Canada Climate Law Initiative | L'Initiative canadienne de droit climatique

Centre for Business Law
University of British Columbia
Peter A Allard School of Law
1822 East Mall, Vancouver, Canada

29 September 2023

To:
Angela Mazerolle
Chair, Canadian Association of Pension Supervisory Authorities (CAPSA)
Vice President, Regulatory Operations, Superintendent of Pensions
Financial and Consumer Services Commission New Brunswick
capsa-acor@fsrao.ca

and to:
Caroline Blouin
Vice Chair, CAPSA
Chair, Risk Management Guideline Committee
Executive Vice President, Pensions
Financial Services Regulatory Authority of Ontario
capsa-acor@fsrao.ca

Re: Submission on CAPSA Guideline for Pension Plan Risk Management for Plan Administrators

Thank you for the opportunity to make a submission on CAPSA's Guideline for Pension Plan Risk Management for Plan Administrators ("Guideline").[1] The Canada Climate Law Initiative (CCLI) appreciates the ambitious nature of the Guideline, covering foundational pension risk management concepts, including environmental, social, and governance (ESG) considerations, leverage, cybersecurity, investment risk, and use of third parties, all of which are currently priorities for pension trustees and administrators when fulfilling their fiduciary duties and statutory standard of care appropriately. Our comments in this submission address one aspect of the Guideline, specifically, guidance related to management of climate-related financial risks.

The CCLI is a collaboration of the faculties of law at the University of British Columbia and York University that examines the legal obligations of corporate directors, pension fiduciaries, and asset managers to manage and report on climate-related financial risks and opportunities and publishes guidance on effective climate governance, working closely with the legal and accounting professions.[2]

Pension standards legislation in Canada requires the pension plan administrator to invest the assets of the pension fund with the degree of care that a person of ordinary prudence would exercise in dealing with the property of another person.[3] When administering and investing pension plan assets, plan administrators must act in accordance with their fiduciary duty to provide lifetime retirement income to the plan beneficiaries.[4] That duty includes conducting effective risk management to advance the objectives of the plan and protecting the plan and its assets from adverse risks. CCLI supports the objectives of creating a risk management framework to identify, evaluate, manage, and monitor material risks, and carrying out detailed analysis of a pension fund's risk management framework regularly. We agree that establishment of a risk management framework can be an important element in fulfilling the required standard of care. We agree with CAPSA's statement that "Plan administrators should establish controls to mitigate and manage plan risk as part of their fiduciary obligation and standard of care" and that "failure to implement effective controls with respect to a known material risk may constitute a breach of the administrator's fiduciary duty."[5]

CCLI agrees that pension fiduciaries must establish sound governance and oversight, establishing processes for identifying, evaluating, managing, and monitoring risks that may adversely impact a pension plan's ability to deliver benefits to plan beneficiaries. We stress the importance of taking into account the long-term nature of pension obligations and the intergenerational interests of pension plan members and beneficiaries. Plan administrators should develop a process for prioritizing climate-related risks, both operational risks and investment risks, and their relationship to other material risks, evaluating risk management strategies on an ongoing basis to ensure continued effectiveness.

CCLI notes that very specific questions are asked in the Guideline on a number of the issues, for example, extensive questions and guidance on the role of third-party service providers, but this level of specificity does not extend to oversight and management of climate-related financial risk. The discussion in the Guideline on climate-related financial risks is subsumed under ESG, which also includes diversity, equity and inclusion, Indigenous rights, employee safety, child labour, forced labour and ethical supply chains, etc, all of which are important; however, it fails to acknowledge the existential nature of the threat that climate change poses, creating unprecedented market-wide risk to pension fund assets and the pension plan members' and beneficiaries' financial well-being. Thus, guidance should be specific and directed to support plan administrators in meeting their fiduciary duties. The CCLI supports Principles 1 to 3 under the ESG part of the Guideline,[6] but believes they should have more specificity in respect of climate matters. CCLI agrees with CAPSA's observation that ignoring or failing to consider ESG information that might materially affect the fund's financial performance could be a breach of fiduciary duty.[7] However, this high-level guidance is inadequate when it come to climate-related financial risk.

We make five recommendations that would strengthen climate-related aspects of the Guideline:

> 1. ***Fiduciary Duty*** – In order to ensure that pension plan administrators and other pension fiduciaries are able to fulfill their fiduciary duties to plan members and beneficiaries, the Guideline should set clear baseline standards they should meet with respect to climate risk management, including identification, oversight, and management of climate-related risks and opportunities that are material to the financial risk-return profile of the pension fund's investments.
>
> 2. ***Governance*** – CAPSA should adopt specific requirements for plan administrators and other pension fiduciaries, requiring them to clearly identify and disclose governance processes, controls, and procedures used to monitor and manage climate-related risks and opportunities; the frequency by which the board and/or board committees discuss climate-related matters, including in their strategic planning; how climate matters are reflected in the pension fund's board mandates and investment policies; and how pension fiduciaries are ensuring the appropriate skills and competencies are available to oversee strategies designed to respond to climate-related financial risks and opportunities.

3. ***Risk Management*** – Pension fiduciaries should be required to identify the processes and tools they use to determine, assess, prioritize, monitor, and manage climate-related risks and opportunities; and the extent to which and how the climate-related risk and opportunity identification, assessment, and management processes are integrated into the entity's overall investment and risk management processes.

4. ***Transition Plans*** – Pension fiduciaries should develop and implement a transition plan to net-zero greenhouse gas (GHG) emissions, including short-term interim targets, as an integral part of their duty of care, ensuring the plan is, at minimum, in line with Canada's international and domestic commitment to net-zero emissions. Pension fiduciaries should have as an objective of the transition plan, a fair, equitable, and just transition.

5. ***Transparency and Accountability*** – Pension fiduciaries should be required to annually disclose the pension fund's oversight and management of climate-related governance, strategy, risk management, targets, and metrics in their financial reporting.

CAPSA does acknowledge in the Guideline that "climate change in particular is considered to pose urgent and material systemic risks to the financial system, which in turn can affect the long-term expected returns of pension plan investments"; and it recognizes that scenario analysis can be a useful exercise to assess the vulnerabilities of the plan over different time horizons, in turn informing investment strategy.[8] We applaud this acknowledgement but believe the Guideline should put weight behind these observations and require plan administrators to establish investment targets, particularly in respect of overall portfolio limits on exposure to GHG emissions, and transition plans that include targets for investment in 'green' assets, with a view to national commitments to transition to net-zero emissions. While brief mention is made of climate plans, no requirement or even direction is included in the Guideline. Our view is that transition plans, with appropriate objectives, targets, and metrics to evaluate progress are completely consistent with the plan administrator's fiduciary duty and standard of care.

Plan administrators and pension trustees must act honestly, in good faith, with the care, skill, and diligence of a prudent person in the best interests of plan members and beneficiaries of the pension plan as part of their fiduciary responsibilities.[9] These fiduciary obligations require treating members and beneficiaries impartially, considering intergenerational interests including members currently accruing a pension, pension beneficiaries, and others who may be entitled to a benefit from the plan; interpreting the plan terms fairly and impartially; managing conflicts of interest; and ensuring that members and beneficiaries receive promised benefits.[10] Given these responsibilities, CAPSA should be offering much more guidance on effective climate governance that will ensure all pension fiduciaries are actively managing and monitoring climate-related risks and opportunities.

While the Guideline specifies that plan administrators should describe whether and how material ESG information is considered or not and make reference to that information in the statement of investment policies and procedures (SIP&P) and plan member statements or other sources of plan member information,[11] it does not offer sufficient guidance. Similarly, while there is a discussion on stress testing and scenario analysis mechanisms for understanding and managing the implications of leverage for the plan's broader investment approach and the funding of its liabilities,[12] the Guideline should require stress testing and scenario analysis for climate risks.

The CCLI appreciates that CAPSA writes “Plan administrators are encouraged to ensure that they are keeping pace with disclosure developments and industry best practices, such as the Financial Stability Board’s Task Force on Climate-related Financial Disclosures (TCFD) and the International Sustainability Standards Board (ISSB).”[13] At this point, however, encouragement alone is inadequate. We recommend regulations pursuant to federal, provincial, and territorial pension legislation of some baseline requirements in respect of pension fund climate governance.

The climate crisis and the immediate need to mitigate the effects of global warming create some urgency in imposing greater requirements and standards on pension plans. In this respect, guidance can be found in the IFRS S2 Climate-related Disclosures,[14] which sets out detailed requirements for governance, strategy, risk management and metrics and targets in respect of climate-related financial risks and opportunities. For example, it requires entities to disclose information that enables users of general purpose financial reports to understand the effects of climate-related risks and opportunities on the entity’s financial position, financial performance and cash flows for the reporting period (current financial effects) and the anticipated effects of climate-related risks and opportunities on the entity’s financial position, financial performance and cash flows over the short, medium, and long term, taking into consideration how climate-related risks and opportunities are included in the entity’s financial planning.[15] Given the convergence of standards globally, CAPSA is missing an opportunity to support pension funds in aligning their governance and investment functions with global standards.

Requiring transition plans would also align CAPSA’s guidance with the Office of the Superintendent of Financial Institutions (OSFI) Guideline B-15: Climate Risk Management, which states that federally-regulated financial institutions should develop and implement a climate transition plan and incorporate the implications of climate change and the transition to a low-GHG economy in their business model and strategy.[16]

In conclusion, the primary purpose of a pension plan is to provide lifetime retirement income. The CCLI agrees that the range of risk issues is constantly evolving, as are the methods and practices needed to be responsive to emerging gaps, risks, and opportunities. While we support CAPSA’s efforts to develop guidance, it is disappointing that after a considerable period of consultation and deliberation, that the proposed CAPSA Guideline does not align itself with developments internationally that are more targeted and ambitious. We believe that CAPSA’s adoption of our five recommendations will help ensure that pension plan administrators and other pension fiduciaries are able to fulfill their fiduciary duties to plan members and beneficiaries.

Sincerely,

Janis Sarra

Dr. Janis Sarra
On behalf of the Canada Climate Law Initiative
sarra@allard.ubc.ca

---

[1] CAPSA/ACOR, 2023-02-22 - DRAFT CAPSA Risk Management Guideline - Consolidated v1 (capsa-acor.org) (Guideline).
[2] See for example, Janis Sarra, Roopa Davé, Meghan Harris-Ngae, and Ravipal Bains, *Audit Committees and Effective Climate Governance, A Guide for Boards of Directors* (CCLI, December 2020), Guide-for-Audit-Committees-on-Effective-Climate-Governance.pdf (ubc.ca);

Comités d’audit et gouvernance climatique efficace, Guide à l’intention des conseils d’administration - Canada Climate Law Initiative (ubc.ca).

[3] The plan administrator must employ the knowledge or skill that they possess or ought to possess by reason of their profession. While the services and responsibilities may be delegated to third-party service providers, the plan administrator remains responsible for the oversight, management and administration of the plan.

[4] Pension fiduciaries must ensure compliance with Regulations under the *Income Tax Act*, s. 8502(a) states that “the primary purpose of the plan is to provide periodic payments to individuals after retirement and until death in respect of their service as employees”; Income Tax Regulations (C.R.C., c. 945), s 8502, Conditions Applicable to all Plans, Income Tax Regulations (justice.gc.ca).

[5] Guideline, note 1 at 10.

[6] Principle 1: Pension plan administrators (either directly or through their delegates) should consider whether and how ESG information may be relevant to the investment performance of their funds and take appropriate action based on their determination. Principle 2: Plan administrators, as part of their standard of care, should ensure that their plan governance, risk management and investment decision-making practices are designed to identify and respond to material ESG risks and opportunities in a manner appropriate for their plan circumstances and investment beliefs. A review should be conducted at least annually, or whenever there is a material change in the risks facing the plan or governance processes. Principle 3: Plan administrators should describe whether and how material ESG information is considered or not and make reference to that information in the SIP&P and plan member statements or other sources of plan member information (e.g., websites or fund fact sheets).

[7] Guideline, note 1 at 25, citing CAPSA Guideline No 4 Pension Plan Governance.

[8] Guideline, note 1 at 26.

[9] CAPSA, Guideline No 4 Pension Plan Governance.

[10] Guideline No 4 Pension Plan Governance at 6.

[11] Guideline, note 1 at 28.

[12] Guideline, note 1 at 36.

[13] Guideline, note 1 at 29.

[14] International Financial Reporting Standards (IFRS) International Sustainability Standards Board (ISSB), IFRS S2 IFRS Sustainability Disclosure Standard, Climate-related Disclosures, (June 2023) at para 15; ISSB-2023-A – Issued IFRS Standards (IFRS S2).

[15] IFRS S2, note 14 at para 15.

[16] OSFI, Guideline B-15 Climate Risk Management, (March 2023), at 4; Climate Risk Management (osfi-bsif.gc.ca).