

Investment Policy Update

Date: January 21, 2020
To: City Council
From: Chief Financial Officer and Treasurer
Wards: All

SUMMARY

Provincial legislation requires City Council to review and update the Investment Policy on an annual basis as required.

Since January 1, 2018, the City's long-term investments have been managed by the Toronto Investment Board under a new Council adopted Investment Policy which is based on the prudent investor standard. Changes to the Investment Policy are reviewed and adopted by TIB before they are brought forward to City Council.

This report also responds to Council direction to review and report on sections of the Investment Policy with regard to Environmental, Social, and Governance (ESG) factors and makes recommendations to enhance these sections.

The Chief Financial Officer and Treasurer (CFO&T) along with other City staff have consulted with several stakeholders and subject matter experts with regard to ESG and climate change. Additional consultations were made with the Toronto Investment Board (TIB) and The Atmospheric Fund (TAF) following the direction by Council in October 2019.

This report makes a recommendation to add a section to allow for the CFO&T to accept minor variations of the City's Investment Policy when compared to the standard terms in the policies of pooled funds (and other types of funds). These funds are allowed by the current legislation and would be reviewed and selected by TIB.

The report makes a recommendation to the Real Assets section of the Investment Policy to allow for the Real Estate sub-component to change its geographic focus to a North American/Global basis. This change would provide greater liquidity and transparency. In addition, widening the geographical scope provides more options and flexibility to improve the risk and return profile.

RECOMMENDATIONS

The Chief Financial Officer and Treasurer recommends that:

1. City Council approve the following amendments to the City Council-approved Investment Policy (Policy) and adopt the amended Policy as shown in Attachment 1:

(a) the Investment Beliefs (Section 2.2) be enhanced to include recognition of Environment, Social and Governance (ESG) factors as material to risk/return outcomes;

(b)) the Environmental, Social, and Governance Factors (Section 6.6) be strengthened by having investment managers consider the United Nations' 17 sustainable development goals (SDGs) which includes climate change, and that these investment managers have a process that integrates ESG in the analysis and on-going review of the assets under management;

(c) Long Term Fund and Sinking Fund Long Term Constraints (Section 3.2 (b)) to add a subsection named "Investments in Pooled Funds, Mutual Funds, and other similar products", to allow the Chief Financial Officer and Treasurer, at their discretion, to accept minor variations of the City's Investment Policy when compared to the standard terms in the policies of these funds;

(d) Asset Mix Guidelines (Section 2.4 (b)) and Real Asset Portfolio Constraints (Section 3.2 (b)(iii)) such that references in the Real Assets sub-category to "Canadian Core" and "Global Core" be replaced with "North American/Global Core"; and

(e) References to the Chief Financial Officer (CFO) updated to reflect the current title of Chief Financial Officer and Treasurer (CFO&T).

2. City Council request the Toronto Investment Board and the Chief Financial Officer and Treasurer to develop a process to monitor and report on external investment firms hired by the City are compliant with the terms of the Investment Policy governing ESG and that the information and data regarding climate change risk from these reviews be reported to City Council semi-annually.

FINANCIAL IMPACT

There is no financial impact resulting from the adoption of the recommendations in this report.

DECISION HISTORY

The Toronto Investment Board requested staff to report back on options as it pertains to ESG factors and to review the various service providers of this data at its meeting on December 4, 2019.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.IB5.3>

The Toronto Investment Board requested that the Council-approved Investment Policy be amended to change the geographical scope of the both Real Estate and Infrastructure sub-categories to North American/Global Core (from Canadian Core and Global Core respectively) at its meeting on December 4, 2019.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.IB5.6>

City Council referred the City of Toronto Investment Report for 2018 and the First Quarter of 2019 and Policy Update to the Chief Financial Officer and Treasurer, and requested the Chief Financial Officer and Treasurer, in consultation with the Investment Board and The Atmospheric Fund, to report to the January 29 and 30, 2020, City Council meeting on additional improvements to the Investment Policy at their meetings on October 2 and 3, 2019.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.EX8.3>

The Toronto Investment Board adopted a Board Decision at their meeting of May 10, 2019 with respect to the ESG sections of the Investment Policy

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.IB2.1>

City Council adopted the updated Investment Policy at their meetings on June 26 to 29, 2018 and passed a motion for staff to review the ESG sections with the focus on climate change after consultations with several stakeholders

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

City Council adopted the New City of Toronto Investment Policy at their meetings on December 5 to 8, 2017

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2017.EX29.6>

COMMENTS

Recent Consultations - The Atmospheric Fund (TAF)

TAF indicated they had previously contributed through meetings with City staff and a presentation to the Toronto Investment Board in May 2019 and did not have any additional information to add.

There was an exchange of information that included wording of the TAF Statement of Investment Objectives and Principles (SIOP) which is very specific on climate risks and low-carbon opportunities, however does not include any "exclusionary" text (e.g. no fossil fuel companies).

TAF also provided the name of their service provider that is used to measure and monitor their portfolio with regard to climate risks.

Recent Consultations - Toronto Investment Board (TIB)

At their December 2019 meeting, the Toronto Investment Board (TIB) considered the City Council Decision with regard to the City's Investment Policy.

TIB had previously discussed and adopted changes at their Special Meeting in May 2019 that focused on ESG (Attachment 2). Several stakeholders made presentations and a broad approach that included the United Nations Sustainable Development Goals (SDGs) was adopted. These SDGs include climate change, but also include other factors such as poverty reduction and gender equality that aligns with City policies. The 17 SDGs are shown in Attachment 3 and their inter-linked connection are shown in Attachment 4.

The Board Decision on ESG is in line with current investment practice and adopted by large Canadian pension funds (e.g. OMERS) that are leaders in this area. Other Canadian municipalities have yet to adopt these measures as the City of Toronto is the first to be given the prudent investor standard with the oversight of an investment board.

TIB had no additional information to add to the proposed Investment Policy that was sent to City Council in October 2019. Changes to the Investment Beliefs (Section 2.2) and the Environment, Social, and Governance (ESG) section (Section 6.6) were in line with current investment practice and adequate to address part (a.) and (b.) of the City Council Decision.

With regard to ESG integration (Council Decision - part (b.)), this is already in the current Investment Policy (Section 6.6) however it is also included in the amendment to the Investment Beliefs (Section 2.2). As mentioned in a previous report, all of the selected external investment managers are United Nations Principles of Responsible Investment (UNPRI) signatories (Attachment 5). The first principle requires the investment manager to "incorporate ESG issues into investment analysis and decision-making processes".

TIB did spend time discussing part (c.) of the City Council Decision and agreed with the concept of Monitoring and Reporting ESG factors which should include a breakdown of climate risks. TIB adopted a motion for City staff to review "governance options as it pertains to the ESG factors and to review the various service providers of this data".

Previous Consultations

On May 11, 2019 a Special Meeting of the TIB was held to consider changes to the Investment Policy with regards to Environmental, Social, and Governance (ESG) issues with a focus on climate change. This item was a result of a motion adopted by City Council at their meetings held June 26 to 29, 2018 where the Investment Policy was reviewed and updated. During this meeting of the Board, several communications were received by various stakeholders and industry experts including TAF, Sustainalytics, and Aon.

In addition to the information presented at the Toronto Investment Board on May 11, 2019, City staff also consulted several industry stakeholders and specialists as outlined in Table 1.

Table 1 – List of Industry Stakeholders Consulted

Organization	Name	Title
Responsible Investment Association	Mary Robinson*	Director of Research, Policy, & Collaboration
Sustainalytics	Gary Hawton	Senior Director, Client Relations, North America
The Atmospheric Fund	Julia Langer	Chief Executive Officer
Aon Hewitt	Brian White	Partner
WSIB/Payments Canada	Pamela Steer*	Chief Financial Officer
C40 Cities	Laura Jay / Friederike Hanisch	Deputy Regional Director for North America / Senior Manager, C40 Divest/Invest Forum, City Finance Programme

*Members of the Toronto Investment Board

Recommendations for Investment Policy Changes

The City of Toronto Act regulations require that Council review its Investment Policy each year. The Investment Board has identified and now proposes some changes, for City Council's consideration, to the Investment Policy adopted by Council at its meetings in June 2018 and October 2019.

The proposed changes comprise i) change the Investment Belief section (Section 2.2) to include recognition of Environment, Social and Governance (ESG) factors as material to risk/return outcomes; and ii) change the Environmental, Social, and Governance (ESG) Factors (Section 6.6) for investment managers to consider the United Nations' 17 Sustainable Development Goals (SDGs) which includes climate change. The recommendations do not change any of the basic principles, objectives, or overall portfolio risk profiles in the current Investment Policy, but are intended to highlight and focus the City of Toronto's commitment to sustainability and in particular climate change.

Other proposed changes are more of a housekeeping nature: i) allow the Chief Financial Officer and Treasurer, at their discretion, to accept minor variations of the City's Investment Policy when compared to the standard terms in the policies of pooled funds, Mutual funds, and similar products; ii) references in the Real Assets sub-category to "Canadian Core" and "Global Core" be replaced with "North American/Global Core";

and; iii) title change reference from Chief Financial Officer (CFO) to Chief Financial Officer and Treasurer (CFO&T).

The updated Investment Policy is attached (Attachment 1) with the new additions in "**bold**".

Amendment Item 1. Change the Investment Belief section (Section 2.2) to include recognition of Environment, Social and Governance (ESG) factors as material to risk/return outcomes.

This item was identified by City Council in its motion to approve the Investment Policy (EX35.16) in June 2018. All stakeholders and staff agreed this was a positive change and would clarify and enhance the policy.

Investment Beliefs - Section 2.2 (vi) was added to read: **Environmental, Social, and Governance (ESG) factors are material to risk/return outcomes and must be considered and integrated in the investment approach.**

Amendment Item 2. Change the Environmental, Social, and Governance (ESG) Factors (Section 6.6) to be broad and consider the United Nations' 17 Sustainable Development Goals (SDGs) which includes climate change.

An additional paragraph was added to the Environmental, Social, and Governance (ESG) Factors – Section 6.6 to read:

These ESG factors should focus on all of the 17 Sustainable Development Goals (SDGs) identified by the United Nations which include, but are not limited to, climate change, gender equality, and poverty reduction.

City Council also requested staff to "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".

This item was more difficult to gain a consensus on with stakeholders. Several industry experts argued exclusionary policies were not the current best practice in responsible investing and are difficult to work with for practical purposes. Given the set-up of the Toronto Investment Board and the need to hire external managers, one industry stakeholder with a long history of over 25 years in sustainable investing indicated the number of firms with a track record longer than five years that could provide an actively managed product in clean energy and climate solutions is severely limited and in the area of three firms. In other words, there is not a lot of choice.

The Toronto Investment Board adopted a more holistic approach that included all of the United Nations 17 Sustainable Development Goals (SDGs) (Attachment 3 and 4) which includes several specific items related to climate change: affordable and clean energy (Goal 7), sustainable cities and communities (Goal 11), and climate action (Goal 13).

The 17 sustainable development goals (SDGs) are:

- Goal 1: No Poverty
- Goal 2: Zero Hunger
- Goal 3: Good Health and Well-being
- Goal 4: Quality Education
- Goal 5: Gender Equality
- Goal 6: Clean Water and Sanitation
- Goal 7: Affordable and Clean Energy
- Goal 8: Decent Work and Economic Growth
- Goal 9: Industry, Innovation and Infrastructure
- Goal 10: Reduced Inequality
- Goal 11: Sustainable Cities and Communities
- Goal 12: Responsible Consumption and Production
- Goal 13: Climate Action
- Goal 14: Life Below Water
- Goal 15: Life on Land
- Goal 16: Peace and Justice Strong Institutions
- Goal 17: Partnerships to achieve the Goal

It should also be noted the Toronto Investment Board has selected external investment managers that are all United Nations Principles for Responsible Investment (UNPRI) signatories. It is an onerous process to become a signatory as well as maintaining this status. Each year, UNPRI signatories must submit a detailed 12 module reporting framework which shows how the investment manager has complied with the principles and improved the integration of ESG factors in their processes. The information is then sent in to the PRI Association be scored and ranked with its peers.

Becoming an UNPRI signatory requires an investment manager to comply with six principles:

Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.

Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.

Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.

Principle 5: We will work together to enhance our effectiveness in implementing the Principles.

Principle 6: We will each report on our activities and progress towards implementing the Principles.

Monitoring and Reporting ESG and Climate Change Factors

Although all of the selected external investment managers are UNPRI signatories, City staff is recommending all of the portfolios be reviewed on a continuing basis in order to ensure compliance with the evolving ESG standards. It is recommended that City Council request the Toronto Investment Board and the Chief Financial Officer and Treasurer to develop a process to monitor and report on external investment firms hired by the City are in compliance with the terms of the Investment Policy governing ESG and that the information and data regarding climate change risk from these reviews be reported to City Council semi-annually.

At its most recent meeting, the Toronto Investment Board asked City staff to review "governance options as it pertains to the ESG factors and to review the various service providers of this data".

Similar to credit ratings, there are several independent third party services that provide these reviews and ratings on individual companies. All of the external investment managers subscribe to one or several of these services. It will be a matter for the Toronto Investment Board along with City staff to determine which of these services is best to use and to develop a process to collect report this information.

Environmental, Social, and Governance (ESG) - Next Steps

The Toronto Investment Board highlighted ESG as one area of investments that is evolving and requested staff to continue to monitor and bring forward updates to this section of the Investment Policy as and when appropriate for City Council's consideration.

City staff also met separately with one Toronto Investment Board member (Mary Robinson) who is the Director of Research, Policy, and Collaboration for the Responsible Investment Association (RIA). The RIA is Canada's industry association for responsible investment. RIA members believe that the integration of environmental, social and governance (ESG) factors into the selection and management of investments can provide superior risk adjusted returns and positive societal impact. The RIA has over 100 organizational members representing asset managers, asset owners and service providers such as Sustainalytics, CIBC, RBC Asset Management, Addenda which are founding members. It should be noted that TAF is also a member of the RIA. The RIA hosts a number of educational and networking events for their members to promote and learn about responsible investment.

As far as monitoring current trends and keeping up-to-date, it would be beneficial for the City to become a member of the RIA. There are currently no other municipalities in the RIA. The City of Toronto would be the first municipality to demonstrate commitment to and leadership in Responsible Investing (RI). City staff are in the process of completing a membership application at the time of writing this report.

Housekeeping Item to Clarify the Use of Pooled Funds, Mutual Funds, and other Similar Funds

Pooled funds, mutual funds, and other similar funds are funds that are created to attract a number of institutional and retail investors. The City of Toronto is permitted to use these funds under the new prudent investor regulations. The Toronto Investment Board has selected to use pooled funds for the global equity allocation as they provide lower cost, ease of use, liquidity, and ease of administration. The current City of Toronto Investment Policy does allow for the use of these funds.

These funds have developed generic investment policies that appeal to large number of investors, however may differ slightly from the City's Investment Policy. For example, the City's policy does not allow margin, borrowing, or other types of leverage, however many of these funds allow for some short term borrowing for liquidity purposes (i.e. large redemption, market disruption, settlement issue, etc.). This is a normal and prudent business practice for all of these funds but may be considered by some as a variation of the City's policy.

Similarly, other individual securities are either not mentioned in the City's policy (e.g. American Depository Receipts (ADRs)) or are mentioned (Repurchase and Reverse Repurchase Agreements) however may be used by these types of funds in the normal course of business.

In order to use these types of funds, it will be necessary to accept these minor variations in policies so that documentation may be completed.

It is recommended that City Council give the Chief Financial Officer and Treasurer the authority to accept these minor variations at her discretion.

Amendment Item 3. Add Section 3.2 (b) (v) Investments in Pooled Funds, Mutual Funds, and other similar products to allow the Chief Financial Officer and Treasurer, at her discretion, to accept minor variations of the City's Investment Policy when compared to the standard terms in the policies of these funds.

Section 3.2 will read as:

Investments in Pooled Funds, Mutual Funds, and other similar products

Given these funds are created to be used by multiple investors and have pre-established policies that do not align exactly with the provisions of this policy, the Chief Financial Officer and Treasurer will have discretion to accept the terms of the fund if such terms are minor variations to this policy.

Housekeeping Item to change the geographical scope of both Real Estate and Infrastructure sub-categories.

The Toronto Investment Board adopted a report from staff at its meeting on December 4, 2019, that recommended the Council-approved Investment Policy be amended to change the geographical scope of both the Real Estate and Infrastructure sub-

categories to North American/Global core from Canadian Core and Global Core, respectively.

The Council-approved Investment Policy prescribes a 10% target allocation to Real Assets for both the Long Term Fund and the Sinking Fund. The Policy also sub-categorizes Real Assets into two parts: 1) Real Estate (Canadian Core) and 2) Infrastructure (Global Core). The allocation to Real Assets was originally included in the strategic asset mix due to its significant diversification properties and beneficial risk and return characteristics.

In a memo to the Board dated November 15, 2019, the investment consultant (Aon) recommended to consider Real Estate and Infrastructure investments in both core and open-ended funds with a North American/Global focus. The rationale for the investment consultant's recommendation are as follows:

- Attractive risk and return profile;
- No expiration cycle whereby assets would need to be sold and re-invested;
- Portfolio transparency (Can see current investments and a history of returns for the fund);
- Instant access to asset and vintage year diversification;
- Visibility into the current valuation of the fund's assets;
- Greater liquidity through ability to redeem;
- Real Assets Allocation Plan Update Page 3 of 3
- 2-3 strong Open-Ended funds currently available within the global infrastructure, global real estate, European real estate, and Asia real estate universe;
- Several strong funds available within US real estate;
- Queues are relatively long for infrastructure (12-18 months for initial investment) and real estate (9-12 months for initial investment); and
- By starting the process now, capital could conceivably begin being deployed in 2021 (allows for search, approval, contracting process, and queueing time).

Amendment Item 4: Section 2.4 (b) Asset Mix Guidelines and Section 3.2 (b) (iii) Real Asset Portfolio Constraints such that references in the Real Assets sub-category to "Canadian Core" and "Global Core" be replaced with "North American/Global Core".

City staff agree with the investment consultant that these changes could provide greater liquidity and transparency. In addition, widening the geographical scope of both of these sub-categories provides more options and flexibility to improve the portfolio's risk and return profile.

Amendment Item 5: All sections to change "Chief Financial Officer" to new title "Chief Financial Officer and Treasurer".

This item is administrative in nature and changes the policy to reflect the current title.

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SIGNATURE

Heather Taylor

Chief Financial Officer and Treasurer

ATTACHMENTS

Attachment 1 – Statement of Investment Policy and Procedures

Attachment 2 – Toronto Investment Board Decision IB2.1

Attachment 3 – United Nations 17 Sustainable Development Goals (SDGs)

Attachment 4 – View of SDG System – Interlinked Goals

Attachment 5 – United Nations Principles of Responsible Investment

Attachment 1

Under Separate Cover

Attachment 2

Investment Board Decision on Item IB2.1, Investment Policy - Environmental, Social, and Governance Review (Considered at the Toronto Investment Board Meeting on May 10, 2019)

Board Decision (May 10, 2019):

The Toronto Investment Board:

1. Requested the Executive Director, Corporate Finance, to incorporate the following comments in the Executive Director's upcoming report to City Council on the Investment Policy - Environmental, Social, and Governance Factors Review:

- a. Include Environmental, Social, and Governance factors as material to risk/return outcomes in Section 2.2 (Investment Beliefs) of the Investment Policy;
- b. Ensure that the focus of Section 6.6 (Environmental, Social, and Governance Factors) of the Investment Policy is all-inclusive and considers the United Nations' 17 sustainable development goals which includes climate change;
- c. Exclude direct investing in Toronto's economy as a separate asset class in the Investment Policy, as it falls outside the Toronto Investment Board's mandate, responsibilities, and resources and these types of investments are direct policy decisions for City Council through its Budget Process;
- d. Maintain the current Section 6.6 (Environmental, Social, and Governance Factors) of the Investment Policy at this time and request Corporate Finance staff to monitor and update it regularly to reflect evolving Environmental, Social, and Governance principles that are aligned with the mandate of this Policy; and
- e. Ensure the policy recommendations support and advance the City's commitment towards carbon reduction targets.

Decision Advice and Other Information

Julia Langer, Chief Executive Officer, The Atmospheric Fund and Hyewon Kong, Member, Investment Committee, The Atmospheric Fund gave a presentation on City of Toronto Investment Policy: Embracing Best Practices, Minimizing Downside Climate Risk, and Maximizing Upside Value from Climate Solutions.

Brian White, Partner, Aon Hewitt gave a presentation on Key Considerations for Responsible Investment.

Attachment 3



Attachment 4

View of the SDG system: Interlinked Goals

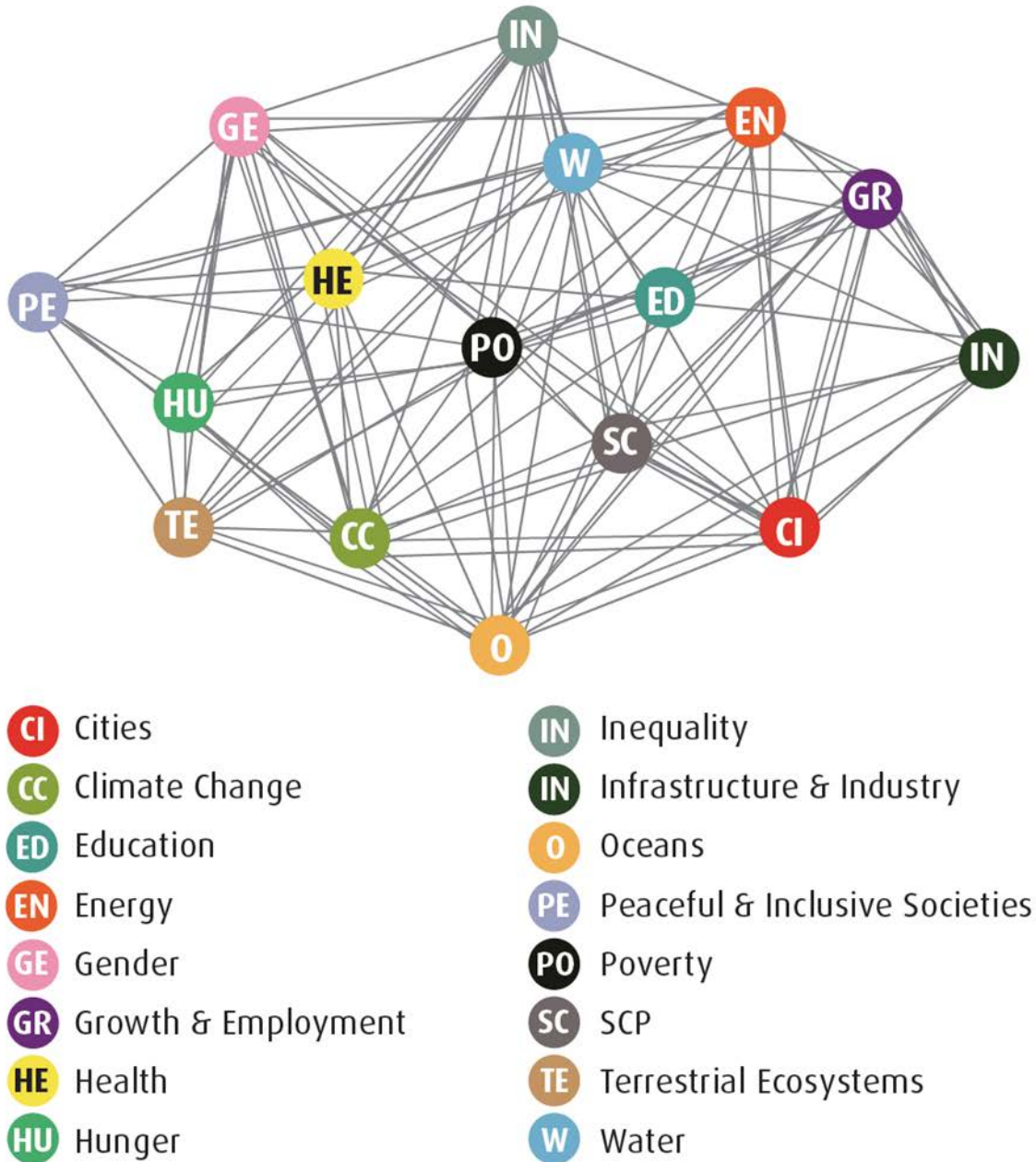


Figure 2: UN 2015 Global Sustainable Development Report

Attachment 5



It should also be noted the Toronto Investment Board has selected external investment managers that are all United Nations Principles for Responsible Investment (UNPRI) signatories. It is a difficult process to become a signatory as well as maintaining this status. Becoming an UNPRI signatory requires an investment manager to abide by six principles:

- **Principle 1:** We will incorporate ESG issues into investment analysis and decision-making processes.
- **Principle 2:** We will be active owners and incorporate ESG issues into our ownership policies and practices.
- **Principle 3:** We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- **Principle 4:** We will promote acceptance and implementation of the Principles within the investment industry.
- **Principle 5:** We will work together to enhance our effectiveness in implementing the Principles.
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