Appendix II

Legal Backgrounder: Duties to understand and manage climate change of nine of the largest Canadian public pension administrators and investment managers

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Overview

1. This backgrounder outlines the legal duties of nine of the largest public sector pension administrators and investment managers in Canada to understand and take active steps to respond to climate-related risks.

2. These nine pension administrators and investment managers are:

- Canada Pension Plan Investment Board (CPPIB),
- British Columbia Investment Management Corporation (BCI) Chief Investment Officer,
- Alberta Investment Management Corporation (AIMCo) Board,
- Ontario Teachers' Pension Plan (OTPP) Board,
- Ontario Municipal Employees' Retirement System (OMERS) Board,
- Ontario Public Service Employees Union Pension (OPTrust) Board,
- Healthcare of Ontario Pension Plan (HOOPP) Board,
- Investment Management Corporation of Ontario (IMCO) Board, and
- Public Service Pension Investment Board (PSP).

3. Although Caisse de dépôt et placement du Québec (CDPQ), is also one of the largest public sector pension investment managers in Canada, we have focussed on the legal duties of pension administrators and investment managers under the common law. Legal duties under Quebec civil law would be similar but not identical.

4. Also, in contrast to the other five pension administrators listed, AIMCo, BCI, PSP, and IMCO are all public sector investment managers, meaning they make investment decisions for several public sector pension plans. We address their legal duties as public sector investment

managers and explain their similarities and differences to pension administrators in this backgrounder.

5. As lawyers at Ecojustice Canada Society ("Ecojustice"), we have been asked by Shift: Action for Pension Wealth and Planet Health ("Shift"), a project of MakeWay, and Environmental Defence Canada to interpret and build on the recent opinion prepared for the Canada Climate Law Initiative by Canadian pensions lawyer, Randy Bauslaugh, on the legal implications of climate-related financial risks on pension fiduciaries.[1] Our backgrounder is intended to provide the necessary legal support to pension fund beneficiaries[2] to write to their respective funds to seek further information on how their pension administrators and investment managers are fulfilling their legal duties to understand and take active steps to prudently respond to climate-related risks.

6. This backgrounder concludes that pension administrators and investment managers have four main duties to respond to climate risks:

i. A duty to understand and assess climate-related risks for the full scope of emissions across the entire portfolio;[3]

ii. A duty to reasonably manage identified climate-related risks to avoid the worst financial impacts of climate change, including divestment or exclusion in certain circumstances and investment;

iii. A duty to honestly and accurately disclose climate-related risks and policies to beneficiaries; and

iv. A duty to avoid or properly manage conflicts of interest when making investment decisions about climate-related risks.

7. This backgrounder has been provided solely for the benefit of beneficiaries seeking more information from their respective pension funds. It is based on a review of relevant statutes, case law, academic commentary, and other legal opinions. Although this backgrounder identifies potential legal risks to these nine pension administrators and investment managers for a failure to

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[1] Randy Bauslaugh, "Climate Change: Legal Implications for Canadian Pension Plan Fiduciaries and Policy-Makers" (McCarthy Tetrault, 2021), online: https://ccli.ubc.ca/resource/climate-change-legal-implications-for-canadian-pension-plan-fiduciairies-and-policy-makers/ [Bauslaugh opinion].

[2] For the purpose of this backgrounder, "beneficiaries" refer to all persons are or will be entitled to benefits under a pension plan, including current employees, retired employees, and related people who may be designated beneficiaries by an employee.

[3] The full scope of emissions refers to all direct and indirect emissions that are the consequence of a company's activities. The GHG Protocol, which is the most widely used international standard for greenhouse gas emission reporting, categorizes emissions into three broad scopes: Scope 1 (direct emissions), Scope 2 (indirect GHG emissions from consumption of purchased electricity, heat or steam) and Scope 3 (other indirect emissions, such as the extraction and production of purchased materials and fuels, transport-related activities in vehicles not owned or controlled by the reporting entity, as well as downstream emissions from the burning of fossil fuels produced by the company). See: https://ghgprotocol.org/calculationg-tools-faq.

meet their fiduciary and statutory obligations, it is not intended to be specific to any of the nine pension administrators and investment managers identified, and any specific claim against a pension administrator would have to be based on a thorough review of all plan documents and applicable law.

8. This backgrounder is also not investment or financial advice. Any reference to financial analysis cited in this backgrounder are assumed to be true and the source of this information has been identified.

Who We Are

9. Shift, a project of MakeWay, is an initiative that monitors the fossil fuel investments of Canadian pension funds and works to protect pensions and the climate by bringing together beneficiaries and their pension funds to engage on the climate crisis. Shift meets with pension administrators, engages with beneficiaries, and researches and writes reports regarding Canadian pension funds' exposure to climate-related risks.

10. Environmental Defence Canada is a leading Canadian advocacy organization that works with government, industry and individuals to defend clean water, a safe climate and healthy communities. More than 250,000 Canadians support the organization's work to end fossil fuel subsidies, ensure a just transition, and increase investment in a clean economy.

11. Ecojustice is Canada's largest national environmental law charity. Ecojustice specializes in bringing novel strategic litigation to defend nature, combat climate change, and fight for a healthy environment for all.[4] Through this work, our lawyers have developed a strong understanding of the need for urgent and effective action to combat climate change, including through the redirection of financial flows away from fossil fuels and towards climate solutions. We have drawn from this expertise to set out in this backgrounder what is likely required for Canada's largest public pension administrators and investment managers to meet their constantly evolving duties to respond to climate-related risks.

Introduction

12. It is clear that pension fund administrators, trustees, and investment managers have legal obligations to address the financial risks of climate change. Well-respected expert pension lawyers in Canada and other common law countries have already published legal opinions concluding that pension administrators and trustees have duties to understand and manage climate-related risks prudently and in the best interests of beneficiaries.[5]

[4] See *Mathur v Ontario*, 2020 ONSC 6918.

[5] In Canada: Bauslaugh opinion, *supra* note 1; Murray Gold and Adrian Scotchmer, *Climate change and the fiduciary duty of pension fund trustees in Canada* (2015), online: https://kmlaw.ca/wp-content/uploads/2015/10/KM_Climate_Change_Paper_06oct15.pdf; In the United Kingdom: Keith Bryant QC and James Rickards, *The Legal Duties of Pension Fund Trustees in Relation to Climate Change*, at paras 23-24; In Australia: Noel Hutley and James Mack, *Memorandum of Opinion: Superannuation Fund Trustee Duties and Climate Change* (15 June 2017); Noel Hutley and James Mack, *Memorandum of Opinion: Superannuation Fund Trustee Duties and Climate Change* (21 February 2021) [Hutley and Mack 2021]; In South Africa: Rosemary Hunter, "Pension funds and climate risk" (4 April 2019).

13. A recent Canadian legal opinion from pensions lawyer Randy Bauslaugh states that:

> ". . .as far as climate change is concerned, the legal question is not whether fiduciaries are permitted to take climate change into account when managing plan assets, but rather, in view of the consensus evidence of the materiality of climate-related risks and opportunities, **whether they can ever be excused for not taking those risks and opportunities into account when investing and managing plan assets … or for not reasonably disclosing what they are doing about it**".[6] [emphasis added]

14. Litigation risks continue to increase for pension funds that fail to reasonably consider and manage climate-related risks.[7] In Australia, a large superannuation fund was sued by beneficiaries for failing to inform themselves of and disclose climate risks in their investments. The fund and beneficiaries settled a day before trial, with the fund acknowledging that climate change was a material financial risk and committing to a net zero carbon footprint for the fund by 2050 as part of the settlement.[8]

15. The problem in Canada has been that it is difficult to obtain information on whether, and exactly how, pension funds are taking active steps to prudently address climate-related risks. Although most large public sector pension administrators and investment managers have acknowledged and started to assess climate-related risks, few have set targets or established credible plans to align with the emissions reductions needed to prevent catastrophic climate change. As a result, pension fund beneficiaries are increasingly demanding to know the details of how pension funds are addressing climate risks in order to evaluate whether they are sufficient to meet the legal duties of pension administrators and investment managers to manage these risks.

The Nature of Climate-Related Risks

16. Climate change is a defining issue of our time. The Supreme Court of Canada recently described climate change as an "existential challenge" and "threat of the highest order to the country, and indeed to the world."[9]

17. The scientific evidence of greenhouse gas emissions and their effects on climate change globally and in Canada are now well-known and widely accepted. Therefore, this section will not reiterate the scientific evidence of climate change. Instead, this section will focus on the policy responses required to mitigate the worst effects of climate change and the expected financial impacts of climate change and climate policy on pension funds as investors.

18. In order to prevent catastrophic economic and social consequences from climate change, nearly 200 governments, including Canada, signed on to the *Paris Agreement* and committed to holding the increase in the global average temperature to well below 2°C above pre-industrial

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[6] Bauslaugh opinion, *supra* note 1 at 10.

[7] The federal regulator of pensions, the Office of Superintendent of Financial Institutions acknowledged the risk to pension administrators of claims brought by pension plan members for failing to account for possible risks to greenhouse gas intensive assets in a recent Discussion Paper: https://www.osfi-bsif.gc.ca/Eng/Docs/clmt-rsk.pdf, at p 10 [OSFI Discussion Paper].

[8] Rest, "Media Release: Statement from Rest" (2 November 2020) <https://equitygenerationlawyers.com/wp/wp-content/uploads/2020/11/Statement-from-Rest-2-November-2020.pdf> accessed 14 December 2020

[9] Reference re *Greenhouse Gas Pollution Pricing Act*, 2021 SCC 11, at para 167.

levels and to pursue efforts to limit the temperature increase to 1.5°C (the "Paris Goals").[10] Studies by scientists for the International Panel on Climate Change indicate that in order to meet this 1.5°C target, carbon dioxide emissions must decline by at least 45% from 2010 levels by 2030 and reach net zero by 2050.[11]

19. Meeting these targets requires significant and urgent changes, including changes in finance and investment, by public and private actors around the world.[12] A recent analysis by the International Energy Agency has modelled what is required to meet the Paris Goals and has concluded that, in order to align with a pathway to net zero emissions by 2050, there is no need for investment in new fossil fuel supply projects, as no new oil and gas fields, coal mines, or coal mine extensions are required as of 2021.[13]

20. Climate change and climate policies create material financial risks that can affect investment returns. As put by Mark Carney, former governor of the Bank of Canada and Bank of England:

> "Changes in climate policies, technologies and physical risks in the transition to a net zero world will prompt reassessments of the value of virtually every asset. The financial system will reward companies that adjust and punish those who don't."[14]

21. The effect of climate-related risks on credit, market, liquidity, insurance, strategic/operational and reputational risks for pension plans has been acknowledged by the federal regulator of pensions, the Office of the Superintendent of Financial Institutions ("OSFI"). Regarding climate-related risks, the OSFI noted that "[m]ismanagement of these risks can affect [a pension plan's] safety and soundness".[15] OSFI is currently engaging in a consultation process to determine its role in regulating the response of federally-regulated pension plans and federally-regulated financial institutions to climate-related risk.

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[10] *Paris Agreement*, being an Annex to the *Report of the Conference of the parties on its twenty-first session, held in parties from 30 November to 13 December 2015--Addendum Part two: Action taken by the Conference of the parties at its twenty-first session*, 12 December 2015, UN Doc FCCC/CP/2015/10/Add.1, 55 ILM 740 (entered into force 4 November 2016) [*Paris Agreement*], Article 2.1(a).

[11] Intergovernmental Panel on Climate Change, "Summary for Policymakers" in *Global Warming of 1.5°C. An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development and efforts to eradicate poverty* (2018) <https://www.ipcc.ch/site/assets/uploads/sites/2/2019/05/SR15_SPM_version_report_LR.pdf>, at 12 [IPCC Special Report].

[12] *Paris Agreement*, *supra* note 10, Article 2.1(c); *Final Report of the Expert Panel on Sustainable Finance: Mobilizing Finance for Sustainable Growth* (Gatineau: Environment and Climate Change Canada, 2019) <http://publications.gc.ca/collections/collection_2019/eccc/En4-350-2-2019-eng.pdf>, at 1-2 [Expert Panel Report].

[13] International Energy Agency, *Net Zero by 2050: A Roadmap for the Global Energy Sector* (2021) https://iea.blob.core.windows.net/assets/4719e321-6d3d-41a2-bd6b-461ad2f850a8/NetZeroby2050-ARoadmapfortheGlobalEnergySector.pdf, at 21 [IEA Roadmap].

[14] Mark Carney, *Remarks given during the UN Secretary General's Climate Action Summit 2019* (23 September 2019) <https://www.bankofengland.co.uk/-/media/boe/files/speech/2019/remarks-given-during-the-un-secretary-generals-climate-actions-summit-2019-mark-carney.pdf>, at 7.

[15] OSFI Discussion Paper, *supra* note 7 at para 3.4.

22. The industry-led Taskforce on Climate-Related Financial Disclosures ("TCFD") categorizes climate-related financial risks as "physical risks" or "transition risks". [16] Physical risks are risks resulting from extreme climate and weather events as well as risks from longer term shifts in climate patterns, such as sea level rise and sustained higher temperatures.

23. Transition risks are risks that arise from the transition to a lower-carbon economy, including:

- Policy risks: The introduction of policies to reduce emissions or adapt to climate change such as carbon pricing or promoting more sustainable land use.

- Litigation risks: The risks from litigation arising from people harmed by climate change bringing claims against those who have caused climate change.[17]

- Technology risk: The impacts of technology that supports the transition to lower carbon economy, which may displace and disrupt parts of the existing economic system.

- Market risk: Shifts in supply and demand as climate risks and opportunities are disclosed and considered.

- Reputation risk: Risks to an organization's reputation if perceived as contributing to or hindering the transition to the lower carbon economy.[18]

24. These risks cannot be ignored until 2030 or 2050, or even the next couple of years: they must be addressed now.

25. Sudden market shifts and re-pricing to align with the Paris Goals can happen suddenly and have already begun to occur.[19] Policies by the federal government continue to commit Canada to meeting the Paris Goals, including through annual increases in carbon pricing to reach $170 per tonne of CO2-equivalent by 2030,[20] legislation committing to net-zero emissions by 2050 and emission reduction plans to achieve five yearly "milestone" targets from 2030 to 2050,[21] and a newly announced nationally determined contribution ("NDC") under the *Paris*

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[16] Task Force on Climate-related Financial Disclosures, *Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures* (June 2017) <https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf> accessed 14 December 2020, at 5-6 [TCFD Recommendations].
[17] Litigation risks have also started to include direct litigation risks to investors that fail to inform themselves of and disclose climate risks in their investments. See, e.g., the settlement in the Australian case of *McVeigh v REST*, where the institutional investor settled by making several commitments including acknowledging that climate change was a material financial risk and adopting a net zero carbon footprint for the fund by 2050: *supra* note 8.
[18] TCFD Recommendations, *supra* note 16 at 5-6.
[19] Mark Carney, Governor of the Bank of England, *Breaking the Tragedy of the Horizon - climate change and financial stability* (29 September 2015) <https://www.bankofengland.co.uk/-/media/boe/files/speech/2015/breaking-the-tragedy-of-the-horizon-climate-change-and-financial-stability.pdf?la=en&hash=7C67E785651862457D99511147C7424FF5EA0C1A> accessed 8 January 2021.
[20] Environment and Climate Change Canada, *A Healthy Environment and A Healthy Economy* (2020), online: https://www.canada.ca/en/services/environment/weather/climatechange/climate-plan/climate-plan-overview/healthy-environment-healthy-economy.html.
[21] *Canadian Net-Zero Emissions Accountability Act*, SC 2021, c 22.

Agreement to reduce greenhouse gas emissions by at least 40% below 2005 levels by 2030.[22] The NDC requires Canada to identify an additional 65 million tonnes of emissions reductions in less than ten years.[23]

26. These shifts in policy as well as sudden market responses can create risks of fossil fuel reserves becoming "stranded assets", as the world moves towards meeting the Paris Goals.[24] A rapid energy transition creates risks for companies and infrastructure involved in extracting, producing, transporting, and refining fossil fuels. An analysis in the *Financial Times* estimated that around $900 billion, or one-third of the current value of oil and gas majors, will no longer be realizable if the 1.5°C Paris Goal is met.[25] The recent conclusion of the International Energy Agency that "[t]here is no need for investment in new fossil fuel supply" in a net-zero emissions pathway further underscores the risk that fossil fuel reserves will never be developed.[26] A recent article in *Nature*, further confirmed that nearly 60% of the world's oil and fossil methane gas, and 90% of coal must remain unextracted to keep within a 1.5 °C carbon budget, with 84% of Canada's oil sands reserves being unextractable.[27] As put by the authors, this means that "country producers, fossil energy companies and their investors need to seriously reassess their production outlooks."

27. Some companies are starting to recognize their stranded assets: in February 2021, Imperial Oil confirmed a loss of $1.1 billion last quarter because it is no longer planning to develop "a significant portion" of its unconventional assets in Alberta.[28] Similarly ExxonMobil, Total, British Petroleum ("BP") and Shell have also written off the value of some of their assets in the last year.[29] Despite this, all global major oil companies in 2018 approved projects for oil

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[22] Environment and Climate Change Canada, "Government of Canada confirms ambitious new greenhouse gas emissions reduction target" (12 July 2021), online: https://www.canada.ca/en/environment-climate-change/news/2021/07/government-of-canada-confirms-ambitious-new-greenhouse-gas-emissions-reduction-target.html.
[23] Environment and Climate Change Canada, "Backgrounder: Updating Canada's Nationally Determined Contribution" (April 2021), online: https://www.canada.ca/en/services/environment/weather/climatechange/climate-plan/climate-plan-overview/backgrounder-nationally-determined-contribution.html.
[24] Christophe McGlade and Paul Ekins, "The geographical distribution of fossil fuels unused when limiting global warming to 2°C" (2015) 517 Nature 187, at 187; Andrew Grant and Mike Coffin, *Breaking the Habit: Why none of the large oil companies are "Paris-aligned", and what they need to do to get there* (Carbon Tracker, 2019) < https://carbontracker.org/reports/breaking-the-habit/> accessed 9 December 2020 [Carbon Tracker Report], at 10.
[25] Alex Livsey, "Lex in Depth: the $900bn cost of 'stranded energy assets'" (3 February 2020), online: https://www.ft.com/content/95efca74-4299-11ea-a43a-c4b328d9061c.
[26] IEA Roadmap, *supra* note 13 at 21.
[27] Dan Welsby *et al*, "Unextractable fossil fuels in a 1.5 °C world" (2021) 597 Nature 230, https://doi.org/10.1038/s41586-021-03821-8.
[28] Sarah Rieger, "Imperial Oil to write down up to $1.2B, no longer plans to develop 'significant portion' of Alberta assets" *CBC News* (30 November 2020), online: https://www.cbc.ca/news/canada/calgary/imperial-oil-1.5822984; https://financialpost.com/commodities/energy/after-massive-writedown-imperial-oil-says-no-big-projects-in-coming-years?utm_medium=Social&utm_source=Twitter#Echobox=1612303603. .
[29] Yadullah Hussain, "Posthaste: Imperial Oil's massive write-off suggests the era of stranded Canadian assets is already here" *Financial Post* (1 December 2020), online: https://financialpost.com/executive/executive-summary/posthaste-imperial-oils-massive-write-off-suggests-the-era-of-stranded-canadian-assets-is-already-here.

and gas development that do not align with the *Paris Agreement*, raising the potential for stranded assets if the world meets the Paris Goals.[30]

28. In summary, there is clear evidence of climate change and responding climate policies increasing prices on greenhouse gas emissions, consequential fluctuations in a wide variety of costs and financial risks for high-emission industries, and increasing evidence of stranded assets. In addition, there is increasing evidence of transition-related costs and opportunities across the economy. These material and imminent risks, costs, and opportunities must be addressed by pension fund fiduciaries.

Duties and Standards of Conduct of Pension Administrators

29. Pension administrators have fiduciary and other statutory obligations to pension beneficiaries when administering pension funds and making investment decisions.[31] Specifically, pension administrators have a duty of care to invest the assets of a pension fund prudently and a duty of loyalty to invest in the best interests of beneficiaries.[32] These duties must guide a pension administrator's response to the risks and opportunities posed by climate change – both in how they inform themselves and beneficiaries about climate risks and opportunities and in how they respond to those risks and opportunities.[33]

The Fiduciary Standard of Care

30. Pension administrators have what is known as a "fiduciary duty of care" when making investment decisions. This is a legal concept that describes a relationship between a person who is given power over another person's interests. The law therefore places a very high duty on the person with the special authority to act in the best interests of the vulnerable person when exercising that power.[34] To fulfill this duty, pension administrators must meet their standard of care —or standard of conduct—to make investment decisions that an ordinary, prudent person would make when dealing with someone else's property in order to meet the obligations of the pension plan.[35] This is also known as the "prudent person rule".

31. To meet this standard of conduct, pension plan administrators must consider the long-term nature of the obligations of the pension fund when creating the investment strategy, take appropriate expert advice where necessary, diversify investments, monitor the performance of the fund, and respond to changing market conditions.[36]

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[30] Carbon Tracker Report, *supra* note 24 at 4, 6.
[31] *Burke v Hudson's Bay Co*, 2010 SCC 34, at para 41 [*Burke*]; see also Bauslaugh opinion, *supra* note 1, for further description of the fiduciary relationship between pension administrators and beneficiaries and employers.
[32] Ari Kaplan and Mitch Frazer, *Pension Law*, 3rd ed (Irwin Law: Toronto, 2020), at 324-28; *Pension Benefits Act*, RSO 1990, c P.8, s 22; *Cowan v Scargill*, [1984] 2 All ER 750, at 760; see also Bauslaugh opinion, *supra* note 1.
[33] A recent opinion from respected Australian pensions lawyers has concluded that the likelihood of the financial risks of climate change being material risks means that pension trustees must undertake a two-step process of understanding the risks posed by climate change and managing any identified risk: Hutley and Mack 2021, *supra* note 5 at para 5.
[34] *Burke*, *supra* note 31 at para 39.
[35] See, e.g., *Pension Benefits Act*, *supra* note 30, s 22(1); *Canada Pension Plan Investment Board Act*, SC 1997, c 40, s 35; *Public Service Pension Investment Board Act*, SC 1999, c 34, s 32.
[36] *Ermineskin Indian Band and Nation v Canada*, 2006 FCA 415, [2007] 3 FCR 245 (Sexton JA, in dissent).

32. Where a pension administrator has special skill or expertise (such as experience in investment, or legal or actuarial qualifications), they will be held to a higher standard of care. Professional boards—that is, pension administration boards composed of industry experts—will be held to the very highest standards of conduct. If pension administrators delegate investment decisions to an investment manager, they must be satisfied of the investment manager's ability to address material climate risks and they must prudently and reasonably supervise the investment manager in their management of this material risk.[37]

The Best Interests of Beneficiaries

33. Pension administrators also have a duty of loyalty to act in the best interests of pension fund beneficiaries, primarily in the financial interests of the beneficiaries over the long-term, in order to be able to continue to pay benefits to individuals after they retire.[38] This requires pension administrators to be loyal to the terms and purposes of the pension plan: that is, to ensure the plan meets its obligations to provide pensions to current and future beneficiaries.

34. With this duty of loyalty comes a duty to act impartially and even-handedly between beneficiaries.[39] This means that when considering climate risks, pension administrators cannot inequitably allow for the short-term interests of, for example, current retirees to privilege the interests of those beneficiaries scheduled to retire in the future.[40]

35. In addition, the duty of loyalty requires pension administrators to avoid or properly manage conflicts of interests between plan beneficiaries and potentially opposing interests of the administrator, or anyone else.[41]

36. In May 2021, the Canada Climate Law Initiative released a legal opinion by pension lawyer Randy Bauslaugh ("Bauslaugh opinion") on the legal implications of climate change for pension administrators (or "plan fiduciaries") based on their fiduciary duty of care and duty of loyalty. This opinion makes several key conclusions including:

- **Fiduciary duties apply to all pension administrators:** All forms of pension structures in Canada including direct benefit and direct contribution plans impose general common law or civil law fiduciary duties on pension administrators, and more onerous statutory duties.[42]

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[37] See e.g., *Pension Benefits Act*, *supra* note 32, s 22(7); *ibid*, at para 239 (Sexton, JA, in dissent summarizing prudent investing principles); *Fales v Canada Permanent Trust Co*, [1977] 2 SCR 302, at 317.
[38] Gold and Scotchmer, *supra* note 5 at 12; *Bathgate v National Hockey League Pension Society*, 1992 CanLII 7525 (Ont Sup Ct), citing *Sinai Hospital of Baltimore Inc v National Benefit Fund for Hospital & Health Care Employees*, 697 F. 2d 562 (1982), at 567; *Cowan v Scargill*, *supra* note 32; Bauslaugh opinion, *supra* note 1, at 5; for registered pension plans under the *Income Tax Act*, their primary purpose is to "provide periodic payments to individuals after retirement": *Income Tax Regulations*, CRC, c 945, s 8502(a).
[39] Gold and Scotchmer, *supra* note 5 at 12.
[40] *Edell v Sitzer*, 2001 CanLII 27989 (ON SC); *Neville v Wynne*, 2006 BCCA 460, at para 9; Gold and Scotchmer, *supra* note 5 at 12.
[41] Bauslaugh opinion, *supra* note 1 at 5; *Sun Indalex Finance, LLC v United Steelworkers*, 2013 SCC 6, [2013] 1 SCR 271, at para 186 [*Sun Indalex*].
[42] Bauslaugh opinion, *ibid* at 4.

- **Financial risks of climate change create obligations:** Pension plan fiduciaries' obligations to address climate change arise from the financial consequences of climate change. Climate change is the "biggest short and long term threat to national and transnational economies."[43]

- **Pension fiduciaries have an obligation to consider and manage climate-related financial risks and could be liable if they fail to do so:** "[P]ension fund fiduciaries who fail to consider or manage climate-related financial risks and opportunities, may find themselves personally liable for economic, reputational or organizational loss resulting from that failure."[44] A fiduciary could also face removal, court-ordered disclosure of information relating to climate change, and fines and penalties under pension legislation.[45] They may also expose the plan to reputational or organizational risk.[46] Pension beneficiaries or regulators could commence litigation alleging breaches of fiduciary duties of prudence or loyalty for failing to consider climate risks and opportunities in making investments or setting investment policy.[47]

- **Duty to consider intergenerational risk:** Pension administrators' duty of impartiality and even-handedness invokes a need to consider intergenerational equity by "maintaining a longer term perspective on investment management and impartiality between generations of plan members."[48] This includes considering intergenerational risk over periods that could exceed human life spans.

- **Climate opportunities:** Pension fiduciaries have a duty to identify and manage climate opportunities as well as climate risks.[49]

- **Likely obligation to disclose:** "Plan fiduciaries may also have an obligation to disclose how they manage climate change risk and opportunity on an ongoing basis."[50]

- **Reasonable actions to manage climate risks:** Pension fiduciaries can defend themselves from litigation alleging breaches of fiduciary duties by acting reasonably and demonstrating they are actively managing climate change risks and opportunities. This includes:[51]

    - addressing climate change in the statement of investment policies and procedures ("SIPP"),

[43] *Ibid* at 1-3, 6.
[44] *Ibid* at 1.
[45] *Ibid* at 9.
[46] *Ibid* at 10.
[47] *Ibid* at 12.
[48] *Ibid* at 5.
[49] *Ibid* at 11.
[50] *Ibid* at 1.
[51] *Ibid* at 14-17.

- allowing for a broad and flexible range of climate risk responses in written policy from informal engagement to proxy voting to divestment to litigation in order to respond to specific circumstances,
- when engaging, plan fiduciaries should be able to "identify and articulate a path to financial improvement that can be driven by engagement on ESG factors",
- recording significant decisions regarding climate-related risks in writing, including decisions about selecting and removing external investment managers based on climate risk management,
- being consistent with written policies and commitments when making decisions,
- disclosing the SIPP, investment policies, management decisions, and climate change plans in a timely manner with plan members and ensuring that these disclosures are accurate, contain meaningful information, and are in line with internal controls and procedures, and
- keeping up to date on evolving climate change developments and industry practices.

37. Based on the findings summarized above, as well as our understanding of the nature of climate risks and large public sector pension funds, we characterize pension administrators in Canada as having four main duties in responding to climate-related risks:

1) A duty to understand and assess climate-related risks;
2) A duty to reasonably manage identified climate-related risks;
3) A duty to honestly and accurately disclose climate-related risks and responses to risk policies to beneficiaries; and
4) A duty to avoid or properly manage conflicts of interest when making investment decisions about climate-related risks.

This backgrounder will now describe each of these duties in detail.

Duty to Understand and Assess Climate-related Risks

38. The first step that a pension administrator must take to manage climate-related risk is to identify and fully and properly assess the climate related risks to the fund.[52] A pension administrator cannot consider climate-related risk without assessing or analyzing the risk first.

[52] See also Hutley and Mack 2021, *supra* note 5 at para 7, which describes this two-step process of 1) understanding climate risks and 2) managing those identified risks.

39. Part of a pension administrator's duty of prudence is to determine the appropriate level of financial risk to assume in a pension fund portfolio and then seek to maximize returns within those constraints.[53]

40. In order to do so, a pension administrator must obtain relevant information and specialized assistance to assess the financial risks from climate change according to industry standards.[54]

41. To be reasonably informed, pension administrators need to seek expert advice and conduct scenario analysis to determine whether their investment strategy is resilient to likely emission scenarios, especially the emission scenarios that align with the Paris Goals.[55] Only by fully informing itself of material risks can a pension administrator develop a prudent investment strategy to manage risks and maximize returns over the long-term.[56]

42. Wider industry standards provide one measure to assist in prudently assessing climate risks.[57] Currently, recommendations from the TCFD regarding climate disclosure provide a "global benchmark" for assessing climate risk and are likely moving towards becoming an industry standard in Canada.[58] At minimum, pension funds should be assessing climate risk in line with TCFD recommendations. A full assessment of climate-related risks should include:

1) Assessing the climate risk of the whole portfolio, including fixed income, private or public equity, other alternative asset classes and investment approaches including actively and passively managed funds;

2) Assessing the full scope of emissions arising from or related to portfolio investments, including indirect emissions (e.g., but not limited to, emissions from the downstream use of a fossil fuel for investments in fossil fuel companies);

3) Conducting stress testing which adopts reasonable assumptions about the use of carbon capture technology and offsetting; and

4) Stress testing the portfolio against a "climate success" 1.5°C scenario, in which Canada and the world succeed in meeting the Paris Goals as well as scenarios

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[53] *Miles v Vince*, 2014 BCCA 289, at para 62 [*Miles*], citing *Waters' Law of Trusts in Canada*, 4th ed (Toronto: Thomson Reuters Canada Limited, 2012) at 1018.
[54] *R v Christophe*, 2009 ONCJ 586 at paras 77-79; *Pensions Benefits Act*, *supra* note 32, s 22(2).
[55] In a class action certification decision, *Green v CIBC*, 2012 ONSC 3637, at para 421, the Superior Court of Ontario noted that publicly listed corporations should have risk management strategies to predict and address even worst case scenarios. This also should apply to a prudent investor's assessment of climate risk.
[56] *Miles*, *supra* note 53 at para 62; Edward Waitzer and Douglas Sarro, "The Public Fiduciary: Emerging Themes in Canadian Law for Pension Trustees" (2012) 91 Can B Rev 163, at 168-69.
[57] "Industry standards" refer to the common practices among other industry actors. They may not be sufficient to address climate risks if industry standards do not adequately address climate risks themselves. In addition, if a particular portfolio is sufficiently distinct from others in the industry, the industry standards may not be appropriate as measures to take to address climate related risks. Given that Canadian pension funds are still behind much of the rest of the world in climate risk disclosure and management, industry standards in Canada may not be sufficient to meet the duty of prudence.
[58] Expert Panel Report, *supra* note 12 at 15; see also Sustineri, *Market standards on climate-related risk by asset owners* (August 2018) <https://www.documents.clientearth.org/library/download-info/market-standards-on-climate-related-risks-by-asset-owners-report-by-clientearth-and-sustineri/> [Sustineri report].

reflecting varying degrees of "climate failure" including 2°C, 3°C and 4°C scenarios.

43. Given the imminent and material risks and costs posed by climate change, a pension administrator must conduct a comprehensive and detailed review of its portfolio and investment strategy for exposure to climate-related risks.

44. In our view, a failure to conduct a review would itself amount to a breach of a pension fund administrator's duty to inform itself of material risks directly relevant to the administration of the pension fund.

Duty to Respond to Climate-related Risks

45. Once identified, pension fund fiduciaries have a duty to take actions to respond to the climate-related risks identified in the review and stress-testing of the portfolio. There are several ways that pension administrators can respond to climate risks once they are identified. They may:

- take no action (e.g., maintain existing portfolio);
- rely on a further diversification of the portfolio to manage the risk of particular investments, including investing in alternative low-carbon investments,
- engage (through a spectrum of activities from informal discussion and suasion to litigation as a stakeholder) with portfolio companies to have companies change practices to reduce investment-specific or sector-specific risks, and
- divest from those companies exposed to the highest risk.[59]

46. None of these options are mutually exclusive, although the systemic nature of climate risk and the shift in standards for investors means that it is likely no longer a prudent approach to deal with climate risks merely by relying on a diversified portfolio.[60] Relying simply on standard market diversification without assessing the portfolio's exposure to climate-related risks would almost certainly be a breach of fiduciary duty in the investment of the fund. Although pension administrators have considerable discretion in the actions they take to respond to climate risk, their duties of prudence and loyalty must ultimately guide their actions.

47. One of the options for responding and reducing climate risk is to divest from those companies where the physical and transition risks are greatest. As noted in a recent Australian legal opinion from respected pensions lawyers, if a climate-related financial risk "is too great for a particular investment objective, a superannuation trustee will need to consider divestment or a reallocation of funds to less risky investment options/asset classes".[61] As emphasized in the

[59] Mercer Global, "Investing in a Time of Climate Change: The Sequel", *Mercer LLC* (2019), online: <https://www.mercer.com/our-thinking/wealth/climate-change-the-sequel.html#:~:text=Investing%20in%20a%20Time%20of%20Climate%20Change%20%E2%80%93%20The%20Sequel%20(the,risks)%20on%20investment%20return%20expectations.> [Mercer Report], at 66.
[60] The position of more than 100 major international investors is that: "[c]limate change is a systemic risk – on which investors cannot diversify away from": ClimateAction100+, "Frequently Asked Questions" <http://www.climateaction100.org/> accessed 14 December 2020; see also, Mercer Report, *supra* note 59, at 14-18.
[61] Hutley and Mack 2021, *supra* note 5 at para 7.

Bauslaugh opinion, pension administrators are to oversee and engage on climate-related risks in the same way they would address other risks.[62] In other words, if a pension administrator would divest or reallocate funds where an investment or asset class is too risky, it should not take a different approach where that risk is climate-related.[63]

48. Fiduciary and statutory obligations do not prevent pension administrators from adopting a divestment or exclusion policy, provided that this policy is prudent and adopted in the best interests of beneficiaries to reduce their exposure to financial climate risks. Clearly, divestment or exclusion of a certain sector due to reputational, social and commercial risks can be prudent and justifiable, given that several Canadian public pension funds have adopted exclusions for tobacco and certain types of weapons.[64]

49. Divestment is increasingly being adopted by institutional investors as a tool to address climate risk. A 2018 survey of 30 large institutional investors based in Organisation for Economic Co-operation and Development ("OECD") member countries found that 67% of them had divestment policies in place.[65] These policies either exclude certain high emitting industries or specific companies that were not responsive to engagement or had no viable plans that would be resilient to a future in which the Paris Goals are met. At least 168 pension funds have fully or partially divested from fossil fuels as of June 2021, including 24 that have divested from coal and tar sands companies only and 121 that have fully divested.[66] These examples support divestment as a prudent way to manage climate risk, especially for sectors with the highest carbon emissions and greatest exposure to climate risk.

50. Although partial or full divestment is a clear option for a pension administrator to reduce climate risk, many Canadian pension plans have indicated that they favour engagement over divestment from fossil fuel companies.[67] This is despite the lack of evidence that engagement is a superior strategy to divestment in managing climate-related risks and the fact that these are not mutually exclusive approaches to manage risk. Engagement can be a prudent measure to manage risk if the pension administrator has a reasonable belief that it will be effective in reducing risk to the fund. As noted in the Bauslaugh opinion, how a pension fund responds on climate-related risks should be based on in part "whether the plan fiduciaries can identify and articulate a path to financial improvement that can be driven by engagement on [environmental, social and governance] factors."[68] If there is no path to the improvement of financial risks through engagement, then presumably engagement is not a prudent way to respond to this risk.

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[62] Bauslaugh opinion, *supra* note 1 at 16.
[63] Hutley and Mack 2021, *supra* note 5 at para 7.
[64] OTPP, CDPQ, HOOPP, OMERS, OPTrust and AIMCo all have tobacco exclusions, https://smoke-free.ca/five-large-canadian-public-pension-plans-have-said-no-to-tobacco-investments/#:~:text=About%20Us-,Five%20large%20Canadian%20public%20pension%20plans,%E2%80%9Cno%E2%80%9D%20to%20tobacco%20investments.&text=For%20most%20Canadian%20workers%2C%20ten,our%20national%20public%20pension%20program.; OTPP, CPP, AIMCo, OMERS, and BCI all have exclusions for certain types of weapons.
[65] Sustineri report, *supra* note 58.
[66] DivestInvest, "Commitments to DivestInvest" (3 June 2021), <https://www.divestinvest.org/commitments/>.
[67] Bauslaugh opinion, *supra* note 1 at 19.
[68] *Ibid* at 15.

51. Climate risks increase rapidly over time, with a risk of sudden market shifts happening over the next few years.[69] As mentioned above, global emissions must decrease by 45% by 2030 to achieve the Paris Goals—a dramatic shift is required in less than a decade.[70] Engagement exposes investors to risk for the time before the company changes its policies. This is demonstrated, for example, by the losses incurred by the shareholders of the oil and gas company, BP, who were engaging with BP on improving its environmental practices to reduce its risks while the Gulf of Mexico spill occurred—those shareholders were still impacted by the risks that they were trying to reduce.[71]

52. In addition, there are certain high-emitting corporations where engagement is not in the beneficiaries' best interests without a radical transformation of their business model. As put by Professor Maziar Peihani at the University of British Columbia: "while engagement can help catalyze better climate risk disclosure by [carbon-intensive] companies, it cannot change the carbon-intensive nature of their business."[72] Although disclosure is important, disclosure alone cannot reduce climate risk. For any company whose profits are primarily based on the ability to explore for, extract, produce, transport, refine or burn fossil fuels, successful engagement could either result in a decrease in value of the corporation (which would not be in the best interests of the beneficiaries) or, more likely, the engagement will never be successful and the pension fund would continue to be exposed to the risk of climate-related losses.

53. A pension administrator's purpose for choosing engagement over divestment must be based on prudence and what is best for beneficiaries, not by a pension administrator's interest in aligning with industrial or government economic priorities. A pension administrator's duty as a prudent investor includes duties to monitor the portfolio and remove those investments that become improper or imprudent.[73] Given the increasing evidence of climate risk, especially in relation to stranded assets, there is a risk that engagement will not be effective in reducing risk in a timely manner, to the detriment of the fund.

54. In contrast, divestment immediately reduces the material financial risks of climate change by removing investments that are most exposed to climate risk. Divestment will therefore be preferable to engagement when pension fiduciaries cannot be confident that the company can or will reduce its climate risks in a timely manner or where the company has failed to respond to shareholder engagement.[74]

55. Given the nature of climate risks, a prudent pension administrator has sound reasons to respond to material climate-related risks by divesting from sectors highly exposed to climate risk, such as thermal coal and oil sands, and/or adopting a prudent, time-bound policy of

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[69] Mercer Report, *supra* note 59 at 36; TCFD Recommendations, *supra* note 16 at 51.
[70] IPCC Special Report, *supra* note 11.
[71] See Alex Gorman, "Exit vs. Voice: A Comparison of Divestment and Shareholder Engagement" (2017) 72:1 NYU Ann Surv Am L 113, at 148.
[72] Maziar Peihani, "Pension Fiduciaries and Climate Change: A Canadian Perspective" (2020) 46:1 Queen's LJ 1 at 28.
[73] *Fales*, *supra* note 36 at 317; *Ermineskin, supra* note 37 at para 239 (Sexton, JA in dissent).
[74] Gorman, "Exit vs. Voice", *supra* note 71 at 183-84; Center for International Environmental Law, *Trillion Dollar Transformation: Fiduciary Duty, Divestment and Fossil Fuels in an Era of Climate Risk* (December 2016), < https://www.ciel.org/wp-content/uploads/2016/12/Trillion-Dollar-Transformation-CIEL.pdf>, at 19-20.

engagement that addresses climate risk by requiring companies to adopt certain minimum standards of Paris alignment,[75] failing which the fund will act to reduce its climate risks by divesting. This has been the approach taken by several funds internationally, including the New York State Common Retirement Fund and the Brunel Pension Partnership in the United Kingdom.[76]

Elevated "Public Fiduciary" Duties of Large Public Pension Funds

56. In addition to pension administrators' duties to manage the direct financial risks of climate change in their pension fund's investments, large public pension funds may be subject to a heightened "public fiduciary" position requiring them to consider the impact of climate change on the economy as a whole.[77] The nine pension administrators and investment managers examined in this backgrounder represent over $1 trillion assets under management.[78] Given their size and economic significance within Canada, they are highly exposed to the domestic market and have an impact on the stability of financial systems as a whole. As a result, they should be considering the destabilizing effects of climate change on the market and domestic economy as a whole (not just their holdings) when designing their investment strategy. As put by Ed Waitzer and Douglas Sarro, investment decisions, and the pension administrator's duty of care, "must take into account the relationship between investment decisions and systems in which the beneficiaries (will) live".[79]

57. Increases in global temperature beyond 2°C are predicted to have a destabilizing effect on the financial system. Mercer, an asset management firm, has predicted that the physical risks of climate change mean that long-term investors should be attempting to avoid 3°C and 4°C scenarios in favour of a below 2°C scenario to maximize returns and minimize risks due to the cross-economy impacts of extreme temperature rise.[80]A coalition of central banks, including the Bank of Canada, has concluded that all monetary regimes will face challenges from climate change and its mitigation, and sudden repricing events could put pressure on central banks' ability to provide credit to the economy.[81] For large Canadian pension administrators and

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[75] The UN-convened Net Zero Asset Owners' Alliance has set out minimum standards for portfolio companies, including that companies enter time-bound discussions with investors to decarbonize their business by 2025: PRI and UNEP Finance Initiative, UN-Convened Net-Zero Owner Alliance: Inaugural 2025 Target Setting Protocol (January 2021), at 55.

[76] Office of the New York State Comptroller, "New York State Pension Fund Sets 2040 Net Zero Carbon Emissions Target" (9 December 2020) https://www.osc.state.ny.us/press/releases/2020/12/new-york-state-pension-fund-sets-2040-net-zero-carbon-emissions-target; Brunel Pension Partnership, "£30bn Pension Partnership calls finance sector 'not fit for purpose' for addressing climate change" (27 January 2020), <https://www.brunelpensionpartnership.org/2020/01/27/30bn-pension-partnership-calls-finance-sector-not-fit-for-purpose-for-addressing-climate-change/>.

[77] Waitzer and Sarro, Public Fiduciary, *supra* note 56 at 208; Edward Waitzer and Douglas Sarro, ""Fiduciary Society Unleashed: The Road Ahead for the Financial Sector" (2014), at 1093; *Maryland Court of Appeal in Board of Trustees v City of Baltimore*, https://casetext.com/case/board-of-trustees-v-city-of-baltimore.

[78] https://www.newswire.ca/news-releases/ceos-of-eight-leading-canadian-pension-plan-investment-managers-call-on-companies-and-investors-to-help-drive-sustainable-and-inclusive-economic-growth-844608554.html.

[79] Waitzer and Sarro, Public Fiduciary, *supra* note 56 at 208.

[80] Mercer Report, *supra* note 59 at 34-35.

[81] Network for Greening the Financial System, "Climate Change and Monetary Policy: Initial takeaways" (June 202), online: https://www.ngfs.net/sites/default/files/medias/documents/climate_change_and_monetary_policy_final.pdf, at 7-9.

investment managers, exercising their public fiduciary duties means urgently decarbonizing investments to avoid the worst destabilizing effects of climate change on the financial system.

58. Pension administrators should be making investment decisions on the basis that a zero carbon future is in the best long-term financial interests of the beneficiaries.[82] This broader duty to beneficiaries provides further support for divesting from high-carbon investments and reinvesting to support the transition to a low-carbon future. This is because climate change creates a systemic risk to the economic and ecological systems underpinning human societies. As a large pension fund, its investments are not only vulnerable to climate change, but can also impact emissions directly by either providing capital to high-emitting companies or redirecting funds to low-carbon initiatives and a just transition.

Duty to Honestly Inform Beneficiaries of Significant Climate-Related Risks

59. Pension administrators also have a duty to disclose accurate information about material risks to the security of the pension plan to beneficiaries. [83]

60. As climate-related risks can pose material financial risks to the pension fund, and potentially impact the overall security of the fund, it is likely that pension administrators have an obligation to inform beneficiaries of the assessed climate-related risks to the fund and how this risk will be addressed.

61. In addition, part of the pension administrators' fiduciary duty includes a duty of honesty and candour. Honesty is a fundamental part of the duty of loyalty. Where pension administrators publicly commit to net-zero targets or make other climate change commitments, they should act according to these commitments and ensure that they do not misrepresent to beneficiaries how this risk is being managed. A failure to act honestly and consistently with written policies, such as policies making commitments to net zero targets or climate-related risk disclosure, can be evidence of inappropriate fiduciary behaviour.[84]

Duty to Avoid or Properly Manage Conflicts of Interest

62. The fourth duty we have focussed on is the duty of pension administrators to avoid or properly manage conflicts of interest. As a general rule, a fiduciary has a duty to avoid conflicts of interest.[85] For pension administrators, where they are unable to avoid conflicts, they must try to minimize conflicts through clear procedures and policies.[86]

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[82] Dr. Janis Sarra, "Fiduciary Obligations in Business and Investment: Implications of Climate Change" (2018), at 69-70, https://ccli.ouce.ox.ac.uk/wp-content/uploads/2018/08/Janis-Sarra_Fiduciary-Obligation-in-Business-and-Investment.pdf.

[83] *Froese v Montreal Trust Co of Canada*, 1996 CanLII 1643; *Ault v Canada*, 2011 ONCA 147, at para 36; Eileen E Gillese, "Pension Plans, Fiduciary Duties and the Thorny Question of Disclosure" (2011) 90:3 Can Bar Rev 517, at 554; Kaplan and Frazer, *supra* note 32 at p 341-42.

[84] Bauslaugh opinion, *supra* note 1 at 16.

[85] *Sun Indalex*, *supra* note 41, at para 186.

[86] *Sun Indalex*, *supra* note 41, at para 198; Cynthia Williams, *Troubling Incrementalism: is the Canadian pension plan fund doing enough to advance the transition to a low carbon economy?* (2020), at 20, online: https://ccli.ouce.ox.ac.uk/wp-content/uploads/2020/09/CCLI_Troubling_Incrementalism_Cynthia_Williams_Sept2020.pdf.

63. In managing climate risks, pension administrators must also meet their duties to avoid or properly manage conflicts. For example, as described by Professor Cynthia Williams, employees of the CPPIB who also sit on the board of investee corporations could be in a conflict of interest if the CPPIB does something in the best interests of the pension fund to the detriment of the investee corporation.[87]

64. Discussions on whether to aggressively engage with high-emitting corporations to adopt a credible plan to align with the Paris Goals or threaten to divest from corporations exposed to climate-related risks could put directors who sit on pension administrator boards and corporate boards in a potential conflict of interest. Given the risk of potential conflicts when addressing climate risks and the potential for pension board directors to also be on boards of high-emitting corporations, pension administrators should disclose their policies for managing these potential conflicts so that beneficiaries can understand how pension administrators are continuing to fulfill their duty of loyalty. At minimum these policies should require that pension board directors disclose when they are significant shareholders, owners, or directors in a corporation that the pension fund may invest in and they should not participate in decisions to invest or not invest in those corporations.[88]

Applicability of these Duties to Public Investment Managers

65. Four of the nine pension funds focussed on in this backgrounder: PSP, AIMCo, BCI, and IMCO are actually public investment managers, rather than pension administrators or trustees. This means that a number of public sector pension funds are managed by these investment managers. In this role, a pension plan administrator retains the responsibility to set investment policy, but the investment manager executes that policy. The investment managers have fiduciary duties and duties of prudence which they owe to their client plans, and likely to the beneficiaries of those plans. As a result, these investment managers should be actively assessing climate risks and advising their participant funds of these risks and strategies to mitigate them.

66. From a common law perspective, although a client pension plan has fiduciary duties to beneficiaries in setting an investment strategy, an investment manager also has fiduciary duties to its client pension plan where it exercises considerable discretion over the implementation of that investment strategy.[89] The client pension plans fulfill their fiduciary obligations by setting investment strategy. The investment manager also has common law duties of loyalty and prudence towards the client pension administrator.[90] Although a pension administrator will usually bring a claim against an investment manager for a breach of duty, it is possible that a

[87] Cynthia Williams, *ibid* at 20.
[88] Donovan WM Waters, Mark R Gillen and Lionel D Smith, eds, *Waters' Law of Trusts in Canada*, 4th ed (Toronto: Carswell, 2012) at 960, 968, fn 255.
[89] Kaplan and Frazer, *supra* note 32 at 365-66; Law Commission, "Fiduciary Duties of Investment Intermediaries" (2014), at 189-90; see *Ridel v Cassin*, 2013 ONSC 2279, at para 193; for IMCO, this fiduciary duty to client pension plans is also set out in statute, see *Investment Management Corporation of Ontario, 2015 Act*, SO 2015, c 20, Sched 19, s 3(3). Further, the Supreme Court of Canada in *Hodgkinson v Simms*, [1994] 3 SCR 377 at 418-19, the majority noted that courts have consistently shown a willingness to enforce a fiduciary duty in the investment advice aspect of many kinds of financial services relationships.
[90] Kaplan and Frazer, *supra* note 32 at 365-55; *Toronto Metropolitan Pension Plan v Aetna*, 1992 CanLII 8618, at paras 30-32 [*Aetna*].

beneficiary could also bring a claim against an investment manager for a particularly egregious breach.[91]

67. The statutory regime governing each of these four public investment managers also indicates a fiduciary relationship between investment managers and their client plans and between investment managers and plan beneficiaries, which requires the investment managers to consider and manage climate-related risks in a similar way to pension administrators. The specific duties and nature of the fiduciary relationship may be altered by the particulars of investment management agreements between each pension plan and investment management corporation. However, generally investment managers will have fiduciary duties towards client plans where the investment manager exercises considerable discretion over the investment of pension money.

68. For PSP, the statute creating the Board supports the Board's fiduciary duties of loyalty and care towards beneficiaries. The objects of the Board are to manage legislated pension funds in the best interests of contributors and beneficiaries and to invest assets with a view of achieving a maximum rate of return, without undue risk of loss.[92]

69. For BCI and IMCO, public sector pension plans can opt to have BCI or IMCO manage the pension funds' investments. Under both BCI and IMCO's statutes, the BCI chief investment officer and the IMCO board of directors must exercise a similar degree of prudence as a pension administrator: the care, diligence and skill that a person of ordinary prudence would exercise in dealing with the property of another person.[93]

70. For AIMCo, several client pension plans are now required by legislation to use AIMCo as an investment manager. Given that fiduciary obligations are related to the degree of discretion and control, the fact that some client pension plans are prevented from disengaging AIMCo as their investment manager, likely elevates AIMCo's fiduciary duties as pension plans now have less control over how their funds are invested.[94] In addition, as an investor of pension fund money, under the Alberta pension statute, AIMCo is required to make investment decisions in the best interests of pension beneficiaries.[95]

Liability of Pension Administrators and Investment Managers

71. A failure to uphold these duties could result in claims for breach of fiduciary and other statutory duties by beneficiaries against pension administrators and investment managers.[96]

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[91] Kaplan and Frazer, *supra* note 32 at 365-66.
[92] *Public Service Pension Investment Board Act*, *supra* note 35, ss 4, 16, 32.
[93] *Public Sector Pension Plans Act*, SBC 1999, c 44, s 18(4), 21(3); *Financial Administration Act*, s. 40(6) (as it read on April 15, 1999); *Investment Management Corporation of Ontario Act, 2015, supra* note 89, s. 19.
[94] *Joint Governance of Public Sector Pension Plans Act*, SA 2018, c J-0.5, e.g., Schedule 1, s 17.1 making LAPP a designated entity with AIMCo as the exclusive provider of investment management services.
[95] *Employment Pension Plans Act*, SA 2012, c E-8.1, s 62; *Exemption (Public Sector Pension) Regulation*, AR 3/2019.
[96] E.g., *Martin v Barrett*, 2008 CanLII 25062 (ON SC) (settlement following certification of class action by beneficiaries for breach of fiduciary duties, among other things, resulting in severe underfunding of pension plan); *Langlois v Roy*, 2006 QCCS 297 (certification of class action by beneficiaries for breach of duty as prudent investor for changing portfolio asset mix); *Aetna, supra* note 90 (claim by pension administrator against investment manager).

Although pension fiduciaries have considerable discretion to determine appropriate levels of risk and to balance the interests of future and present beneficiaries when making investment decisions, they must act prudently and loyally.

72. Pension administrators, and their individual board members, can also be subject to regulatory prosecutions if they fail to meet statutory obligations, such as the duty to invest prudently as well as the duty to follow statutory investment requirements and to properly supervise those people delegated with investment decision-making.[97]

73. Although proof of financial loss is not required for a claim of breach of fiduciary duty, a failure to follow an investment strategy or a failure to prudently design an investment strategy could result in a claim for damages or restitution where investment losses or underfunding of the plan results.[98]

74. Pension fiduciaries, such as directors on pension administration board, can be personally liable for breaches of fiduciary or statutory duties to assess and manage climate-related risks.[99] The risk of personal liability will depend on the specific pension legislation, the structure of the board and pension administrator, and pension documents. However, the risk of personal liability will be greater where board members fail to act honestly and in good faith.[100]

75. As noted in the Bauslaugh opinion, the best protection against liability is for pension fiduciaries to act reasonably and prudently in assessing and managing climate risks, and to stay ahead of evolving industry standards.[101]

Conclusion

76. Given the economy-wide risks from climate change, pension administrators and investment managers have fiduciary and statutory obligations to understand, manage, and disclose climate-related risks to beneficiaries. As prudent investors, they must keep up with industry standards and respond to increasing risks from high-emission holdings. As documented in an international survey of 30 asset owners across the OECD, the global market standard for asset owners in disclosing and managing climate risk "is growing in sophistication" and those asset owners not meeting the existing market standard "must quickly ramp up their efforts".[102]

77. In response to the duties to assess and manage climate-related risks described above, pension funds should take the following actions in order to prudently respond to climate-related risks:

77.1. Disclose to all beneficiaries how the fund is exposed to climate-related risk and how it is managing that risk, in a way that meets current industry standards on climate risk disclosure. At minimum, disclosure should meet TCFD recommendations.

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[97] *Christophe*, *supra* note 54.
[98] Kaplan and Frazer, *supra* note 32 at 439; Bauslaugh opinion, *supra* note 1 at 14-15.
[99] Bauslaugh opinion, *supra* note 1 at 1, 9; *Christophe*, *supra* note 54 at paras 217-18.
[100] For example, for OTPP, Board members are protected from liability unless they act in bad faith in executing their duties, *Teachers Pension Act*, RSO 1990, c T.1, s 8(2).
[101] Bauslaugh opinion, *supra* note 1 at 15.
[102] Sustineri report, *supra* note 58 at 2.

77.2. Integrate climate change risk into the Statement of Investment Principles and Policies to provide guidance to internal and external investment managers on how climate risks should be defined, measured and managed.

77.3. Assess the physical and transition climate risks of all assets under management, including Scope 3[103] emissions to assess the transition risk from fossil fuel holdings. A prudent assessment of climate risk cannot exclude a significant proportion of assets or a significant portion of the risks arising from climate change.

77.4. Release a credible plan for aligning with the Paris Goals, which considers Scope 3 emissions from fossil fuel companies and which does not rely on unrealistic assumptions about carbon capture or sequestration or offsetting. Such a plan should clearly state all assumptions employed.

77.5. Conduct scenario analysis that considers the broader negative financial impacts on the plan and beneficiaries for four scenarios, being a 1.5, 2, 3, or 4°C warming trajectory over the next 75 years. These scenarios should be identified with steps the pension administrator or investment manager will take to protect the plan in the event of each scenario.

77.6. If engagement is part of the climate risk management strategy, implement an active stewardship and engagement strategy for all investments, which is time-bound and consistent with the fund's objective for all assets under management to align with the Paris Goals and achieve net zero emissions by 2050, and communicate this strategy to beneficiaries. This strategy should include a proxy voting policy and a clear escalation policy where engagement is unsuccessful or slow.

77.7. Establish clear consequences through an escalation policy if portfolio companies fail to meet those timelines to respond to engagement. These consequences should include divestment from companies which do not show that they have a credible and timely climate transition plan to align with meeting the Paris Goals.

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[103] Scope 3 emissions are the indirect emissions from a corporation's value chain. For a company that primarily is involved in oil extraction and transportation, for example, Scope 3 emissions would include all the emissions that come from the burning of the oil by consumers. See Greenhouse Gas Protocol: Corporate Value Chain (Scope 3) Accounting Standard, https://ghgprotocol.org/standards/scope-3-standard.
[104] Member of the Law Society of British Columbia and the Law Society of Ontario
[105] Member of the Law Society of British Columbia