ADVISOR INSIGHTS

Answering Your Clients' Questions about Responsible Investing Funds

As more and more Canadian investors look to align their investments with their values, there is a growing need for information on responsible investing (RI) in the Canadian fund industry. This publication was developed to provide an overview of RI and answers to common questions your clients might have as they continue to explore or employ this approach to investment.

What is Responsible Investing?

Responsible investing is an investment approach that incorporates environmental, social and governance (ESG) factors into investment decision-making and active ownership processes in combination with traditional fundamental financial research. Other names for the broad definition of RI include: sustainable investing, ESG investing, ethical investing, or socially responsible investing.

RI covers a range of investment strategies, from excluding companies involved in areas like tobacco or weapons manufacturing, to thematic investing, which targets investments based on ESG themes such as women in leadership roles or clean energy. It is important to do your research and ensure that the funds you recommend align with your clients' investment objectives.

RI Issues

The table below, while not comprehensive, provides some examples of RI issues of concern.

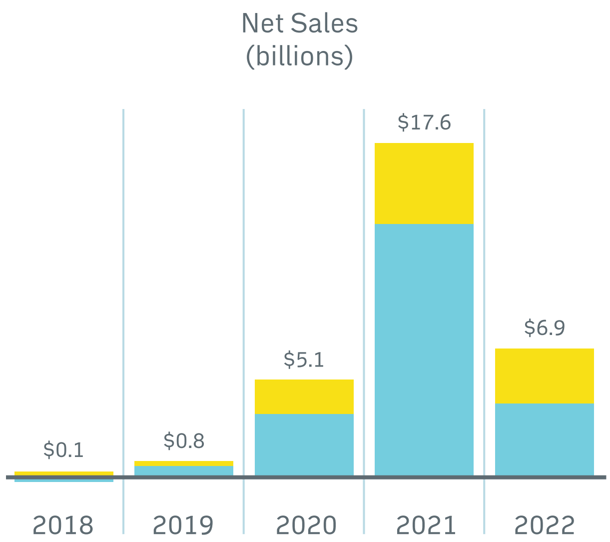
Environmental	Social	Governance
✓ Biodiversity	✓ Diversity, Equity, and Inclusion	✓ Executive compensation
✓ Climate change	✓ Human rights	✓ Anti-corruption
✓ Energy transition	✓ Modern slavery and labour rights	✓ Tax fairness
✓ Sustainable land use	✓ Supply chains	✓ Whistleblowing
✓ Water scarcity		

Why do Investors Choose Responsible Investing?

RI meets a variety of different investor needs and interests. There are three primary drivers. In some cases, these objectives are overlapping and mutually reinforcing. These include:

- **Financial Performance** – Many investors believe that integrating ESG factors in decision-making can reduce financial risk and deliver better risk-adjusted returns.
- **Aligning Investments with Personal Values** – Investors may want to avoid achieving an investment return from certain types of companies or industries. An example is a company that profits from the sales of weapons or through the use of child labour.
- **Making a Positive Impact** – Investors are looking to generate positive social and environmental outcomes alongside achieving financial returns. This might include seeking to invest in companies involved in renewable energy technologies or that are achieving greater levels of diversity and inclusion in their workforce.

How Large is the RI Fund Industry in Canada?[1]



At the end of 2022, there was a total of $34.5 billion in RI mutual fund assets and $10.2 billion in RI ETF assets[2]. This represents 1.9% of total mutual fund assets and 3.2% of total ETF assets, respectively. Despite the small relative amount of mutual fund and ETF assets, there has been a notable increase in RI net sales over last three years. In 2022, RI mutual funds were one of the few areas of growth in the mutual fund industry. Overall, mutual fund net sales totalled $3.9 billion and ETF net sales totalled $2.9 billion. For IFIC to consider a fund a responsible investment fund, the fund prospectus must mention an explicit responsible investing or ESG mandate in its investment objective or describe a recognized approach to RI in its investment strategy. In future years, IFIC will use the RI Framework developed by the Canadian Investment Funds Standards Committee (CIFSC) to identify RI funds.

At the end of 2022, there were 43 investment fund companies offering 231 mutual funds and 20 companies offering 114 ETFs with RI investment objectives and strategies.

[1] Numbers provided apply to retail prospectus-based mutual funds and ETFs and do not include market exempt funds, pooled funds, or other institutional funds.

[2] For IFIC to consider a fund an RI fund, the fund prospectus must mention an explicit responsible investing or ESG mandate in its investment objective or describe a recognized approach to RI in its investment strategy.

Regulatory Framework

Investment funds in Canada are subject to detailed rules affecting all aspects of disclosure, including the prospectus, Fund Facts and ETF Facts, annual information forms, financial statements, sales communication, proxy voting records, and management reports on fund performance. These rules are designed to ensure that disclosure is complete, accurate, and comprehensible.

In early 2022, the Canadian Securities Administrators (CSA) published guidance for investment funds on RI disclosure practices, particularly for funds with investment objectives that reference ESG factors and other funds that use ESG strategies. The CSA guidance addressed areas of disclosure, including investment objectives, fund names, investment strategies, risk disclosure, continuous disclosure, and sales communications.[3]

How are RI Funds Identified?

There were major developments during 2022 in response to the growing demand to establish standards for identifying RI funds.

Most significantly, the CIFSC finalized and published its *RI Identification Framework*[4]. The framework identifies funds that apply one or more RI approaches as identified by CIFSC. CIFSC identifies and provides definitions for six separate RI strategies, including:

- ESG Integration and Evaluation
- ESG Thematic Investing
- ESG Exclusions
- Impact Investing
- ESG Related Engagement and Stewardship
- ESG Best-in-Class

CIFSC published its final RI fund list in January 2023. This list is the authoritative list of RI funds in Canada and will be used by IFIC and third-party data providers, such as Morningstar, Fundata, Refinitiv, and others. IFIC released an FAQ on the Framework.

Additionally, in 2021, the CFA Institute released its final voluntary *Global ESG Disclosure Standards for Investment Products*.[5] The Standards set out detailed ESG reporting requirements for investment managers that choose to apply them. The Standards also provide recommended terminology and definitions for investment managers to use in describing their RI strategies.

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[3] CSA Staff Notice 81-334 ESG-Related Investment Fund Disclosure.

[4] CIFSC Responsible Investment Identification Framework.

[5] CFA Global ESG Disclosure Standards for Investment Products.

Do RI Funds Perform Better than Non-RI Funds?

One of the most common questions people have is whether RI funds are associated with lower investment returns. There has been a lot of research in this area and the short answer is no; the incorporation of RI strategies into the investing process does not, overall, produce below market-rate returns [6][7]. Like any other investment strategy, performance will differ across investment products. According to regular quarterly reporting by the Canadian Responsible Investment Association, a significant proportion of Canadian RI funds outperform their respective asset class category peers, both over short and long time periods[8]. It is also important to keep in mind that performance is only one consideration in aligning investors' investment objectives with investment products.

RI Resources

IFIC has developed the infographic *Responsible Investing in Canada: A Snapshot* to provide an overview of the Canadian RI industry.

Information about RI, along with many other topics relevant to investors, has been added to IFIC's Investor Centre.

6 ESG and Financial Performance. NYU Stern Center for Sustainable Business.

7 IFIC Report on Responsible Investing.

8 Responsible Investment Association.

Prepared by

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