

# CHANGING REQUIREMENTS FOR STATEMENTS OF INVESTMENT POLICIES AND PROCEDURES... ARE YOU READY?

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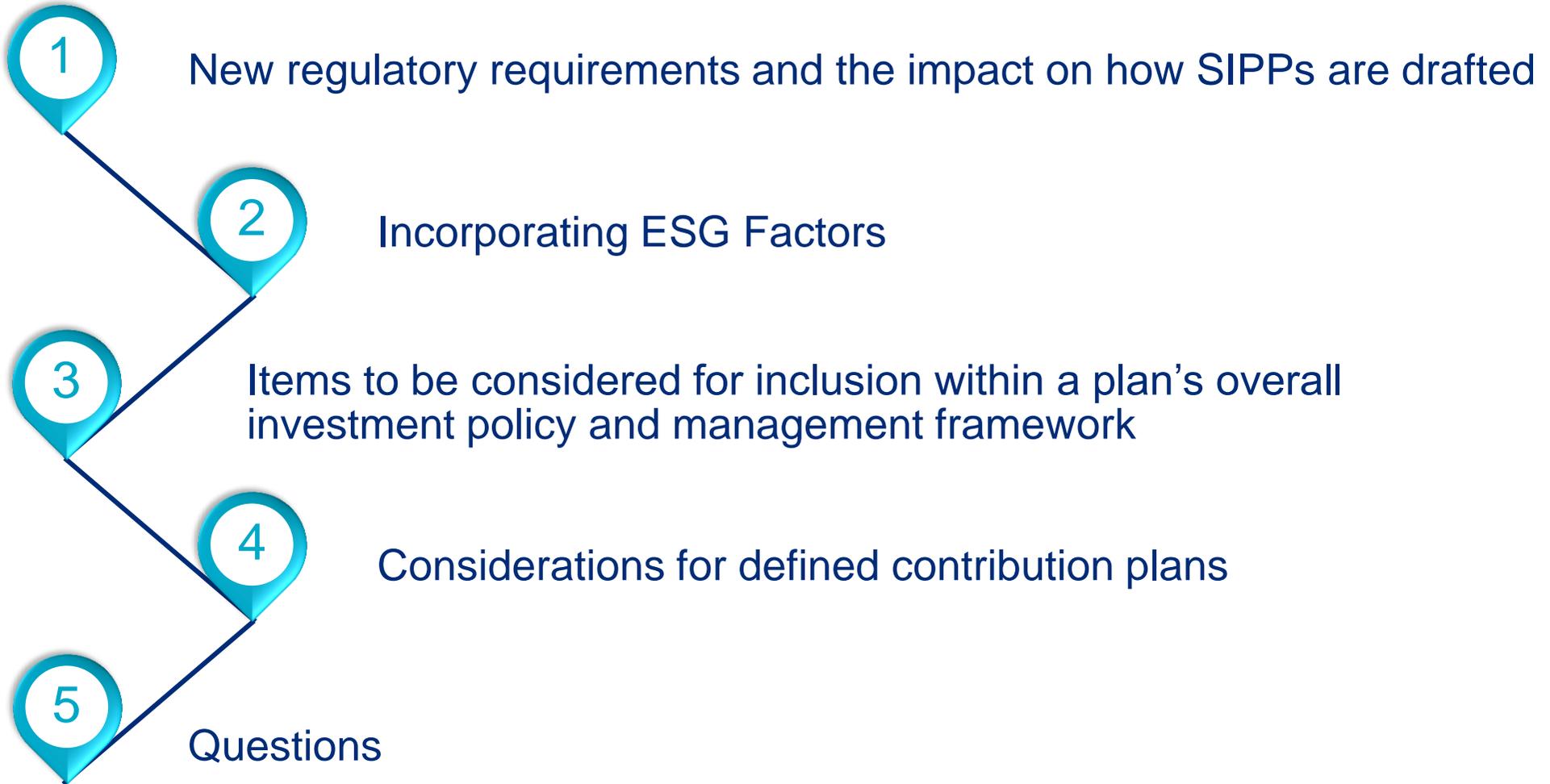
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# Today's Discussion





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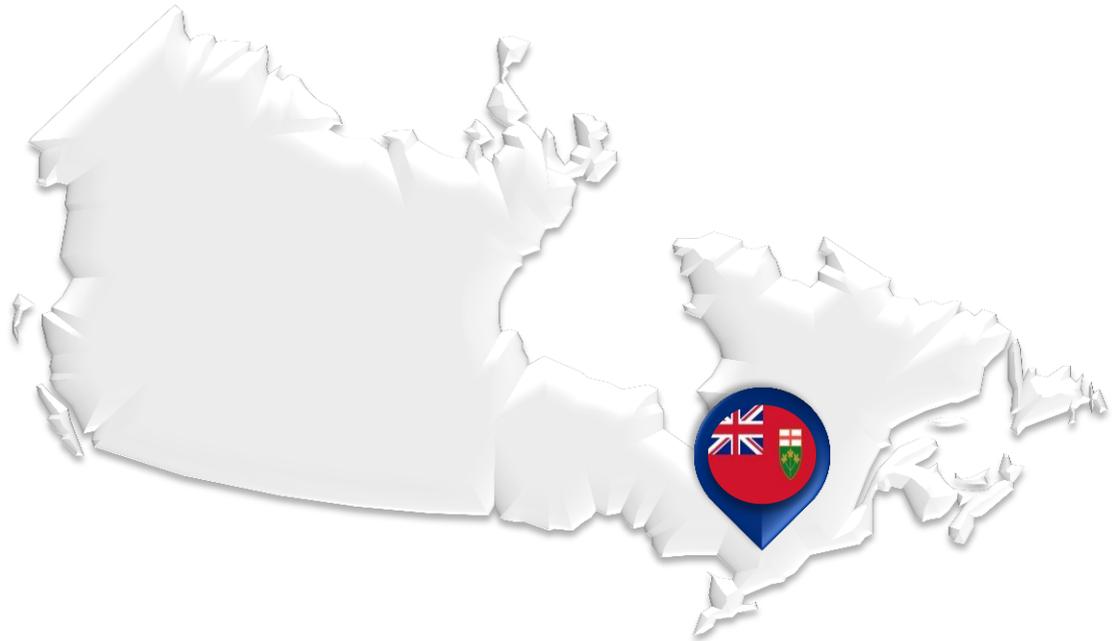
Canadian Law  
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# New Regulatory Requirements And The Impact On How SIPP's Are Drafted

# Legislative Changes & Regulatory Updates

- Jurisdiction involved is Ontario
- Regulations to the *Pension Benefit Act*
  - New sections (40 and 78) of the Regulations
  - Applicable going forward after January 1, 2016

IMPACT ON  
SIPPS:



# Legislative Changes & Regulatory Updates

## IMPACT ON SIPPS:

### SIPP and FSCO

- Previously, plan administrators only required to have established a SIPP and to review it on annual basis; no requirement for filing
- Effective **Jan 1, 2016**, the SIPP must be filed with FSCO within **60 days**
- Thereafter, any SIPP amendments must also be filed within **60 days**

# Legislative Changes & Regulatory Updates

## IMPACT ON SIPPS:

### SIPP and Member Statements

#### Previously

Statements only needed to be sent to active members



#### Now

Plans are required to send statements to former members

#### Previously

No references to SIPP in member statements



#### Now

Must include information regarding the SIPP in statements sent to members (active and former)

For existing plans, first set of statements with new requirements must be sent no later than **July 1, 2017**

# Legislative Changes & Regulatory Updates

## IMPACT ON SIPPS:



### SIPP and ESG

- SIPP must now include information regarding Environmental, Social and Governance (ESG) factors
- Declare whether ESG factors are incorporated in the plan's investment policies and procedures, and, if so, how they are addressed in the plan's investment strategy
- Regulatory amendments do not require ESG factors be included in the plan's decision making process
- Member statements will now include information regarding whether ESG factors are incorporated in the plan's SIPP and, if so, how the ESG factors are incorporated

# Legislative Changes & Regulatory Updates

## IMPACT ON SIPPS:



- SIPPs should be reviewed to confirm they contain required information before being filed in 2016
- SIPPs often contain information that is over and above what is required
- Number of problems with the inclusion of supplemental provisions:
  - may commit the plan sponsor to an undertaking or course of action (accountable to members or the regulator);
  - amendments to such provisions must be filed with the regulator; and
  - communication challenge to members



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# Incorporating ESG Factors



# Environmental, Social, Governance (ESG)

## What are ESG factors?

Intangible factors that investors consider in the context of corporate behavior in the belief that these factors can have a material financial impact.

### ENVIRONMENTAL

- Climate change and GhG emissions
- Energy efficiency
- Resource scarcity
- Pollution
- Water availability



### SOCIAL

- Health and safety
- Population/consumption
- Stakeholder relations/reputation
- Supply chains
- Working conditions



### GOVERNANCE

- Accounting & audit quality
- Board structure
- Remuneration
- Shareowner rights
- Transparency



# A Consideration of ESG Factors ≠ Ethical Investing (negative screening)

## Beliefs underlying the consideration of ESG factors

- ESG analysis is a complement to - and not a substitute for - traditional investment analysis.
  - Modern references to ESG issues pertain to lack of their systematic and comprehensive consideration, as opposed to no consideration, in traditional investing.
- There is no one way to perform ESG analysis in investment decision making or share ownership practices.
- ESG issues vary significantly in their importance across sectors.

## Most common approach among Canadian pension plans



**ESG INTEGRATION:** The inclusion of material ESG risks and opportunities in investment analysis (e.g. as part of top-down or bottom-up security selection or in asset allocation)



**ACTIVE OWNERSHIP:** Investors using their formal rights and informal influence (e.g. ability to engage) to encourage improvement by companies with a poor track record of ESG management

# Drivers Behind Investor Interest in ESG Factors

## Changing expectations from regulators, stakeholders and beneficiaries

### Sustainability widespread

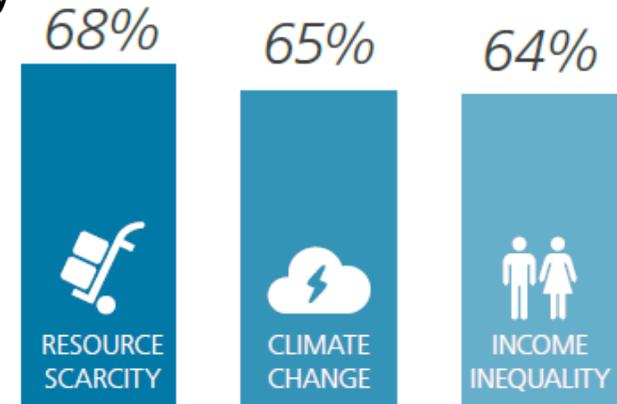
93% of largest 250 global listed companies issue sustainability / corporate responsibility reports



Source: KPMG CR Survey 2014

### Changing expectations

Millennials believe business can do more to help society



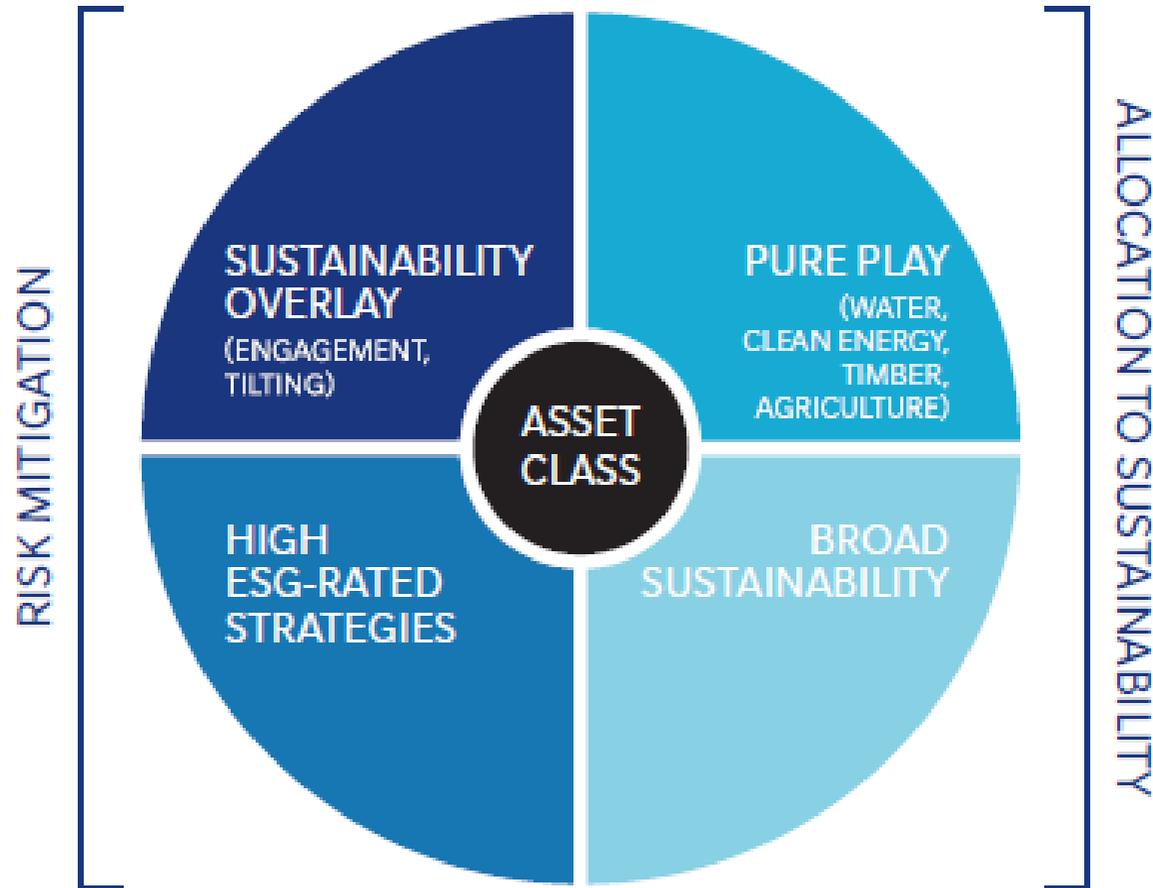
Source: Deloitte Millennial Survey 2014

### Investor commitments



# Integrating ESG Factors

## Methods of Integration Vary by Asset Class



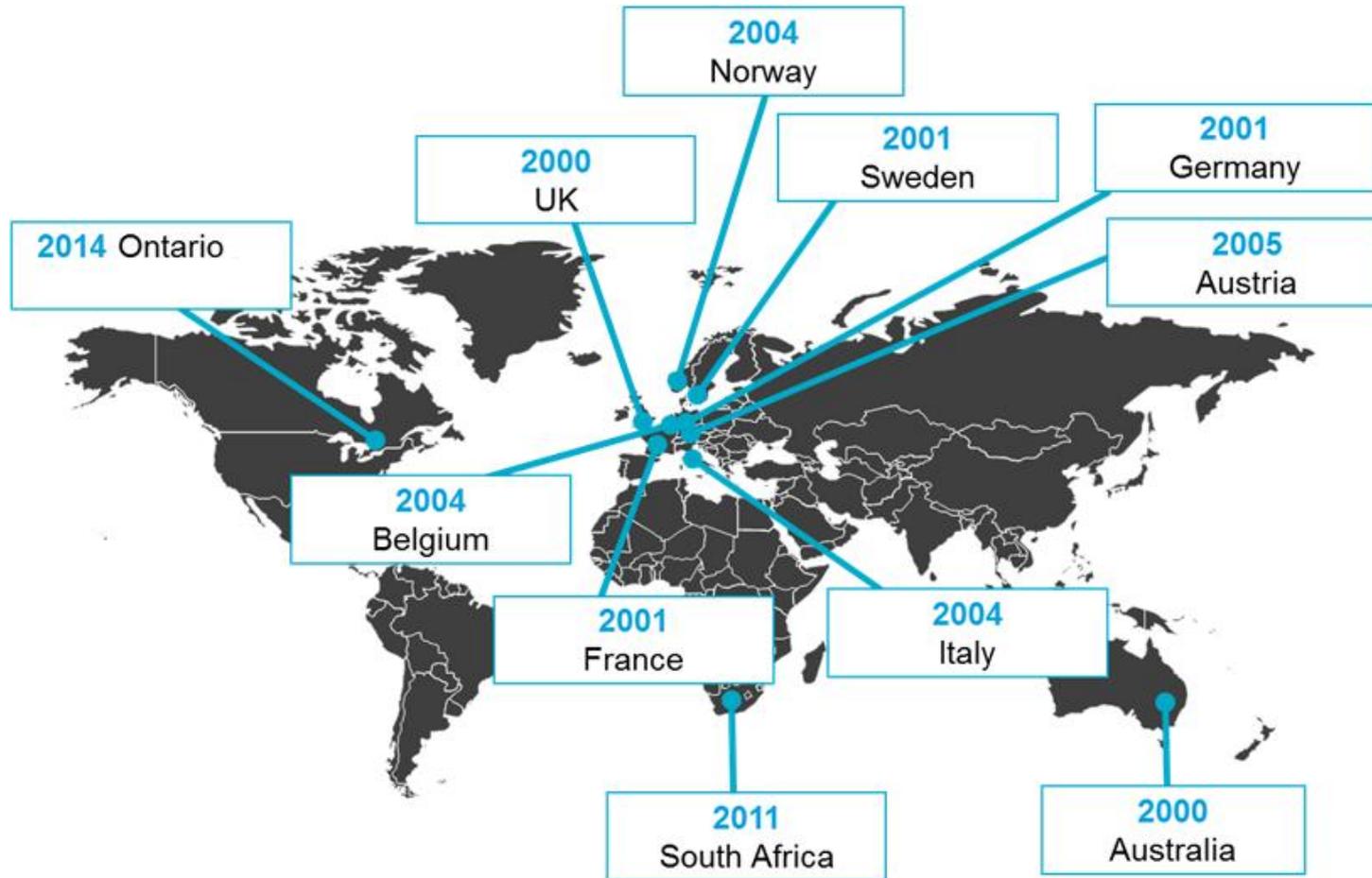
# ESG in Passive Equity Management

## Is ESG relevant?

- Passive managers **cannot express views by buying / selling** like active managers but....
- The **scale** of passively managed strategies: the “big 4” manage approximately \$10 trillion in assets globally, of which over 50% is in passive equities and growing. There is a huge opportunity for passive managers to express views and engage with company management.
- Passive equity managers are long-term shareholders of stocks, therefore the key focus is on exercising ownership rights to generate value through good ESG practices
  - **Longer holding periods** should enable higher quality conversations with company management: the holding period for passively managed equity strategies is typically longer than that of actively managed equity strategies.

# The Trend Towards ESG Disclosure

## Ontario requirement first proposed in 2008 Arthurs' Commission Report



*While such disclosure does not necessarily dictate a different approach to investments, it will likely encourage plan administrators to give more specific consideration to ESG factors.*  
Hicks Morley ([‘Ontario Proposes Significant Pension Regulation Reforms’](#))

# Recommended Next Steps for Plan Administrators

**1**

**Determine whether establishing an investment belief with respect to ESG considerations is appropriate.**

- To what extent do members of the investment committee believe that ESG factors will/can materially impact the financial performance of the plan's investments? Are plan members likely to be interested?
- Do members of the pension committee or board of directors require additional education or expert advice?

**2**

**Document the decision.**

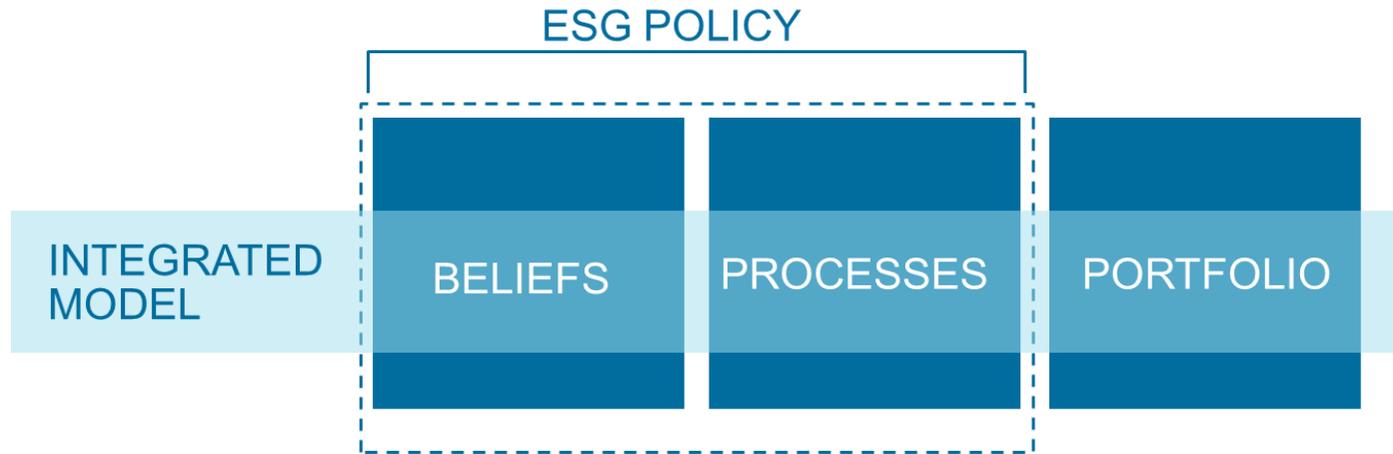
**3**

**Draft appropriate language that reflects beliefs and expectations with respect to ESG.**

**4**

**Consider how ESG beliefs and expectations (if articulated) are best incorporate into existing processes, including ongoing oversight.**

# Reflecting ESG Beliefs in Investment Procedures



## Plan Administrators are focusing on:

- Manager Selection
- Manager Appointments
- Monitoring and Oversight of Managers

# Manager Selection and Monitoring Tools

## Mercer's ESG Ratings



### IDEA GENERATION

We look for evidence of market leading capability with respect to identifying and integrating ESG factors into active fund positions as a source of value added. We look for an integrated approach to incorporating ESG factors into buy/sell decisions, as evidenced by the skill of team members, data sourcing and the inclusion of ESG factors in the identification of attractive investment opportunities



### PORTFOLIO CONSTRUCTION

We look for evidence that the manager makes an effort to integrate ESG driven views into the active bets in the portfolio, taking into account the strength of the conviction and the expected time period upon which the ESG factor is likely to become material



### IMPLEMENTATION

We look for evidence of voting and engagement activities with investee companies. We also look for evidence that the manager has a long-term investment horizon (as evidenced by portfolio turnover data) to effectively implement ESG views

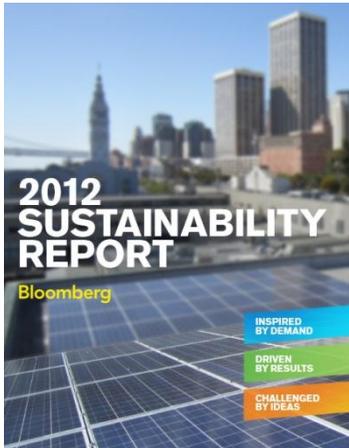


### BUSINESS MANAGEMENT

We assess the extent to which the business leaders understand the importance of ESG/RI and active ownership and the extent to which they have committed to integrating this across the firm. This includes participation in collaborative initiatives

# Case Study: Bloomberg LP

## BLOOMBERG CORPORATE LEADERSHIP



*“In alignment with our customers’ priorities, and reflecting the depth of our commitment to sustainability, we worked with Mercer to assess how funds available in the Bloomberg’s 401(k) Plan consider ESG in their investing strategies. **Each investment manager was evaluated on his/her investment-integration strategy for ESG, active ownership and engagement efforts, and firmwide commitment to sustainability principles. Information on fund assessments is now available for employees on internal HR web pages. It’s another opportunity Bloomberg offers to employees who seek to extend the Company’s commitment to better understand the broad impact of sustainability issues.**”*

Source: Bloomberg 2012 Sustainability Report

# Trends and Key Considerations for Plan Administrators

## In Closing

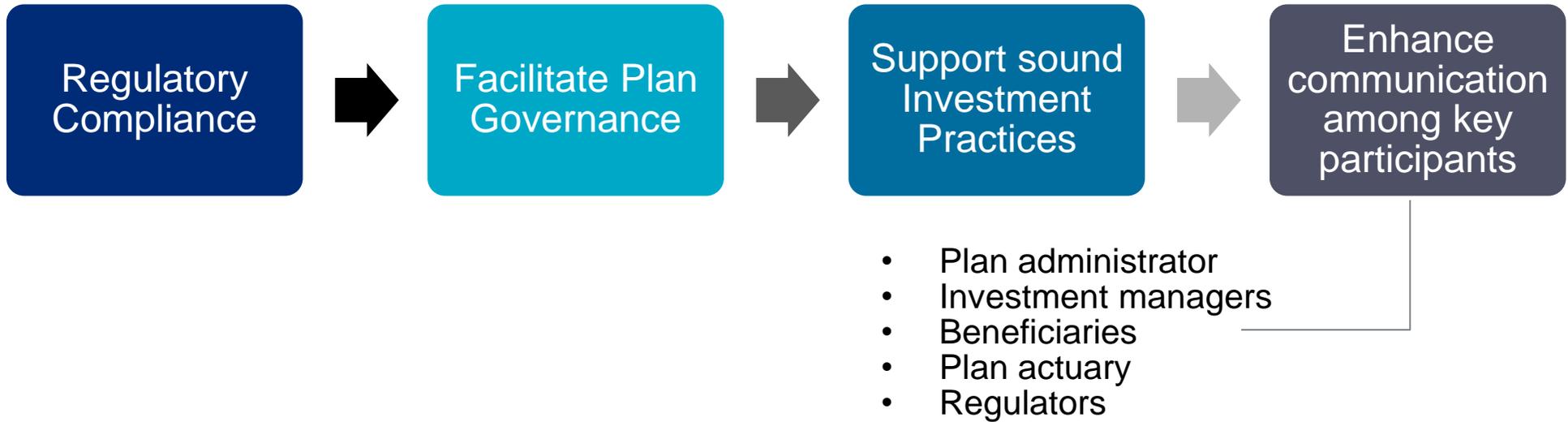
- Sustainability and ESG issues are increasingly on investors' agendas
- ESG factors can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time).
- ESG factors are only one consideration among many that may be relevant to the selection and suitability of a particular investment.
- An expression of support in considering ESG factors, in general, should not restrict an investor to investing exclusively in mandates or companies that explicitly and comprehensively take into account ESG.
- Characteristics of the investment mandate (e.g. passive or quantitative strategies) may influence what may practically be achieved.



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# Items To Be Considered For Inclusion Within a Plan's Overall Investment Policy And Management Framework

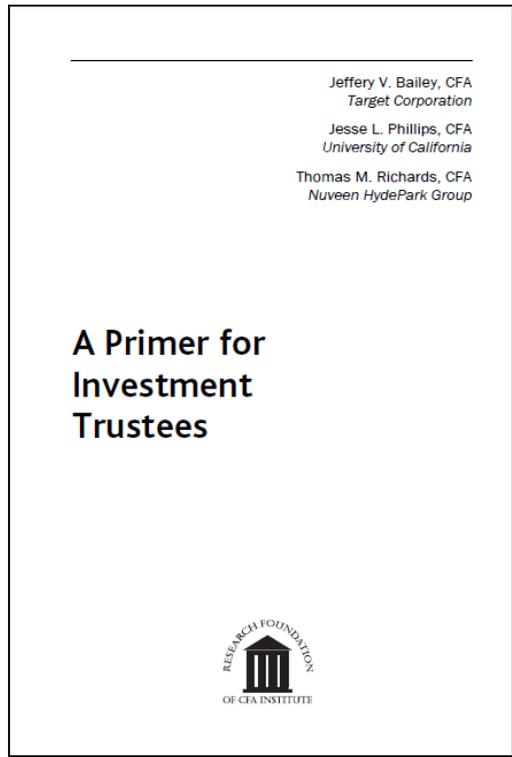
# What is the Objective?



## Required Elements of an Investment Policy

Requirement	Federal, BC, SK, MB, NS, PE, NL	AB	ON	QC	NB
Categories of investments	X	X	X	X	X
Diversification of the portfolio (QC: proportions of debt and equity)	X	X	X	X	X
Asset mix	X	X	X		X
Rate of return expectations	X	X	X	X	X
Liquidity of investments	X	X	X		
Lending of cash or securities	X	X	X	X	X
Retention or delegation of voting rights	X	X	X	X	X
Valuation methods or rules	X	X	X	X	X
Related party transactions	X	X	X		
Description of factors considered	X	X	X		
Volatility or risk of the portfolio		X		X	
Liquidity requirements				X	
Conflict of interest policy					X
Portfolio monitoring rules and schedule				X	
Schedule for investment policy reviews				X	
Rules for derivative contracts				X	
Information on ESG factors			X		

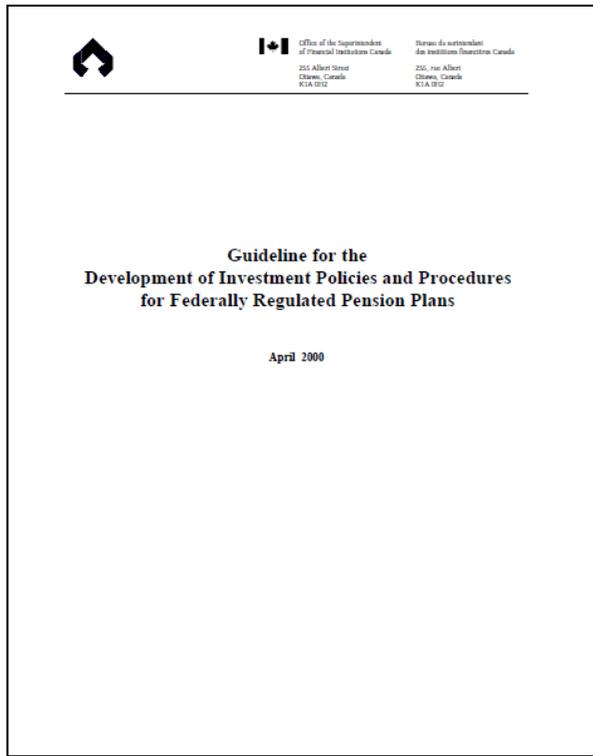
# CFA Institute – A Primer for Investment Trustees (January 2011)



<http://www.cfapubs.org/doi/pdf/10.2470/rf.v2011.n1.1>

- An investment policy statement serves three primary functions:
  - To facilitate communication of investment policy
  - To ensure continuity of policy during periods of trustee and staff turnover
  - To provide a baseline against which to evaluate proposed policy changes
- A comprehensive investment policy addresses:
  - The fund's mission
  - Risk tolerance
  - Investment objectives
  - The policy asset mix and **rebalancing policy**
  - **Performance evaluation**

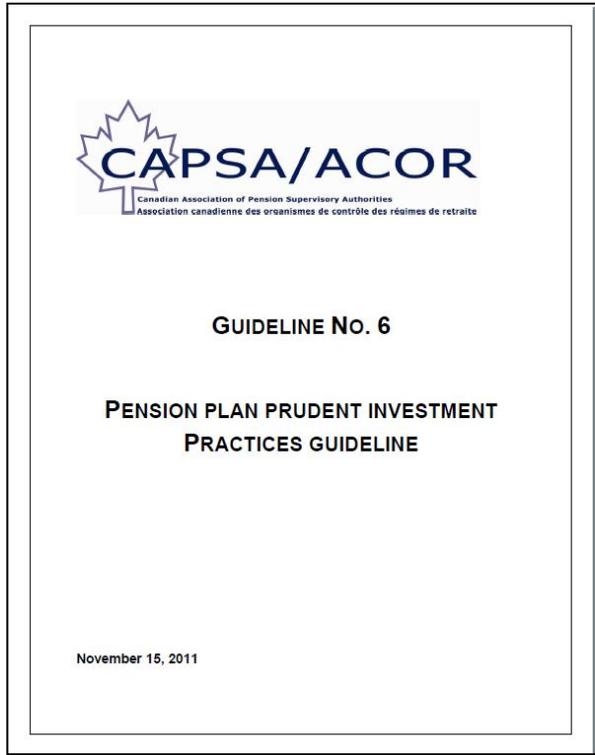
# OSFI Guidelines (April 2000)



<http://www.osfi-bsif.gc.ca/eng/pp-rr/ppa-rra/inv-plc/pages/penivst.aspx#mozToCl d925734>

- The investment procedures should:
  - Identify **responsibilities** and accountabilities
  - Set out the **process for recommending, approving, and implementing decisions**
  - Determine the frequency and format of **reporting** and of performance measures
- Additional items, including:
  - Specify choice between active vs. passive management and the rational
  - Consider the effects of:
    - management fees,
    - transaction costs, and
    - custodial fees

# CAPSA Prudent Investment Practices Guideline (November 2011)



- Suggestions for a statement of investment policies and procedures include identifying:
  - **Performance objectives**
  - **Risk tolerances**
  - **Process for regular monitoring**
  - **Delegated authority**
  - **Investment responsibilities**
  - **Decision-making and approval process, including the process for manager selection and replacement**

[http://www.capsa-acor.org/en/init/prudence/Pension\\_Plan\\_Prudent\\_Investment\\_Practices\\_Guideline.pdf](http://www.capsa-acor.org/en/init/prudence/Pension_Plan_Prudent_Investment_Practices_Guideline.pdf)

## Documentation

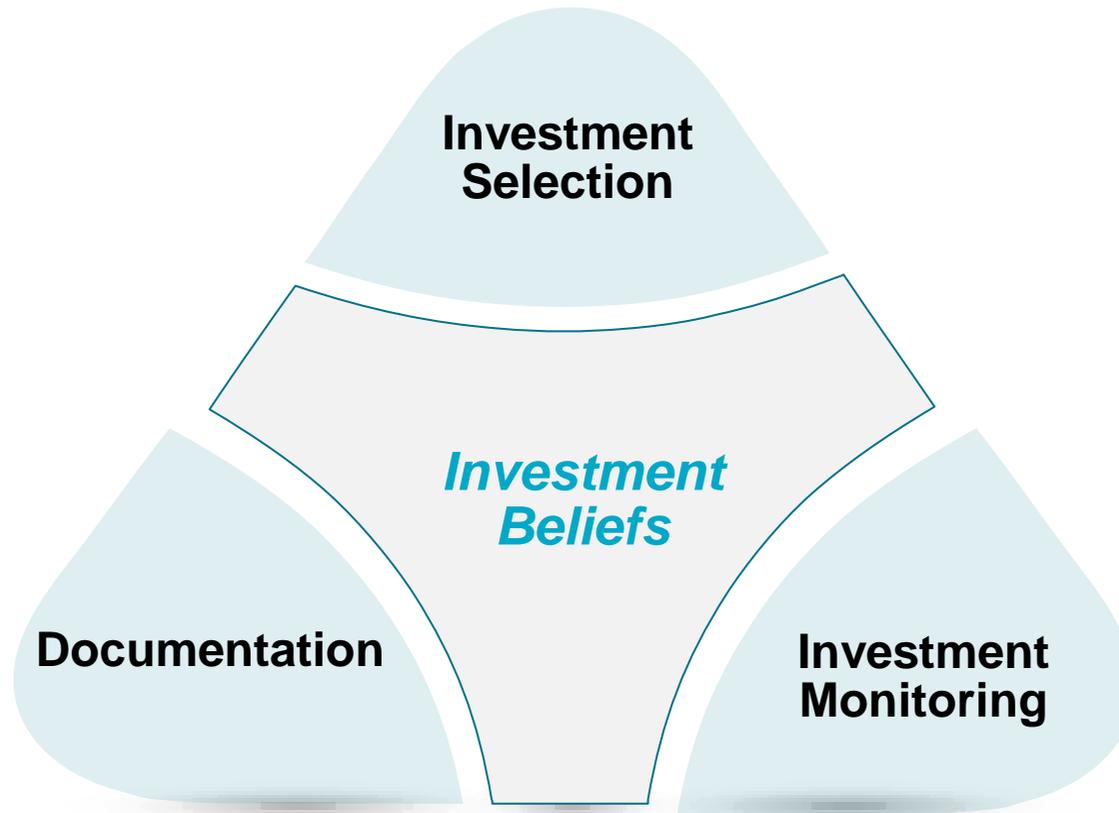
- Additional items could be included within:
  - The “official” statement of investment policies and procedures
    - The document which satisfies the regulatory requirements
  - Investment manager mandates
  - Governance documents
  - Statement of investment beliefs
  - Other documentation addressing investment processes



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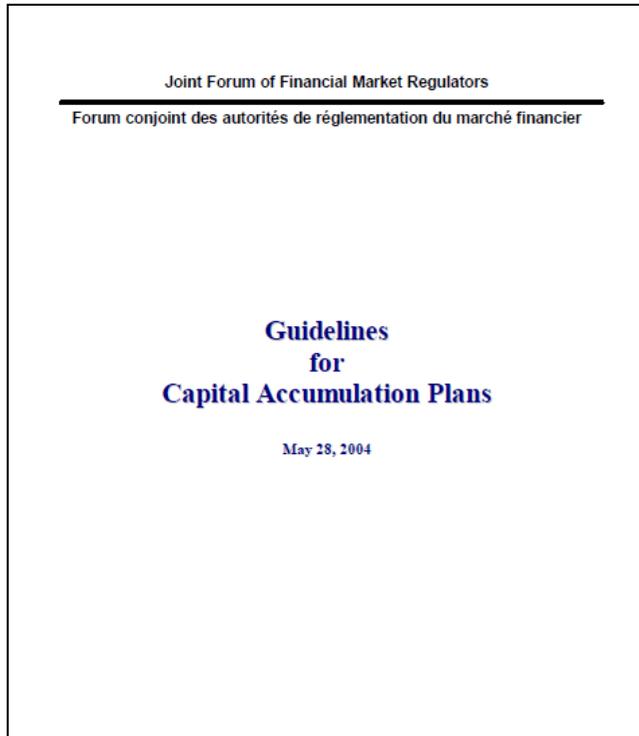
# Considerations For Defined Contribution Plans

# Considerations for Defined Contribution Plans



# Considerations for Defined Contribution Plans

## Investment Selection and Monitoring



- Additional investment considerations:
  - **Number of Investment options**
  - **Diversity and demographics of plan members**
  - **Fees associated with the investment options**
  - **Limitation of options**

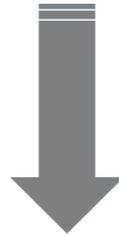
[http://www.capsa-acor.org/en/init/cap\\_accumulation/guideline%20number%203.pdf](http://www.capsa-acor.org/en/init/cap_accumulation/guideline%20number%203.pdf)

# Considerations for Defined Contribution Plans

## Investment Selection and Monitoring

### Best practices for DC SIPP

1. **Conducting an initial and regular ongoing review of investment beliefs** (e.g. member investment behaviour, types, number and structure of the investment line-up)
2. **Setting clear investment objectives** to evaluate qualitative and quantitative aspects of investment performance, fee impact, investment decision making process of members and appropriate default option

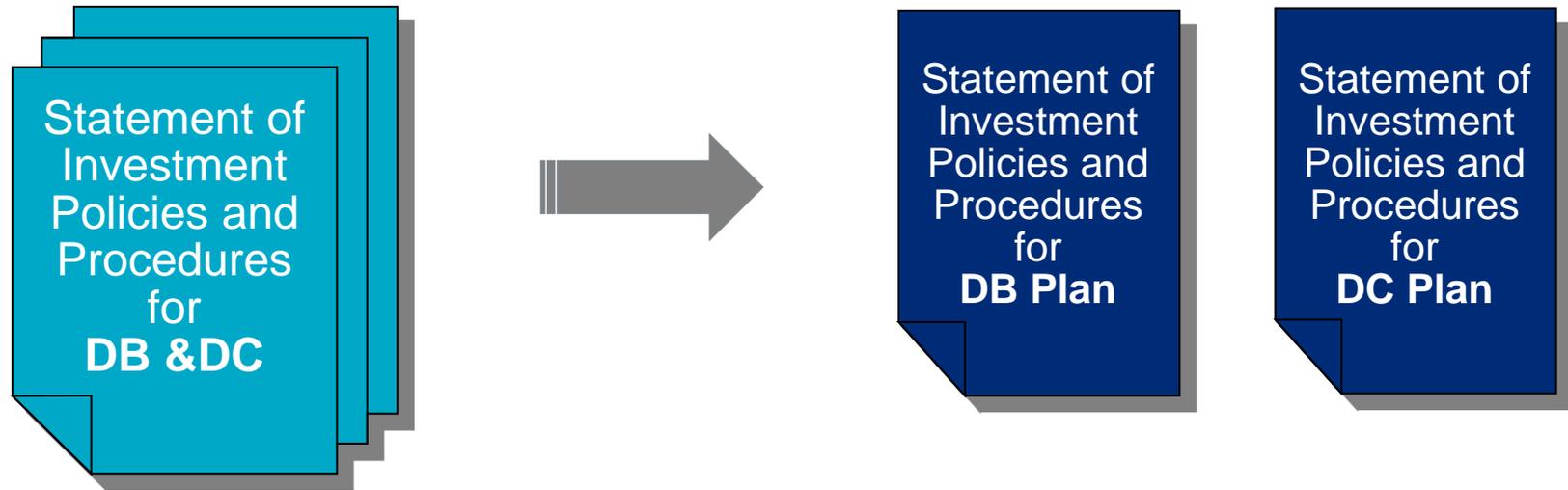


**SIPP: Measure and Document Objectives**

# Considerations for Defined Contribution Plans

## SIPP Documentation

- Standalone DC SIPP vs. incorporating within the DB SIPP



- Inclusion of non-DC Pension type arrangements (e.g. RRSP/DPSP)

# Considerations for Defined Contribution Plans

## SIPP Documentation

### Detailed vs. General Information

- Transparency to plan members
- Finding the appropriate documentation process
- Governance process and documentation updates

### Additional Considerations: Plan governance education and training

# Considerations for Defined Contribution Plans

## SIPP Documentation

- A look at ESG
  - Service provider limitation
  - Service provider disclosure practices
  - Influence with investment managers
  - Plan member engagement

## Next Steps



# QUESTIONS



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