March 19th, 2021

RE: CIFSC response to public comments regarding the RI Fund Identification Proposal

On October 7th, 2020 the CIFSC released a proposal to adopt a Responsible Investment Fund Identification Framework followed by a 60-day comment period.

The CIFSC is thankful those who put together thoughtful and constructive comments in terms of how the RI fund identification process should be implemented.

The intent of this letter is to highlight the common themes identified in the comments the CIFSC has received and to provide response and explanation to the greatest extent possible.

Summary

The CIFSC has formally proposed displaying the fund level ESG and Sustainability scores from its member data providers next to the funds in the RI list, but has not formally proposed the use of quantitative criteria in identifying RI funds. A quantitative assessment is not part of the initial framework. There were however several comments regarding the use of quantitative criteria, consequently the CIFSC has chosen to address those comments in this document.

The CIFSC will wait until the next iteration of the CFA's *ESG Disclosure Standards for Investment Products* before releasing a second version of the RI Fund Identification Framework. The goal being to align, to the greatest extent possible, with the terminology and the categories of RI strategies that the CFA chooses to promote. The CIFSC anticipates that most fund companies will follow the CFA guidelines in describing their RI approach in regulatory documents.

After releasing the second version of the RI Fund Identification Framework, the CIFSC will allow for a second comment period.

Comments and Responses

The common themes from the comments are numbered, followed by a summary of the comments and the CIFSC's response.

1. **The general proposal to identify RI funds and label the RI approach(es) of the fund.**

   Most commenters were in favour of the proposal in terms of having the CIFSC review regulatory documents and investment mandates to identify RI funds and to label the RI approach(es) used by the fund.

2. **The process of reviewing the RI approach in a fund's regulatory documents.**

   Most commenters were supportive of the concept to review regulatory documents as part of the process to identify the responsible investing approach used by the fund. Some commenters suggested this alone was sufficient in identifying responsible investment funds and the RI approach followed by the fund.

   Another commenter suggested that the CIFSC provide more clarity as to what specific language regarding the RI approach is expected in the regulatory documents.

   CIFSC Response:

   The CIFSC believes that reviewing regulatory documents to identify and assess the RI approach is a necessary part of the process and it will continue to be, at the very least, a significant step in identifying RI funds and the RI approaches used by funds.

   The CIFSC also believes that only reviewing regulatory documents is not enough to claim a robust and complete process in assessing a fund's RI approach. For a complete, comprehensive assessment, the committee believes that a fund's portfolio must be examined.

   The CIFSC has made broad recommendations regarding how the RI approach should be described in regulatory documents including: intention, process and strategies, intended results and impact, and transparency. The committee believes that for more specific disclosure guidelines, most funds should, and will, follow the CFA Institute ESG Disclosure Standards for Investment Products.

3. **Including a quantitative evaluation in the process of identifying RI funds and RI approaches.**

The CIFSC has not formally proposed using quantitative criteria in identifying RI funds but has received comments on the topic and has therefore chosen to address those comments. The CIFSC has considered the idea and suggested that quantitative criteria may be added in the future. The reason being that simply reviewing regulatory documents and marketing material while ignoring portfolio holdings leaves room for greenwashing.

The CIFSC has formally proposed displaying the fund level ESG and Sustainability scores from its member data providers next to the funds in the RI list. The reason for this is to improve the transparency and accountability of RI funds.

There have been comments both in favour and opposing the use of quantitative metrics.

The comments, both in favour and opposing, are listed and numbered below followed by the CIFSC's response to each numbered comment:

Comments opposing:

3.1 Low correlation amongst the scores of the data providers.
3.2 ESG scores don't capture every RI approach or certain RI approaches (most commonly Corporate Engagement) cannot be measured with ESG scores.
3.3 Using ESG scores from member data providers presents a conflict of interest for the CIFSC.
3.4 Such an approach would in essence provide CIFSC and its voting members the task of using proprietary ESG fund evaluative frameworks to determine the quality of available RI funds.
3.5 Small cap or emerging markets funds are at a disadvantage due to lack of data and lack of coverage.
3.6 Fund rating systems score funds relative to international funds, but Canadian investors are only investing in Canadian funds.
3.7 ESG ratings are not sector specific.
3.8 There would be a problem with taking the average of the ESG scores across data providers.
3.9 This would be similar to CIFSC taking on the role of using their own evaluative schemes to determine, for example, which funds are truly active funds, which are truly low volatility funds or measuring and sanctioning some other investment manager's stated approach to investing.

Comments in Favour:

3.10 To try to identify RI funds without looking at the portfolio or ESG scores is akin to trying to determine asset allocations without looking at the portfolio, a practice that hasn't been acceptable by anyone in the investment fund industry for at least 25 years.

3.11 There should be a relationship between a fund's ESG score and its identification as an ESG incorporation fund.

3.12 The only way to ensure that a fund is following through on their investment mandate is to look at the portfolio.

3.13 Looking at a fund's portfolio increases the transparency and accountability of the fund.

3.14 There are currently several bond funds claiming an RI approach and/or corporate engagement in regulatory documents but are holding primarily government bonds.

CIFSC Response:

3.1 – Low correlation amongst the scores of the data providers.

The CIFSC acknowledges that there is low correlation amongst the ESG ratings from the different data providers. This is the primary reason the committee believes that using scores from three (or more) different providers is a far better solution than using data from one provider or relying on proprietary evaluation systems from the individual fund companies. Low correlation amongst the scores is not a reason to ignore the scores all together. Having an organization that can aggregate at least three different data sources is step in the right direction towards consistency.

3.2 – ESG scores don't capture every RI approach or certain RI approaches (most commonly Corporate Engagement) cannot be measured with ESG scores.

In any fund classification process, there are strategies and approaches that do not fit the standard definitions as is the case with the CIFSC asset-based categories. In such situations the committee looks in depth at the fund's regulatory documents and holdings and asks for additional data and information before reaching a consensus on the best category for the fund. We would follow a similar approach for RI funds.

The CIFSC acknowledges that ESG scoring systems generally don't account for corporate engagement and that the effectiveness of corporate engagements is almost impossible to quantify. For this reason, the proposal intends to recognize and label funds that use corporate engagement. The CIFSC will consider displaying other ESG or Sustainability scores beyond the overall fund ESG score/rating to better capture data that measures other RI approaches; this proposal will be subject to public consultation.

If a fund is marketed as a responsible investment and invests in such a way that it targets companies with poor ESG scores and uses corporate engagement in an attempt to improve those scores, investors and advisors should be aware of this strategy and the types of companies the fund is holding. The CIFSC believes the best way to accomplish this is to identify the fund as one that uses corporate engagement, and to show the ESG scores.

3.3 – Using ESG scores from member data providers presents a conflict of interest for the CIFSC.

The CIFSC acknowledges that the member data providers sell aggregate data on ESG ratings at the fund level. However, the CIFSC disputes the claim that this presents a conflict of interest for the committee. Member data firms will not profit because of the CIFSC using fund ESG ratings as they will be made available for free on member websites.

In addition, the CIFSC operates in an efficient and effective manner because it relies on the use of data from member data providers. For more than 20 years, the CIFSC has been using holdings data supplied by member data providers, data that those providers also sell, in order to categorize funds based on their portfolios. The issue has never been raised that the CIFSC's reliance on member's data presents a conflict of interest. Member data providers are competitors and the committee never has, and never will, promote the use of data from one firm over another.

Furthermore, the CIFSC has always been open to fund companies submitting their own data in regard to asset, sector, and geographic allocation-based categories. The CIFSC will continue this by considering a fund company's proprietary approach to responsible investing and their evidence in support of it. In fact, the committee welcomes this as it was founded on a spirit of industry-wide collaboration. The CIFSC will never attempt to force anyone to use the data from member data providers but will itself continue to use that data as it has enabled the committee to successfully pursue its mission for over 20 years.

The CIFSC collects no membership fees and receives no external funding, relying solely on the efforts and data of its constituent member firms. Rather than a point of weakness, this puts the committee in a position of strength unique to the Canadian market and empowers it to act with good intentions and in the best interests of Canadian investors.

While no evaluation process can be entirely free from bias, the CIFSC and its member firms make every effort to fairly interpret data from a variety of sources, verify their conclusions and remain open to working with all industry participants.

3.4 – Such an approach would in essence provide CIFSC and its voting members the task of using proprietary ESG fund evaluative frameworks to determine the quality of available RI funds.

The CIFSC's member data providers do assess the quality of RI funds with the ESG scores in the context of their own firms. By showing the ESG scores next to each RI fund the CIFSC is attempting to add a level of transparency into what the fund is holding and how those holdings score across the ESG factors according to the different methodologies. If the CIFSC were to incorporate ESG scores from the member data providers, it would be to ensure certain criteria are met. This would be analogous to how the CIFSC currently evaluates investment funds for suitability in the assets-based categories.

3.5 – Small cap or emerging markets funds are at a disadvantage due to lack of data and lack of coverage.

The committee is aware of, and constantly deals with data availability and quality issues. In a situation where the CIFSC did not have sufficient ESG data on a particular fund, the committee will consider data from the fund company or any other source available. This situation would be treated in the same way that funds are treated for asset categorization when none of the member data providers has holdings data; fund companies are always allowed to submit data directly to the committee for consideration.

3.6 – Fund rating systems score funds relative to international funds, but Canadian investors are only investing in Canadian funds.

The data that would be used by the CIFSC would be the ESG score at the fund level that is not compared to funds domiciled in other countries. All member data providers can provide ESG scores that are elative only to other Canadian funds.

3.7 – ESG Ratings are not sector specific.

The ESG scores at the company level do account for the sector and industry in which the company operates. This is the case for all three of the CIFSC's data providers.

3.8 – There would be a problem with taking the average of the ESG scores across data providers.

The CIFSC has never suggested that taking the average ESG scores across the three data providers would be an appropriate approach.

3.9 – This would be similar to CIFSC taking on the role of using their own evaluative schemes to determine, for example, which funds are truly active funds, which are truly low volatility funds or measuring and sanctioning some other investment manager's stated approach to investing.

The CIFSC does not evaluate portfolios for active share or volatility because there are no categories based on those strategies. The CIFSC does evaluate fund portfolios to determine if they are suitable for all the existing 60 categories. If the CIFSC were to create categories or flags based on active, passive or low volatility approach, quantitative measures would be put in place to ensure funds were investing in line with their stated approach to investing.

3.10 - To try to identify RI funds without looking at the portfolio or ESG scores is akin to trying to determine asset allocations without looking at the portfolio.

The CIFSC has been evaluating fund portfolios to determine appropriate asset-based categories for 23 years, a practice that has been accepted as standard in the Canadian investment fund industry. The CIFSC has been able to achieve this because of the breadth and integrity of the data from the member data providers and because the committee operates as an independent body removing as much bias and subjectivity as possible from the process. The CIFSC anticipates a similar process and results if the committee were to examining fund portfolios and ESG scores to identify RI funds.

3.11 - There should be a relationship between a fund's ESG score and its identification as an ESG incorporation fund.

The CIFSC agrees that it is logical to assume that a fund that claims to use ESG integration would have relatively high scores across the ESG factors from at least one of the member data providers.

3.12 - The only way to ensure that a fund is following through on their investment mandate is to look at the portfolio.

The CIFSC has operated under this premise for over 20 years. Evaluating a fund's portfolio is the only way to see how that fund is invested.

3.13 - Looking at a fund's portfolio increases the transparency and accountability of the fund.

Evaluating a fund's portfolio is the only way to ensure the fund is invested according to its investment mandate.

3.14 – Further analysis must be done on fixed income funds claiming an RI approach and/or corporate engagement.

The CIFSC acknowledges that this is an area of concern and that fund reporting and data on green or sustainable bonds needs improvement as does reporting on the extent to which bondholders are engaging with corporations.

4. Aligning with existing and developing global standards, specifically the CFA ESG Disclosure Standards.

Some comments suggested the CIFSC align exactly with existing terminologies and add Positive Screening as a standalone approach while others suggested the five approaches proposed by the CIFSC where sufficiently in line. There were other comments suggesting the CIFSC align with the proposal put forth by the CFA.

CIFSC Response:

At this time, the CIFSC is planning to align exactly with existing terminologies and add Positive Screening or Best in Class as a sixth distinct RI approach, as such the CIFSC would align almost exactly with the CFA in terms of terminology.

There are however key differences in the CIFSC's approach and the CFA's approach. Primarily, the CFA is proposing a disclosure-based approach suggesting the fund providers describe their RI approach in regulatory documents based on self-assessment.

The CIFSC is proposing an approach where the committee would identify responsible investment funds by evaluating the investment mandate as stated in regulatory documents to determine which RI approach(es), if any, the fund is using. The intent is that the CIFSC would remove some of the onus from investors and advisors by examining regulatory documents and adding a level of information that would allow investors to more closely align their values with the funds in which they invest. The CIFSC would attempt to determine if a fund's portfolio reflects its stated RI approach similarly to how the committee determines if a fund's portfolio aligns with its investment mandate regarding asset, sector and geographic allocations.

The CIFSC believes that the CFA's approach and the CIFSC's approach can be very complimentary in fulfilling the needs of investors and advisors.

5. **The definitions of the five RI approaches proposed by the CIFSC.**

   There were comments saying the definitions where oversimplified and others saying they were straightforward and easy for users to understand.

   CIFSC Response:

   The definitions were meant to be simple and concise to allow for widespread understanding across all industry participants. Lengthy and complicated definitions restrict the flexibility of the investment funds and the CIFSC committee. Regardless of the level of detail put into the definitions, there will always be investment products with specific nuances that are not addressed.

6. **The CIFSC's process in developing the standard.**

   There was a comment stating that the CIFSC may not have sufficiently consulted with key stakeholders throughout this process and a comment saying the CIFSC has conducted this work without meaningful engagement with the asset management community – the key stakeholders who will be directly impacted by this work.

   CIFSC Response:

   The CIFSC acknowledges that asset management firms are key stakeholders in this process, but investors and advisors are at the very least equal stakeholders and are the industry participants for whom the CIFSC was created to serve.

   The CIFSC did seek input and consultation from major industry associations who represent the mutual fund, ETF and alternative fund companies, as well as other key stakeholders. In addition, the proposal was made public and distributed as widely as possible to seek comments and feedback after which the committee heard from most of the fund providers who offer RI products.

7. **Assessments at the fund level versus the company level.**

   There was a comment suggesting that the CIFSC examine RI products at the fund level as opposed to at the firm level.

   CIFSC Response:

   The CIFSC's intent has always been to examine the individual funds as opposed to all, or a group of funds offered by a fund provider.

8. **The review process for new and existing funds.**

There was a question as to how the CIFSC would deal with new funds and how existing funds would be reviewed.

CIFSC Response:

The committee would deal with new funds in a similar manner to how new funds are currently dealt with in terms of asset-based categorization. Each month the committee's member data providers will collect new funds as they are listed in the respective databases and flag those that label themselves as RI funds. At the end of each month the committee will review the aggregate list and determine which RI approach the fund is using.

The review process would also be handled in a similar manner to how reviews are currently dealt with in terms of asset-based categorization. Each month the committee will review requests to have a fund's RI approaches changed or updated.

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