September 29, 2017

Director
Financial Institutions Division
Financial Sector Policy Branch
Department of Finance Canada
James Michael Flaherty Building
90 Elgin Street
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Sent by email to: fin.legislativereview-examenlegislatif.fin@canada.ca

Dear Director:

Re: Supporting a strong and growing economy: Positioning Canada's financial sector for the future

We are writing in response to the request for comments on the second-stage consultation document on policy measures to position Canada's financial sector for the future.[1] We consent to the disclosure of this submission, noting that in the interests of transparency we post policy submissions to our own website routinely.[2]

As a Canadian investment management company with approximately $6 billion in assets under management, NEI Investments' approach to investing incorporates the thesis that companies can mitigate risk and take advantage of emerging business opportunities by integrating best environmental, social and governance (ESG) practices into their strategies and operations. The company evaluations, corporate engagement and research activities that we conduct to fulfill our responsible investment commitments give us insight into Canadian companies' progress in responding to sustainability risks, the obstacles they face, and how appropriate policy could support their efforts. NEI's holdings include Canadian Federal fixed income instruments, so we also offer our perspective as a financial stakeholder in Canada's own investment offerings. The continuing soundness of federally-regulated financial institutions is critical to our business and to the health of the Canadian economy. In addition, a wide range of Government of Canada policies impact or are impacted by the financial sector, and it is important that the financial sector framework should contribute to federal policy coherence.

As well as providing comments on specific topics included in the consultation paper, we take this opportunity to ask the Department of Finance to consider convening a High-Level Expert Group on sustainable finance.

[1] Department of Finance Canada (2016). Supporting a Strong and Growing Economy: Positioning Canada's Financial Sector for the Future. A Consultation Document for the Review of the Federal Financial Sector Framework https://www.fin.gc.ca/activty/consult/ssge-sefc-eng.asp

[2] NEI's submissions on public policy and standards can be found at: https://www.neiinvestments.com/pages/about-nei/about-ethical-funds/esg-difference/public-policy-and-standards/

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Comments on the Second Consultation Paper

Improving the Protection of Bank Consumers

In our earlier submission, we highlighted the need to maintain the "social license to operate" of the financial sector, noting concerns about the utility to wider society of some activities by financial institutions and the role of the sector in exacerbating income inequality, and urging consideration of the extent to which any reforms enhance the stability, efficiency and utility of the financial sector when viewed from the perspective of other stakeholders (businesses, individuals and families). We are pleased to see references in the second consultation paper to the need for economic growth to be inclusive, and for enhanced protection of bank customers.

The Wells Fargo fraudulent cross-selling scandal and media reports on questionable bank sales practices in Canada have served to emphasize the importance of financial consumer protection. As an investor in the banking sector, we support the assertion that *"fair treatment of bank customers… should be an integral part of banks' corporate culture."* Alongside U.S. peers, over the past year NEI Investments has been involved in dialogue with Wells Fargo on the need to explore and address any ethical challenges within its corporate culture that may have contributed to emerging scandals. This engagement included co-filing a shareholder proposal calling for a comprehensive business standards review. The dialogue has also encompassed board independence and accountability concerns, ways in which compensation practices at different levels of the company may have contributed to unethical practices, claw-backs of executive compensation, and how the future executive compensation framework could be revised to discourage unethical practices.

We await with interest the results of the Financial Consumer Agency of Canada (FCAC) and Office of the Superintendent of Financial Institutions (OFSI) reviews of bank sales practices in Canada. We would like to highlight the importance of transparency about the findings of these reviews, not only because of the public interest, but also as inputs for shareholder engagement with Canadian banks.

Modernizing the Framework

In our earlier submission, we had urged that as a minimum, corporate governance enhancements to the Canada Business Corporations Act (CBCA) under Bill C-25 should also be integrated to statutes covering federally-regulated financial institutions. We are pleased to note the inclusion in the consultation paper of proposals relating to corporate governance. We favour mandating both diversity disclosures and the annual election of directors on an individual basis under a majority voting regime. It is important that shareholders should be able to target voting at individual failing directors, rather than the entire board. Majority voting for directors is already a well-established practice at many federally-regulated financial institutions, and we see no reason why it should not now be mandated. Shareholders withhold their vote from directors because of the belief that their presence on a board detracts from its ability to provide independent oversight, or because they have failed in their oversight duties.

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Aligning with the proposed CBCA governance enhancements should be seen as a minimum. We believe that highly-effective corporate governance is critical to the sound functioning and stability of the financial sector. Experience has shown that corporate governance failures can have disastrous impacts on financial institutions and markets. In particular, the Financial Stability Board has acknowledged the importance of corporate governance by designating the OECD Principles of Corporate Governance as one of its key standards for sound financial systems. We would argue that higher-than-usual standards of corporate governance should be expected at federally-regulated financial institutions, given their significant potential to impact the public and the economy as a whole either positively or negatively. In particular, enhanced requirements based on established board independence and executive compensation good practices could be considered, including mandating an advisory vote on executive compensation. As noted in our earlier submission, global financial institutions, including Canadian banks, have long been criticized for excessive executive compensation. Based on fifty years of data across member countries, the OECD found that financial expansion fueled greater income inequality, mainly because of credit overexpansion benefiting a wealthier demographic, and high pay in the financial industry.[3]

Safeguarding a Stable and Resilient Sector

As well as safeguarding the stability and resilience of the financial sector, it is vital to ensure that the financial sector contributes to environmental, social and economic sustainability.

We reiterate our support for assigning a high priority to collaborative work on cyber risk. For our part, we are continuing to participate in the Principles for Responsible Investment Advisory Committee on Cyber Security, tasked with enhancing signatories' understanding of investment risks and opportunities associated with cyber security and developing a strategy for engaging publicly-traded corporations on this topic.

Article 2 of the Paris Climate Agreement highlights the key role of the financial sector in enabling the transition to a low-carbon economy.[4] We are pleased to note the reference in the present paper to climate risk disclosure and the recommendations of the Financial Stability Board Task Force on Climate-related Disclosure (TCFD), as we had identified this as a gap in the earlier round of consultation. We welcome the work being undertaken by the Canadian Securities Administrators (CSA) on climate risk disclosure by publicly- traded companies. However, this work does not encompass the full scope of the climate question that the TFCD project was set up to explore: namely, systemic climate risk to financial institutions and financial stability. As noted in our previous submission, the Office of the Superintendent of Financial Institutions (OSFI) has questioned the extent to which Canada's major banks are prepared to absorb credit losses from fossil-fuel loans, such as oil and gas lending, especially in the context of collapsing of commodity prices and credit

[3] OECD (2015), "How to restore a healthy financial sector that supports long-lasting, inclusive growth?", OECD Economics Department Policy Notes, No. 27, June 2015. http://www.oecd.org/eco/How-to-restore-a-healthy-financial-sector-that-supports-long-lasting-inclusive-growth.pdf

[4] http://unfccc.int/files/essential_background/convention/application/pdf/english_paris_agreement.pdf

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downgrades in the energy sector.[5] We believe that Canadian banks should be expected to have a robust credit assessment process with regard to fossil fuel exposure, and provide disclosure to investors, enabling this exposure to be better understood. Further consideration should also be given to ways in which the financial sector policy framework can better support innovation and clean technologies that take advantage of opportunities presented by the transition to a low-carbon economy, in line with the government's vision of a Clean Growth Economy.[6] For example, this may include supporting innovative climate financing mechanisms from commercial financial institutions. We note the growing market (and support) for green bonds and climate bonds, both within Canada and globally.[7] We believe green bonds can play a growing role in stimulating the energy transition. The Federal Government has a role to play in both increasing the access to high quality green bonds and in ensuring that standards around green bond issuance are credible, robust and transparent.

In our earlier submission we raised the issue of uncertainty regarding the prohibition of investment in cluster munitions. We hope that this will be addressed by the bill currently before Parliament, but as an investment institution currently operating a cluster munitions exclusion policy, we reiterate the suggestion that further specific consultation with the investment community on this topic would be helpful.

We also highlighted emerging expectations of responsible business conduct by financial institutions in relation to the OECD Guidelines for Multinational Enterprises and the United Nations Guiding Principles on Business and Human Rights. The OECD has since published due diligence guidance for institutional investors,[8] and consultation is beginning on developing similar guidance for banks. This is especially timely given the reputational risks that Canadian and international banks are facing over lending to controversial projects such as pipelines.

As indicated in our earlier submission, we believe there is more potential for the financial sector to contribute positively to federal social and environmental objectives, as well as economic objectives. This potential was highlighted in the recently-published Federal Sustainable Development Strategy 2016-2019, which recognizes that *"a strong economy and a clean environment must go hand in hand in the modern world."* In addition, investors are identified as one of the key partners in sustainable development *"by taking environmental, social and governance factors into account in investment decisions and by engaging with companies to encourage sustainable practices."*[9] We would also like to highlight once again emerging discussion of the role of finance in the achievement of the United Nations Sustainable Development Goals.[10]

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[5] Trichur Rita 2016. "Regulator urges Canadian banks to review oil and gas reserves". The Wall Street Journal, March 21. http://www.wsj.com/articles/regulator-urges-canadian-banks-to-review-oil-and-gas-reserves-1458576613
[6] Government of Canada (2016). Chapter 4 - A Clean Growth Economy http://www.budget.gc.ca/2016/docs/plan/ch4-en.html
[7] Investor Statement re: Green Bonds & Climate Bonds (2014). https://www.neiinvestments.com/documents/PublicPolicyAndStandards/2014/Investor%20Statement%20on%20Green%20Bonds%20and%20Climate%20Bonds%2020141211.pdf
[8] http://mneguidelines.oecd.org/rbc-financial-sector.htm
[9] Government of Canada (2016). Achieving a sustainable future. A federal sustainable development strategy for Canada 2016-2019. https://www.ec.gc.ca/dd-sd/CD30F295-F19D-4FF9-8E03-EAE8965BE446/3130_FSDS_Eng_FINAL.pdf
[10] For example: Dialogues at the PRI level involving global stock exchanges, institutional investors and policy makers on the role of

Convening a High-Level Expert Group on Sustainable Finance

Given the wide range of challenges and opportunities at the interface of finance and sustainability, we believe that the Department of Finance should consider playing a convening role in bringing together stakeholders to develop a comprehensive vision for sustainable finance in Canada. In this context, we would like to highlight the example of the European Union High-Level Expert Group on Sustainable Finance (HLEG)[11], which was established by the European Commission to develop a comprehensive EU strategy in this area. It consists of experts from the financial sector, civil society and academia, with secretariat support from the Commission.

The HLEG's interim report was published in July 2017.[12] Early recommendations include:

- developing a classification system for sustainable assets
- establishing a European Standard and label for green bonds and other sustainable assets
- clarifying that fiduciary duty encompasses sustainability
- strengthening ESG reporting requirements
- introducing a "sustainability test" for EU financial legislation
- creating "Sustainable Infrastructure Europe" to channel finance to into sustainable projects
- enhancing the role of European Supervisory Authorities in assessing ESG-related risks
- unlocking investments in energy efficiency through relevant accounting rules

In Canada, we believe that a similar expert group would need to draw together financial institutions, regulators, policy-makers and other stakeholders across Federal and provincial boundaries. Preliminary conversations on sustainable finance visioning are already taking place among various institutions, but it is doubtful that any private initiative could be sufficiently comprehensive and inclusive. In our view the Government of Canada, and in particular Finance, would have a critical role to play to convening and supporting such a process.

Conclusion

We appreciate the opportunity to offer our perspective on the financial sector framework review, and encourage continuing outreach to the responsible investment community and its networks, including Responsible Investment Association of Canada, the Canadian Coalition for Good Governance and PRI Canada Network. Please do not hesitate to contact me if you have any questions in relation to this submission.

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private sector in UNSDGs https://www.unpri.org/press-releases/exchanges-policymakers-and-investors-share-views-on-supporting-the-united-nations-sustainable-development-goals

[11] https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en#high-level-expert-group-on-sustainable-finance

[12] https://ec.europa.eu/info/publications/170713-sustainable-finance-report_en

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Sincerely,
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