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Climate Change and the Fiduciary Duties of Pension Fund Trustees in Canada

BY

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Climate change has emerged as one of the defining economic as well as environmental and social issues of our time. For Canadian pension fund trustees, this has created debate about how climate change should be factored into trustee decision-making, including how trustees can engage with public policymakers. As fiduciaries, pension fund trustees owe a duty to beneficiaries and plan members to act prudently and in their sole interest. Faced with the impact of climate change on fund portfolios and by the potential for funds to exacerbate or mitigate climate change by their investment decisions, what are trustees' obligations and how should they respond?

As a national not-for-profit organization dedicated to improving investment practices that protect the long-term interests of investors, working people, communities and society as a whole, the Shareholder Association for Research and Education (SHARE) believes that a greater understanding of the relevance of climate change to trustee decision-making will help improve outcomes for pension plan members and other beneficiaries of trusts.

With financial support from the Environmental Dispute Resolution Fund administered by British Columbia's West Coast Environmental Law Association, SHARE commissioned Koskie Minsky LLP, one of Canada's leading pension law firms, to prepare a research paper setting out the legal basis for considering climate change as part of a pension trustee's fiduciary duty. As climate change continues to emerge as a significant issue for the investment community, this paper will help trustees gain a greater understanding of how this unique and pressing challenge relates to their responsibilities to those they serve.

A handwritten signature in black ink that reads "Peter W. Chapman". The signature is fluid and cursive, with a long, sweeping underline that extends to the right.

Peter Chapman
Executive Director, SHARE

This report examines the nature of pension fund trustees' fiduciary duties to beneficiaries specifically in the context of global climate change. It briefly summarizes key conclusions of contemporary climate science, and then proposes a legal lens through which pension fund fiduciaries may approach the challenges posed by global climate change. The report is divided into four parts. Part I summarizes the scientific consensus with respect to climate change. Part II describes the law relating to pension fund trustees' fiduciary duties, with a particular focus on British Columbia. Part III considers how those fiduciary obligations may shape pension fiduciaries' approach to the Earth's changing climactic conditions. Finally, Part IV considers pension fund fiduciaries' interface with public policy and with governments specifically in regard to climate change.

Part 1

A Summary of the Scientific
Consensus Regarding
Global Climate Change



PART 1

The foremost global authority on climate change is the Intergovernmental Panel on Climate Change (IPCC). The United Nations Environmental Programme (UNEP) and the World Meteorological Organization (WMO) established it in 1988 to ensure the world's governments would receive objective assessments of the science of climate and climate change. The IPCC's current mandate is defined as assessing "on a comprehensive, objective, open and transparent basis the scientific, technical and socio-economic information relevant to understanding the scientific basis of risk of human-induced climate change, its potential impacts and options for adaptation and mitigation."¹ The IPCC assessment process is the most comprehensive in any branch of science. The IPCC assessment reports are prepared for thousands (literally) of scientists volunteering to summarize and synthesize the findings from the peer-reviewed scientific literature. The reports are then themselves subject to open peer review by the scientific community. The IPCC is therefore able to represent the full range of scientific work on the subject of climate; work that does not meet scientific standards is not promoted or endorsed by the IPCC. The IPCC's latest Synthesis Report, published in November 2014, distills a number of unambiguous conclusions about the Earth's climate and the changes it is undergoing. The main conclusions are as follows:

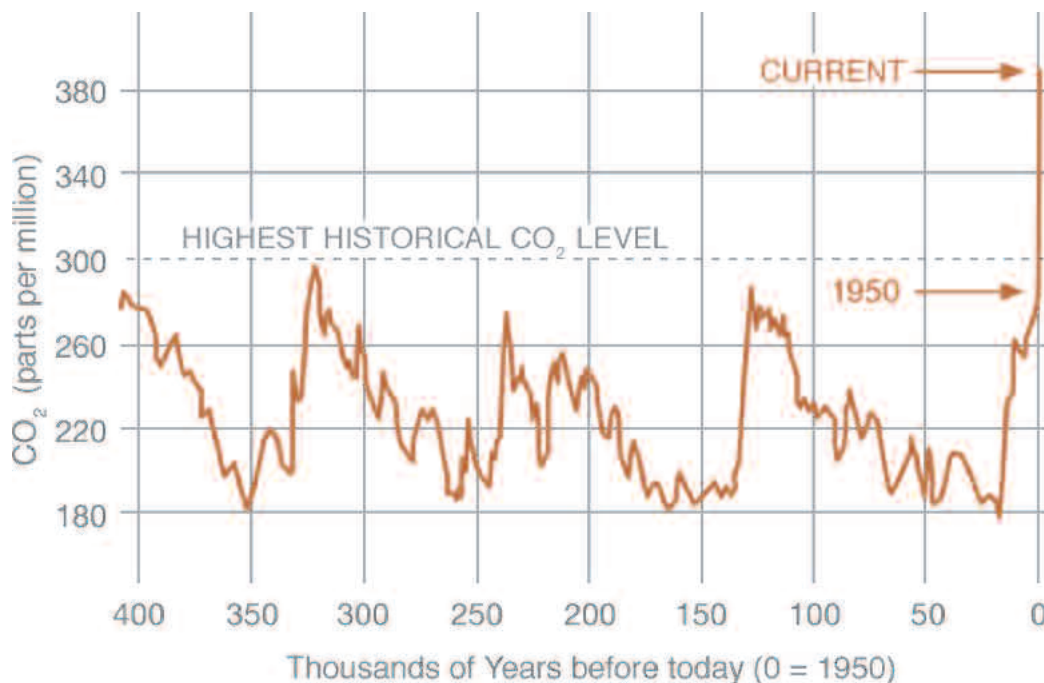
- Anthropogenic greenhouse gas emissions have increased since the pre-industrial era, driven largely by economic and population growth, and are now higher than ever. This has led to atmospheric concentrations of carbon dioxide, methane and nitrous oxide that are unprecedented in at least the last 800,000 years. Their effects, together with those of other anthropogenic drivers, have been detected throughout the climate system and are extremely likely to have been the dominant cause of the observed warming since the mid-20th century.²
- Continued emission of greenhouse gases will cause further warming and long-lasting changes in all components of the climate system, increasing the likelihood of severe, pervasive and irreversible impacts for people and ecosystems. Limiting climate change would require substantial and sustained reductions in greenhouse gas emissions, which together with adaptation can limit climate change risks.³

1 Intergovernmental Panel on Climate Change, Organization (Geneva: IPCC), online: Intergovernmental Panel on Climate Change <https://www.ipcc.ch/organization/organization_history.shtml>.

2 Intergovernmental Panel on Climate Change [Core Writing Team, R.K. Pachauri and L.A. Meyer (eds.)], *Climate Change 2014: Synthesis Report, Contribution of Working Groups I, II and III to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change* (IPCC: Geneva, 2014) 151 pp. [IPCC, "Synthesis Report"] at 4.

3 *Ibid* at 8.

- Surface temperature is projected to rise over the 21st century under all assessed emission scenarios. It is very likely that heat waves will occur more often and last longer, and that extreme precipitation events will become more intense and frequent in many regions. The ocean will continue to warm and acidify, and global mean sea level to rise.⁴
- The scientific research assessed by the IPCC further identifies that a large fraction of climate change from human-driven greenhouse gas emissions is irreversible on a multi-century to millennial timescale, such that decisions made about emissions today can affect the climate for generations. The broad scientific consensus reflected by the IPCC reports is supported by every major national science academy, in 80 different countries, including Canada, the U.S. and the U.K., as well as by all the major scientific organization in related fields.
- The long-term record of atmospheric CO₂ levels, extracted from ice cores, shows that the atmospheric CO₂ is well in excess of the range over the past 400,000 years⁵:



⁴ Ibid at 10.

⁵ NASA, "Facts," Global Climate Change: Vital Signs of the Planet (California Institute of Technology: Pasadena, 2015), <www.climate.nasa.gov/evidence/>.

PART 1

As a result of climate change science, there is a scientific and political consensus that an increase in global average temperature beyond 2 degrees Celsius, from pre-industrial levels, is potentially catastrophic.⁶ In June 2015, the G7 countries, of which Canada is a member, issued a declaration from their Summit held in Schloss Emau recognizing that urgent and concrete action is needed to address climate change through the introduction of binding rules to hold the increase in global average temperature below 2 degrees Celsius with a common vision for a global goal of greenhouse gas emissions reductions of 40 to 70 per cent by 2050 compared to 2010 by inter alia supporting vulnerable countries' own efforts, eliminating inefficient fossil fuel subsidies, incorporating climate mitigation and resilience considerations into development assistance and investment decisions and applying effective policies and actions including through carbon market-based and regulatory instruments.⁷

The dramatic increase in global greenhouse gas (GHG) emissions is not in any scientific dispute, nor is the general impact of such emissions on the Earth's climate. Climate scientists have measured increases in the planet's global average temperature and have modelled the probable consequences of higher average temperatures on the Earth's climate. Their conclusions are widely accepted in the scientific community. It is this consensus that is relevant to pension fiduciaries.

It is also important to note that climate science does not predict that every part of the planet will warm, or that warming will take place in a straight line or at the same rate over the planet's surface. Climate science is complex, takes account of factors other than GHG emissions, recognizes feedback loops (some of which mitigate and others of which exacerbate underlying climate trends) and, as its projections are based on models that cannot precisely replicate the Earth's complex climate systems, recognizes uncertainty. None of this detracts from the IPCC's conclusions. Indeed, the IPCC's conclusions reflect a scientific consensus that reflects all of these factors.

The IPCC has also focused on future actions that may minimize or mitigate climate change. It has focused on both mitigation and adaptation strategies, concluding that:

- Climate change will amplify existing risks and create new risks for natural and human systems. Risks are unevenly distributed and are generally greater for disadvantaged people and communities in countries at all levels of development.⁸

6 Samuel Randalls, "History of the 2°C climate target" (2010) 1(4) WILE CL CH, 598.

7 United Nations Department of Economic and Social Affairs, Leaders' Declaration: G7 Germany Schloss Elmau (June 7-8, 2015), 12-13.

8 IPCC, "Synthesis Report" supra note 2 at 13.

- Adaptation and mitigation are complementary strategies for reducing and managing the risks of climate change. Substantial emissions reductions over the next few decades can reduce climate risks in the 21st century and beyond, increase prospects for effective adaptation, reduce the costs and challenges of mitigation in the longer term and contribute to climate-resilient pathways for sustainable development.⁹

⁹ Ibid at 17.

The background of the slide is a photograph of a city skyline at sunset or sunrise. The sky is filled with large, billowing clouds that are illuminated from below, creating a gradient of colors from deep blue at the top to bright orange and yellow near the horizon. The city buildings are silhouetted against the bright light, with some windows glowing. The overall mood is dramatic and serene.

Part 2

The Scope of Fiduciary Duties
in a Pension Plan Context

Fiduciary duties are imposed on a person who exercises discretionary power on behalf of another person who has reposed their trust and confidence in that person.¹⁰ A fiduciary's duties to beneficiaries are twofold: a duty to act prudently and a duty of loyalty.¹¹ A variety of duties, in turn, emanate from these two principal duties.

The precise scope of a fiduciary's duties is dependent upon the nature of the fiduciary's relationship with the beneficiaries.¹² In the pension context, pension plan trustees are fiduciaries,¹³ whose duties must be interpreted in a manner consistent with the purposes of a pension plan – to provide a retirement income for employees upon retirement.¹⁴ Fiduciary law applicable to pension trustees has been established by the courts, modified to the pension context and codified in pension benefits legislation.

a) Duty of Prudence

All of the provinces have legislation in respect of the duties of trustees. In British Columbia, the Trustee Act requires a trustee to exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments.¹⁴

The standard of care inherent in the duty of prudence, has, in the pension context, been elevated beyond what would normally be required of a fiduciary. Instead of being required to exercise the same degree of care as would a person of ordinary prudence in respect of their own property, the duty of care codified in section 35(3)(b) of British Columbia's new Pension Benefits Standards Act (PBSA), expected to come into force in September 2015, requires an administrator to "exercise the care, diligence and skill that a person of ordinary prudence would exercise when dealing with the property of another person."¹⁶ The PBSA's reference to another person is intended to obligate pension fund fiduciaries not simply to exercise the degree of prudence that they exercise in conducting their own affairs, but to conduct themselves in a more objectively justifiable manner that reflects the fiduciary's obligations to others – others who, in a pension context, are the beneficiaries of the pension plan, and, as such, vulnerable to the exercise of discretion by the pension fund fiduciary.

10 *Hodgkinson v Simms*, [1994] 3 SCR 377 [Simms] at 419.

11 *Ibid*; *Blueberry River Indian Band v. Canada (Department of Indian Affairs and Northern Development)*, [1995] 4 SCR 344.

12 *Guerin v The Queen*, [1984] 2 SCR 335 at 384.

13 *Burke v Hudson's Bay Co*, [2010] 2 SCR 273 at para. 41; *Nolan v. Kerry (Canada) Inc*, [2009] 2 SCR 678 at para 187.

14 *Income Tax Act*, RSC 1985 c 1 (5th Supp), s 147.1(11)(a) and *Income Tax Regulations*, CRC c 945, s 8502(a).

15 *Trustee Act*, RSBC 1996, c 464, s 15.2. This can be modified by the terms of the trust agreement itself. (*Trustee Act*, s 21.) In the event of a conflict between British Columbia's *Trustee Act* and *Pension Benefits Standards Act (PBSA)*, pension benefits legislation prevails. (*Bill 38, Pension Benefits Standards Act*, 4th Sess, 39th Leg, British Columbia 2012, (assented to 31 May 2012) s 2(b) [Bill 38].) A trustee is not liable for a loss if it accrued pursuant to "a plan or strategy for the investment of the trust property, comprising reasonable assessments of risk and return, that a prudent investor could adopt under comparable circumstances." (*Trustee Act*, s 28.)

16 *Bill 38*, *supra* note 15, s 35(3)(b); Ari Kaplan & Mitch Frazer, *Pension Law* (Toronto: Irwin Law, 2006) at 322.

PART 2

To acquit themselves of this duty of care, the law requires trustees to use all relevant knowledge and skill that the plan administrator possesses or, by reason of the plan administrator's profession, business or calling, ought to possess.¹⁷ Practically speaking, pension fund fiduciaries are required to make decisions on an informed basis, after conducting appropriate due diligence. Although they are required to apply the knowledge and skill that they themselves possess (or ought to possess), they are also required to retain specialized advice where it is relevant to the decision at hand; in order to meet a fiduciary standard, an investment process designed to bring to bear relevant information, often from different perspectives or disciplines, and to generate reasoned and informed decisions, is required.

British Columbia's new Pension Benefits Standards Act ("PBSA") specifically addresses the nature of a pension fiduciary's investment objective by providing that plan investments must be made with a view to the plan's liabilities, must not be unduly risky and must be made with a reasonable expectation of return commensurate with the risk assumed:

60(2) Pension plan assets must be invested in a manner that a reasonable and prudent person would adopt if investing the assets on behalf of a person to whom the investing person owed a fiduciary duty to make investments

- (a) without undue risk of loss, and
- (b) With a reasonable expectation of a return on the investments commensurate with the risk, having regard to the plan's liabilities.¹⁸

Draft regulations to British Columbia's PBSA also require the establishment of a statement of investment policies and procedures governing the pension fund's portfolio, again in the context of the plan's liabilities and of "all factors that may affect the funding and solvency of the plan and the ability of the plan to meet its financial obligations."¹⁹ An investment policy must also describe all of the factors to which a fiduciary had regard in establishing the policy, and must set out how those factors were applied to arrive at the policy.

In general, the PBSA maintains an investment focus on risk and return in a diversified portfolio that is constructed in beneficiaries' best financial interests and with specific regard to the liability characteristics of the particular plan. Although a specific level of acceptable risk is not specified in the PBSA, fiduciaries are required to invest pension plan assets 'without undue risk of loss' and with a 'reasonable expectation of return commensurate with the risk'. With its emphasis on a portfolio of investments, and on the balance between risk and return within the portfolio, the BC PBSA may reflect the underlying concerns of modern portfolio theory; with its strong direction to configure an investment portfolio with regard to the specific characteristics of the plan's liabilities, it also reflects more recent concerns about asset/liability matching.

¹⁷ Kaplan & Frazer, *supra* note 16 at 322.

¹⁸ Bill 38, *supra* note 15, s 60(2).

¹⁹ *Ibid*, s 51(2).

For the purposes of this paper, the PBSA's admonition that a pension plan's liability structure is the appropriate reference point for its investment policy is particularly important. Different plans do, of course, have different liability structures. Some are more mature than others, for example, and we know, based on recent mortality tables issued by the Canadian Institute of Actuaries, that mortality varies according to the type of work plan members perform during their working lives. Nevertheless, it is generally true that pension plan liabilities include liabilities for active employees who range in age from their twenties to their sixties and, as well, for retirees whose ages typically range from the mid-fifties to (in some cases) over 100. Young active members may not draw a pension for 40 years, and, once they begin to draw their pension they may continue to do so for 30 or more years. Even the population of current retirees can generally be expected to remain on a pension payroll for more than 30 years. This means that pension liabilities are long term; considering investment strategy in the context of a plan's liabilities means that an investment strategy must be cognizant of long duration liabilities, often for 70 years or more. For most open defined benefit plans, young employees are becoming new plan members as the employer's labour force is renewed; accordingly, pension liabilities for most open plans may be expected to remain longer term indefinitely.

Some commentators prefer to look at a pension plan's liability as multi-generational – as consisting of different groups of beneficiaries with different time horizons. On this view, it is sensible to have shorter-term investment strategies for some groups, and longer term investment strategies for others, with the balance in any particular plan depending on its demographic characteristics. When viewed through this lens, the choice of asset allocation involves multi-generational considerations, or, put another way, it involves inter-generational equity.

However one views a pension plan's liabilities, one thing is clear – pension plans may not adopt investment policies for the short term and comply with the requirement to configure their asset allocation to their longer term liabilities. Pension plans must have regard for the long term on the asset side, because they are long-term actors on the liability side, and the two sides must be aligned.

b) Duty of Loyalty

The duty of loyalty to beneficiaries is the paramount duty of pension fund trustees.²⁰ At its heart, the duty of loyalty requires that pension fund fiduciaries act in the best interests of beneficiaries²¹ in accordance with the terms of the trust. In turn, this duty implies a number of related duties to:

- (a) Treat all beneficiaries impartially;²²
- (b) Act honestly;²³
- (c) Disclose relevant information,²⁴ inform, and consult²⁵; and
- (d) Prevent other interests from conflicting with their duty to beneficiaries -
for example to:
 - (i) Not profit from their position;²⁶
 - (ii) Not benefit third parties;²⁷ and
 - (iii) Not be swayed by personal, political or social/economic belief.²⁸

All of the provinces, but for Prince Edward Island have pension benefits legislation dealing with the fiduciary duties of pension trustees and reflecting the duty of loyalty. British Columbia's PBSA codifies the duty of loyalty in section 35(3)(a) by requiring that, "In the administration of a pension plan, the administrator must (a) act honestly, in good faith and in the best interests of the members and former members and any other person to whom a fiduciary duty is owed."²⁹

The duty of loyalty is central to the legal obligations of pension fiduciaries. It requires that fiduciaries act in the interests of pension fund beneficiaries and in no other interests. As noted above, the long-term nature of pension funds' liabilities gives rise to issues of inter-generational wealth maximization such that pension fiduciaries management of trust assets requires allocation of assets between near-term needs and future wealth creation.³⁰ Some commentators have stressed that in undertaking an asset allocation between short-term and long-term investments, the duty of impartiality precludes short-term investments that prejudice long-term investments.³¹ At a minimum, the duty of impartiality implies that short-term interests ought not to be privileged over long-term interests, militating in favour of having due regard to systemic risks. The PBSA's admonition to consider an investment policy in the context of a plan's liabilities reflects at least a partial codification of the duty of impartiality.

20 Arthur B Laby, "Resolving Conflicts of Duty in Fiduciary Relationships" (2004) 54 Am U L Rev 75; Paul Miller, "A Theory of Fiduciary Liability" (2011) 56 McGill LJ 235 at 270; Cowan v Scargill, [1985] Ch 270 at 287 [Scargill]; Kaplan & Frazer, supra note 16 at at 323

21 Galambos v Perez, [2009] 3 SCR 247 at para 69.

22 Ari Kaplan & Mitchell Frazer, supra note 16 at 331; Laby, supra note 20 at 99-108; Eileen Gillese, *The Law of Trusts*, (Toronto: Irwin Law Inc., 1997) at 137.

23 Gillese, supra note 22 at 137.

24 Kaplan & Frazer, supra note 16 at 335; Froese v. Montreal Trust Company of Canada, 1996 CanLII 1643 (BCCA) at para 61.

25 Edward J Waitzer & Douglas Sarro, "The Public Fiduciary: Emerging Themes in Canadian Fiduciary Law for Pension Trustees" (2013) 91 (1) Can Bar Rev 163 [Waitzer & Sarro "Public Fiduciary"] at 197; Gary Watt, *Trusts and Equity*, 2d ed (New York: Oxford University Press, 2006) at 437.

26 Canadian Aero Services Ltd. v O'Malley, [1974] SCR 592 at 609.

27 Bristol & West Building Society v. Mothew, [1998] Ch 1.

28 Gillese, supra note 22 at 137.

29 Bill 38, supra note 15, s 35(3)(a).

30 Gillese, supra note 22 at 137.

31 James Hawley, Keith Johnson & Ed Waitzer. "Reclaiming Fiduciary Duty Balance" (2011) 4:2, at 13.

In the pension context, because of the statutory codification of this duty, it is unlikely that a trust document could allow pension fiduciaries to act otherwise than in accordance with the duty of loyalty. It clearly bars fiduciaries from acting in pursuit of a conflicting pecuniary interest, but it is a broader obligation that also precludes fiduciaries from acting otherwise than in the best interests of the beneficiaries themselves. In a broad sense, the duty of loyalty distinguishes a pension fund from other legal entities with a broader scope for action. Individuals, for example, can do whatever they wish with their assets (within the scope of the criminal law), including giving their assets away. Trustees, and pension fund fiduciaries, may not give their trust assets away – this would not be in their beneficiaries' best interests. Governments may tax and use their revenues for any purpose they wish – their spending powers are constrained by democratic processes and institutions, but not by legal constraints. Directors of business corporations must act in the best interests of the corporation, but this gives them a fairly wide berth to make charitable donations and contribute to causes that improve their reputations or enhance their community relations. Pension fiduciaries have expended resources on explaining themselves to government and to the public, and pressing for legal or regulatory changes, but these expenditures are usually closely tied to specific objectives that fiduciaries believe will protect or enhance their beneficiaries' interests.

Below, we consider how the duties of prudence and loyalty have been interpreted and applied in the well-known UK case of *Cowan v. Scargill*. We then consider how this duty, owed as it is to the pension plan's own beneficiaries, affects pension fiduciaries in their consideration of broader issues, such as climate change.

c) **Cowan v. Scargill**

A frequently referenced decision dealing with pension fund trustees' fiduciary duties in relation to the pursuit or integration of social objectives through pension fund investment policies remains the U.K. decision of *Cowan v. Scargill*. It has been heavily criticized, and many consider it out-dated. Much has changed in our approach to pension investments since 1984, the year of the *Scargill* decision, and it is doubtful that a court would adopt the same approach to fiduciary obligations today. Nevertheless, it remains a useful reference for the strong view that social objectives are inimical to a fiduciary investment mandate. An understanding of the case, and the changes that have taken place since 1984 allows us to take a clearer view of where we stand today.

Scargill involved proposed changes to the investment policies governing the National Coal Board pension fund, a jointly trustee fund with five trustees appointed by the National Coal Board ("NCB") and five appointed by the National Union of Mineworkers ("NUM"). The NUM Trustees proposed an investment policy under which the plan would cease foreign investments, withdraw existing foreign investments, and withdraw investments in companies that competed with coal. In the course of deciding that the proposed policies would be in breach of the trustees' fiduciary obligations, the presiding Judge, Megarry V.C., set out six principles to guide fiduciary conduct:

1. **Beneficiaries' interests are paramount.**

The "starting point" of inquiry into trustees' fiduciary duties is that they owe a duty to their beneficiaries. Subject to obeying the law, "they must put the interests of their beneficiaries first"³² which interests are usually financial.³³ To advance beneficiaries' financial interests, the duty is to maximize returns having regard to investment risk, as the investment power "... must be exercised so as to yield the best return for the beneficiaries, judged in relation to the risks of the investments in question, and the prospects of the yield of income and capital appreciation both have to be considered in judging the return from the investment."³⁴

2. **Personal views are irrelevant.**

In order to maximize financial returns having regard to investment risk, trustees cannot have regard to their own strongly held social or political views.³⁵ Instead, trustees must exercise their powers "fairly and honestly for the purposes for which they are given and not so as to accomplish any ulterior purpose, whether for the benefit of the trustees or otherwise."³⁶ This was, in effect, a statement about conflicts of interest – trustees with strongly held personal views could

32 *Scargill*, supra note 20 at 287.

33 *Ibid* at 287.

34 *Ibid* at 287.

35 *Ibid* at 287-288: Trustees may have strongly held social or political views. They may be firmly opposed to any investment in South Africa or other countries, or they may object to any form of investment in companies concerned with alcohol, tobacco, armaments or many other things. In the conduct of their own affairs, of course, they are free to abstain from making any such investments. Yet under a trust, if investments of this type would be more beneficial to the beneficiaries than other investments, the trustees must not refrain from making the investments by reason of the views that they hold.

36 *Ibid* at 288.

not act upon those views if they conflicted with the best interests of the plan's beneficiaries. But Megarry V.C. went further, holding that the single-minded pursuit of beneficiaries' best interests compelled fiduciaries to act dishonourably (though not illegally):

Trustees may even have to act dishonourably (though not illegally) if the interests of their beneficiaries require it. Thus where trustees for sale had struck a bargain for the sale of trust property but had not bound themselves by a legally enforceable contract, they were held to be under a duty to consider and explore a better offer that they received, and not to carry through the bargain to which they felt in honour bound: *Buttle v. Saunders* [1950] 2 All E.R. 193 In other words, the duty of trustees to their beneficiaries may include a duty to "gazump." ... In *re Wyvern Developments Ltd.* [1974] 1 W.L.R. 1097, 1106, Templeman J. said that he "must do his best by his creditors and contributories. He is in a fiduciary capacity and cannot make moral gestures, nor can the court authorise him to do so."³⁷

3. Non-financial benefits may sometimes outweigh financial benefits.

The "benefit" of beneficiaries to which trustees must have regard is a word of "very wide meaning" which may include non-financial benefits.³⁸ Subject to a heavy justificatory burden – given that the paramount duty of trustees is to provide the greatest financial benefits for present and future generations³⁹ – which burden is satisfied in very rare cases, the exclusion of a potentially more profitable investment in favour of a non-financial benefit is sometimes appropriate.⁴⁰

4. Prudent person standard.

The relevant standard of care is that of an ordinary prudent person investing for other people, including a duty to seek advice.⁴¹

5. Diversification is important.

Trustees have a duty to consider the need for diversification of investments.⁴²

³⁷ Ibid at 288.

³⁸ Ibid at 288.

³⁹ Ibid at 289.

⁴⁰ Ibid at 288: For instance, Megarry V.C. noted that if all beneficiaries preferred the condemnation of alcohol, tobacco, armaments and the like over higher financial returns then "it might not be for the "benefit" of such beneficiaries to know that they are obtaining rather larger financial returns under the trust by reason of investments in those activities than they would have received if the trustees had invested the trust funds in other investments"; See also: P. Palmer, et al., *Socially Responsible Investment: A Guide for Pension Schemes and Charities* (London: Haven Publications, 2005) at 97.

⁴¹ Ibid at 289.

⁴² Ibid at 289.

6. **Pension trusts are governed by the same rules as ordinary trusts.**⁴³

General trust law imposes a duty of undivided loyalty on pension trustees, and this applies as well (even more so in the case of pension trusts to which members have made contributions to support their own retirements) to pension trusts.⁴⁴ Actions whose consequences are too remote and insubstantial to have any impact on the pension trust and its ability to deliver the promised retirement benefits cannot be justified.⁴⁵ In this regard, *Megarry V.C.* distinguished the U.S. case of *Withers v. Teachers' Retirement System of the City of New York*.⁴⁶ In *Withers*, trustees of the New York City Teachers' Retirement System had purchased highly speculative bonds issued by the City of New York to avert its bankruptcy. The trustees were challenged by retirees, and defended their decision on the basis that the pension fund was underfunded and would be depleted in eight to ten years without ongoing contributions from New York City.

The trustees argued that they didn't purchase the bonds to preserve teacher jobs but rather to preserve New York City as a viable entity able to pay for the pension fund's funding deficiency. In that case, *Megarry V.C.* said the benefits to the plan's members from the bond purchase were not remote, and the trustees' decision was in their best interests. In the case of the proposed NUM investment policy, on the other hand, the court found that the National Coal Board pension fund was simply too small to affect the future course of the industry, and any impact of the investment policy on the coal industry would be too limited and too remote to benefit the plan's beneficiaries.

⁴³ *Ibid* at 290.

⁴⁴ *Ibid* at 292.

⁴⁵ *Ibid* at 292.

⁴⁶ *Withers v Teachers' Retirement System of the City of New York*, (1978) 447 F Supp 1248.

ii) The limits of Scargill

Ultimately, Scargill was a case about conflicts of interest. The NUM trustees had proposed a policy intended to protect the coal industry, but were unable to persuade Megarry V.C. that such a policy was in the best interests of the plan's members. Rather, the Judge found that the policy was intended to preserve jobs and was not motivated by the beneficiaries' interests in the retirement fund. Megarry V.C. noted that the retirement fund covered retirees as well as active members and that a policy directed towards protecting employment in the coal industry was of no benefit to retired members of the plan. In this regard, and as noted by the UNEP Finance Initiative (UNEP FI), 2005 Report on Fiduciary Responsibilities (the "Freshfields Report") the Scargill decision simply advances the "uncontroversial position that trustees must act for the proper purpose of the trust, and not for extraneous purposes."⁴⁷

Megarry V.C. himself unusually commented years later on his own decision⁴⁸ stating that it was an uncontroversial case that simply involved the application of established principles: that trustees cannot prefer their own interests – be they protectionist or otherwise, where those interests are not shared by the beneficiaries and are detrimental to those beneficiaries' financial interests.

At least three major lines of thought that have developed since 1984 affect how we should view Scargill today, 30 years after the decision was released.

First, the way we think about the factors that are relevant to investment decision-making is evolving. While traditional finance based metrics remain at the core of investment decision-making, those metrics are themselves proliferating as the available data sets expand and our electronic analytical capabilities develop apace. As well, we recognize the significance of technology, design and culture in evaluating the success of companies like Apple or Blackberry, and the importance of governance in cases such as Enron, WorldCom and Tyco. The importance of environmental and health and safety risks, and the consequences of a company's failure to manage them well, have been on display for companies such as Exxon and BP and have affected the value of companies in industries ranging from tobacco to asbestos to chemicals and mining.

In the result, it is now commonplace for investors and legal commentators to recognize that investment decision-making must consider a range of relevant factors beyond those that lie at the heart of traditional securities analysis.

⁴⁷ UNEP Finance Initiative (UNEP FI), "A Legal Framework for the Integration of Environmental, Social, and Governance Issues into Institutional Investment" (London: Freshfields Bruckhaus Deringer LLP, 2005) [UNEP FI, "Freshfields Report"] at 9.

⁴⁸ *Ibid* at 9 citing in TG Youdan, *Equity, Fiduciaries and Trusts* (Toronto: Carswell, 1989).

PART 2

In this regard, the Freshfields Report, prepared by the international business law firm Freshfield Bruckhaus Deringer in 2005, concluded not only that all factors relevant to risk and return should be considered by fiduciaries in investment decisions, but that it may be a breach of fiduciary duties not to take into account non-financial criteria:

Rather, in our opinion, it may be a breach of fiduciary duties to fail to take account of ESG [Environmental, Social and Governance] considerations that are relevant and to give them appropriate weight, bearing in mind that some important economic analysts and leading financial institutions are satisfied that a strong link between good ESG performance and good financial performance exists.⁴⁹

Put another way, there is no real distinction between ‘financial’ and ‘non-financial’ criteria that may affect financial performance – both must be taken into account by fiduciaries in making investment decisions. This conclusion is not really at odds with Scargill because the court in Scargill considered that the NUM trustees were basing their policy recommendations on irrelevant or extraneous considerations, unrelated to financial performance. But the Freshfield conclusion is an important and sensible one that requires consideration of all factors, including climate change, where those factors may affect the risk or return of an investment.

Second, as well illustrated by British Columbia’s new PBSA, pension investment regulation increasingly requires a focus on a plan’s liabilities. In this context, the duration of pension fund liabilities becomes much more material than it was in 1984, when the Scargill decision was released and the ‘modern portfolio theory’ paradigm was not framed within a longer-term time horizon. While there are many other important elements to the relationship between assets and liabilities, an important feature of the new regulatory approach to pension investments is the implicit requirement that investment strategies be framed within a time horizon that has regard to a plan’s liabilities. In many cases, the duration of a pension plan’s liabilities corresponds to the relevant time frame for significant economic impacts due to climate change.

Third, and this development is more recent and emanates primarily from academic commentators, there is a growing recognition that ‘systemic’ factors are critically important for long term pension investments. As Waitzer and Sarro wrote in their seminal paper “Fiduciary Society Unleashed: The Road Ahead for the Financial Sector”:

It is now broadly accepted that most investment returns come from general exposure to the market (beta) rather than from seeking market benchmark outperformance strategies (alpha). As a result, systemic market factors have become critical to fiduciary responsibility. Investments are increasingly expected to look past current market benchmarks and consider questions of future value—to “assess the impact of their investment decisions on others including generations to come.” Risk management means considering such factors as market integrity, systemic risks, governance risks, advisor risks, and the

49 Ibid at 100.

like. There is also a growing recognition that asset classes of longer duration often yield the highest private (as well as societal) returns.⁵⁰

This economic conclusion recognizes that pension funds, and other large investment funds (such as sovereign wealth funds and some charitable trusts), are dependent on overall market performance, and therefore upon the factors that affect economies and markets generally. The clear implication of this dependence is that institutional investors, and especially large institutions, must attend to systemic factors. They cannot afford to ignore systemic factors and focus on incremental (alpha) strategies alone. In Waitzer and Sarro's view, institutional fiduciaries have suffered a loss of public trust at the same time as the recognition of their dependence on systemic factors has crystallized. The authors argue that, in this environment, institutional fiduciaries will either evolve towards higher ethical standards that take account of the public good, or find themselves increasingly regulated by governments that are no longer tolerant of dysfunctional cultures and practices in the financial services industry.

These three changes in the legal, regulatory and industry approaches to pension investments suggest that courts today may approach the duty of loyalty and its requirements differently than did the court in Scargill.

At the same time, it no doubt remains the law that fiduciaries must set aside their own interests and beliefs to the extent that these conflict with beneficiaries' best interests, as they would be in breach of the requirements of their fiduciary duties were they to act in accordance with either their self-interests or their own ideological priorities in their investment of trust assets.

As well, the court's concern in Scargill that the actions of fiduciaries must be tangibly and not be too remotely related to beneficiaries' best interests also stands as good law. In pursuit of beneficiaries' best interests, and especially where a decision may not seem to resonate with beneficiaries' best interests, it continues to be important that fiduciaries make clear how and why their decisions are consistent with their fiduciary mandates.

50 D. Sarro & Ed Waitzer (2014) "Fiduciary society unleashed: The road ahead for the financial sector" *Business Lawyer*, 69(4) 1081-1116, at 1093.

PART 2

A rather controversial aspect of the Scargill decision is its requirement that fiduciaries act 'dishonourably' to further beneficiaries' interests, provided their conduct is not illegal. This admonition is inconsistent with recent decisions recognizing the imperative of good faith dealing in contractual performance.⁵¹ Similarly, courts have held that the duty of loyalty in the corporate law context requires "acting honourably towards another"⁵² and precludes deceitful or manipulative behaviour inconsistent with loyal behaviour.⁵³ Indeed, the Supreme Court of Canada has emphasized that fiduciary law protects vulnerable beneficiaries from abuses of power by those who owe them a fiduciary duty of loyalty, but is also intended to reinforce the social institutions in which those fiduciaries operate.⁵⁴

Waitzer and Sarro note that the Supreme Court in BCE held that corporate directors' duty of loyalty to the corporation requires that they act in the best interest of the corporation viewed as a good corporate citizen, as defined by reasonable expectations,⁵⁵ and further that, "... courts have increasingly held that, in assessing the best interests of the beneficiary, a fiduciary must consider not only the beneficiary's narrow pecuniary interests, but the beneficiary's status as a responsible member of society,"⁵⁶ requiring compliance with the law, avoidance of unethical actions and actions in accordance with prevailing norms.⁵⁷ The same view has been well articulated by Steve Lydenberg, who writes that fiduciary law has typically required 'reasonable' rather than 'rational' behaviour; while 'rationality' is a function of self-interest only, 'reasonable' behaviour is behaviour that takes account of others' interests. While rational behaviour may promote the self, it may also engender conflict and dysfunction; reasonable behaviour, capable of being generalized and adopted by all, is more conducive to well-functioning social institutions.⁵⁸

51 Bhasin v Hrynew, [2014] 3 SCR 495 at paras. 60, 65 and 86. Ordinary contractual dealing is subject to a requirement of good faith; the interjection of a fiduciary cannot render permissible what is otherwise impermissible.

52 Waitzer & Sarro "Public Fiduciary", supra note 25 at 189; Andrew S Gold, "The New Concept of Loyalty in Corporate Law" (2009) 43 UC Davis L Rev 457 at 493; Desimone v. Barrows, 924 A.2d 908, 933 (Del. Ch. 2007); Stone v Ritter, 911 A. 2d 362, 370 (Del. 2006).

53 Gold, supra note 52 at 461-462.

54 Simms, supra note 10 at 422.

55 Waitzer & Sarro, "Public Fiduciary" supra note 25 at 189.; BCE v 1976 Debentureholders, [2008] 3 SCR 560 [BCE] at para 81; Peoples Department Stores Inc (Trustee of) v Wise, [2004] 3 SCR 461 at para 42.

56 Waitzer & Sarro, "Public Fiduciary" supra note 25 at 184 citing BCE, supra note 55 at paras 43 and 81; Joseph William Singer, "Corporate Responsibility in a Free and Democratic Society" (2008) 58 Case W Res L Rev 1; Gold supra note 52; Ed Waitzer and Johnny Jaswal, "Peoples, BCE and the Good Corporate Citizen" (2009) 47 Osgoode Hall LJ 439 at 475-77 [Waitzer & Jaswal "Peoples, BCE"]; See also R. v. Christopher, 2009 ONCJ 586 [Christopher] at para. 23; Kaplan & Frazer, supra note 16 at 334.

57 Waitzer & Sarro, "Public Fiduciary", supra note 25 at 189-190.

58 Steve Lydenberg, "Reason, Rationality and Fiduciary Duty" J. Bus Ethics (2014), 119; 35-380.

Thus, the evolution of fiduciary law and pension industry practice since 1984 must temper our approach to Scargill in at least the following respects:

- All factors relevant to risk and return, including environmental, social and governance factors, must be considered in determining whether any particular investment offers an appropriate risk-return trade-off;
- Pension fund fiduciaries may not take a 'moment in time' approach to their investment portfolios, but must rather consider the duration of their investment portfolio in the context of their liabilities, and of the duration of those liabilities – this means, among other things, that investment-relevant factors must be considered over a longer time frame during which the consequences of climate change will be increasingly apparent;
- Pension fund fiduciaries, especially of larger funds, must focus not only on 'alpha' (beating investment benchmarks) but on the conditions necessary for sustainable beta (market benchmark performance); this means that factors relevant to long term market performance are relevant to pension fiduciaries;
- Pension fiduciaries may not act dishonourably in narrow pursuit of short term gain, but are rather required to act as responsible citizens, in good faith and in manner that reinforces rather than detracts from fiduciary institutions.



Part 3

Climate Change and
Pension Fund Investment
Decision-Making

Our review of the duties of prudence and loyalty suggest the following conclusions in regard to pension fiduciaries consideration of climate change:

Given the overwhelming scientific consensus about the causes and implications of global climate change, climate change denial is not an option for pension fiduciaries. Per Scargill, it is not permissible for a fiduciary to bring personal or ideological views to bear on fiduciary decision-making; rather, the duty of prudence requires a thoroughgoing and rational evaluation of relevant information to support fiduciary decision-making.

At the security selection or investment decision-making level, all factors relevant to risk and return must be considered; if climate change is relevant to an investment and not too remote, it must be considered.

At the investment strategy level, pension fund fiduciaries are obligated in British Columbia, to the extent possible, to avoid undue risk of loss, and to consider their investment strategies in a time frame commensurate with the pension plan's liabilities. For many factors, information beyond a near or medium term frame becomes speculative and of limited use, but the shorter and medium term implications of climate change may be germane to the avoidance of undue loss, and the longer term implications of climate change are sufficiently clear that they may inform longer term investment strategies. On the other hand, if certain potential impacts of climate change are too remote, they cannot be relied upon in fashioning an investment strategy.

In Canada, there is no authoritative law that obligates fiduciaries to act dishonourably. To the contrary, Canadian courts have located the fiduciary obligation at a social level, and characterized fiduciary law as performing a systemic function of protecting social institutions and relationships; it is difficult to reconcile dishonourable conduct with the social functions of fiduciary law identified in Canadian jurisprudence.

The obligations of pension fiduciaries to attend to the systemic elements of pension fund investing – the elements that contribute to 'beta' – are attracting increased attention, and may encourage pension fiduciaries, especially the largest and most 'systemically significant' pension funds, to engage in public policy interactions with governments in regard to climate change. We review the fiduciary interface with public policy in Part IV of this report.

These conclusions suggest that fiduciaries may approach climate change at strategic, security selection and public policy levels only after considering how climate change may or may not affect their overall ability to generate 'beta' and the implications of climate change for specific asset and security types. Below, we summarize some of the implications of climate change that may be relevant to fiduciaries.

a) The Mercer Report Analysis

A 2011 report by Mercer Inc. (the Mercer Report) estimates that as much as 10 per cent of a fund's portfolio risk exposure within only the next twenty years (let alone over a longer time period), arises from climate change technology, regulatory, and other impacts.⁵⁹ The Mercer Report noted that in performing strategic asset allocation assessments, historic precedent is not an effective indicator of future performance⁶⁰ as a result of the unclear climate policy environment and uncertainty around the full economic consequences of same and proposed the addition of qualitative inputs in modelling the effects of climate change risks on:

... the rate of development and opportunities for investment into low carbon technologies (Technology), the extent to which changes to the physical environment will affect investments (Impacts) and the implied cost of carbon and emissions levels resulting from global policy developments (Policy).

Using this framework, the Mercer Report concluded that climate policy contributes as much as 10 per cent to overall portfolio risk with risk stemming from "impacts" and "technology" not as significant over the next twenty years. The report concludes that in managing climate risks, institutional investors will need to diversify across sources of risk rather than traditional asset classes, including increased allocation to climate positive assets as a potential hedge for risk.⁶¹

In 2015, Mercer updated its 2011 report, adding another risk input – resource availability, defined as the impact on investments of chronic weather patterns, and, among other findings, noted that climate change will unequivocally have an impact on investment returns such that it needs to be regarded as a new return variable.⁶² The report modelled four different scenarios: transformation (under which climate change mitigation limits global warming to 2 degrees Celsius); coordination (under which actions are aligned to hold warming to 3 degrees Celsius); and two types of fragmentation, the first where lack of action and coordination results in a four degree Celsius warming and the second, in which the same occurs but higher damages result.⁶³ In assessing the effects of climate change under these scenarios, industry sector effects were the most meaningful, particularly in the coal sub-sector and renewables sub-sector and asset class return effects in market equities, infrastructure, real estate, timber and agriculture are improved by a 2 degree Celsius warming but negatively affected by a 4 degree Celsius warming. Contrary to received wisdom, the report noted a 2 degree Celsius warming would not have negative return implications for long-term diversified investors at a total portfolio level to 2050,⁶⁴ provided that that threshold is not exceeded,

59 Mercer LLC, Carbon Trust and International Finance Corporation, "Climate Change Scenarios - Implications for Strategic Asset Allocation" February 2011 online: < http://www.mmc.com/content/dam/mmc-web/Files/Climate_Change_Scenarios_Implications_for_Strategic_Asset_Allocation.pdf > [Mercer "Climate Change Scenarios"] at 7.

60 Ibid at 1-2; Mercer LLC, International Finance Corporation and UK Department for International Development, "Investing in a Time of Climate Change" April 2015 online: < <http://www.mercer.com/content/dam/mercer/attachments/global/investments/mercer-climate-change-report-2015.pdf> > [Mercer, "Time of Climate Change"] at 44.

61 Mercer, "Climate Change Scenarios", supra note 59 at 1-2.

62 Mercer, "Time of Climate Change", supra note 60 at 14.

63 Ibid at 10.

64 Ibid at 17.

as the negative impact on returns for market and private equity could be compensated by gains in infrastructure, emerging market equity and low-carbon industries. The situation is bleaker under a 4 degree Celsius scenario where chronic weather patterns pose risks to many asset classes including agriculture, timberland, real estate and emerging market equities, while real asset investment risks could be mitigated provided geographic risk assessments are undertaken.⁶⁵

The two most significant categories of risk introduced by climate change that pension fund trustees may take into account are the physical risk of destroyed assets or assets with diminished value and the regulatory risk of stranded assets or assets with diminished value, both of which are discussed below. As the Mercer Report notes, traditional diversification across asset classes is insufficient to mitigate the portfolio risks of climate change. Instead, diversification must take place across sources of risk.⁶⁶

b) Physical Risk of Destroyed Assets or Assets with Diminished Value

As noted in the introduction of this report, there is an international consensus, recently reiterated by the G7, that the increase in global average temperature, from pre-industrial levels, must be limited to no more than 2 degrees Celsius.⁶⁷ On the current trajectory, this goal will be exceeded as the “current trend-line will take the planet by 2050 to 7 degrees Fahrenheit higher than the preindustrial average, twice the level [3.5 Fahrenheit] set in Cancun,”⁶⁸ with the anticipated result that warming will reach, “as much as 10 degrees Fahrenheit above the preindustrial era by 2100.”⁶⁹

Whether we can avoid a global average temperature increase of more than 2 degrees Celsius will depend on what action, if any, is taken in the next decades to reduce greenhouse gas emissions.⁷⁰ Some investments may be very vulnerable to the effects of climate change on a physical level (rather than as a result of regulatory impact), such as coastline real estate,⁷¹ and other assets vulnerable to drought, flooding and other environmental factors. Less directly, but still significantly, the insurance and agricultural sectors, among others, that depend on a reasonable predictability about weather patterns may also be vulnerable to changing climate conditions.

65 Ibid at 7, 15-16

66 Ibid at 2.

67 Randalls, supra note 6 at 598-605.

68 Vevis Longstreth, “The Compelling Case for Divestment” *Journal of Environmental Investing*, 2015 6 (1) 7.

69 Ibid.

70 Mercer Investment Consulting (MIC), “A Climate for Change: A Trustee’s Guide to Understanding and Addressing Climate Risk” (MIC, 2005), at 18-19.

71 Benjamin J. Richardson, “Socially Responsible Investment and Climate Finance” *Climate Law and Developing Countries Post-2012: North and South Perspectives*, IUCN Academy of Environmental Law, Ottawa, 26-28 September 2008, at 24 citing J. Philpott, “Keeping it Private, Going Public: Assessing, Monitoring and Disclosign the Global Warming Performance of Project Finance” (2005) 5 *Sustainable Development Law and Policy* 45; See also Mercer, “Climate Change Scenarios”, supra note 59 at 7.

c) Regulatory Risk of Stranded Assets

Limiting warming due to greenhouse gas emissions to 2 degrees Celsius will lessen some of the more severe consequences of climate change.⁷² In order to avoid an above-2 degree warming, our production of GHG emissions must decline, and this means that our consumption of fossil fuels must also decline. According to some estimates $\frac{3}{4}$ of existing fossil fuel reserves must remain in the ground and not be consumed.⁷³

International recognition of the serious risks of climate change, including by governments, suggests that governmental actions to limit GHG emissions and to encourage the production of green energy are increasingly likely. Thus, the likelihood of governmental action to restrict GHG emissions, and by implication, limit the consumption and therefore the production, of fossil fuels, appears increasingly likely. This gives rise to the possibility that fossil fuel reserves held by coal and oil and gas companies may not be exploitable, due to GHG constraints. Pension fiduciaries with holdings in the fossil fuel sector must evaluate the risk of increased regulation that constrains fossil fuel consumption/production, and therefore 'resets' the value of companies whose assets consist of reserves that may no longer be exploited.

To be sure, the possibility that fossil fuel companies will be left with non-marketable "stranded assets" is contingent on an uncertain regulatory outcome. Yet, a number of dynamics indicate that the severity of climate change risks is now moving governments and institutional investors to accept the need for significant change:

- Supported by the Principles of Responsible Investment (PRI), a UN-supported association, and UNEP FI, and overseen by the former, a growing number of investment funds, including pension funds, are signatories to the Montreal Pledge whereby investors commit to measure and publicly disclose the carbon footprint of their investment portfolios on an annual basis. As of July 2015, sixty institutional investors have signed the Montreal Pledge.⁷⁴

72 IPCC, "Synthesis Report", supra note 2 at 20.

73 Damian Carrington and Caelainn Barr, "Coal crash: how pension funds face huge risk from climate change" The Guardian (15 June 2015) online: <www.theguardian.com/environment/2015/jun/15/coal-crash-how-pension-funds-face-huge-risk-from-climate-change>.

74 UNEP PRI, "PRIMontréal Pledge", online: <www.montrealpledge.org>.

- In a separate discussion paper, the UNEP FI advocates for the measurement, disclosure and gradual reduction of greenhouse gas emissions embedded in global institutional investment portfolios.⁷⁵ The UNEP FI notes the increasing global landscape of policies and regulations to cap and reduce GHG emissions at the national and sub-national levels, the likely sudden and radical policy interventions to be expected in the future given the current lack of ambition, the growing mainstream perception of risk stemming from GHG emissions, the increasing pressure for disclosure and the concomitant need for same to control regulatory and reputational risk, and the accordant need to lower emissions within a portfolio.⁷⁶
- As noted in the introduction, the leaders of the G7 issued a declaration at the G7 Summit held in Schloss Emau recognizing that urgent and concrete action is needed to address climate change through the introduction of binding rules to hold the increase in global average temperature below 2 degrees Celsius with a common vision for a global goal of greenhouse gas emissions reductions of 40 to 70 per cent by 2050 compared to 2010.⁷⁷
- The Vatican released its encyclical on ecology and climate change urging immediate action on a global scale to combat climate change as a moral imperative.⁷⁸

Internationally, there is increased attention to mitigating climate change. Recently, and notably:

- Norway's \$900 billion sovereign wealth fund, in June 2015, sold off its \$8bn worth of holdings in coal assets;⁷⁹
- Led by the PRI and five regional investor climate change organizations, investors with more than \$12 trillion of assets sent an open letter to the G7 Finance Ministers asking them to include long-term emission reduction targets at the international climate talks in Paris in December 2015,⁸⁰

75 UNEP FI, "Portfolio Carbon – Measuring, disclosing and managing the carbon intensity of investments and investment portfolios" UNEP FI Investor Briefing, A document of the UNEP FI Climate Change Advisory Group and Investment Commission (July 2013) online: <http://www.unepfi.org/fileadmin/documents/UNEP_FI_Investor_Briefing_Portfolio_Carbon.pdf> at 3.

76 Ibid at 4-8.

77 G7, supra note 7 at 12-13.

78 Pope Francis, "Encyclical Letter Laudato Si of the Holy Father Francis on care for our Common Home" Vatican, The Holy See: 24 May 2015, online: <http://w2.vatican.va/content/francesco/en/encyclicals/documents/papa-francesco_20150524_enciclica-laudato-si.html>.

79 Damian Carrington, "Norway confirms \$900bn sovereign wealth fund's major coal divestment" The Guardian (4 June 2015) online: <www.theguardian.com/environment/2015/jun/05/norways-pension-fund-to-divest-8bn-from-coal-a-new-analysis-shows>.

80 Institutional Investors Group on Climate Change, "Open letter to Finance Ministers in the Group of Seven (G-7)" (26 May 2015), online: <www.iigcc.org/publications/publication/open-letter-to-finance-ministers-in-the-group-of-seven-g-7>.

PART 3

- Swedish pension fund AP4 and French Fonds de Réserve pour les Retraites, along with Amundi Asset Management seeded the creation of a low carbon index by MSCI;⁸¹
- The Green bond market increased threefold in 2014 to \$36.6 billion;⁸²
- Over eight hundred institutional investors, representing \$US95 trillion, are supporting the CDP, (formerly Carbon Disclosure Project), which maintains the largest global database of self-reported environmental information including climate change data;⁸³
- The District Court in The Hague recently ordered Netherlands to cut emissions by 25 per cent of 1990 levels by 2020 to protect its citizens. While not directly relevant to the situation of pension trustees in Canada, it is indicative of a general trend towards greater liability for inaction and the increased likelihood of greater action in respect of climate change.

Finally, economic projections demonstrate that delays in limiting GHG emissions will increase the costs of climate related losses and climate mitigation. In other words, it is less expensive to take steps now to reduce GHG emissions than to wait and take steps when atmospheric GHG levels are higher than they are now. The foremost report on the costs associated with action today or in the future is the Stern Report. That report concludes that the collective cost of not taking immediate action to mitigate climate change will amount to 5 to 10 per cent of worldwide GDP, but only 1 to 2 per cent if action is taken now.⁸⁴ Accordingly, climate change mitigation is possible and less costly if taken proactively rather than at a later time.⁸⁵

81 MSCI, MSCI Launches Innovative Family of Low Carbon Indexes (News release) [London: Climate Bonds Initiative, (16 September 2014)], online: <https://www.msci.com/resources/pressreleases/MSCI_Launches_Innovative_Family_of_Low_Carbon_Indexes_16Sep2014.pdf>.

82 Tess Olsen-Rong, Final 2014 green bond total is 36.6 bn... (Blog post) [London: Climate Bonds Initiative, (15 January 2015)] online: <www.climatebonds.net/2015/01/final-2014-green-bond-total-366bn--that-s-more-x3-last-year-s-total-biggest-year-ever-green>.

83 CDP, CDP investor initiatives (London) online: <<https://www.cdp.net/en-US/WhatWeDo/Pages/investors.aspx>>.

84 Nicholas Stern, Stern Review on the Economics of Climate Change (IPCC: 2014), online: <http://www.ipcc.ch/pdf/assessment-report/ar5/syr/AR5_SYR_FINAL_SPM.pdf>. Of course, others have noted that the consequences of inaction could be much more severe: G. Monbiot, *Heat: How to Stop the Planet Burning* (HarperCollins, 2005); T. Flannery, *The Weather Makers* (Atlantic Monthly Press, 2006); T. Homer-Dixon, *The Upside of Down: Catastrophe, Creativity and the Renewal of Civilisation* (Alfred A. Knopf, 2006).

85 *Ibid*

Part 4

Pension Fund Fiduciaries'
Interface with Public Policy
in regard to Climate Change



PART 4

Pension fund trustees have, over recent decades, become increasingly engaged with public policy issues. Many plans have advocated positions on pension reform, investment, securities and corporate governance issues, for example, where they believe that public policy advocacy is in the best interests of plan members and is a prudent expenditure of plan resources. Sometimes, advocacy takes place directly with government or regulatory authorities; in other instances, it takes place through industry associations to which pension fiduciaries belong as paid members and in which they participate and may take leadership roles.

Climate change presents an important challenge to pension fiduciaries in regard to public policy. Pension funds depend on sustainable markets, and earn their investment returns primarily on the basis of overall market performance. To the extent that climate change, either through its physical consequences, or through governmental and regulatory measures, may affect pension fiduciaries' prospects for 'beta' level returns, climate change engages pension fiduciaries' vital interests. On the other hand, pension fiduciaries are challenged by the global scale of climate change, and the potential remoteness or even insignificance of public policy steps that any individual pension fund may take to address the global challenge.

As noted above, the admonition in Scargill for pension fund fiduciaries to act dishonourably is not the law in Canada.⁸⁶ The genesis of fiduciary law lies in the protection of vulnerable beneficiaries and in the interests of the public as a whole,⁸⁷ which requires acting honourably, avoiding unethical actions, and acting in accordance with prevailing norms⁸⁸ as a responsible member of society.⁸⁹ On balance, especially for large funds, the urgency of climate change, coupled with its potentially severe consequences suggest that pension fiduciaries may engage governments on climate change issues to attempt to achieve a collective outcome that they are incapable of achieving alone. This is particularly the case given the long-term character of pension fund liabilities and the likely effects of climate changes within the duration of those liabilities.

86 Waitzer & Sarro, "Public Fiduciary", supra note 25 at 189; Gold, supra note 52.

87 Simms, supra note 10 at 420-22.

88 Waitzer & Sarro, "Public Fiduciary", supra note 25 at 189-90.

89 Waitzer & Sarro, "Public Fiduciary" supra note 25 at 184 citing BCE supra note 55 at paras 43 and 81; Singer, supra note 56; Gold, supra note 52; Waitzer & Jaswal, "Peoples, BCE" supra note 56 at 475-77; See also Christopher, supra note 56 at para. 23; Kaplan & Frazer, supra note 16 at 334.

A landscape photograph showing a two-lane asphalt road stretching into the distance under a dark, stormy sky. A vibrant rainbow arches across the sky, its colors clearly visible. The foreground shows green grass and utility poles along the roadside. The overall mood is dramatic and hopeful.

Conclusion

CONCLUSION

Fundamentally, this report concludes that a pension fund trustee's fiduciary duty in investing pension funds is, as far as possible, to try to ensure that there are funds with which to pay pension benefits owing to members, both at present and into the future. This necessarily requires that in making investment decisions, climate change denial is not an option, climate change risks must be taken into account, and pension trustees may protect the longer term interests of their beneficiaries by acting as effective public policy advocates for climate change regulation. In assessing the nature of pension fund fiduciaries' duties to beneficiaries in the context of climate change this report has arrived at the following conclusions:

- There is a scientific consensus about the anthropogenic roots of climate change and the potentially catastrophic consequences that could potentially arise in the event that we are unable to limit the increase in the global average temperature to 2 degrees Celsius.
- Investment decision-making is evolving with increasing recognition that investment decision-making must consider a range of relevant factors beyond those lying at the heart of traditional securities analysis.
- There is no meaningful distinction between 'non-financial' criteria that may affect financial performance and financial criteria; trustees must take both into account when making investment decisions.
- Climate change denial is not an option for reasonable fiduciaries that must disregard their personal ideological positions.
- Climate change risks may affect financial performance and must be considered by pension fund fiduciaries where the risk is not too remote.
- Pension investment regulation is increasingly focused on asset strategy development with a view to a plan's liabilities, which requires pension fiduciaries to focus on investment strategies and risk over the duration of their liabilities, a duration that includes likely consequences of climate change.
- Systemic factors that underlie the long-term benchmark performance of financial markets are critically important for long term pension investments, and pension fiduciaries, particularly those engaged with large pension plans, who may engage governments on climate issues relevant to their long term investment policies in the best interests of beneficiaries.

DISCLAIMER

This report has been prepared for SHARE and is designed to provide an outline of the impact of climate change on Canadian pension fiduciaries' duties as at August 2015. The report does not reflect any changes in law or practice after that date.

The information and expressions of opinion that it contains are not intended to provide legal or investment advice, and should not be treated as a substitute for specific advice concerning individual situations.

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