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Delivered by Email:

Canadian Investment Funds Standards Committee

Dear Sirs and Mesdames:

RE: ***IFIC Response to CIFSC Proposed Responsible Investment Framework***

The Investment Funds Institute of Canada (**IFIC**) appreciates the opportunity to comment on the CIFSC Proposed Responsible Investment Framework (**Framework**).

IFIC is the voice of Canada's investment funds industry. IFIC brings together 150 organizations, including fund managers, distributors and industry service organizations to foster a strong, stable investment sector where investors can realize their financial goals. IFIC operates on a governance framework that gathers member input through working committees. The recommendations of the working committees are submitted to the IFIC Board or board-level committees for direction and approval. This process results in a submission that reflects the input and direction of a broad range of IFIC members.

IFIC believes that fund managers, dealers, advisors and investor would be well served by a straight-forward identification and classification framework and that such a framework could ultimately help to align investor interests with fund objectives. Currently, there is inconsistency and confusion about RI and ESG-related terminology and investment approaches and there is no broadly supported industry standard or regulatory initiatives that would bring about a standard.[1]

While IFIC supports the disclosure based approach described by CIFSC, where RI funds are identified based on prospectus and other disclosure, we are strongly opposed to the stated plan to incorporate a quantitative component to the Framework. Such an approach would in essence provide CIFSC and its voting members the task of using proprietary ESG fund evaluative frameworks to determine the quality of available RI funds. In IFIC's view this should not be the role of an independent industry-supported organization. Please find our detailed comments below.

Responsible Investment Approach Component

In principle, IFIC supports the component of the Framework described by the CIFSC, that a fund is considered a RI fund if the fund articulates in its prospectus or other key regulatory filings, a recognized RI approach, strategy and processes. However, IFIC recommends that CIFSC align its classification scheme

[1] It should be noted that in the Federal Government's Fall Economic Statement it was announced that the Department of Finance Canada and Environment and Climate Change Canada will create a public-private Sustainable Finance Action Council aimed at "developing a well-functioning sustainable finance market in Canada" which includes "…developing standards for investments to be identified as sustainable." The Framework should monitor these development and consider how to align the Framework with potential regulation or to defer altogether.

to the forthcoming CFA's Voluntary Disclosure Standards. While still under development, the initiative is supported by an ESG Working Group and is the culmination of input from a broad range of Canadian and international stakeholders, including industry experts, from asset managers and asset owners, research analysts, consultants, service providers, data providers, and nonprofit industry organizations. There is already very close alignment between the proposed CFA "product features" and the CIFSC "RI approaches". It is conceivable that the CIFSC could use the CFA Disclosure Standards to identify and classify Canadian investment funds for the benefit of investors and advisors. Additionally, the Canadian CFA Working Group recommended that the CFA also consider a parallel set of firm level standards to accommodate firm level considerations when evaluating specific ESG products. IFIC's response to the CFA Consultation on the Voluntary Disclosure Standards can be found here.

Greater alignment with the CFA Disclosure Standards would also avoid conflicting or inconsistent definitions and definitions that are not supported by the broader fund industry. For example, IFIC does not agree with how ESG Evaluation and Integration is defined. In the CIFSC Framework, ESG Evaluation and Integration is defined as, "where the fund uses Environmental, Social and Governance (ESG) criteria as the primary evaluation method for security selection." Most definitions of ESG Integration describe ESG criteria being considered alongside other more traditional financial metrics in the investment decision-making process, without requiring primacy of ESG factors. As defined, this resembles more an ESG "Best-in-Class" or "ESG Tilt" strategy.

Alternatively, if the Framework is not aligned to the forthcoming CFA Disclosure Standards, IFIC encourages the CIFSC to incorporate the views of stakeholders and ensure industry support for RI definitions before finalizing.

The Framework indicates that regulatory documents also include a description of intended impact. IFIC recommends broadening this to include a description of RI purpose or intention. The reason for this is that not all RI funds have an objective of impact but only of aligning holdings with investor preferences (e.g. tobacco free funds).

Quantitative Evaluation

CIFSC states in its proposal that "initially the framework will only consider regulatory and marketing materials in identifying responsible funds, but the CIFSC is working to develop a quantitative evaluation that would be integrated into the framework. The CIFSC believes that a quantitative assessment is necessary to improve the transparency of the process and the accountability of the funds."

As stated above, IFIC is strongly opposed to a quantitative assessment if it is based on the CIFSC member data providers. It is the ratings of these firms that the Framework currently envisions including on the CIFSC website as part of the framework. IFIC is opposed for the following reasons:

1. It is well established that there is low correlation in fund rating systems of the three CIFSC member data providers. This is an indication that there are multiple ways to evaluate the ESG performance of funds and underlying securities. It is not justifiable by any objective measure to suggest that these are the only or best ways to evaluate ESG quality.
2. Fund managers do not manage according to the fund rating systems but to their own ESG analytical frameworks that would not always be captured by the CIFSC member data provider systems. It is highly likely that a particular fund manager's RI tilt or approach, despite being rigourous and meaningful, would not be captured by the evaluative frameworks of the CIFSC member data providers.
3. Fund ratings are not well suited to capturing and evaluating shareholder engagement, impact and thematic investing, which are key approaches to RI.
4. There is a real, or at least perceived, conflict of interest if the voting members of CIFSC are using their firms' proprietary rating systems to determined what funds can be considered RI funds.
5. The rating systems of the CIFSC data providers are limited by the availability and comparability of ESG data for underlying securities. The rating systems are well understood as favouring large-

cap funds or funds with predominately developed market securities where there is more extensive ESG disclosure. Small and mid-cap, emerging market, and fixed income funds face a systematic disadvantage.

6. The fund rating systems of the data providers score funds relative to all funds internationally, however, Canadian investors are only choosing mutual funds from a base of Canadian mutual funds.
7. ESG ratings may only consider ESG risks across all sectors when, in fact the materiality of specific ESG risks may vary significantly depending on the sector in which a company operates. Failing to consider sector-specific nuances in the ESG evaluation process may underplay or overplay specific risks and in turn mislead investors.
8. As ESG Fund Ratings are available on two of the three research providers public website, namely Sustainalytics (through Morningstar) and MSCI, there already exists a publicly available option that draws data from each individual ESG provider's proprietary approach. Refinitiv Lipper only recently launched their fund ratings in July, 2020. Their Fund ESG scores are not currently publicly available, but can be accessed through their Refinitiv Workspaces, Eikon or API Feed.
9. As there was discussion about potentially taking an average of the three data-provider scores to identify RI funds, we would further note the challenge of this potential approach given the low correlation and varying approaches to measuring ESG risks and opportunities.

The fund ratings and ESG security rating agencies have an important role in Canadian and the global fund marketplace. It is appropriate that they promote their ratings to fund companies, researchers, consultants, advisors and investors. However, it would be inappropriate for these data providers to use their role within CIFSC to sanction their own approach to ESG performance and fund rating. This would be similar to CIFSC taking on the role of using their own evaluative schemes to determining, for example, which funds are truly active funds, which are truly low volatility funds or measuring and sanctioning some other investment manager's stated approach to investing.

IFIC believes that CIFSC needs to refocus the stated objective of the framework. While the preamble to the Framework states that "CIFSC's goal is to meet the need for an objective, comprehensive list of Canadian responsible investment funds" it also states that it is "proposing to adopt a framework to identify Canadian investment funds that ***sufficiently practice*** [emphasis added] responsible investing." These are two very different objectives and IFIC does not believe that CIFSC should be taking on the role of determining the relative strength, quality or "sufficiency" of a fund's approach to RI. Only the latter would require an evaluative framework, such as the quantitative scoring proposed by CIFSC, which, as stated above, IFIC strongly opposes.

Additional Comments

IFIC would recommend that CIFSC provide a second draft iteration of the Framework and encourages CIFSC to address these issues in the next draft:

- To IFIC's knowledge, CIFSC does not have a budget or dedicated staff that would be able to maintain RI fund identification and classification. It would be helpful to understand how CIFSC will maintain the Framework given the work required reviewing fund documentation.
- The proposed Framework states that the approach to RI by a fund will have to be disclosed in an "investment mandate or elsewhere in the regulatory documents". It would be helpful for CIFSC to provide more detail about expectation around disclosure and if existing disclosure for funds identified as RI funds by IFIC or the RIA are already meeting expected disclosure. It would be IFICs expectation that disclosure requirements would not require articulation in the investment objective as a change to investment objective would require a unit holder vote.

Yours sincerely,
THE INVESTMENT FUNDS INSTITUTE OF CANADA

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