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CPPIB: A Global Leader For SRI

By: David McCann

More and more, **investors** are looking at the motivations behind their **investment** strategies. Increasingly, environmental, social, and **governance** (ESG) issues are playing a factor in those decisions. But motivations can vary depending on the mandate of the institution in question. As an **investment** manager with a distinct structure, the Canada **Pension Plan Investment** Board (CPPIB) has been and continues to look at ESG factors as part of its **investment** strategy. Within its mandate to maximize returns without undue risk of loss, the CPPIB believes that responsible corporate behaviour, with respect to ESG factors, can generally have a positive influence on long-term financial performance.

Framework

In order to understand why we think and invest the way we do, it is best to get a complete picture of the CPPIB. Its governance model is unique in that it competes within a private sector framework of investment management, but, at the same time, is a crown corporation accountable to one federal and nine provincial finance ministers. Operating at arm's length from governments, it maintains a strong private sector governance model in which the officers report to an independent, qualified board of business experts.

This puts the CPPIB, which manages the \$120 billion CPP fund on behalf of 16 million Canadians, in a very unique position, different from other investment management organizations. First, the CPPIB has an 'investment-only' mandate whose sole purpose is to maximize returns on behalf of the contributors and beneficiaries that are part of the plan. Second, the CPPIB is a long-term investor. It is within this framework, mandate, and time horizon that the CPPIB has developed and conducts its Policy on Responsible Investing (PRI).

Policy On Responsible Investing

The PRI was first published almost two years ago in October 2005. It commits the CPPIB to encouraging companies to adopt policies and practices that enhance long-term corporate financial performance. Therefore, it looks at ESG factors only as they affect the potential risk and return of investments in accordance with its mandate of maximizing investment returns.

It also works with other investors to advance fiduciary frameworks for responsible investing. An example of that would be its involvement in developing and signing the United Nations' Principles of Responsible Investing launched in April 2006.

The CPPIB, within its PRI, is guided by three core elements. The first element is engagement with companies in the CPP fund portfolio through proxy voting, working with investor coalitions, and direct communications with managements and boards. Second, it helps to fund and conduct research into the longterm materiality of ESG factors. Finally, it integrates ESG factors into its investment processes.

Engagement

As a large institutional investor with a longterm investment horizon, the CPPIB can use engagement to encourage improved performance on, and disclosure of, ESG issues. It believes that when investors speak out, corporations take note and can be encouraged to take action.

It engages directly with companies and through coalitions of like-minded investors. Generally, it seeks dialogue with senior executives, investor relations, and/ or the sustainability managers at the firm in question.

A prime example of its collaborative engagement practice is its support of the Carbon Disclosure Project (CDP). This is a coalition of 284 global investors managing more than US\$41 trillion in assets. The CDP is designed to encourage companies around the world to disclose the implications of climate change to their businesses.

Another coalition the CPPIB has signed on to is the Extractive Industries Transparency Initiative (EITI). This body represents a coalition of government, industries, investors, and non-governmental agencies and is based on the belief that transparency and good governance are preconditions for converting government revenue from the oil, gas, and mining industries into improved local community development and greater shareholder value.

At the CPPIB, there is a framework for engagement that allows it to prioritize issues based on their potential impact on the portfolio. The key goal of engagement is improved transparency on relevant ESG factors and assurance that companies in which the CPP fund is invested are adequately managing relevant ESG issues in the long- and short-term.

Focus Areas

The board has recently identified three areas in which it is focusing its engagement activities. They include:

- extractive industries
- climate change
- executive compensation

It has opted to focus on engagement with companies in the extractive industries for two reasons. First, they are so prevalent in the Canadian economy and, therefore, within its investment portfolio. And second, because companies in the extractive industries typically deal with a wide range of environmental, social, and governance factors that can – if managed well or poorly – translate into more or less favourable prospects for long-term financial performance.

The second focus area is climate change. Here, it believes that the effects of climate change and the corresponding regulatory response could have significant economic consequences if not managed well. It follows that it will have significant implications from an investment perspective in many parts of the portfolio, including opportunities for those that manage the issue effectively.

Finally, its third focus area is executive compensation. Like most investors, it believes in pay for performance in the companies in which the CPP fund is invested, with two qualifications. The first is that pay be correlated with both good and bad performance. The second is that companies provide full disclosure of the true economic value of executive compensation packages.

Another form of engagement is through proxy voting. The CPPIB's proxy voting guidelines state that it "will support resolutions that request the reasonable disclosure of information related to ESG factors." In the past 12 months, the CPPIB voted at 2,366 shareholder meetings on 12,393 agenda items. It has generally supported shareholder proposals seeking improved sustainability reporting and requesting advisory votes on executive compensation. The CPPIB believes in being transparent on its proxy voting and discloses how it votes on its website the day following the vote.

Research On ESG Factors

In addition to engagement, the CPPIB supports research into the long-term materiality of ESG factors. In March 2006, it was the first Canadian investment organization to join the Enhanced Analytics Initiative (EAI). This is an international collaboration of investors representing more than \$2 trillion in assets aimed at encouraging better investment research into ESG factors. It is augmenting the work of the EAI and others in the investment research community with work being conducted internally as it seeks greater insight into these issues and their potential investment risks or opportunities.

And within the public market investments department, it is developing a Responsible Investment capability. This team is responsible for implementing its policy and managing its direct engagement efforts and will also execute strategies involving direct engagement of companies with a primary objective of adding incremental value to the public markets investment portfolio.

The Beginning

The goal of any investment management team is to maximize returns. However, strategies and motivations can vary depending on the structure of the organization.

As such, the CPPIB supports companies in creating a culture of transparency through engagement as it relates to ESG factors. It is still at the beginning stages of its engagement initiatives, but is confident in their outcomes to improve disclosure and performance on ESG factors. ■

David McCann is vice-president, head of relationship investments, at the Canada Pension Plan Investment Board. For more information on the CPP Investment Board's policy on responsible investing, visit www.cppib.ca.