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THE INVESTMENT  
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DU CANADA

# REPORT ON RESPONSIBLE INVESTMENT

June 2020

Canadian fund managers and advisory firms have a long history of providing responsible investment products and services to their clients, in some cases, going back decades. In recent years, there has been an explosion of interest in this approach to investing. With this interest, has grown some debate and confusion over what responsible investment is and how it is done. This report provides a straightforward overview of responsible investment in Canada and around the world, addressing topics from terminology, to the motivations driving responsible investment, the performance of responsible investment strategies, and the shape of things to come.

## About IFIC

The Investment Funds Institute of Canada 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. By connecting Canada's savers to Canada's economy, our industry contributes significantly to Canadian economic growth and job creation.

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# WHAT IS RESPONSIBLE INVESTMENT?

Responsible investment (RI) is an investment approach that incorporates environmental, social and governance (ESG) factors, along with broader systemic issues, into investment decision-making and active ownership processes, in addition to or in combination with traditional fundamental financial research.

This definition of RI is consistent with the working definitions used by organizations like the Principles for Responsible Investment (PRI), national RI industry associations, and institutional and retail investors. RI strategies are used by virtually all types of investors, from individual investors saving for retirement to institutional investors such as large public pension plans and private equity firms.

## TERMINOLOGY

A variety of terms are used (or have been used) to describe RI and related practices. They include, but are not limited to, socially responsible investing (SRI), sustainable investing, ethical investing, faith-based investing, norms-based investing, ESG investing and impact investing. In part, the range of terminology is reflective of an RI marketplace that is evolving and encompasses a wide range of diverse approaches and products.

Despite the range of approaches, there is a growing consensus about the definitions and terminology used to describe the key strategies and approaches.

For the purpose of this paper, the term Responsible Investment is used as the all-encompassing term.



## APPROACHES

The PRI, RI industry associations and other organizations, along with some investment firms, have made efforts to codify the approaches or strategies used to apply RI principles in practice. The resulting frameworks are largely consistent, although some inconsistencies remain. The most common approaches are summarized below:

### Screening/Exclusions

- Prohibiting investments in firms with material involvement in the manufacture or sale of excluded products (e.g. tobacco, weapons, thermal coal).
- Excluding companies that have poor ESG performance or that violate international norms for business practice (e.g. the UN Global Compact, International Labour Organization Conventions, UN Declaration on the Rights of Indigenous Peoples).

### ESG Integration

- Explicit and systematic inclusion of ESG factors into fundamental analysis — in a manner that influences the determination of a security's value — and investment decision-making processes.

### Corporate Engagement

- Exercising active shareholder stewardship through:
  - Direct engagement with senior management and company boards.
  - Filing shareholder proposals on ESG issues.
  - ESG-based proxy voting.
  - Engaging with policymakers.

### Thematic Investing

- Investment in companies whose products and services advance sustainability (e.g. renewable energy, carbon emissions reduction, sustainable agriculture, diversity).

### Impact Investing

- Targeted investment with the intention of generating positive social or environmental impact and delivering competitive financial return.

These approaches are not mutually exclusive and there may be some overlap. A single asset manager might employ multiple strategies across different mandates, and even within a specific fund.

# DRIVERS AND MOTIVATIONS

RI has gained significant momentum among mainstream investors in recent years.

A scan of survey data and industry reporting<sup>1</sup> suggests that the significant growth in RI is driven by three primary motivations. In many cases, investors are motivated by a combination of these drivers.

<sup>1</sup> Global Sustainable Investment Alliance (2018). Global Sustainable Investment Review, Harvard Business Review (2019). The Investor Revolution, Harvard Initiative for Responsible Investment. About Responsible Investment, McKinsey & Co. (2017). From 'why' to 'why not': Sustainable investing as the new normal, Mercer 2018. The ABC of ESG, Responsible Investment Association Australasia (2018). Responsible Investment Benchmark Report, Responsible Investment Association. Intro to Responsible Investment, UN Principles for Responsible Investment. What is responsible investment?

## FINANCIAL PERFORMANCE

**Risk management:** There is a growing recognition among investment managers and researchers that ESG factors are relevant to companies. Investors increasingly believe that companies that fail to manage ESG issues expose themselves to a range of risks, including physical, regulatory, competitive, litigation and reputational, that can have a measurable effect on market value.

Considering ESG factors in the investment process can reduce exposure to risks because analyzing a company's ESG performance in combination with financial metrics provides a more holistic view of that company's overall risk profile.

### Responsible investments: Shaping the future of investing<sup>2</sup>

In this report, SwissRe examined the stock portfolio-level sustainability of a large sample of institutional investors. The insurer found evidence that investors with better sustainability footprints exhibit higher risk-adjusted investment performance. Further analysis suggested that the main mechanism for this outperformance is not return enhancement but rather risk reduction, as many standard risk measures were significantly lower for institutions with better sustainability footprints.

**Portfolio returns:** The belief that RI portfolios underperform has been a significant barrier to growth for the industry. However, long-term financial outperformance is often cited by investment managers as one of the primary motivators for embracing RI.

Academic and investor research has demonstrated that RI produces market-rate returns as effectively as other investment approaches and some research suggests that RI has the potential to improve long-term, risk adjusted returns (see Performance section of this report). This evidence, along with the other motivations described here, has provided a strong incentive to adopt RI strategies.

## CLIENT DEMAND

According to the Global Sustainable Investment Alliance's 2018 Review, 365 U.S. investment managers with combined RI assets of \$4.2 trillion responding to a survey question on their motivations for incorporating ESG criteria into their investment process cited client demand as their number one motivation.

Investment managers are reporting that clients and beneficiaries are:

- aware that ESG factors are relevant to a company's future performance, as they have the potential to influence a company's value, returns and reputation
- putting pressure on investment decision makers to adopt RI approaches as a best-practice expectation
- calling for greater transparency about how and where their money is invested
- increasingly inquiring about RI
- demanding that their investments generate positive impacts beyond investment returns

Demographic shifts are further driving this demand as the profile of wealth-holders changes. More wealth is now in the hands of women and millennials, and survey data suggest that women are more likely than men and millennials are more likely than older investors to view ESG integration as an essential component of their own investments.<sup>3</sup>



<sup>2</sup> SwissRe (2017). Responsible investments: Shaping the future of investing

<sup>3</sup> Forbes (July 5, 2018). Demographic Trends Are Driving Demand For Impact Investment - And The Industry Is Starting To Adapt

As described in another section of this report, the demand for RI options is so strong that many asset management firms are rushing to develop new products.

Ultimately, businesses create products because they believe they will sell, so it makes sense that client demand is an important motivator for the large number of new RI products that have come to market in recent years.

## POSITIVE SOCIETAL OUTCOMES

The goal of positive societal and environmental outcomes was the foundation for the RI movement and continues to be a strong motivator. Some refer to this as alignment with values, but this is not an accurate, or pragmatic, interpretation, as values tend to be idiosyncratic and personal. In contrast, internationally recognized conventions and principles<sup>4</sup> have set out the broad elements that are considered to be vital for prosperity and general well being – protection and rejuvenation of the land, air and oceans, equality, freedom from poverty and hunger, and good health, to name a few.

The idea that individuals can contribute to positive societal and environmental outcomes by providing capital to companies with strong ESG performance or by improving performance through engagement is still a compelling one for many investors.



<sup>4</sup> For example, the UN Sustainable Developments Goals, the UN Global Compact and the OECD Guidelines for Multinational Enterprises.

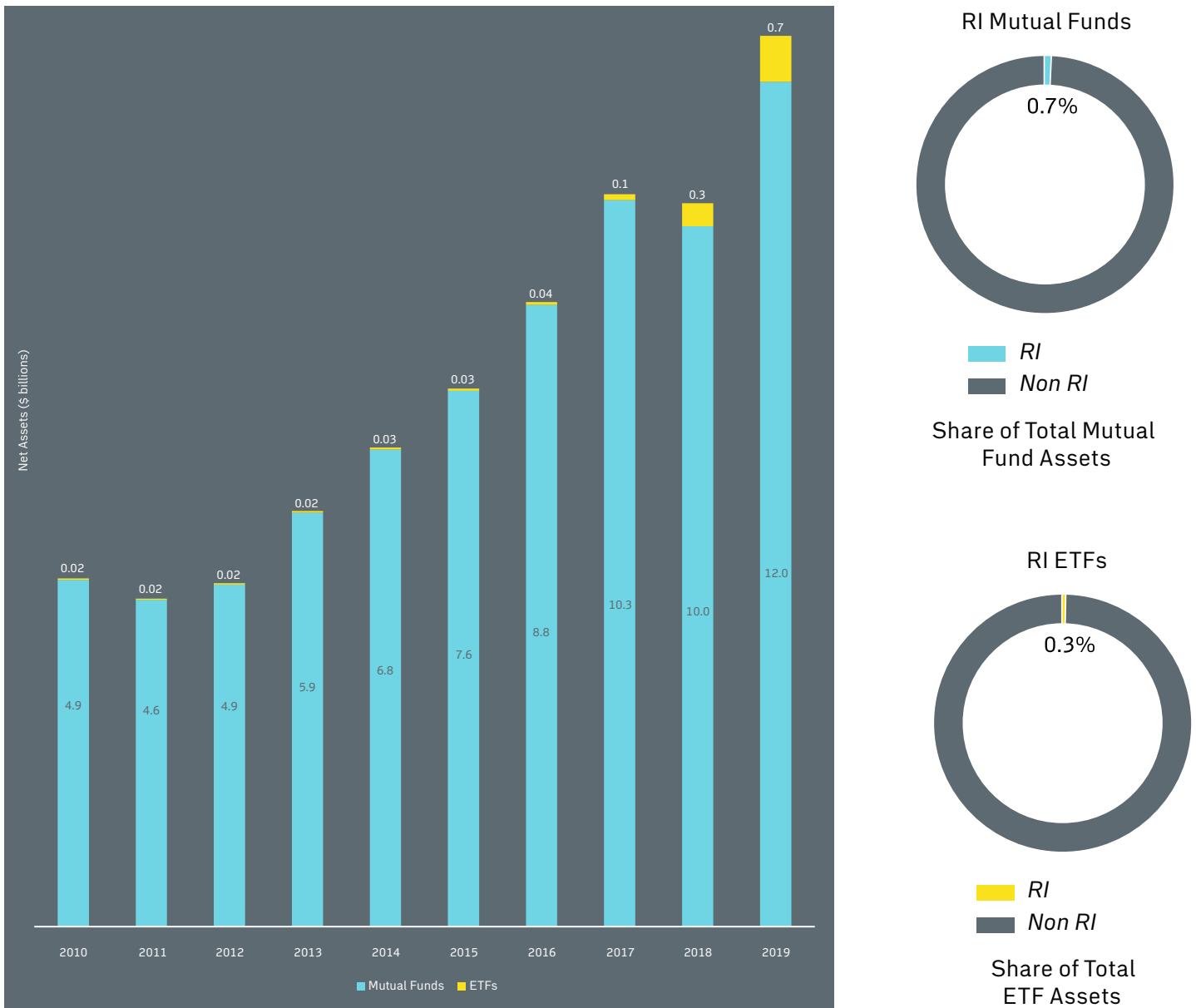
# THE RI MARKET

The Investment Funds Institute of Canada reports that at the end of 2019, there were a total of \$12 billion in RI mutual fund and \$654 million in responsible investment ETF assets. This represents 0.7% of total mutual fund assets and 0.3% of ETF assets, respectively.<sup>5</sup> RI mutual funds maintained a similar share of mutual fund assets between 2010 and 2019.

Despite RI's small share of mutual fund and ETF assets, there are 16 firms offering 69 responsible investment mutual funds and 10 firms offering 23 responsible investment ETFs.

<sup>5</sup> Investment Funds Institute of Canada (2019). 2019 Investment Funds Report

## RESPONSIBLE INVESTMENTS (RI) FUNDS



Evidence suggests that there is potential for growth in retail RI. According to the 2019 RIA Investor Opinion Survey:<sup>6</sup>

- 72% of respondents expressed interest in RI, up from 60% in 2018.
- 79% of respondents would like their financial services provider to inform them about RI options.
- Overall, 26% of respondents said they currently own responsible investments.

It is important to note that the data presented above relates to retail invested funds that are branded or presented as RI funds. If considering all retail and institutional assets that fit a broad definition of responsible investment, RI assets in Canada stand at \$2.1 trillion, according to the Responsible Investment Association (RIA). The vast majority of these assets are owned and managed by large institution investors, including large public pension plans. Some of these assets are also managed by the same firms offering dedicated RI mutual funds and ETFs. In many cases, these firms have integrated ESG considerations and processes across business units and investment strategies and across asset classes.<sup>7</sup>

<sup>6</sup> Responsible Investment Association (2019). 2019 RIA Investor Opinion Survey

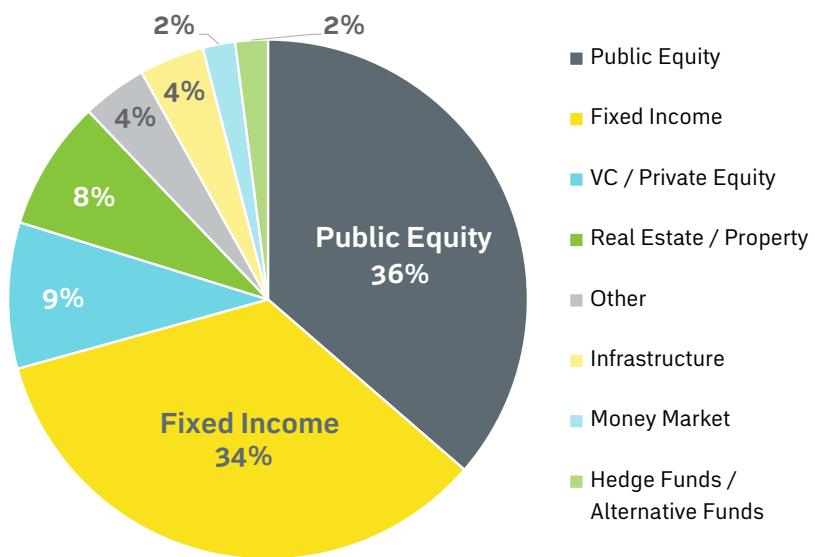
<sup>7</sup> Responsible Investment Association (2018). 2018 Canadian RI Trends Report

Looking more broadly, according to the Global Sustainable Investment Alliance, which collates the results from the market studies of regional sustainable investment forums for Europe, the United States, Canada, Japan, Australia and New Zealand, RI assets in the five major markets (including retail and institutional) totalled \$30.7 trillion at the start of 2018, a 34% increase over two years.<sup>8</sup>

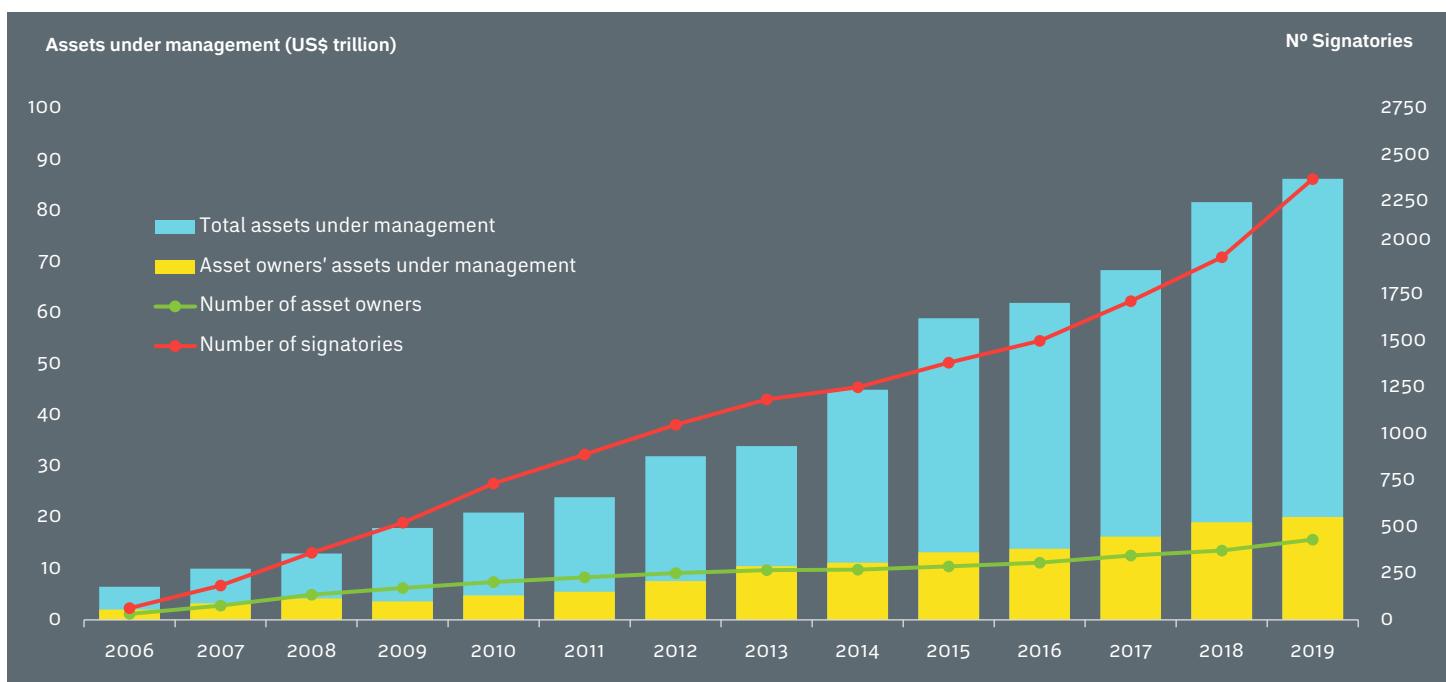
The Global Impact Investing Network's most recent survey reports that global Impact Investment assets under management increased by more than 70%, to USD 502 billion, between 2015 and 2019.<sup>9</sup> In Canada, the RIA reported that impact investing assets grew by 30% over 3 years, to USD 15 billion in 2017.<sup>10</sup> Impact investing is a specific RI strategy, as described in the Approaches section of this report.

Another indicator of the increasing acceptance of RI is PRI signatory growth. Signatories commit to the PRI's six principles and are required to report annually on their activities in relation to each principle. The PRI was launched in 2006 with 63 signatories with USD 6 trillion in assets under management. At the end of 2019, the PRI had 2,372 signatories with USD 86.3 trillion in assets under management.<sup>11</sup>

## RI ASSET ALLOCATION



## PRI SIGNATORY GROWTH



<sup>8</sup> Global Sustainable Investment Alliance (2018). Global Sustainable Investment Review

<sup>9</sup> Global Impact Investing Network (2019). 2019 Annual Impact Investor Survey

<sup>10</sup> Responsible Investment Association (2018). 2018 Canadian RI Trends Report

<sup>11</sup> Principles for Responsible Investment. About the PRI

# PERFORMANCE

The RI industry, supported by the work of academics, has long attempted to answer the following questions:

1. Does incorporating ESG principles into the investment process negatively impact returns?
2. Can investors that apply ESG factors to the stock selection and stewardship process achieve higher risk-adjusted returns?

Based on review of the available evidence, the answer to the first question is clear: the incorporation of ESG principles into the investing process produces market-rate returns as effectively as other investment approaches.

The answer to the second is more nuanced. The evidence is not definitive, but academic and investor research to date has shown that RI portfolios have outperformed traditional portfolios more often than not, suggesting that an intentional and systematic approach to RI has the potential to improve risk-adjusted returns. This evidence is strong enough that some investors have identified the potential for better investment outcomes as the primary driver behind their RI programs.<sup>12</sup>

A further question to be examined is what are the mechanisms that might lead to outperformance? To date, the mechanisms behind these results are not well understood, but early research into this question suggests that companies with strong ESG performance have lower costs of debt and capital and exhibit stronger financial and accounting performance. Additionally, effective management of material ESG issues is viewed by many as an indicator of strong management of the business overall.

Some of the most noteworthy studies about RI and performance are described below:

## META-STUDIES

- A 2015 meta-study reviewed 2,200 individual studies about the relationship between ESG performance and corporate financial performance (CFP) — the most exhaustive overview of academic research on the topic.<sup>13</sup> Roughly 90% of studies found a non-negative ESG–CFP relation and the majority of studies reported positive findings. The authors concluded that the business case for ESG investing is empirically very well founded, stating that “the orientation toward long-term responsible investing should be important for all kinds of rational investors in order to fulfill their fiduciary duties and may better align investors’ interests with the broader objectives of society.”
  - An earlier (2012) study by Deutsche Bank Group’s DB Climate Change Advisors reviewed 100 academic studies, 56 research papers, 2 literature reviews and 4 meta studies. It found “overwhelming” evidence that firms with high ratings for corporate social responsibility (CSR) and ESG factors have lower cost of capital, “compelling” evidence that strong CSR/ESG factors are correlated with financial outperformance and “mixed” results for the relationship between CSR/ESG factors and fund returns.<sup>14</sup>

## PORTRFOOLIO PERFORMANCE

- A 2015 study by Calvert Investments used historical analysis of its own portfolios over various time periods to evaluate different methods for introducing ESG factors into the investment process.<sup>15</sup> The study's authors found empirical evidence across approaches (exclusionary screens, ESG factors, integration) that incorporating ESG improves the investment selection process and enhances risk-adjusted returns.
  - While not research studies *per se*, RI industry associations collect and analyze data about the performance of RI funds. The RIA and Fundata Q4 2019 report<sup>16</sup> that nearly two-thirds of Canadian RI funds outperformed their average asset class return over the one-year period ending in December 2019, 70% outperformed over three years, 73% outperformed over five years and two-thirds outperformed over a 10-year period. The Responsible Investing Association of Australasia reported that Australian share funds surveyed outperformed mainstream Australian share fund benchmarks for all periods except the three-year term.



<sup>12</sup>It is important to note that the studies have had to rely on imperfect data and contend with evolving definitions of RI over time. Additionally, research that suggests outperformance for certain approaches to RI does not necessarily imply outperformance for all approaches.

<sup>13</sup> Gunnar Friede, Timo Busch and Alexander Bassen (2015). ESG and financial performance: aggregated evidence from more than 2000 empirical studies. Journal of Sustainable Finance & Investment, 5:4, 210–233

<sup>14</sup> DB Climate Change Advisors (2012). Sustainable Investing Establishing Long-Term Value and Performance

<sup>15</sup> Calvert Investments (2015). Perspectives on ESG Integration in Equity Investing: An opportunity to enhance long-term, risk-adjusted investment performance

<sup>16</sup> RIA (2019). RI Funds Quarterly Performance Report: Q4 2019

## CAUSATION AND MATERIALITY

- Perhaps the most widely cited RI study was published in 2015<sup>17</sup> by researchers at Harvard Business School. They examined the impact of material versus immaterial sustainability issues and found that firms with good performance on material sustainability issues significantly outperform firms with poor performance on these issues, suggesting that investments in material sustainability issues are shareholder-value enhancing. The authors also reported that firms with good performance on material issues and concurrently poor performance on immaterial issues perform the best.
- A 2016 study by Calvert and George Serafeim (one of the principal authors of the Harvard study) explored how systematic analysis of material ESG data may help portfolio returns without adding additional risk.<sup>18</sup> The study found that systematic analysis of ESG data can potentially help boost portfolio returns without adding additional risk, and that material ESG issues affect companies' financials in three areas: revenues, costs and cost of capital. The authors concluded that integration of ESG factors can lead to better societal outcomes as investors enable or constrain business development by altering the cost of capital and operations for firms with good or poor ESG performance.
- A 2018 study by MSCI applied an ESG filter to a selected universe of 100 companies that had been screened for value creation as measured by return on invested capital (ROIC), economic spread, margins and asset turnover ratio.<sup>19</sup> The study found that over the previous five years, companies with higher ESG ratings exhibited higher average return on invested capital compared to companies with lower ESG ratings. They were also valued at a premium over their other top performing peers with lower ESG ratings. The authors noted that, contrary to popular opinion, the main value of ESG did not come from governance, but from how well firms managed their industry-specific environmental and social risks.

Building on this research, MSCI has developed a variety of ESG Indexes. The chart below shows the performance of the MSCI Canada ESG Leaders Index relative to the MSCI Capital Index. The MSCI Canada ESG index provides exposure to companies with high ESG scores relative to sector peers.

**MSCI CANADA ESG LEADERS INDEX: CUMULATIVE PERFORMANCE, GROSS RETURNS**



<sup>17</sup> Khan, Mozaffar N., George Serafeim, and Aaron Yoon (2025). Corporate Sustainability: First Evidence on Materiality. Harvard Business School Working Paper, No. 15-073, March 2015

<sup>18</sup> Calvert Investments and George Serafeim (2016). The Financial and Societal Benefits of ESG Integration: Focus on Materiality

<sup>19</sup> MSCI (2018). Enhancing Economic Value with ESG

## ENGAGEMENT

- A 2015 study analyzed a database of corporate social responsibility engagements with U.S. public companies from 1999-2009.<sup>20</sup> The study found that after successful engagements, particularly on environmental and social issues, companies experienced improved accounting performance and governance and increased institutional ownership.
- A 2016 study classified 2,665 shareholder proposals that addressed environmental and social issues as financially material or immaterial, and analyzed how proposals on material versus immaterial issues related to firms' subsequent market valuation.<sup>21</sup> The researchers found that shareholder proposals on material issues led to increases in firm value, while proposals on immaterial issues led to declines in firm value.

## ESG FACTORS

- **Diversity:** Two studies about diversity, specifically the impact of women on boards,<sup>22 23</sup> found that companies with greater board gender diversity achieved excess returns.
- **Human Capital:** A 2015 study examined 92 studies that are specific to human capital management, including training and work systems.<sup>24</sup> It found evidence that human capital management can be material to a company's financial performance and recommended inclusion of human capital data in traditional investment analysis.



<sup>20</sup> Elroy Dimson, Oğuzhan Karakaş and Xi Li (2015). Active Ownership. *Review of Financial Studies*, Volume 28, Issue 12, pp. 3225-3268, 2015

<sup>21</sup> Jyothika Grewal, George Serafeim and Aaron Yoon (2016). Shareholder Activism on Sustainability Issues

<sup>22</sup> Credit Suisse AG (2014). The CS Gender 3000-Women in Senior Management

<sup>23</sup> MSCI (2016). The Tipping Point: Women on Boards and Financial Performance

<sup>24</sup> Larry W. Beeberman and Aaron Bernstein (2015). The Materiality of Human Capital to Corporate Financial Performance.

# ESG DATA AND RATINGS

As with any investment approach, RI fund managers need comprehensive, high quality, comparable and, above all, material data about companies' ESG practices. While publicly traded companies are required by regulators to report extensive data related to, among other things, environmental performance, health and safety and governance, these data do not fully satisfy the needs of investment managers that incorporate ESG data into their investment processes.

Almost all investors that responded to EY's most recent survey on non-financial reporting said they evaluate target companies' nonfinancial disclosures, either as an informal evaluation (65%) or a structured, methodical evaluation (32%).<sup>25</sup>

The primary sources of ESG data are company self-reporting and ESG data providers, who gather and analyze data from a variety of sources to produce ESG scores and ratings for companies. According to The Global Initiative for Sustainability Ratings, there are more than 125 ESG data providers.<sup>26</sup> These include providers with comprehensive ESG coverage and specialized data providers that focus on specific issue areas like governance or controversial activities.

Many responsible investors use the scores and ratings from third-party data providers to make investment decisions, while more sophisticated investors incorporate ESG data from various sources into their own evaluation models.

Despite the contributions these data providers have made in advancing RI, investors have ongoing concerns about its limitations. They include:

- **Poor quality:** Corporate reporting often consists of tailored narratives — often poor indicators of how effectively companies are managing ESG risk — rather than robust performance indicators.
- **Inconsistency:** The voluntary nature of company sustainability reporting means that the metrics used are inconsistent, limiting comparability across companies.
- **Incomplete coverage across holdings:** The available data are incomplete, making accurate assessments across a portfolio difficult. This concern applies mostly to small-capitalization and emerging markets funds.
- **Lack of standardization and transparency:** ESG data providers develop their own research and scoring methodologies, often resulting in widely different ratings for a single company, which can pose significant challenges for investors, particularly those that subscribe to more than one data platform.
- **Immaterial data:** Metrics that are not related to the company's most material ESG risks are included.

Promisingly, steady progress has been made in the quality, availability and consistency of corporate reporting since the launch of the Global Reporting Initiative (GRI) in 2000. More recently, the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standard Board (SASB) have helped to advance industry-specific reporting. SASB has gained significant traction with investors because of its focus on materiality.

Currently, more than 80% of the world's largest corporations use the GRI standards and in 2017, 85% of S&P 500 Index companies published sustainability reports. Additionally, the number of companies integrating ESG and financial data and third-party assurance of ESG data continues to grow.

Two catalysts for future improvements in reporting and analysis are climate change and the UN Sustainable Development Goals (SDGs).

1. In 2017, the Task Force on Climate-related Financial Disclosures (TCFD) released its recommendations for a voluntary framework for disclosing climate-related risks in financial filings. The recommendations were designed to complement existing accounting standards, such as SASB, and have received significant support.
2. The SDGs were adopted by the UN in 2015 as a universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity by 2030. While they were not specifically designed to guide corporate disclosure, companies are increasingly tailoring their reporting to the SDGs — and in some cases using the SDGs as inputs into strategy — as investors demand clarity on how business activities contribute.

Finally, research and reporting platforms based on machine learning and big data are already gaining traction in the market and have the potential to accelerate the progress already made.



<sup>25</sup> EY (2018). ESG Investor Survey

<sup>26</sup> OECD Observer (Nov 2019). Sustainable investment: A new landscape

# **STANDARDS, CERTIFICATIONS AND REGULATIONS**

RI standards, also referred to as frameworks, guidelines, principles or conventions, are increasing in number and importance, as investment managers endeavour to demonstrate the rigour built into their programs and investors and other stakeholders seek to assess the quality of RI programs.

In Canada, there is no formal certification or classification system for RI funds, but bodies like the Investment Funds Institute of Canada (IFIC) and RIA identify certain funds as RI. IFIC, for example, considers a fund an RI fund if the prospectus mentions an explicit RI or ESG mandate in its investment objective or investment strategy.<sup>27</sup>

These standards, the most essential of which are described below, are supported by growing list of certifications, ratings and regulations.

Standards	Why it matters?
<b>Principles for Responsible Investment (PRI):</b> The original global standard — signatories must report annually on adherence to the PRI's six principles.	Still highly influential and considered table-stakes for investors entering the RI space.
<b>The Organisation for Economic Co-operation and Development (OECD) Responsible Business Conduct for Institutional Investors:</b> Built on the OECD Guidelines for Multinational Enterprises, which provide "voluntary principles and standards" for responsible business conduct, "consistent with applicable laws and internationally recognised standards."	Confirmed that the OECD Guidelines also apply to investors in relation to their holdings, meaning investment managers are accountable for the behaviour of companies within their portfolios.
<b>Financial Stability Board's Task Force on Climate-Related Financial Disclosures (TCFD):</b> Climate-related financial risk disclosure framework for use by companies in providing information to investors, lenders, insurers and other stakeholders	Applies to both corporations and investment managers. Recognizes climate change as a systemic risk to the financial system. Has gained significant traction as the principal climate reporting standard.
<b>UN Sustainable Development Goals (SDGs):</b> A global framework that includes seven goals designed to be a "blueprint to achieve a better and more sustainable future for all."	Not specifically designed to guide corporate disclosure, but companies are increasingly tailoring their reporting to the SDGs.
Certifications and labels	
<ul style="list-style-type: none"> <li>• <b>Australia / New Zealand: RIAA Responsible Investment Certification</b></li> <li>• <b>Europe: Luxflag ESG Label</b></li> <li>• <b>France: AFNOR Label Investissement Socialement Responsable</b></li> </ul>	Certify investment funds that meet standards for, among other things, objectives, evaluation methodology, portfolio construction and disclosure. Assures investors that the product has been assessed and verified by an independent certification body.
Fund ratings	
<ul style="list-style-type: none"> <li>• <b>Morningstar Sustainability Rating</b></li> <li>• <b>MSCI ESG Fund Quality Score</b></li> </ul>	Designed to allow investors to understand and manage portfolio-level ESG risks.

<sup>27</sup> Investment Funds Institute of Canada (2019). 2019 Investment Funds Report

## Regulations

**Canada: Ontario Pension Benefits Act** requires that pension funds disclose whether ESG factors are incorporated into investment policies and procedures and, if so, how those factors are incorporated.

**European Union: Revised Occupational Retirement Provision Directive** requires European pension funds to disclose how they consider ESG issues in their investment approach and establish risk management processes for emerging ESG issues.

**Sweden: National Pension Insurance Funds (AP Funds) Act** states that environmental and ethical considerations must be considered without compromising returns.

**South Africa: Johannesburg Stock Exchange's listing rule** mandates the adoption of the Institute of Directors' King Code, which requires integrated reporting.

**South Korea: National Pension Act of Korea** requires the National Pension Scheme to consider ESG issues and disclose the extent to which they are considered.

**United Kingdom: UK Stewardship Code** requires signatories to systematically integrate stewardship and investment, including material ESG issues and climate change, to fulfil their responsibilities.

In the form of pension fund regulations, stewardship codes and corporate disclosure guidelines.

To date, applicable primarily to pension funds and focused mostly on reporting.

Establish ESG or RI requirements for investment managers.



# THE SHAPE OF THINGS TO COME: RI IN THE 2020s

Here are four RI developments to monitor in the short term:

1. **Regulation:** In the past two decades, RI regulation has increased significantly, driven in part by the 2008 financial crisis, the realization that the financial sector can play an important role in meeting global challenges such as climate change, and the impact of poor corporate governance and other ESG practices on shareholder value. This trend is expected to continue.
2. **ISO standard:** The International Standards Organization's Technical Committee ISO/TC 322 on Sustainable Finance is developing a standard for the integration of sustainability considerations and ESG practices into institutional investment decision-making and wider finance management.
3. **EU Sustainable Finance Taxonomy:** The EU Taxonomy Regulation will establish a classification system to provide firms and investors with a common framework for identifying to what degree economic activities can be considered to be environmentally sustainable. Briefly, for an activity to be eligible, it must demonstrate that it makes a substantial contribution to one of the EU's six environmental objectives — climate change mitigation, climate change adaptation, water and marine resources, circular economy, waste prevention and recycling, pollution and healthy ecosystems — without having a detrimental impact on any of the other five.
4. **Expert Panel on Sustainable Finance:** In June 2019, the Canadian Expert Panel on Sustainable Finance released its final report. The report noted that the effects of climate change are upon us, with shifting weather that is amplifying floods, storms, heat and drought. The report promoted a range of policies and regulations that would help facilitate the transition to a lower-carbon economy, and noted that the asset management industry will play a critical role in delivering the financing and capital flows required to execute carbon reduction objectives.

In conclusion, these and other developments will help drive the progress of RI in the coming years, contributing to more rigour, sophistication and higher expectations for the industry.