TORONTO

REPORT FOR ACTION

Investment Policy - Environmental, Social, and Governance Review

Date: March 28, 2019
To: Toronto Investment Board
From: Executive Director, Corporate Finance
Wards: All

SUMMARY

City Council has directed the Executive Director, Corporate Finance to review sections of the Statement of Investment Policy and Procedures for the City of Toronto Investment Funds (Investment Policy) pertaining to Environmental, Social, and Governance (ESG) factors and to consult with a number of relevant industry stakeholders, including the Toronto Investment Board (the Board), and report back to the Executive Committee in the first quarter of 2019.

The purpose of this report is to summarize the ESG provisions contained in the Investment Policy and to solicit advice from the Board and other stakeholders on how these provisions can be enhanced.

RECOMMENDATIONS

The Executive Director, Corporate Finance recommends that:

1. The Toronto Investment Board receive this report for information.

FINANCIAL IMPACT

There is no financial impact to City's operating or capital budgets as a result of this report.

DECISION HISTORY

At its meeting of September 6, 2018, the Toronto Investment Board received the updated Council approved City of Toronto Investment Policy. The Board also received copy of a motion adopted by Council to review the Environmental, Social, and Governance Factors contained in the policy.

http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2018.IB7.1

COMMENTS

The current Investment Policy (Section 6.6) includes the following section on Environment, Social, and Governance (ESG) Factors:

"The City of Toronto believes that well-managed companies are those that demonstrate high ethical and environmental standards and respect for their employees, human rights, and the communities in which they do business, and that these actions contribute to long term financial performance.

Corporations should account for their behaviour and its implications for the creation of value. The City supports the view that companies should maintain policies and procedures with respect to Environmental, Social, and Governance (ESG) issues that materially affect long term shareholder value.

The City encourages the adoption of high standards of behaviour as a means to maximize long term shareholder value.

The Investment Board should incorporate ESG factors into its investment decision-making through its due diligence processes when choosing Investment Managers. As such, when a prospective investment manager is assessed, or an existing Investment Manager is reviewed, the Investment Board will consider the Investment Manager's ESG policies. The approach to ESG integration in the investment process will, however, vary both between and within asset classes based upon a number of factors, including the degree of control exercised by the Investment Board, contractual restrictions and the nature of the investment.

The City has chosen to monitor the developments of ESG factors and will reconsider its approach as and when appropriate to do so."

Staff has invited several relevant industry stakeholders to make presentations to the Board with respect to the City Council motion on ESG Factors. The motion is presented in Attachment 1 of this report. The current Statement of Investment Policy and Procedures appears in Attachment 2.

The investment consultant to the Board, Aon, is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Their 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance. Aon has supplied a recent white paper entitled "Key Considerations for Responsible Investing Initiatives" by Meredith Jones (Attachment 3).

The Atmospheric Fund (TAF) was established in 1991 to assist the City of Toronto in meeting its goal of reducing greenhouse gas (GHG) emissions. TAF assists in slowing global climate change and improving air quality in collaboration with non-government organizations, governments, corporations, official committees, neighbourhood organizations, universities, public and private schools, investors and other stakeholders to demonstrate, de-risk, and help advance social, financial, policy and technological innovations that reduce air pollution and greenhouse gas emissions. Julia Langer, CEO of TAF has been asked to provide a presentation and speak to the Board on this matter.

Sustainalytics is a leading independent global provider of ESG and corporate governance research and ratings to investors. They are a global leader in sustainability research & analysis, serving investors & financial institutions with responsible investment solutions. Sustainalytics provided an independent third party certification to the City of Toronto's "green" bond framework. Gary Hawton, Senior Director of Institutional Relations for Sustainalytics, has been asked to present to the Board.

City staff also contacted The C40 Cities Climate Leadership Group (C40) and met with them recently. C40 is a peer-to-peer coordinator and connects 90 of the world's largest cities that are facing similar issues in regard to climate change. C40 staff have also been invited to present to the Board, however they regret that they are unable to attend.

City staff are conducting a review of best practices with regard to ESG policies. This review, together with submissions from stakeholders and input from the Board will better inform the staff report to Executive Committee and Council.

CONTACT

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SIGNATURE

Joe Farag
Executive Director, Corporate Finance

ATTACHMENTS

Attachment 1 - City Council Decision on Item EX35.16, City of Toronto Investment Report for 2017 and the First Quarter of 2018 and Policy Update (Considered at the City Council Meeting on June 26-29, 2018)
Attachment 2 - Statement of Investment Policy and Procedures for the City of Toronto Investment Funds
Attachment 3 - Key Considerations for Responsible Investing Initiatives (Meredith Jones, Aon)

Attachment 1

City Council Decision on Item EX35.16, City of Toronto Investment Report for 2017 and the First Quarter of 2018 and Policy Update (Considered at the City Council Meeting on June 26-29, 2018)

City Council Decision

City Council on June 26, 27, 28 and 29, 2018, adopted the following:

1. City Council approve the following amendments to the City Council-approved Investment Policy (Policy) and adopt the amended Policy set out in Attachment 2 to the report (June 5, 2018) from the Interim Chief Financial Officer:

a. the Asset Mix for Equities for Long Term Fund and Sinking Fund be adjusted by combining all four equity categories into one category called "Global Equity" with a Targeted Asset Mix of 20-percent with a range from a Minimum of 0-percent to a Maximum of 30-percent;

b. the MSCI All-Country World Index be included as a benchmark to measure the performance of the equity portfolio in its entirety for the Long Term Fund and Sinking Fund;

c. the benchmark for the Fixed Income component of the Sinking Fund be changed to "Customized" based on the "Liability Driven Investments" approach;

d. the average credit rating of the fixed income portfolio for the Long Term Fund and Sinking Fund be lowered from "A" to "A-" (or equivalent) to be equal to the fixed income benchmark (Financial Times Securities Exchange (FTSE) TMX Universe Canada Bond Index);

e. the Asset Mix for the Trust Fund be adjusted by increasing the Maximum weight of Schedule 1 Bank from 50 percent to 100 percent which aligns with the current limit in the Investment Policy for the City's Short Term Fund; and

f. the minimum credit rating requirements of the Schedule 1 Banks for the Trust Funds be lowered from "AA-" to "A" (or equivalent) to be the same as the requirements for the City's Short Term Fund.

2. City Council establish a corporate reserve account named the Investment Stabilization Reserve in Schedule 3 - Stabilization Reserves of City of Toronto Municipal Code Chapter 227, Reserves and Reserve Funds ("Chapter 227"), the purpose of which is to stabilize investment income contributions to the operating budget by minimizing in-year variances through receiving funds in years when investment income is in excess of the amount expected in the operating budget and withdrawing funds in years when investment income is below budget, with criteria as

set out in Attachment 5 to the report (June 5, 2018) from the Interim Chief Financial Officer.

3. City Council request the Executive Director, Corporate Finance to report to the Executive Committee in the first quarter of 2019, in consultation with the Toronto Investment Board, the Chief Executive Officer and Board of The Atmospheric Fund, the C40 Cities Climate Change Leadership Group and relevant industry stakeholders, on possible amendments to the Statement of Investment Policy and Procedures that would:

a. improve Section 6.6 Environment, Social and Governance Factors to reflect current responsible investment best practices, excluding fossil fuels from the portfolio, and actively investing in clean energy and climate solutions;

b. enhance Section 2.2 Investment Beliefs including recognition of Environment, Social and Governance factors as material to risk/return outcomes; and

c. add an asset class for Direct Investment with a focus on investments that would benefit and enhance the local economy in Toronto.

4. City Council further advise the Toronto Investment Board of the request in Part 3 above and of Council's intent to review the investment policy as it relates to fossil fuel investments, climate risk and climate solutions.

Background Information (Committee)

(June 5, 2018) Report and Attachments 1, 3, 4, 5 from the Interim Chief Financial Officer on City of Toronto Investment Report for 2017 and the First Quarter of 2018 and Policy Update
(http://www.toronto.ca/legdocs/mmis/2018/ex/bgrd/backgroundfile-116241.pdf)
Attachment 2 - Statement of Investment Policy and Procedures
(http://www.toronto.ca/legdocs/mmis/2018/ex/bgrd/backgroundfile-116242.pdf)

Motions (City Council)

1 - Motion to Amend Item (Additional) moved by Councillor Mary-Margaret McMahon (Carried)

That:

1. City Council request the Executive Director, Corporate Finance to report to Executive Committee in the first quarter of 2019, in consultation with the Toronto Investment Board, the Chief Executive Officer and Board of The Atmospheric Fund, the C40 Cities Climate Change Leadership Group and relevant industry stakeholders, on possible amendments to the Statement of Investment Policy and Procedures that would:

a. improve Section 6.6 Environment, Social and Governance Factors to reflect current responsible investment best practices, excluding fossil fuels from the portfolio, and actively investing in clean energy and climate solutions;

b. enhance Section 2.2 Investment Beliefs including recognition of Environment, Social and Governance factors as material to risk/return outcomes; and

c. adding an asset class for Direct Investment with a focus on investments that would benefit and enhance the local economy in Toronto.

2. City Council further advise the Toronto Investment Board of the above request and of Council's intent to review the investment policy as it relates to fossil fuel investments, climate risk and climate solutions.

Link to additional information:

http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2018.EX35.16