June 15, 2022

Delivered By Email: ian.tam@morningstar.com

Mr. Ian Tam
Chair, The Canadian Investment Funds Standards Committee (CIFSC)

Dear Mr. Tam:

RE: CIFSC Responsible Investment Identification Framework

The Investment Funds Institute of Canada (IFIC) is the voice of Canada's investment funds industry. IFIC brings together approximately 150 organizations, including fund managers, distributors, and industry service organizations, to foster a strong, stable investment sector where investors can realize their financial goals. IFIC operates on a governance framework that gathers member input through working committees. The recommendations of the working committees are submitted to the IFIC Board or board-level committees for direction and approval. This process results in a submission that reflects the input and direction of a broad range of IFIC members.

IFIC appreciates the opportunity to comment on the CIFSC Responsible Investment Identification Framework (**Framework**). We are supportive of the Framework and believe that investors and advisors will be well served by a disclosure-based framework that is managed, applied, and sustained by CIFSC, an independent third party. IFIC believes that the Framework is complementary to the Canadian Securities Administrators (CSA) disclosure requirements generally and, specifically, CSA Staff Notice 81-334, ESG Related Investment Fund Disclosure.

This Framework will provide a standard by which responsible, ESG or sustainable funds can be consistently identified and then classified according to defined ESG strategies or approaches employed by the funds. Such a standard will help investors and advisors easily identify responsible, ESG or sustainable investing funds in Canada and provide key information that will help to align investment objectives with investment products.

Please find our comments below for consideration in the development of the final Framework.

Identification Framework

The Framework states that for a prospectus fund to "be identified under the CIFSC Responsible Investment Framework, a fund must have an investment mandate stated in the prospectus investment objectives relating to a responsible approach, and/or a separate document compliant with CFA Institute's Global ESG Disclosure Standards for Investment Products or other widely accepted disclosure standards." IFIC believes that only those funds with an investment mandate relating to a responsible investing approach stated in the investment objective of the prospectus should be considered responsible investment funds. Prospectus disclosure, unlike other disclosure contemplated by the Framework, such as voluntary CFA ESG disclosure or "or other widely accepted disclosure", is subject to regulatory review and auditing.

Furthermore, requiring that the RI/ESG mandate be specifically stated in the objective, as opposed to other parts of prospectus disclosure, would align the Framework with regulatory guidance from the CSA on ESG-Related Investment Fund Disclosure. In this guidance, the CSA states that a "fund that uses one or more ESG strategies as a material or essential aspect of the fund, as evidenced by the name of the fund or the manner in which it is marketed, is required to disclose such ESG strategies as an investment objective in its prospectus." The CSA guidance also states that a fund "that does not include ESG in its fundamental investment objectives should not characterize itself as a fund that is focused on ESG as it would not be an accurate identification of the fund type".[1]

Fund Universe

IFIC believes that the Framework can be simplified and strengthened by removing the Fund Universe sections from the Framework. While the heading itself is vague, IFIC believes that the definitions of each ESG approach or strategy should be comprehensive, complete, and able to stand alone. IFIC believes that this will be the case when the definitions are finalized. The Fund Universe sections contain additional terms that are not defined in the Framework, and there is considerable overlap in terms and concepts across strategies. These factors have the potential to cause confusion. If this section is not removed, then IFIC suggests moving the components of the Fund Universe sections to a separate appendix or integrating them into the existing table in Appendix A of the Framework.

ESG Integration and Evaluation

The Framework defines ESG Integration and Evaluation as follows: "The fund uses Environmental, Social and Governance (ESG) criteria as an essential component of the evaluation method for security selection alongside traditional financial factors, such that all securities in a portfolio have been evaluated based on ESG factors and the ESG factors are significant and influential in the buying and selling of securities in the portfolio."

IFIC recommends that this definition is altered to include the requirement that a fund articulates its approach to integration and evaluation in its investment strategy. Furthermore, IFIC recommends that the definition is altered to, "the fund must use Environmental, Social and Governance (ESG) factors as a *component* of the evaluation method for security selection. Furthermore, it should be specified that this approach applies to all securities in a portfolio *that can been evaluated based on ESG factors, with consideration for data limitations*.

ESG Thematic Investing

The Framework defines Thematic Investing as funds that have identified "a major disruptive theme and seek to invest in companies that stand to benefit from it through products and services. ESG Thematic funds have a specific focus on a theme that fits into one or more of the Environmental, Social or Governance buckets but does not focus on all the elements of the ESG spectrum." IFIC believes that "disruptive" is a vague and subjective term and we recommend removing that term or finding an alternate term that will meet the objective of the definition. Furthermore, IFIC believes that the definition should be clarified to allow for a focus on more than one theme. Currently, it is written in the singular with "a major disruptive theme" and "a specific focus".

The first part of the final sentence of the definition states "the ESG Theme must be the primary evaluation method for security selection…". IFIC is concerned that "primary" can infer that ESG factors take precedence over traditional financial factors. IFIC believes that an investing theme does not need to be applied at the expense of traditional financial factors. Rather, a theme filters out companies that are not relevant to the fund's theme and then traditional financial factors are considered for security selection. We recommend that the term "primary" be replaced with "initial".

The definition also states that "the degree to which the theme is integrated is well documented and "easily measurable". Given the challenges of measurement generally in this area, IFIC recommends that CIFSC change "easily measurable" to "easily identifiable", "clearly documented", or something similar.

[1] Only a mutual fund, and not ETFs, are required to identify in prospectuses the type of fund that the fund is best characterized as. (Item 3(a) of Part B of Form 81-101F1)

ESG Exclusions

The Framework definition in this area states that, "The fund has specific sectors, industries, materials, or companies that will be excluded from the investible universe based on ESG criteria or other specific ethical considerations and can also be referred to as norms-based screening".

IFIC understands that the intent of this definition is to include both negative screening and norms-based screening. As such, IFIC recommends that these terms are both specifically named and defined. Definitions should align with broadly supported terminologies such as those used or provided in the CSA ESG disclosure guidance, the CFA ESG Voluntary Disclosure Standards and the PRI.

Impact Investing

The Framework definition for Impact Investing states that, "The fund invests in companies or projects that intend to have a measurable positive environmental and or social impact as well as the intent to generate a positive financial return." IFIC recommends that the definition be tightened to include the notion of intentionality, which we believe is a defining feature of impact funds. Specifically, IFIC recommends that the definition require that Impact Investing funds have an investment objective or investment strategy that articulates the intention to invest in securities that drive positive and measurable ESG outcomes.

ESG-Related Engagement and Stewardship Activities

The Framework's definition in this area states that a fund manager, "use the fund's position of ownership to influence the company to make decisions that increase the company's positive impact on ESG factors. This can include collaborative efforts with peers and/or training on specific ESG issues. The goals of the engagements, including the ESG issues that are addressed and the process for monitoring the issues, should be documented, clear and should be reflected in formal dialogue with the company's board and/or by voting on shareholder proposals."

Many funds that are not identified as RI funds under this Framework participate in engagement activities and all funds vote on shareholder proposals, and, as required by regulation, disclose proxy voting records. As such, IFIC recommends that this category include the requirement that a fund articulate engagement, proxy voting, or stewardship activities as an investment strategy and that the fund disclose this and the strategies used. If this requirement is included, it will not be necessary for CIFSC to include the phrase, "Engagements and Stewardship Activities are considered at the fund level" given that the focus will be on disclosed strategies and in consideration of the fact that many fund managers engage with companies while representing assets across multiple funds.

IFIC also recommends that CIFSC broaden the definition as it relates to the objectives of engagement. Currently, the definition states that the objective of engagement and stewardship is to increase the company's positive impact on ESG factors. However, some engagement is also focused, or more focused, on reducing the negative impact of ESG factors on the company.

Further, IFIC recommends that the concept of engagement be expanded to include formal dialogue with company management rather than restricting it to engagement with the company's board. It is unclear by what is meant by "training" and suggests that this be clarified or removed.

ESG Best in Class

IFIC believes that this name could be misleading and that there is a serious risk of investor confusion with this name. Investors may believe that funds identified as Best in Class are the "Best" ESG funds or have achieved a certain level of success or recognition. Such misunderstanding could have the negative effect of creating false expectations among investors. IFIC recommends that CIFSC change this category name to Positive Screening. Such a change would still align, and could even more closely align, with the CFA

Disclosure Standards, given that the CFA Standards do identify Positive Screening as a particular and distinct ESG feature.

ESG and Sustainability Scores

Given that the Framework is disclosure based and explicitly is not "meant to measure [ESG] performance or magnitude", IFIC strongly recommends that links to ESG or sustainability score methodologies provided by certain vendors be removed from the Framework. IFIC believes that there is a danger of real or perceived conflict of interest, given that the only links to ratings are those of data providers that comprise the majority of voting membership of CIFSC.

However, IFIC would be supportive of keeping certain elements of this section. There is value in pointing out that the Framework is disclosure based and encouraging investors and advisors to conduct further investigation to ensure suitability and alignment of investment objectives and investment products. Part of that investigation or research could also include evaluation of financial performance and ESG or sustainability performance as determined by third-party data providers. If CIFSC does not remove the links to the research methodologies of voting member firms, IFIC encourages CIFSC to acknowledge the potential conflict of interest and consider adopting and disclosing criteria that would be used for determining inclusion of third-party data vendor links within the Framework. If that criteria includes voting membership in CIFSC, then this should be disclosed. Furthermore, CIFSC should summarize what the ratings-methodologies are seeing to evaluate with associated limitations. Limitations should reference that ratings are not meant to evaluate the degree to which individual funds are achieving their investment objectives.

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Thank you for this opportunity to provide IFIC's input to CIFSC on this important initiative. Please feel free to contact me by email at ibragg@ific.ca or by phone at 416-309-2325. I would be pleased to provide further information or answer any questions you may have.

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

By: Ian Bragg
Vice President, Research & Statistics