxonomy’s objectives while doing no significant harm to any of the other objectives.

Alignment or, ideally, interoperability among national or regional taxonomies is important given that a key driver for the development of sustainable finance taxonomies has been a lack of consistency in defining sustainable activities, which has hindered a scaling-up of sustainable investment.

\textsuperscript{37} These recommendations are partly based on the UK’s Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021.
From a design perspective, interoperability broadly requires taxonomies to:

- have objectives similar to other taxonomies', although there can be some adaptation to national contexts;
- use the same or easily comparable industry classification systems to define economic activities;
- take a similar approach to the design of technical screening criteria (i.e., the “significant contribution” and “do no significant harm” criteria);
- use consistent metrics and calculation methodologies.

A Canadian “Transition Finance Taxonomy” is currently under development, led by the SFAC. We recommend the following:

- The taxonomy should include a demonstrated commitment to developing science-based technical screening criteria by a set date, with governance arrangements that ensure an independent criteria-setting process.
- In developing the taxonomy, the SFAC should include technical experts from both industry and civil society (e.g., NGOs).
- “Transition” economic activities – which sit between green activities and those causing significant harm to the environment – should be defined as activities that are continually improving their environmental performance to stay out of the “significant harm” category. This definition mirrors the definition of activities with “intermediate (or Amber)” environmental performance in the final proposal for an extended environmental taxonomy from the EU Platform on Sustainable Finance.

To ensure international interoperability, the Canadian taxonomy should be aligned with the EU sustainable finance taxonomy in its approach to what constitutes an environmentally sustainable economic activity. Specifically, in the Canadian framework, such an activity should contribute substantially to the taxonomy’s climate and other environmental objectives, do no significant harm to any other environmental objectives of the taxonomy and meet minimum social safeguards.

STEWARDSHIP

The Legal Framework for Impact report argues that stewardship – especially in collaboration with other investors – is an essential tool for addressing system-level risks and pursuing sustainability impact goals. We recommend that policy makers consistently promote the appropriate use of stewardship by investors as part and parcel of discharging their duties and pursuing their investment objectives.

Establishing a national stewardship code\(^\text{38}\) is key to driving long-term improvements in stewardship. Among other benefits, it helps ensure investors use their stewardship powers consistently – alongside capital allocation and policy engagement – to manage sustainability risks and impacts.

Collaborative shareholder engagement is a particularly powerful way to effect positive change. It also spreads the costs of pursuing collective goals across the investment industry and enables all institutional investors to reap the benefits.\(^\text{39}\)

We recommend the following steps by Canada’s policy makers:

- They should determine the appropriate regulatory body to oversee the development and implementation of a national stewardship code, which should build on the stewardship principles first developed by the Canadian Coalition of Good Government in 2017. The code should cover all asset classes and ensure that stewardship policies and practice address sustainability risks and impacts. It should also include guidance on disclosure of stewardship activities.
- Policy makers should encourage collaborative engagement by investors. This policy measure entails addressing barriers to such action; ensuring stewardship activities are adequately resourced by investors; and providing examples of best practice to reflect the importance of effective engagement with investee companies.

---

\(^{38}\) See, for example, the UK Stewardship Code 2020.

\(^{39}\) PRI (2019). Active ownership 2.0: The evolution stewardship urgently needs
SUSTAINABILITY-RELATED DISCLOSURES
The recommendations that follow build on recommendation 5 in the Final Report of Canada’s Expert Panel on Sustainable Finance, which is to “define and pursue a Canadian approach to implementing the recommendations of the Task Force on Climate-Related Financial Disclosures”.

- Investors need the ability to perform due diligence on potential investments regarding their sustainability impacts and the sustainability risks they are exposed to. Among other things, such due diligence should cover the sustainability threats posed by potential investments to the economies and markets on which the fund’s financial performance depends, and whether and how pursuing sustainability impact goals through the potential investments could help achieve the fund’s financial objectives.

To facilitate such due diligence, Canada should introduce requirements for comprehensive and globally comparable public disclosures of sustainability-related information by companies, including but not limited to climate-related information.

- Similarly, Canadian investors should be required to disclose how they take sustainability risks and impacts into consideration in their decision-making; the details of any sustainability impact goals set; the policies in place to achieve the goals; and their progress towards these goals.

To this end, the PRI supports current efforts to create the CSSB – an independent, transparent and publicly accountable body that will work with Canadian regulators to implement the recommendations on sustainability disclosures from the International Sustainability Standards Board, taking into account issues specific to Canada.

When designing reporting requirements for companies and investors – as well as requirements for third-party assurance of disclosures as a next step – attention should be paid to the long-term interests of a diversity of stakeholders, including Indigenous groups, and to the concerns of Canadian society more broadly. When interpreting public interest, the CSSB should bear in mind that a current sustainability risk could become a financial risk over time and thus affect a given fund’s financial performance over the time horizon of the fund.

Over time, reporting requirements on companies should become stricter, in line with investors’ rising need for granular sustainability data from investees. Likewise, disclosure requirements on Canadian investors should be gradually tightened.

When designing rules on sustainability disclosures, as well as on labelling/classification of investment products, policy makers should recognise that all investors need to take sustainability factors into account when making decisions and may need to consider pursuing relevant sustainability impact goals. These steps will be necessary if they are relevant to achieving financial returns, whether or not the investor has a particular sustainability objective or makes sustainability claims about its investment products or strategy.

4. EXPLORE MEASURES TO ENCOURAGE CONSIDERATION OF RETAIL INVESTORS’ VIEWS
The Legal Framework for Impact (LFI) report finds that the levels of assets committed to sustainable investment approaches are lower than what might be expected based on preferences expressed by individual investors. There may be various reasons for this, including common differences between what people say and do, and individuals’ inertia (since aligning their investments with their beliefs could involve revising existing investment arrangements). However, it is also possible that individual investors do not have adequate information or are not prompted to consider the role of their sustainability aspirations in their investment decisions. The LFI report states that, based on available research, the difference between sustainability aspirations and investment practice can at least partly be explained by structural factors of this sort.40

The Canadian Securities Administrators and the Investment Industry Regulatory Organization of Canada (IIROC) should explore measures to encourage investment professionals to assess retail investors’ views on the extent to which they want their money to be managed in line with achieving positive sustainability impacts and take those into account in product design and distribution. Such policies should ensure that those responsible for managing the underlying investments retain ultimate ownership of, and legal responsibility for, investment decisions and that final investment decisions balance all relevant factors.

CREDITS

AUTHORS:
- Kelly Krauter, PRI
- Robert Nash, PRI

CONTRIBUTORS:
- Freya Bannochie, PRI
- Louisa Guy, PRI
- Mayleah House, PRI
- Alina Neculae, PRI
- Margarita Pirovska, PRI

EDITOR:
Olesya Dmitracova, PRI

DESIGN:
Alessandro Boaretto, PRI
ABOUT THE PROJECT

A Legal Framework for Impact is a flagship project of the Principles for Responsible Investment, the United Nations Environment Programme Finance Initiative and the Generation Foundation. The project is part of the Investment Leadership Programme, a joint initiative between the Principles for Responsible Investment and the United Nations Environment Programme Finance Initiative, created to accelerate collaboration among leading investors and boost action on achieving key global sustainability objectives. The project aims to identify and overcome the barriers to a financial system that is consistent with achieving the Sustainable Development Goals and limiting global warming to 1.5°C. Freshfields Bruckhaus Deringer were commissioned to produce a report on the extent to which legal frameworks in 11 jurisdictions enable investors to consider the sustainability impacts of their activities. The report provided the first comprehensive analysis of how far the law requires or permits investors to tackle sustainability challenges in discharging their duties – a practice called “investing for sustainability impact” or IFSI. The project is a multi-year work programme and is now focused on five key markets: Australia, Canada, Japan, the European Union and the UK.

ABOUT THE PROJECT PARTNERS

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 menu 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. More information: www.unpri.org

The Generation Foundation is a UK registered charity and was established alongside Generation Investment Management LLP, the sustainable investment firm founded in 2004. Its vision is an equitable society in which global temperature rises do not exceed 1.5°C. In pursuit of this, the Foundation operates a proactive grant-making and research programme that focuses on four priority areas: investor climate action; carbon pricing; gender inclusion and empowerment; and action on economic inequality. For further information, please visit www.genfound.org.

United Nations Environment Programme Finance Initiative (UNEP FI) is a partnership between UNEP and the global financial sector to mobilise private sector finance for sustainable development. UNEP FI works with more than 400 members – banks, insurers and investors – and over 100 supporting institutions – to help create a financial sector that serves people and the planet while delivering positive impacts. UNEP FI aims to inspire, inform and enable financial institutions to improve people's quality of life without compromising that of future generations. By leveraging the UN's role, UNEP FI accelerates sustainable finance. https://www.unepfi.org/about/