

Responsible investing and the Western Pension Plans: Questions and Answers from the Panel Discussion May 5, 2022

Background: On May 5, 2022 the Western pension plans hosted a panel discussion on responsible investing. This document contains the questions received during that session. Questions 1-5 were answered live, and supplemental information has been added here where noted. Questions 6-12 were not answered live due to time; responses have been included for completeness.

Panelists:

- Tom Keenleyside, Associate Director, Investments, Western
- Eric Mooney, Investment Solutions Executive, Sun Life
- Ryan Pollice, Principal, Investment Consulting, Mercer

Moderator: Cara Bourdeau, Sr. Human Resources Consultant, Western

Q1. “Can I choose a fund for my pension which doesn't follow this responsible investing virtue signaling, and instead meets your fiduciary duty to maximize growth?”

A1.

Cara: In the polling responses on interest in different approaches to incorporating ESG we saw that not everybody is interested in this information being part of the consideration in investment choices.

Tom: We do have growth-oriented strategies built into our Diversified Equity Fund and you can get exposure to growth through that. And even within that strategy that manager does integrate ESG; there are examples where they haven't invested in companies specifically for ESG reasons.

A1. Additional Comments

The Western Pension Boards' fiduciary duties are to act in the best interest of plan members in supporting the accumulation of retirement savings and they are guided by the following principles:

1. Offer members the broad and diversified **CHOICE** of both investment and retirement vehicles.
2. Maintain **FAIRNESS** among members in plan operations.
3. Provide investment alternatives which possess high **LIQUIDITY**.
4. Assist members in making **WELL—INFORMED DECISIONS** about investment and retirement alternatives.
5. Solicit information about and be **RESPONSIVE TO MEMBER PREFERENCES** regarding the plan.
6. Use **PRUDENCE** in assessing and reviewing plan decisions and operations.
7. Assure **COST EFFECTIVE ADMINISTRATION** of plan operation.

The Western pension plans currently have one dedicated socially responsible investment (“SRI”) fund option. The other funds incorporate ESG oversight/integration at the discretion of the investment managers whose goal is to achieve the objectives of their funds within their stated policy constraints.

Q2. “Do fund managers proxy vote based on ideology or based on maximizing return on investment?”

A2.

Eric: I would generally say that they would [i.e. ideology/philosophy plays a role when proxy voting], but they would create their policies designed to maximize long-term value for their investors. So with that you know that they have to recognize certain things within the industry that are changing. They might adapt their policies and change their policies but it's really about creating long-term value for the shareholders. We have seen changes to policies around things like climate and around things like diversity and inclusion, voting rights on how they vote for things like board of directors composition with respect to diversity inclusion so while it is more focused on long-term shareholder growth there very much is an ESG lens being applied to how they're crafting proxy voting policies these days, and then how they act on it as well.

Cara: In the Board's discussions with investment managers in the review process we can see that even where there hasn't been any direction to managers about ESG matters, across the board, it's clearly folding in to become part of the standard reporting which may or may not be driving decisions, but is certainly something that is being monitored and spoken to more frequently.

Q3. “I would imagine most companies will bring ESG into their practices because it is good PR. I suspect the extent of ESG is engaged varies a bit. Exactly how is Western selecting good ESG companies?”

A3.

Cara: We've heard that Western isn't doing the selection themselves, and other than our Socially Responsible Fund, as Tom mentioned at the beginning, we do not have a directive mandate for our investment managers.

Tom: The managers that we choose, they do have ESG integration for the most part, within their processes. They will not invest in a particular company if it doesn't screen well from an ESG lens, or they will balance maybe the environmental risk with other factors that are more relevant to that manager just in terms of its ability to kind of manage those risks and it might have strong governance, might have a very good product that has a lot of potential.

A3. Additional Comments

Neither Western's investment team nor the Pension Boards take part in stock and/or bond selection i.e. making investments in specific companies. These are selected by the investment managers which have been hired by the Pension Boards. The due diligence process when hiring a new investment manager, and in monitoring thereafter, involves an in depth review of the firm, the investment team, investment philosophy and process, risk controls, their ESG framework, whether they are a signatory to the Principles for Responsible Investment, how they are integrating ESG into investment decisions, what resources they have committed to responsible investing, and more. The process also takes into account Western's consultant's view and rating of the investment manager and the specific strategy. In most cases the consultant would also have an ESG rating which essentially measures for how far along the manager is in terms of ESG integration. Prospective managers would also be subject to Western's in

depth ESG questionnaire which facilitates greater transparency into this area, including Equity, Diversity and Inclusion (EDI) and seeks specific examples of actions taken to apply ESG policy and improve ESG and EDI.

Q4. “How profitable are ESG funds in in general, or are ESG funds more of a longer-term investment? As in bad and low for the short term?” And a related question about how our ESG fund has performed compared to other funds.”

A4.

Tom: I don't have the performance numbers in front of me. I'll look that up and come back to it.

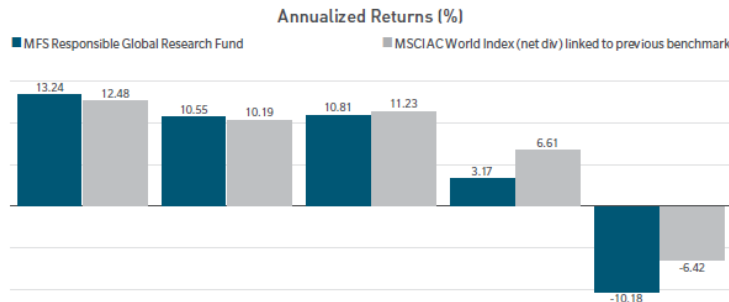
Eric: You know this website that we have launched that's available to plan members now we do link to a study of one thousand studies from New York University, where they did examine the performance of managers that integrated ESG versus ones that did not and they did find that over the long-term horizon funds that integrated ESG did tend to out-perform; they did do a better job of protecting on the downside during social or economic crisis, and they out-perform negative screening approaches, those screening and divestment style funds, ESG integration outperformed that as well. So there is a link to that on the plan member website [www.mysunlife.ca/western > my plan > Resource Centre > Sustainable investing], where you can read the studies and the factors that go along on this. But typically most academic research does show that funds that do integrate ESG there is a either a performance or a risk advantage to them.

A4. Additional Comments

For actively managed funds performance can vary depending on the skill/experience and depth of resources of the investment managers involved and also the investment style they use. The performance of the Socially Responsible Global Equity Fund is measured against it's benchmark, the MSCI ACWI (a broad, global, all country index). The fund has outperformed its benchmark in 9 of the past 10 calendar years and has added 0.76% value over the index over the 10-year period ending March 31, 2022 (gross of fees).

MFS Responsible Global Research Fund (CAD)

Performance as of 31 March 2022



Excess Returns (%)	10 Years	5 Years	3 Years	1 Year	1Q22
MFS vs. MSCI AC World Index (net div) linked to previous benchmark	0.76	0.36	-0.42	-3.44	-3.76

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
MFS Responsible Global Research Fund	13.02	36.19	15.38	19.02	1.49	16.82	0.63	23.22	14.85	17.94
MSCI AC World Index (net div) linked to previous benchmark	12.64	31.04	13.55	17.10	4.13	15.83	-1.26	20.20	14.22	17.53
Excess Returns (%)										
MFS vs. MSCI AC World Index (net div) linked to previous benchmark	0.38	5.15	1.83	1.92	-2.64	0.99	1.89	3.02	0.63	0.41

Effective 5 March 2012, the Fund's benchmark was changed from MSCI World Index to MSCI All Country World Index (net dividends reinvested). In connection with this change, the fund's strategy changed.

Source: Benchmark performance from SPAR, FactSet Research Systems Inc. It is not possible to invest directly in an index.

The GIPS Composite Report is provided as the last page of this presentation.

Fund returns are net of fund expenses, and do not reflect any management fees. Had management fees been reflected, the performance shown would be lower. Performance data shown represents past performance and is no guarantee of future results. Periods less than one year are actual not annualized.

Since many funds integrate ESG factors, the performance of ESG is difficult to set apart. Here is the performance of some of the globally diversified funds available under the Western pension plans as at December 31, 2021 (returns are gross of fees).

FUND	\$ assets (in millions)	% of total plan assets	FMF*	1 year	3 year	5 year	10 year
Socially Responsible Global Equity Fund	\$23.9	1.7%	0.52%	17.72%	18.55%	14.37%	12.37%
Diversified Equity Fund	\$738.6	52.9%	0.50%	18.73%	16.51%	11.72%	12.91%
Non North American Equity Fund	\$30.3	2.2%	0.69%	14.50%	12.06%	9.21%	11.22%

*FMF – Fund Management Fee is the fee to cover the cost of operations and investment expertise, paid by plan members for the funds they are invested in.

Q5. “Western’s Social Ethical Grown (sic) investments were set up many years ago – and I have profited immensely due to the very high returns (approximately 13 percent). I took a look recently and nowadays most of the ethical investments are in Amazon and Alphabet and this worries me. These companies have profited a lot, especially during Covid.”

A5.

Cara: I do just want to call out if you're looking at the Morningstar Fund Sheet for our Socially Responsible Global Equity Fund, which you can find through your Sun Life account you will see sort of the top, I think it's the top 5 holdings, listed which do include Amazon, Alphabet and I think Microsoft is in there and what you want to also keep in mind is the percentage. I think we max out, probably around 4% as a as a max holding so there are lots of components going on in there. But fair enough for the call out, these are some of the bigger holdings.

Tom: Speaking on behalf of that MFS [SRI] fund it specifically is a sector-neutral fund, so it's difficult for it not to hold companies like Amazon and Alphabet just due to their relative makeup of the of the of the sectors. Those companies in particular are making very strong headways in terms of ESG improvements, and so that's something that would be taken into account on whether they overweight or underweight those positions. Just as far as fossil fuels go, or sorry on the nuclear power topic, that particular fund looks at how well a particular company that may be engaged in those activities is doing relative to its peers and benchmarks. So that's how it screens on that front.

A5. Additional Comments

The top ten holdings in the portfolio for the Socially Responsible Global Equity Fund, as March 31, 2022:



Top 10 Holdings	Portfolio (%)	MSCI All Country World Index (%)
MICROSOFT CORP	4.8	3.3
AMAZON.COM INC (EQ)	3.1	2.2
TAIWAN SEMICONDUCTOR MANUFACTURING CO LTD	2.4	0.8
ALPHABET INC	2.4	2.5
NESTLE SA	2.0	0.6
ROCHE HOLDING AG	1.9	0.4
AON PLC	1.8	0.1
LINDE PLC	1.7	0.2
ADOBE INC	1.7	0.3
CONOCOPHILLIPS (EQ)	1.6	0.2

Top holdings for all funds offered under the Western pension plans are available from the Morningstar fund sheets, which can be access by members from their Sun Life account. Visit www.mysunlife.ca/western and select 'my plan' > Accounts > Investment performance. Click on any fund name and select the Fund Sheet (pdf) from the menu. Details are updated quarterly.

Q6. Will Western be divesting from nuclear power, which is unsustainable. Will it be divesting from military firms, like General Dynamics? I assume that the social ethical investment decisions were made in line with recent decisions by Royal Bank and other big banks to think about steering away from nuclear power as a sustainable development growth fund.

A6.

The SRI fund offered under the Western pension plans has some screening (see below) which avoids certain investments that may fall into the categories described in the question, although the Western SRI Global Equity Fund does not screen out nuclear power. At the present time, other investment mandates do not require the investment managers to make investment decisions on individual stock or bond holdings based on ESG criteria. However, most managers are proactively integrating ESG in their investment process and the Pension Boards monitor the ESG policy and practice of all investment mandates.

Socially Responsible Investing

Company screens¹



Annual Revenue	Companies that derive annual revenue from the manufacture and sale of tobacco products, cannabis products, alcoholic beverages, armaments, pornography, or from the provision of gaming facilities.
Employment Standards	Companies with significant operations and/or suppliers that do not adhere to local employment standards, and do not address the issue.
Environment	Companies whose negative impact on the environment is worst in class.

Q7. “Are the pension boards looking at changing the Diversified Equity fund to include some ESG integration funds as this is in alignment with the University's sustainable development goals?”

A7. The Diversified Equity Fund currently has twelve underlying investment mandates managed by ten different investment managers. All of the managers within the Diversified Equity Fund are currently signatories of the Principles for Responsible Investment (PRI). As such, all of these managers are required to integrate ESG factors into their investment process in order to maintain that certification, even though Western does not require them to. All managers have been reporting on their ESG approach, if any, and we anticipate this will continue to occur given the wide-spread interest and demand from the broader investment market. The Western Pension Boards will be taking feedback from engaging with plan members to consider whether a different approach should be pursued. At this time, only the Socially Responsible Global Equity Fund requires screening based on ESG factors. The manager of this fund, MFS, also actively integrates ESG factors into the investment process, proxy voting and company engagement.

Q8. “I support the recognition that more information on sustainable investing is an area for improvement. I wonder if there is consideration too for Regenerative Investing for staff and faculty?”

A8. Regenerative finance/investing focuses on the circular economy and creating health and equitable social and environmental systems. It is a relatively new investment area. For some active in his area, there is a desire to make positive change possible, with the financial return as a by-product or secondary objective. In that sense it is different from sustainability-focused funds as well as impact investment funds who target both the financial return on capital and positive social or environmental impacts. Our discussion within the pension plans has used the language of Sustainability-focused funds. These funds are diversified, targeting a competitive rate of return and risk profile and are often invested in specific areas such as renewable energy, waste and water management, sustainable forestry and agriculture. These funds are just starting to emerge as options for investors and could be considered in the future is deemed beneficial and prudent to plan members. We continue to work with our providers to evaluate the suitability of any new investment funds for our plan.

Q9. “It seems to be important to invest in the well-being of our planet to prosper, or humanity could be in trouble regarding, air, water, food sources. But how does that translate into investment dollars?”

A9. There is supporting evidence that that these investment thesis can also provide a financial return in addition to social and environmental returns. During the panel discussion Eric mentioned a research initiative of over 1,000 studies. This comprehensive review was undertaken by the NYU Stern Center for Sustainable Business, in collaboration with Rockefeller Asset Management and Casey Clark, CFA (MBA '17) to examine the relationship between ESG and financial performance in more than 1,000 research papers from 2015 – 2020. The full report is available from the link below and through the Sun Life plan member website, under Resource Centre > Sustainable investing.

From the press release in February, 2021

“We’ve seen an exponential increase in ESG and impact investing as evidence builds that business strategy focused on material ESG issues goes hand-in-hand with high-quality management teams and improved returns,” notes Professor Tensie Whelan, Founding Director of NYU Stern’s Center for Sustainable Business.

The authors surveyed 1,141 peer-reviewed papers and 27 meta-reviews (based on ~1,400 underlying studies) published between 2015-2020; select papers are available through the Center’s new ROSI™ Research Database. Six key takeaways from the research indicate:

1. Improved financial performance due to ESG becomes more noticeable over longer time horizons
2. ESG integration as an investment strategy performs better than negative screening approaches
3. ESG investing provides downside protection, especially during a social or economic crisis
4. Sustainability initiatives at corporations appear to drive better financial performance due to mediating factors such as improved risk management and more innovation
5. Studies indicate that managing for a low carbon future improves financial performance

6. ESG disclosure on its own does not drive financial performance

Source: <https://www.stern.nyu.edu/experience-stern/about/departments-centers-initiatives/centers-of-research/center-sustainable-business/research/research-initiatives/esg-and-financial-performance>

Q10. “Where do we look for performance of the Socially Responsible Investment Fund?”

A10. Information on the strategy, performance and investment fees of each of the funds under the Western pension plans is available to members from their Sun Life account.

Login: www.mysunlife.ca/western and select: **my plan**

For Strategy: the Morningstar fund sheets have the detailed information. Select Accounts > Investment performance > and then click on the name of the fund you wish to explore. Select Fund Sheet to view the details and explanation as a pdf.

For Performance: select Accounts > Investment performance and the chart will display the returns for 1 Month, YTD, 1 Year and 5 Years

For Investment Fees: Select Account > Account fees. The Fund Management Fees (FMFs) paid by plan member to cover the costs of operations and investment expertise. Members only pay the fees of the funds they selected for their account.

Q11. “How much of ESG investing is based on fundamentals vs. the flow of money from bigger hedge funds or pension plans?”

A11. It is important to distinguish between ESG investing, which often refers to products with varying approaches and objectives and ESG analysis or ESG integration. ESG analysis and integration looks at risks and opportunities revealed by the analysis of environmental, social and governance issues that are material for a company, industry or country. Often, the investment managers used by the pension plans will include ESG analysis to assess risk, augmenting their evaluation of a company’s fundamentals.

In thinking about the flow of money, it is difficult to refer to ESG investing in the sense of there being a definable pool of securities of ‘Good ESG Companies.’ There are some investment products with significant assets (including index funds or exchange-traded funds) that utilize third-party ESG scores or ratings to select companies. If larger institutional investors like hedge funds or pension funds were to approach ESG in this manner, there is the potential that the flow of money into these “good ESG companies” could result in them trading at higher valuations and reducing future expected returns. The pension plans do not invest in these type of funds.

Q12. “How are ESG scores calculated?”

A12. There are a number of models which attempt to measure ESG and assign a score. At this time, the criteria and scoring systems are varied and produce inconsistent results. The Western Pension Boards review ESG ranking information from a variety of sources (including MSCI, Sun Life, and Mercer) and does not currently rely on one source of data in decision making. Investment managers making decisions regarding the holdings for their investment portfolio utilize a variety of external and

proprietary systems for evaluating ESG. Discussion of the approaches form part of the ESG discussion in each investment manager review conducted by the Boards.