REPORT FOR ACTION WITH CONFIDENTIAL ATTACHMENT

Environmental, Social, and Governance Update

Date: September 23, 2020
To: Toronto Investment Board
From: Director, Capital Markets
Wards: All

REASON FOR CONFIDENTIAL INFORMATION

This report involves the security of property belonging to the City or one of its agencies or corporations.

SUMMARY

This report provides initial Environmental, Social, and Governance (ESG) scoring information from Bloomberg for current portfolios as previously requested by the Toronto Investment Board ("Board"). Initial interviews with all of the investment management firms were also completed to discuss their ESG process and the various tools and resources used.

The report points out some of the issues surrounding ESG scoring. One complicating factor is the information provided on Bloomberg has no ESG scores for government bonds which is an issue given the holdings of the City's portfolios. Several of the investment management firms also pointed out the shortfalls of using ESG ratings from a single third party provider. Most investment managers preferred to examine source data and other qualitative factors to produce an overall assessment.

Although there are shortfalls in the information, it is recommended that a process to procure the services of a third-party ESG information provider that will adequately cover the holdings of the City's portfolios. This information should not only include overall scores or ratings for ESG, but should also include detailed information with regard to climate change (e.g. carbon metrics) along with additional metrics on social and governance issues.

In addition, the report reviews the United Nations Principles for Responsible Investment (UNPRI) assessment completed on each investment manager contracted by the Board.

RECOMMENDATIONS

The Director, Capital Markets recommends that:

1. The Toronto Investment Board authorize the Director, Capital Markets to initiate a Request for Proposal (RFP) for a third-party information provider that could provide metrics in the area of assessing Environmental, Social, and Governance (ESG) performance which would facilitate a response to the City Council request to the Toronto Investment Board and the Chief Financial Officer and Treasurer to develop a process to monitor and report on whether or not external investment firms hired by the City are compliant with the terms of the Investment Policy with respect to ESG factors.

2. The Toronto Investment Board be provided with the results of the RFP and a recommendation for contract award to the successful third-party ESG information provider.

3. The Toronto Investment Board direct that the confidential information contained in Confidential Attachment 1 remain confidential in its entirety, as it contains information that involves the security of property belonging to the City or one of its agencies or corporations.

FINANCIAL IMPACT

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

DECISION HISTORY

At its meetings on June 29 and June 30, 2020, City Council approved the amendments to the City Council-approved Investment Policy related to ESG. City Council also requested the Toronto Investment Board and the Chief Financial Officer and Treasurer to develop an ESG process, to incorporate ESG factors into its investment decision-making, and to consider and incorporate internationally-recognized best practices for ESG when considering any changes to the Investment Policy.
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2020.EX14.2

At its meeting on January 29, 2020, City Council referred Item CC14.4 to the Executive Committee for further consideration.
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2020.CC14.4

At its meeting on December 4, 2019, the Toronto Investment Board received a report which provided a brief update on the changes to the Investment Policy regarding ESG. The board requested the Director, Capital Markets to report on the governance options as it pertains to the ESG factors and to review the various service providers of this data.
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.IB5.3

At its meetings on October 2 and 3, 2019, City Council referred item EX8.3 to the Chief Financial Officer and Treasurer, and requested the Chief Financial Officer and Treasurer, in consultation with the Investment Board and the Toronto Atmospheric Fund, to report to the January 29 and 30, 2020 meeting of City Council on additional improvements to the investment policy regarding ESG.
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.EX8.3

At its special meeting on May 10, 2019, the Toronto Investment Board received a report which requested changes to the Investment Policy regarding ESG. The board requested the Executive Director, Corporate Finance to include recommendations to enhance and update the Investment Policy with regard to ESG factors.
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.IB2.1

COMMENTS

Environmental, Social, and Governance (ESG) Measurement and Reporting

At its meetings on June 29 and 30, City Council requested that the Toronto Investment Board and the Chief Financial Officer and Treasurer develop a process to monitor and report on whether or not external investment firms hired by the City are compliant with the terms of the Investment Policy governing Environmental, Social, and Governance Factors and that the information and data regarding climate change risk from these reviews be reported to City Council semi-annually.

Environmental, Social, and Governance Metrics from Bloomberg

Initially there was some consideration that ESG metrics provided by the Bloomberg system would have sufficient information to meet reporting needs. Capital Markets staff, with the assistance of a Bloomberg specialist, were able to input the current investment portfolios into a Bloomberg terminal and assess results.

The majority of ESG information provided to Bloomberg is from Sustainalytics which is a well-known third-party information provider. Sustainalytics has been involved as a verifier of the City of Toronto's Green Bond and Social Bond Frameworks. However, the Bloomberg specialist along with staff from Sustainalytics cautioned that the information in Bloomberg is basic level ESG information and that more information was available to clients for a fee.

Table 1 contains a sample of recent ESG metrics obtained from Bloomberg for each investment manager for the Long Term Fund (LTF). The portfolio score represents only holdings that could be scored in Bloomberg. This is a major caveat for the fixed income portfolios, where more than 60% of holdings were not scored in Bloomberg. Moreover, approximately 9% of holdings in the equity portfolios were not scored in Bloomberg.

Table 1 - ESG Scoring from Bloomberg as of Sept. 2020 by Investment Manager

Investment Manager	ESG Rank	Environmental Percentile	Social Percentile	Governance Percentile	ESG Disclosure Score	ISS Quality Score
CC&L	62.30	53.99	49.70	81.40	50.27	3
Leith Wheeler	58.31	51.00	49.07	71.53	46.65	4
Harris / Oakmark	67.77	64.51	61.29	67.49	45.71	5
Fiera Capital (Global Equity)	74.28	75.32	68.81	72.53	46.65	5
Pier 21	67.93	67.71	67.89	64.59	44.32	4

Table 2 shows the Bloomberg scoring percentages in detail. The major difficulty in obtaining scores in Bloomberg for the fixed income portfolios was due to government or sovereign debt holdings and private company debt holdings. The specialist from Bloomberg noted that ESG scores in their database were associated to an "equity ticker", or the "equity" counterpart for non-equity securities. As a result, it is difficult to obtain ESG scores for non-public companies. Ultimately, ESG scores can be produced in Bloomberg, but the process would require workarounds and input from external sources or by staff.

Table 2 - Percentage of Bloomberg Scoring Available by Investment Manager

Investment Manager	% Portfolio ESG Scored	% Portfolio Not Scored	% Portfolio Not Scored (Private Company)	% Portfolio Not Scored (Sovereign / Government)
CC&L	**33.2%**	**66.8%**	1.0%	65.8%
Leith Wheeler	**36.2%**	**63.8%**	22.5%	41.3%
Harris / Oakmark	**92.8%**	**7.2%**	-	-
Fiera Capital (Global Equity)	**91.1%**	**8.9%**	-	-

Investment Manager	% Portfolio ESG Scored	% Portfolio Not Scored	% Portfolio Not Scored (Private Company)	% Portfolio Not Scored (Sovereign / Government)
Pier 21	**89.3%**	**10.7%**	-	-

Environmental, Social, and Governance (ESG) - Industry Best Practices

Capital Markets staff also communicated with all current investment managers in to gain insight into industry practice surrounding the measurement of ESG performance.

Despite the quickly evolving nature of ESG in the industry, investment managers have proactively responded to heightened investor ESG awareness by publishing periodic ESG newsletters and reporting. Examples of such documents can be found in Attachment 1 and Attachment 2 of this report. These documents highlight the many ways that investment managers are already tackling ESG concerns.

Third-party ESG information providers were discussed during these communications. While there were some common elements to these discussions, most of the investment managers go beyond any single source in their management of ESG factors.

Several investment managers noted the shortfalls of single ESG ratings aggregated at the company or issuer level, with notable pitfalls being: 1) the lack of transparency in rating methodologies amongst raters, 2) the disparity in ESG rating of the same company or issuer amongst raters, 3) the lack of ESG data and information produced by issuers and companies, and 4) that ESG ratings are largely backward-looking and do not give due credit to companies or issuers that are transitioning or investing to improve ESG aspects of their business. Rather than taking aggregate-level ESG rating at face value, most investment managers preferred examining source data along with qualitative business factors to assess the ESG merits of companies and issuers. The investment management firms usually have a specialized group or internal committee reviewing these methodologies and to ensure quality of results.

Taking high-level ESG ratings at face value may not be the best way to assess ESG performance for an investment manager. However, the Board and City Council requires some straightforward way to monitor and assess the investment manager's adherence to ESG factors and monitor their performance over time. While these third-party ESG information providers may not be perfect, they will provide some information that could trigger further investigation by the Board.

It is recommended that the Director, Capital Markets initiate a Request for Proposal (RFP) for a third-party ESG information provider that will be able to provide detailed ESG scoring on the overall portfolio, including a breakdown of information on various climate change metrics along with other metrics for social and governance items.

Investment Managers and the United Nations Principles for Responsible Investment (UNPRI)

At its meetings on June 29 and 30, 2020 City Council also requested the Toronto Investment Board to incorporate ESG factors in its investment decision-making through its due diligence process when choosing investment managers. Supporting this aspect is the qualification of all current investment managers as UNPRI signatories. Each signatory is required to commit to the six UNPRI principles. The ESG themed principles are factored in each investment manager's investment decision. The six UNPRI principles are as follows:

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.

In addition to committing to the above principles, each investment manager must report to the UNPRI annually, and is assessed on their ESG merits relative to their peers. Confidential Attachment 1 shows the Summary Scorecard for each of the City's current investment managers. The Summary Scorecard is just one of many ESG measures included in the annual UNPRI assessment. With each of the City's investment manager held to UNPRI standards, City Council can have confidence that ESG is being incorporated in the investment process.

CONTACT

Randy LeClair, Director, Capital Markets, Corporate Finance
Tel: 416-397-4054; Email: Randy.LeClair@toronto.ca

Betsy Yeung, Manager, Capital Markets, Corporate Finance
Tel: 416-392-6302; E-mail: Betsy.Yeung@toronto.ca

SIGNATURE

Randy LeClair
Director, Capital Markets

ATTACHMENTS

Attachment 1 - CC&L: Responsible Investing Update

Attachment 2 - Fiera Capital: Good Governance. Greater Returns

Confidential Attachment 1 - City of Toronto Investment Manager UNPRI Summary Scorecard