



# PUTTING RESPONSIBLE INVESTMENT INTO PRACTICE

A TOOLKIT FOR  
PENSION FUNDS,  
FOUNDATIONS AND  
ENDOWMENTS



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## How to use this toolkit

**Interest in responsible investment has grown dramatically, as investors increasingly understand that their long-term bottom line is affected by more than just strictly financial factors. This toolkit is designed to provide practical tools for pension funds, foundations and endowments interested in learning about responsible investment and incorporating responsible investment practices into their investment management.**

**The toolkit defines responsible investment and looks at various implementation strategies that are available to institutional investors. It also provides an**

**overview of the relationship between responsible investment practices and the fiduciary and legal requirements that pension funds, foundations and endowments in Canada must work within.**

**To use this toolkit, follow the comprehensive four-step implementation process, which helps organizations incorporate responsible investment practices into their overall asset management.**

### The Online Toolkit

SHARE has also compiled links to background information and real world examples of pension plans and endowments using responsible investment practices. This online toolkit is available at [www.share.ca](http://www.share.ca).

*Four steps to implementing responsible investment*



## What is responsible investment?

Responsible investment is most commonly defined as the integration of environmental, social and governance (ESG) considerations into the investment management process. It is based on an active ownership approach and on the belief that these factors can have an impact on the financial performance of investments. Some common examples of ESG issues are climate change, human rights and executive compensation. For responsible investment, ESG issues—sometimes referred to as “extra-financial factors”—are taken into account not only for the selection, retention and disposition of investments, but also used to positively influence companies’ decision-making around these areas.

Funds can implement responsible investment practices in several ways. These are often categorized under four types of activities, that will be described at length later in the toolkit: 1) Proxy Voting; 2) Shareholder Engagement; 3) Economically Targeted Investments; and 4) Investment Screening.

## Why choose responsible investment?

Investors choose to incorporate responsible investment practices into their asset management strategies for many reasons. The two most common are:

### **Sample investment policy: An excerpt from the ABP Pension Fund Sustainable Investment Statement.**

The first responsibility of ABP, the Dutch government pension fund, is to achieve the highest possible return on investment. This enables ABP to safeguard the pensions of the fund’s 2.4 million participants. In addition to this, ABP, in the capacity of investor, is aware of its social responsibility. For institutional investors as well, sustainable investment is becoming an increasingly important item.

Increasingly often the question is asked, by ABP’s fund participants as well as by external interested parties, if ABP in its investment operations could not take into account other considerations as well, besides the financial requirements. ABP considers this to be a relevant question. All in all the question here is whether inside a company in which ABP invests there are any features – ‘value’ or risks – which are not (yet) reflected in its annual report. This could for instance relate to environmental risks, healthy labour relations and the quality of research. In its assessment of companies, ABP takes into account such criteria. In a discussion on sustainable investment there is one thing, in ABP’s approach, that is indisputable: sustainability should never be to the detriment of return on investment.

### **The Shareholder Value Case**

Following responsible investment practices can help institutional investors avoid potential risks that ESG issues pose to investment performance, risks that are not often captured through standard financial analysis. At the same time, incorporating ESG considerations into investment analysis helps funds identify valuable investment opportunities. For example, opportunities may include investing in companies with strong environmental records or in growing sectors of the economy, such as green technology and renewable energy.

### **The Values-Based Case**

The move towards responsible investment has also been driven by the expectations of pension plan members and beneficiaries, foundation donors and stakeholders, as well as general society. The expectation is that these institutions behave in a manner that is consistent with broader, positive societal values, including environmental protection, sustainability, good corporate governance and social justice.

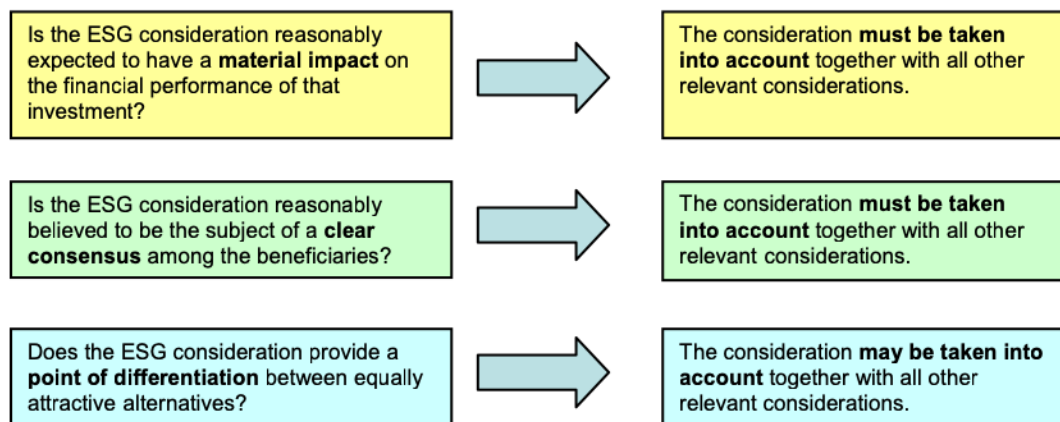
## Fiduciary Duty and Responsible Investment

*"Am I allowed to consider ESG issues when making investment decisions?"*

This is a common question among trustees, investment committee members and other decision-makers who play a fiduciary role within an investment fund. The answer is: **Yes**. Trustees have a fiduciary relationship and owe fundamental duties of care to their fund, along with loyalty and good faith, to ensure that the pension plan or endowment is well-governed over the long-term and provides beneficiaries with adequate financial returns. There is growing evidence that ESG issues can have material impact on investment performance. It is increasingly understood that environmental and social issues are connected to financial issues, and companies that fail to consider ESG factors subject investors to increased risk and the potential for poor performance.

A well-regarded 2005 study examining the legal framework of fiduciary duties by leading UK law firm Freshfields Bruckhaus Deringer concluded that "integrating ESG considerations into investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions." According to this study, trustees not considering ESG factors may be compromising their fiduciary duties.

### **The fiduciary case for responsible investment<sup>1</sup>**



Thus responsible investment practices such as proxy voting, shareholder engagement, economically targeted investments and screening are all permitted investment strategies provided they are authorized in a fund's investment policy and carried out in a prudent and impartial manner in the best interest of pension plan members or endowment beneficiaries.

## Responsible Investment and Financial Performance

Another common concern among pension funds, foundations and endowments is that incorporating responsible investment practices will hurt the financial performance of their funds. In fact, well-constructed responsible investment policies can help mitigate risks associated with portfolio investment and can contribute to sustaining strong financial returns while protecting investment value over the long-term.

Recent research supports the proposition that ESG issues impact business performance and the financial value of companies in both the short- and long-run. The United Nations Environment Programme Finance Initiative (UNEP FI) conducted a study in 2006 looking at the materiality of ESG issues to equity pricing<sup>2</sup>. This extensive analysis produced a robust case for the financial materiality

<sup>1</sup> pg. 14, "A legal framework for the integration of ESG issues into institutional investment." UNEP FI, 2005.

<sup>2</sup> UNEP Finance Initiative, 2006, Show Me the Money: Linking Environmental, Social and Governance Issues to Company Value. Available from: <http://www.unepfi.org/publications/investment/index.html>.

of ESG issues. For example, the UNEP FI study included an assessment by Deutsche Bank on the governance of FTSE350 companies using 50 corporate governance standards, which established a clear link between corporate governance and share price performance. During the three-year period examined, the 10% of companies with the best corporate governance structures and behaviour outperformed those in the bottom 10% by 25%.

The performance of socially screened indexes is also a valuable indicator of the impacts of responsible investment on financial performance. The Jantzi Social Index (JSI) is a socially screened, market capitalization-weighted common stock index modeled on the S&P/TSX 60. The Index consists of 60 Canadian companies that pass a set of broadly-based ESG rating criteria. In creating the JSI, Jantzi Research set out to create a benchmark against which institutional investors could measure the performance of socially screened portfolios.

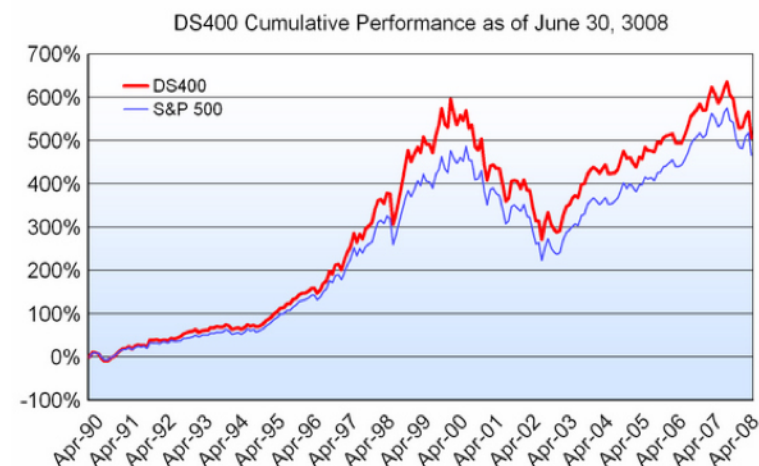
A comparison shows that the JSI regularly outperforms the TSX Composite and TSX 60 indexes, highlighted in the graph below. Since its inception on January 1, 2000 through June 2008, the annualized returns for the Jantzi Social Index have been 9.04%—compared to 8.83% for the S&P/TSX Composite and 8.89% for the TSX 60 Index.

#### ***Jantzi Social Index - Historical performance comparison***



Another example is the Domini 400 Social SM Index (DS400). This is a float-adjusted, market capitalization-weighted, common stock index of U.S. equities. Launched by KLD Research and Analytics, Inc. in May 1990, as the first index constructed using environmental, social and governance (ESG) factors the DS400 offers a longer performance history. It is a widely recognized benchmark for measuring the impact of social and environmental criteria on investment portfolios. The Domini Index has outperformed, on an annualized basis, the S&P 500 since inception through the end of June 2008, delivering an annualized return of 10.43%—compared to 10.01% for the S&P 500.

#### ***Domini 400 Social SM Index - Historical Performance***





## 01

**GETTING STARTED: EDUCATING  
KEY DECISION-MAKERS**

The first step toward responsible investment is education. Fiduciaries, trustees and fund or endowment staff must have a thorough understanding of responsible investment to ensure their investments are well-governed and their decisions well-informed. To get started, a responsible investment educational session offers a great way to help decision-makers build this knowledge. Some key questions to address in such a session include:

- What are the key drivers for responsible investment in the organization, including both performance-based and ethical drivers? These will vary significantly for pension plans with strict regulatory requirements versus mission-based foundation endowments.
- What is the relationship between responsible investment and fiduciary duty, and what are the relevant legal requirements that must be taken into account?
- How can responsible investment strategies impact rate of return, and what does historical performance show?

**Key steps to take in order to educate the decision-making body (the board of trustees or investment committee members) and gain support for responsible investment:**

- » Identify the information needs of board members and provide relevant resources to meet these (For example, historical performance data on responsible investment funds)
- » Participate in educational opportunities (Such as conferences and seminars)
- » Outreach to trustees or investment committee members from a similar organization and invite them to share their experience in implementing responsible investment
- » Identify external experts and service providers that may be able to work with the board through a customized education and policy development process

## 02

## THE POLICY DEVELOPMENT PROCESS



With a better understanding of responsible investment, it is time to develop a policy framework that will support responsible investment practices in the investor's broader asset management strategy. This means establishing a responsible investment policy, and ideally incorporating responsible investment into the fund or endowment's overarching investment beliefs and investment policy. This provides a clear mandate to integrate ESG considerations throughout the investment process.

### Establishing responsible investment policy objectives - Key questions to answer:

- » What does responsible investment mean for our organization?
- » What are the key triggers that led us to consider responsible investment? (Examples can include pressure from beneficiaries or stakeholders, or acknowledgement of the potential financial implications of issues such as climate change)
- » Are there any specific rules or legislation pertaining to responsible investment practices that need to be incorporated into our overall policy objectives?

Once the policy objectives are determined, an official responsible investment policy can be created. This may also be integrated into other relevant policy frameworks, such as a fund or endowment's Investment Beliefs, Statement of Investment Policies and Procedures (SIPP) or Investment Guidelines.

Finally, remember that when establishing a responsible investment policy, it is important to review the fund's current investment policies to identify any restrictions or limitations that would affect its implementation.

### Sample investment policy: BP Pension Fund, UK

Consistent with its obligation to act in the best interest of the Fund, the Trustee supports a bias towards investments in companies with positive social, environmental and ethical policies. This is consistent with the stance taken by BP in respect of these matters and reflects the view that such companies can be reasonably expected to deliver superior financial performance over the longer term. The Trustee has therefore delegated to the investment manager responsibility for taking social, environmental and ethical statements of policy into account when assessing the financial potential and suitability of investments and for exercising the rights (including voting rights) attaching to the Fund's investments.



### **Sample investment policy:**

#### **TIDES Canada Socially Responsible and Mission Aware Investing Policy**

The Foundation begins the investment management process with the recognition that its responsibility does not end with the traditional goals of maximizing return and minimizing risk. Effort to mitigate environmental destruction, address issues of social and economic justice, and promote healthy communities and societies will be successful to the extent that these concerns exist as central rather than peripheral issues to the business and investment communities.

While recognising that addressing these concerns while pursuing financial objectives is an imperfect process, the Foundation is committed to the development of healthier corporate cultures as an integral part of creating healthier societies. The responsibility to address these concerns must be shared by management, directors, staff, investors and the communities in which businesses operate and serve. The Foundation considers these same concerns in our relationship with vendors and suppliers. Within foundations, this means reducing the dissonance between the charitable mission and investment management. It means a conscious effort not to undermine grants made by the Foundation through investments that contravene the work and mission of grantees.

In pursuit of this investment philosophy, the Foundation's funds shall be invested in those organizations and institutions whose policies and practices are as consistent as possible with the mission of the Foundation.

## **Responsible Investment Policy Checklist**

### **Verify that the investment policy:**

- ☐ Acknowledges the fiduciary duty requirements within which the fund is bound to operate
- ☐ Allows for the consideration of extra-financial criteria
- ☐ For mission-based investors, indicates whether or not rate of return is the paramount consideration
- ☐ Allows for appropriate diversification levels in accordance with legal requirements
- ☐ Takes into account the structure of the fund's liabilities or perpetuity requirements
- ☐ Indicates which responsible investment strategies are permissible including proxy voting, shareholder engagement, economically targeted investments and screening
- ☐ Indicates whether investments are to be managed in-house or externally
- ☐ Indicates permitted categories of investments
- ☐ Describes how proxy voting rights will be exercised
- ☐ Addresses how policy implementation will be monitored, including fund performance

## CASE STUDY: A Brief History of the Atkinson Foundation

In 2000, two new faces at the Atkinson Charitable Foundation – Charles E. Pascal, Executive Director and Peter A. Armstrong, member of the Board of Trustees – catalyzed a process of incorporating responsible investment practices into the overall management of the Foundation's endowment.

Both were appointed to the Foundation's investment committee, where they began to discuss responsible investment with their fellow investment committee members and with the Foundation's investment managers. While they received a range of reactions, including polite scepticism, Charles and Peter were able to secure broad buy-in for the idea that aligning the Foundation's grant-making and investing practices with its mission made sense.

In 2002, the Board of Trustees approved a mission-based investment (MBI) policy. The Foundation's overarching MBI statement reads:

*The Foundation believes that it should implement its mission not only through the ideas, people, organizations and projects it supports, but also by how it invests and otherwise uses its assets. Ensuring that its deeds match its words, the Foundation seeks to ensure that its grant making and investment practices all align with its mission.*

*The Foundation is committed to its fiduciary responsibilities and recognizes that this responsibility does not end with maximizing return and minimizing risks. The Foundation believes its fiduciary responsibility includes the consideration of its investment decisions on corporate conduct, and broader social concerns as well.*

Since 2002, the Foundation has taken significant steps in implementing a responsible investment strategy. Some of these steps included auditing the Foundation's portfolio; developing a customized set of proxy voting guidelines and hiring a dedicated proxy voting service; appointing a member to its investment committee with a background in responsible investment; and designing a strategic shareholder engagement program with an initial focus on improving precarious employment practices in the Canadian property services sector.

The Atkinson Foundation has emerged as a responsible investment leader and innovator, illustrating that a Foundation can strategically utilize all of its assets towards advancing its mission – not only through grant-making but also by how it invests and manages its overall endowment.

## 03

## IMPLEMENTING RESPONSIBLE INVESTMENT STRATEGIES



A responsible investment policy provides a framework for a fund or endowment's approach to responsible investment; next comes designing an implementation strategy. At this stage, it is necessary to determine which responsible investment approaches best suit the organization. There is no set path to implementing a responsible investment strategy. Indeed, most investors use an incremental approach, selecting one responsible investment strategy at a time. This allows investment decision-makers to adequately assess each strategy's relevance and value, as well as monitor results over time.

There are several ways to implement responsible investment practices, and these are often categorized under four main areas of activity:

1. Proxy Voting
2. Shareholder Engagement
3. Economically Targeted Investments
4. Investment Screening

The following section briefly describes each of the approaches and the steps required to implement this strategy. A fund or endowment might use just one, or all, of these strategies.

### What do proxy voting guidelines cover?

A comprehensive set of proxy voting guidelines will protect a fund's long-term interests by covering all areas of corporate governance, including:

- » Board of directors
- » Auditors
- » Executive compensation
- » Protection of shareholder rights

As well as ensuring investments follow strong corporate social responsibility practices, such as:

- » Labour rights
- » Community dialogue
- » Product liability
- » Environmental stewardship (eg. climate change)

*Taken from SHARE's 2009 Model Proxy Voting Guidelines*

## 1) Proxy Voting

### How does my existing fund manager vote proxies?

As fund administrators, trustees are entitled to have access to their current proxy voting record from their fund manager (now a legal requirement in Quebec). Also, SHARE's annual *Key Proxy Vote Survey* compares how many fund managers vote proxies.

Attached to the voting shares of every public company is a proxy that legally permits the shareholder to have a say in how the company is run. A fund or endowment's investment policy typically outlines how these proxies get voted, ideally in accordance to formal proxy voting guidelines established by the fund. Except for very large funds, the actual casting of proxies is typically carried out by an investment manager or a dedicated proxy voting service provider. Responsible investors use proxy voting as a tool for encouraging companies to improve their transparency and accountability to shareholders, as well as to improve companies' management of environmental, social, and governance (ESG) issues.

Many investors choose proxy voting as an initial approach to implementing responsible investment, as it is typically something that a fund or endowment is already undertaking. Also, proxy voting is increasingly recognized as a fundamental duty for investors; trustees have a responsibility to oversee the voting of all proxies in the best interest of plan members or fund beneficiaries.

Commonly, many groups leave the voting of proxies to the discretion of their fund managers. However, this practice is changing as shareholders recognize that the voting rights associated with each share represent an important tool for communicating expectations to management on key ESG issues.

The following are key steps to consider when implementing a responsible proxy voting strategy:

- **Determine how the organization currently votes its proxies.** Is proxy voting allocated to an investment manager? Has a dedicated proxy voting service been retained? What is the fund's past proxy voting record?
- **Develop a set of proxy voting guidelines.** Guidelines should include comprehensive coverage of ESG issues. It is helpful to look at the proxy voting guidelines of similar organizations, or refer to a set of model proxy voting guidelines.
- **Vote proxies annually according to the established guidelines.** Once guidelines are approved, ask if the current service provider will accommodate customized proxy voting, or explore the option of a dedicated proxy voting service.
- **Monitor, review and update.** An active proxy voting strategy requires regular reporting on how proxies are voted, as well as an annual review of the fund's proxy voting guidelines to address evolving ESG issues.

### Proxy voting in a pooled fund

Because smaller pension plans or endowments often invest through pooled funds, they may find themselves faced with more limited proxy voting options. Investors in pooled funds generally cannot direct the voting of proxies. However, they can try to negotiate an arrangement to permit the voting of a proportionate number of the pooled fund's proxies according to individual fund guidelines. In the least, funds in this situation should advise investment managers of their voting preferences and request a voting report on how the pooled fund's shares are voted.

## 2) Shareholder Engagement

Using the strategy of shareholder engagement, responsible investors can communicate directly with companies in their portfolio on ESG issues. Engagement is an ownership approach that focuses on actively influencing companies within an investment portfolio to improve their ESG performance. Engagement may take the form of letter writing, face-to-face meetings with company management or directors, or filing shareholder proposals (also known as shareholder resolutions). The goal of engagement is to create constructive dialogue with companies held in a fund or endowment's portfolio, leading to improvement on key ESG issues and enhancing long-term corporate performance.

There are several options for implementing a shareholder engagement strategy. Common strategies include building in-house capacity, establishing engagement in investment manager mandates, or hiring a dedicated engagement service. Time and monetary resources often determine the actual method selected.

Investors should consider the following steps when implementing an engagement strategy:

- **Consult key stakeholders to determine the specific issues of importance.** Surveying key stakeholders may help focus engagement efforts by identifying common values or areas of concern.



- **Determine what ESG criteria will provide the framework for engagement activities.** A fund or endowment may decide to focus their engagement activities on one specific issue or it may decide to establish criteria that reflect a broader set of ESG issues. Other investors may focus engagement activities in areas where they have the greatest investment exposure; for example, Canadian investors may focus engagement with Canadian companies.
- **Decide what engagement strategies will be initially employed.** Will the fund or endowment write letters? Seek meetings with corporate management? File shareholder resolutions?
- **Finalize how (and by whom) the engagement activities will be coordinated.** Who will be responsible for approving specific engagement activities? Will the fund cooperate with other investors on engagement activities? Who will represent the fund in discussions with companies?
- **Seek professional advice.** Investors can request that their current fund managers implement their engagement strategy, or they can engage additional or alternative service providers to develop specialized engagement services that adhere to the fund's responsible investment policy.
- **Establish a monitoring provision.** Having the capacity to assess the long-term costs and benefits associated with carrying out a shareholder engagement strategy helps pension plans and endowments improve the effectiveness of their engagement program.

### 3) Economically Targeted Investments

Economically targeted investments (ETIs)—also known as community investments—are investments that seek to generate a market rate of financial return along with specific social, economic and environmental (SEE) benefits. Examples of ETIs include investments designed to increase the availability of affordable housing, provide capital to small- and medium-sized enterprises, revitalize inner cities or support non-traditional industries such as renewable energy.

**ETIs = market rate return + social, economic and environmental benefits**

Investors choose ETIs as a responsible investment strategy in order to:

- Support social or economic development or environmental protection within a specific geographical region;
- Advance technological developments in a targeted industry; and
- Cultivate job creation and business development in a specific sector, or for particular disadvantaged groups such as women or minorities.

In recent years interest in ETIs has grown immensely. Generally, investing in ETIs is prudent and permissible as long as the investment return is commensurate with similar types of investments having similar risk profiles. However, meeting this increasing demand remains challenging because of the lack of potential deals that deliver market returns and social, environmental and economic benefits.

There is still a need to develop new financial instruments and corresponding benchmarks for ETIs, as well as viable partnerships with other investors, intermediaries, civil society organizations and the public sector. Creative financing strategies have been developed in some countries, notably in the United States, with ETIs facilitated through long-term loans, mezzanine financing and other varieties of debt and quasi-debt financing.

A fund or endowment interested in implementing an ETI strategy should consider the following steps:

- **Determine the types of collateral social, economic and/or environmental returns the fund seeks to achieve through an ETI strategy.** The investor may want to consult key stakeholders directly to determine the types of benefits that are most important.
- **Determine the types of ETI investment vehicles that are viable.** Examples include: venture capital, private placements, mortgages, debt financing and real estate.
- **Identify the percentage of assets to allocate to ETIs, and the fund or endowment's overall risk-return profile.**
- **Evaluate each investment decision for an ETI on a case-by-case basis.** This is relevant given the nascent stage of ETIs and the relatively new financing models behind many initiatives.
- **Collaborate with other investors interested in ETIs.** Pooling assets and expertise can help build a viable ETI vehicle. Potential collaborators include pension funds, foundations and the public sector, along with financial intermediaries.

### CASE STUDY: Investing in affordable housing, an ETI strategy

When the Public Service Alliance of Canada (PSAC) went looking for ways it could make its investments work for the community, it led to the creation of an innovative economically targeted investment (ETI) that provides a model for other funds. PSAC sought double returns for its money: a market rate financial return plus a social return in the form of increased affordable housing.

The result is the Alterna Community Alliance Housing Fund, a unique partnership between PSAC, Alterna Savings, and The Ottawa Community Loan Fund.

The Housing Fund was created through a \$2 million investment by the PSAC Staff and Officers Pension Plan. The funds are held at Alterna Savings, which issued the pension plan five-year guaranteed income certificates, ensuring market rates of return and fulfilling the Plan's fiduciary requirements. This arrangement permits PSAC to provide long-term, patient capital.

The Housing Fund is used to supply low-cost, second mortgage financing for developers and other groups that want to build, maintain, or expand affordable housing projects in the Ottawa region. Proposed developments are screened by a third, independent group: The Ottawa Community Loan Fund. This non-profit community development financial institution ensures that the projects meet the Housing Fund's social criteria:

1. Housing will be affordable to those most in need;
2. Housing will be affordable in the long-term;
3. Housing will be constructed by unionized workers.

In addition to the above criteria, other preferred factors were also established, including buildings that are energy efficient and sustainable; mixed income housing that incorporates wheelchair accessibility; resident involvement in the management of the project; and maintenance by unionized workers.

This ETI is a groundbreaking example for Canada, helping build a case for investing in affordable housing that has the potential to be replicated across the country. It also demonstrates that smaller pension funds and other institutional investors can find innovative solutions for sustainable returns—and sustainable community development.



## 4) Screening

Historically, investment screening was generally carried out using a negative, or avoidance screen, whereby investors excluded investing in companies that did not meet established ethical criteria. This strategy was largely pioneered by religious investors during the 1960s, who screened out “sin stocks” such as companies involved in gambling, arms manufacturing, or the production and selling of alcoholic beverages. Negative screening can be a useful tool to address ethical and reputational risks, particularly for mission- or values-based investors.

Recently, more complex, positive screens have been employed in responsible investment strategies. These positive, or affirmative screens, incorporate normal investment risk analysis along with the consideration of ESG criteria in an effort to assess which companies perform best measured against similar corporations in an investment universe. This strategy is often referred to as a “best of sector” approach. By considering companies’ expected ESG performance, the fund or endowment has potential to gain insight into risks or opportunities that a strict financial analysis will not uncover.

Investors choose investment screening as an approach to responsible investment in order to:

- Eliminate specific risks from their portfolio;
- Protect the organization’s reputation as an investor supporting companies that are committed to responsible business practices;
- Respond to the expectations of key stakeholders around ethical standards.

A fund or endowment can apply investment screening to its portfolio a number of ways, including investing in an existing screened fund, or hiring an investment manager to create a customized screen based on a fund’s current investment portfolio. Regardless of the path, the following are steps to consider for effective implementation of an investment screen:

- **Determine what ESG criteria will be incorporated into the investment screen.** These criteria may reflect a key set of values if the organization is a mission-based investor, or they may reflect key sectors or products that the investor wants to avoid for either reputational or ethical reasons.
- **Consult key stakeholders in order to determine specific issues that are important to them.** For example, some pension fund trustees will consult the beneficiaries of the pension plan to determine common priorities. Similarly, community foundations may want to consult their donors through questionnaires to determine whether there are specific sectors that they want to exclude, or criteria they want incorporated into the investment selection process.
- **Conduct a portfolio audit on current holdings against the fund’s ESG criteria.** An audit will reveal the portfolio’s current exposure to ESG risks and opportunities and will help trustees and fiduciaries become more knowledgeable about the companies they own, a crucial step to becoming more active shareholders.
- **Seek professional advice.** Organizations may work with a specialist investment consultant to develop a mandate for a managed responsible investment fund. Others may opt to approach their current managers to insist that they apply the screen to their portfolio.

## Communicating with Investment Managers

Implementing a successful responsible investment policy and carrying out responsible investment practices requires careful selection and on-going communication with the professional advisors employed by the fund or endowment.

When undertaking an investment manager selection process, it is important that trustees ask their investment consultants to evaluate fund managers on their responsible investment capabilities and performance. Fund custodians should also ask potential service providers questions about

their approach to specific responsible investment approaches, including analysis of ESG issues, engagement with companies, proxy voting and ideas for economically targeted investments. The following questions should supplement standard questions asked in the evaluation and selection of investment managers. They deal with responsible investment practices broadly, including investment screening, proxy voting and shareholder engagement.

## **Questions to ask investment managers about their responsible investment practices**

### **General**

- ☐ Have you had experience working with clients who are implementing responsible investment practices as part of their overall asset management strategy?
- ☐ Do you have a policy which explains your approach to environmental, social and governance (ESG) performance of investee companies?
- ☐ What financial resources are dedicated to responsible investment management?
- ☐ Do you systematically monitor environmental, social and governance (ESG) issues at companies? Is this monitoring conducted by a dedicated ESG team or by financial analysts?
- ☐ Do managers integrate ESG considerations as part of their regular decision-making?
- ☐ What research services do you use to help determine which stocks/bond to buy? Would you change services or add services that incorporate environmental, social and governance considerations into the research process? If yes, what impact would this have on your (company's) decisions?
- ☐ What is your historical performance record with respect to screened investments?
- ☐ What have been the changes (significant) to the portfolio holdings since the last report and why?
- ☐ Are you aware of any community action, environmental group initiative, labour dispute/boycott involving any of our holdings? If so, what are they? Do you think this will have an impact on the value of our holdings? What, if anything, have you done to get management to deal with the issue? What have been the changes (significant) to the portfolio holdings since the last report and why?

### **Investment Screening**

- ☐ Do you offer screened products? If not, are you willing and able to find appropriate screened investments or develop them if desired?
- ☐ What type of screening methods have you used?
- ☐ Are you willing to work with the pension plan's screening criteria?
- ☐ How do you select benchmarks for screened portfolios that satisfy the fiduciary duty of prudence?

### **Proxy Voting and Shareholder Engagement**

- ☐ What is your policy with regard to evaluating and voting proxies?
- ☐ Do you use a proxy voting service?
- ☐ Do you provide quarterly proxy voting reports?
- ☐ Are you prepared to vote our shares differently if directed, either by following our proxy voting guidelines or on a case-by-case basis?
- ☐ How do you evaluate shareholder proposals dealing with environmental or social issues? What is your voting record on shareholder proposals regarding environmental and social issues?
- ☐ Does your firm actively engage with companies on issues of concern? What types of issues do you talk to companies about? Have you spoken to companies about environmental or social concerns?
- ☐ Do you disclose your engagement activities to your clients? Do you publicly disclose?
- ☐ Do you collaborate with other fund managers when engaging with companies on issues of concern?

## Implementation through collaboration

A growing trend in responsible investment is investor collaboration, which is occurring at both national and international levels. Collaboration among investors has taken different forms, for example groups of investors engaging a *specific company* on an ESG issue, or investor collaboration on a *specific issue*, such as the Carbon Disclosure Project's work on climate change. Investors are increasingly recognizing the benefits of collaboration and pooled resources for economies of scale and increased clout.

Several collaborative initiatives have emerged on an international level. Prominent examples include the United Nations Principles for Responsible Investment (PRI), the Investor Network on Climate Risk, the Enhanced Analytics Initiative and Pharma Futures. At the local level, responsible investors are also working creatively together to build viable finance vehicles for enabling ETIs. Smart growth funds, urban private equity funds and securitized microfinance investment funds are all examples. These types of collaborative models will continue to evolve alongside the general growth of responsible investment practices.

### CASE STUDY: Smaller funds benefit from PRI collaboration

The Nathan Cummings Foundation (NCF), a New York-based foundation committed to the creation of a socially and economically just society, is a smaller fund with big responsible investment aspirations. Long committed to responsible investment, when the foundation decided to become a signatory to the UN Principles for Responsible Investment (PRI) it was nonetheless somewhat concerned that the size of its endowment would prove a hindrance to successful implementation of the voluntary and aspirational Principles:

The Principles provide a "menu" of possible actions, they don't actually list prices. How's a small fund with limited resources supposed to figure out where it can have the most bang for its responsibly invested buck?

For NCF, the answer was two-fold: 1) Keep in mind that the voluntary nature of the PRI allows for selective implementation and focus on efforts with a direct link to its program objectives; and 2) Continually think about ways to more effectively implement the PRI. This specifically meant:

- **Targeting asset managers where the foundation can make an impact.** Two smaller US equity managers in particular have proven very responsive to enquiries regarding key responsible investment issues, including their stances on climate change and investor rights to proxy access.
- **Collaborating with other PRI signatories on shareholder resolutions** to expand the capacity of their in-house engagement work, particularly with governance issues such as executive compensation.
- **Getting creative with portfolio composition**, not simply relying on mutual funds and other pooled investments, but researching and selecting an investment manager willing to track an index (and screen for tobacco) in a separately managed account (at comparable fees!) so the foundation maintains proxy voting rights and the ability to file shareholder resolutions.

The NCF readily admits that successful implementation of the PRI is a big undertaking. However, the PRI—through its common framework for ESG integration, information Clearinghouse, annual meetings and other resources available to investors—provides unparalleled opportunities for funds (small and big) to collaborate on responsible investment. As the Foundation explains, with the application of the Principles helping to drive long-term financial returns, they're well on their way to becoming one of the 'big boys.'

## 04

OVERSIGHT: MONITORING  
AND REVIEW

Maintaining a fund or endowment's responsible investment policy is an ongoing process. Once implemented, it is important to monitor and review policies as well as responsible investment strategies. This allows for regular assessment, including whether the investment decisions have achieved the desired impact and met the investor's established aims.

Some general considerations when reviewing responsible investment policy and implementation are:

- **Monitor and review on a regular basis.** This normally occurs alongside the annual review of the fund or endowment's investment policies and procedures, or when there is a significant regulatory change that affects current policies.
- **Request regular reports from service providers.**
- **Assess and review the performance of investment managers and other service providers.** This review should take place on an annual basis to ensure that all service providers are meeting their obligations, as well as the objectives outlined in investment policies and mandates.
- **Review any costs associated with the responsible investment implementation strategy.**
- **Determine whether the organization should take any further steps in responsible investment.** For active ownership, it is important to maintain a proactive, forward looking perspective.

## And don't forget to report!

Transparency is an important part of the review process, and clear reporting mechanisms help a fund or endowment stay on track with its responsible investment path. Successful reporting requires reporting on a variety of levels:

1. **Report to trustees.** The entire Board of Trustees needs to know that the responsible investment strategy is being carried out consistently, and with prudence.
2. **Report to beneficiaries and stakeholders.** It is important to ensure all direct stakeholders understand responsible investment. This also helps validate investment decisions.
3. **Report to the public.** Some investors may choose to publicly report their responsible investment initiatives, either for strategic reasons or for building general awareness.

**[www.share.ca](http://www.share.ca)**

The Shareholder Association for Research and Education (SHARE) is a social enterprise based in Vancouver, British Columbia. SHARE provides leadership, expertise and advocacy for responsible investment. SHARE assists institutional investors through a variety of active ownership services:

- **Proxy Voting & Advisory Services**
- **Shareholder Engagement**
- **Responsible Investment Tools & Training**
- **Pension Investment & Governance Education**

