



# Connecting to the future

— 2021 Responsible Investment Report

**PSP**

Public Sector Pension Investment Board

At PSP, we have a longstanding practice of responsible investing as a means to better manage risk and generate the long-term returns needed to achieve our mandate. Through our actions, we can also promote positive change on pressing social and environmental challenges, and contribute to a more inclusive, equitable and sustainable future.

### Why it matters

Environmental, social and governance (ESG) factors are some of the most significant drivers of change in the world today, with major implications for businesses and long-term investors. We believe that ESG risk factors must be taken into account in every investment we make; however, we also want to capitalize on the significant investment opportunities that can arise as companies put sustainability at the centre of their strategies and operations.

**\$204.5 B**  
Net AUM\*

### Diversified asset mix\*

% of total net AUM

Capital Markets	Private Equity
<b>47.6%</b>	<b>15.5%</b>

Credit Investments	Real Estate
<b>7.1%</b>	<b>13.1%</b>

Infrastructure	Natural Resources
<b>9.0%</b>	<b>4.7%</b>

\* As at March 31, 2021. Excludes Cash and Cash Equivalents and the Complementary Portfolio. All dollar amounts in this report are in Canadian dollars unless otherwise indicated. Net AUM denotes net assets under management.

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# Responsible Investment Report

After an unprecedented 12 months, PSP's fiscal year ended the same way it started—in the midst of the COVID-19 pandemic. That said, society is managing through the uncertainty and making progress, and so are we.

What's been interesting to us, as long-time proponents of responsible investing, is how the pandemic has been an accelerator of ESG trends and opportunities. COVID-19 has demonstrated the value of futureproofing investments by focusing on resilience in the face of long-term structural trends such as climate change, digitalization, and diversity and inclusion. Institutional investors like PSP play a vital role in promoting resilience by investing with an ESG lens and using our influence to encourage companies to put sustainability and inclusive growth at the centre of their operations.

At PSP, we have put in place a robust ESG integration framework, which we continually strengthen, to identify emerging ESG risks and opportunities early and steer capital to investments best placed to deliver long-term value. Our agile approach is aligned with international best practices and enables us to adapt quickly to changing circumstances, as was the case this past year.

Data and disclosure were focus areas in fiscal year 2021. In an increasingly complex world, it's imperative that investors have consistent and complete information on how companies are addressing ESG factors that can contribute significantly to value creation or erosion. To this end, our CEO joined the CEOs of Canada's seven other largest pension plan investment managers in signing a statement that called on companies and investors to report more transparently and in a standardized way that is useful to investment decision-making.

Aside from the pandemic, 2020 was historic in terms of government, corporate and investor efforts to limit global warming to well below 2°C, in line with the Paris Agreement. As of early 2021, countries representing more than 65% of global CO<sub>2</sub> emissions and more than 70% of the world economy have pursued opportunities to adapt quickly to a low-carbon economy ([source](#)). Moreover, according to the Task Force on Climate-related Financial Disclosures (TCFD) 2020 Status Report, the number of organizations aligning with the TCFD framework has grown to more than 1,500 organizations globally, including more than 1,340 companies with a market capitalization of \$12.6 trillion and financial institutions responsible for assets of \$150 trillion ([source](#)). Keeping pace with these trends, climate change and its related risks and opportunities remain at the forefront of PSP's investment strategy and stewardship activities.

In fiscal year 2021, we further enhanced tools to better integrate climate change factors into our investment decisions, at the total portfolio, asset class and individual asset levels. We also participated in the Investor Leadership Network's climate change initiative, contributing to a report on climate change mitigation and scenario analysis, and continued to refine our reporting in alignment with the TCFD framework.

Another significant focus area for us in fiscal year 2021 was diversity and inclusion. We led engagement efforts on diversity and inclusion through our global stewardship service provider and continued to support the 30% Club Canada, whose aim is to achieve a better gender balance at the board and senior management levels of companies. We also signed the BlackNorth Initiative's pledge, committing to specific actions and targets designed to end anti-Black systemic racism and create opportunities for underrepresented groups.

**As the world looks to rebound and recover from the COVID-19 pandemic, PSP remains committed to ensuring its operations and investment strategies promote positive environmental, social and governance outcomes. In this decisive decade for the planet, we see it as more important than ever that all segments of society work together to unlock a better future for people and the planet.**

Sincerely,



**Stéphanie Lachance**  
Managing Director, Responsible Investment

## Key achievements

In our last Responsible Investment Report, we identified four priorities for fiscal year 2021. Here we discuss key achievements for each of these priorities, and provide insights into market developments that will continue to shape these topics.



## Managing and monitoring ESG key performance indicators (KPIs)

**Priorities** – Effective management of ESG factors increases the likelihood that companies will perform well over the long term, while managing risk and capitalizing on opportunities. To that end, we will refine the tools we use to monitor and manage ESG KPIs across our portfolio.

**Fiscal year 2021 achievements** – To gain insight into the ESG performance of our portfolio and identify opportunities to mitigate risk and create value, we made progress on several initiatives.

- Leveraged the use of innovative data solutions to develop a proprietary scoring methodology to dynamically measure and identify material ESG risks and opportunities in our public market portfolios.
- Strengthened our approach to managing and monitoring ESG KPIs by leveraging new data sources and analytics.
- Developed and launched a robust asset-level data gathering tool to facilitate benchmarking and analysis of our real estate assets across ESG KPIs, including energy, greenhouse gas (GHG) emissions, water, waste and building certification.
- Designed consolidated ESG monitoring dashboards to help the Responsible Investment group monitor the integration of ESG considerations in investment activities.

### **PSP Forward** –

Gaining access to comparable and reliable data will remain a priority as we seek to drive value by extracting deeper insights from ESG information. We also aim to increasingly link ESG KPIs to traditional financial indicators in order to assess their financial materiality.

## Support knowledge sharing and value creation

**Priorities** – Support knowledge sharing and collaborative initiatives to strengthen ESG practices as drivers of value creation for our portfolio companies.

**Fiscal year 2021 achievements** – With the COVID-19 pandemic and the rise of ESG considerations across our investment activities and asset classes, it became increasingly clear that organizations can no longer get by with siloed information. Knowledge sharing enables an organization to learn from mistakes and keep its employees empowered and engaged. It also enables PSP to advance its strategy and scale success in a systematic way.

- Developed climate change toolkits for our investment professionals, which provide guidance and resources for identifying and assessing potential material climate risks and opportunities at the investment level.
- Developed our corporate governance dashboard, a collaborative tool that transforms our approach to using traditional proxy voting data into a dynamic process for monitoring portfolio company governance over time and sharing insights with our Capital Markets group.
- Collaborated with like-minded organizations to advance responsible investment best practices and ESG trends, including the Principles for Responsible Investment (PRI), the Investor Leadership Network (ILN), the Institutional Limited Partners Association (ILPA), the SASB Alliance, the Canadian Coalition for Good Governance (CCGG), the Pension Investment Association of Canada (PIAC) Investor Stewardship Committee and CFA Montréal's ESG Committee.
- Shared insights on ESG governance considerations with PSP's private company board nominees and continued our engagements on corporate governance and ESG practices with public portfolio companies.
- Conducted research on emerging ESG trends to guide investment professionals through the process of identifying and assessing potential material risks and opportunities that can be integrated into fundamental analysis.

**PSP Forward** – In an effort to further integrate ESG factors into our portfolio construction process, investment decision-making and active ownership, we will focus on incorporating ESG trends into our investment theses and engagement activities, and developing new strategies that keep us at the forefront of ESG innovation.



## Continue assessing climate change risks and opportunities

**Priorities** – We will continue our assessment of the multifaceted risks and opportunities associated with climate change and improving the resilience of our portfolio.

**Fiscal year 2021 achievements** – We continue to advance a multi-year, fund-wide climate change approach approved by our Board of Directors and senior management.

- Continued to systematically assess climate change physical and transition risks when evaluating investment opportunities.
- Performed climate change scenario analysis and stress testing on our Policy and Reference Portfolios to assess the resilience of our total fund strategy to different climate temperature pathways.
- Actively participated in the Investor Leadership Network's (ILN) Climate Change initiative and contributed to a new report, [Climate Change Mitigation and Your Portfolio](#), aimed at helping colleagues and peer investors better understand the implications of climate change mitigation scenarios that align to the Paris Agreement's target of limiting the increase in average temperature to 1.5°C.
- Participated in the CDP Science-Based Targets Campaign, which focused on accelerating the adoption of science-based climate targets and objectives in the corporate sector.
- See page 18 for details on these initiatives and our TCFD-aligned climate-related disclosures.

**PSP Forward** – We will update our corporate view on climate change, initially developed in 2018, to establish a stronger link between PSP's climate change commitments and our overall ESG and corporate strategy.

## Measuring the impact of our investments

**Priorities** – In the context of a changing world, we will continue to refine our approach to measuring the impact of our investments, with a greater focus on social factors.

**Fiscal year 2021 achievements** – The COVID-19 pandemic has prompted a focus on social considerations as critical and positive contributors to long-term value creation and risk mitigation. This has reaffirmed our commitment to measuring the social impact of our investments.

- Enhanced our ability to measure and manage our positive and sustainable social impact by engaging with partners on tools and methodologies for assessing impact, and discussing their stakeholder reports.
- Delivered a presentation with industry peer on impact measurement and management to internal groups.
- Increased the number of engagements with companies we are invested in to address issues related to diversity, human capital management and human rights.
- Increased our focus on metrics related to diversity and inclusion, including the percentage of women at the executive and board levels of our portfolio companies.

**PSP Forward** – We will shift to an ESG approach that is firmly anchored to data and focused on key ESG opportunities as determined by measuring and managing social and environmental outcomes resulting from our investment activities and operations.

# Our evolving approach to responsible investment

**PSP's responsible investment activities are a key pillar of our Chief Investment Officer (CIO) group's strategy and total fund approach. Over the past several years, we have built a strong responsible investment foundation and a robust ESG integration and active ownership framework.**

Our approach has matured over time, with ESG factors now included in PSP's broader investment risk framework and the Government's Funding Policy for the Public Sector Pension Plans, and the importance of ESG integration being one of our fundamental investment beliefs.

Our dedicated Responsible Investment group is housed in our CIO group, giving them the unique ability to systematically oversee and implement responsible investment activities across the total fund. The Responsible Investment group works across all asset classes to:

- Integrate material ESG factors into the investment decision-making and monitoring processes.
- Provide advice and guidance on key ESG themes and trends.
- Pursue active ownership through proxy voting and engagement.
- Share knowledge and build internal scalability through ESG training and collaborative analytical tools.

As a global investor on the cutting edge, we recognize that our responsible investment framework must continually evolve to account for emerging ESG risks and opportunities. Over the past year, we empowered our investment teams to gain additional insights from new data and enhanced our ESG integration approach to dynamically monitor the materiality of emerging risks and opportunities.

## Fiscal year 2021 updates

- Continued sharpening our focus on diversity and inclusion.
- Developed innovative and proprietary tools to monitor the ESG profile of our portfolio companies and partners on a total fund basis, throughout the entire investment cycle.
- Enhanced our approach to monitoring corporate governance practices and engagement with a focus on board effectiveness in overseeing material ESG risks and opportunities, including climate change, and our proxy voting priorities.

***PSP Forward*** – To remain agile and insightful, we intend to enhance our approach to climate change and data integration, while continuing to strengthen our governance and partnerships. We believe this will help us elevate ESG as a key value driver and an integral part of PSP's portfolio construction process and investment decisions.

To further align capital allocation decisions with their expected economic, environmental and social outcomes, we will continue developing tools that improve our ability to measure and manage against relevant industry standards and benchmark (e.g., GRESB, Sustainability Accounting Standards Board (SASB), TCFD, UN Sustainable Development Goals).



# ESG integration framework

Our ESG integration framework is evergreen and embedded into our total fund approach, enabling us to address material ESG factors throughout the life of every investment we make. Beyond simply identifying and assessing material ESG risks, we look to capitalize on investment opportunities provided by ESG factors and capture new trends. At all times, our process is flexible and dynamic, readily adapted for different asset classes and investment strategies, and to account for emerging ESG factors.

Throughout the ownership period, we actively manage and monitor material ESG factors with a view to mitigating risks, identifying changes in ESG performance, and capturing value-creation opportunities to improve results. Our ESG integration approach is highly collaborative, with investment teams and the Responsible Investment group working together to assess ESG performance over time to protect and enhance long-term financial value.

Our ESG integration framework, shown below, provides a snapshot of how ESG factors are considered at different stages of the investment process for both internally and externally managed investments. This framework prioritizes materiality but remains flexible so that processes can be tailored to the asset class and investment strategy and keep pace with emerging ESG risks and opportunities. The focus on materiality is about ensuring that we thoroughly account for the ESG factors that could have a significant impact on a company's financial or operating performance.

## ESG integration framework

	Investment opportunity	Investment decision	Asset management & active ownership
Internally managed investments	Identify key ESG factors and determine due diligence scope	In-depth assessment of material ESG risks and opportunities	Monitoring and re-assessment of ESG risks, opportunities and performance, shareholder engagement and proxy voting
Externally managed investments	Define due diligence scope based on investment strategy	In-depth assessment of ESG integration practices of the manager	Monitoring and re-assessment of ESG practices and engagement on ESG best practices

In the sections that follow, we provide a more comprehensive view of our approach to ESG integration for internally managed public and private market investments, and for externally managed investments.

# ESG integration for internally managed investments

## Investment analysis and decision-making

As part of the investment analysis and decision-making processes for internally managed investments, we conduct an in-depth assessment of material ESG risks and opportunities. Findings are incorporated into the investment thesis and considered alongside traditional financial factors.

### Applying dynamic materiality to public market investments

Our approach to ESG integration seeks to be agile and reflective of the dynamic nature of ESG materiality—recognizing that ESG considerations that may not be viewed as material can become material in the future. One has only to look at the COVID-19 pandemic as an example of how issues such as employee health and safety can increase in materiality over time. For this reason, we recently enhanced our approach to ESG integration by factoring in the dynamic nature of materiality and monitoring companies' ESG performance using an artificial intelligence screening tool. The tool captures real-time changes in stakeholder sentiment through various media sources, which can help in the early identification of potential risks and opportunities.

When contemplating active positions in publicly traded securities, we prioritize corporate governance practices, focusing on board composition and effectiveness, executive compensation practices and shareholder rights. We believe that well-governed companies are better able to manage social and environmental issues and more likely to prosper over time. This process should also include transparent, timely disclosure of reliable information sufficient for investors to make informed long-term decisions.

In fiscal year 2021, we produced more than 150 ESG assessments to support our Capital Markets group across developed and emerging markets, integrating ESG considerations into fundamental analysis and decision-making.

### Case study

#### Innovative corporate governance dashboard for benchmarking ESG best practices

Our Responsible Investment, Fundamental Equity Strategies and Digital Business Solutions groups sought to gain an information edge from governance data gathered through the traditional proxy voting process. Using a data-driven scoring and screening solution that monitors portfolio company governance over time, we developed a dashboard for systematically benchmarking a company's corporate governance performance against its peers – alongside fundamental analysis and using similar concepts such as trend and momentum. The teams were also able to pull in information from various public company disclosure materials housed in a library of more than 230 governance factors, which has enabled us to transform qualitative insights from our proxy voting activities into critical input for our investment decision-making process.

## Private market opportunities

ESG due diligence and assessment for private market investments is tailored to the opportunity, and varies by industry, sector and geography. Where required, we engage external experts and consultants to provide additional insight. In fiscal year 2021, ESG considerations were reviewed for more than 140 direct transactions across PSP's five private market asset classes: Credit Investments, Infrastructure, Natural Resources, Private Equity and Real Estate. The most common material ESG factors raised were employee health and safety, labour practices, business ethics, cybersecurity and climate change risks.

### Case study

#### Climate change toolkits

Climate change is a critical challenge of our time. We are witnessing the magnitude of the risks that it poses to the assets and businesses in which we are investing. We are also experiencing an unprecedented acceleration of the impact of climate change in certain regions of the world and in certain industries. In this changing world, we must be able to identify and assess potential material climate risks and opportunities at the investment level.

Given the dynamic nature of the materiality of climate change, in fiscal year 2021, we enhanced our tools for integrating climate change factors into our investment decisions, at the total portfolio, asset class and individual asset levels. These toolkits were useful, notably when we considered an investment in a real estate asset in a coastal US city.

Leveraging the real estate toolkit, we were able to identify climate change physical risks—primarily flooding and sea level rise—as material to the transaction. The toolkit highlighted relevant resources to assess and understand the asset's potential risk exposure and financial impacts associated with the location. Moreover, using the toolkit, we became aware of potential opportunities related to climate change in the form of resource efficiency and energy source improvements.

### Case study

#### Eye on cybersecurity

Recent trends and cybersecurity statistics reveal an exponential increase in data hacks and breaches triggered by the COVID-19 pandemic, resulting most notably from the unexpected implementation of stay-at-home policies across organizations. Cybersecurity stands as one of the biggest risks to business and the global economy ([source](#)). Ever agile and dynamic in our approach to emerging ESG risks, we rolled out a cyber maturity framework, processes and tools to assist our asset classes in assessing investee cyber risks and addressing the identified risks throughout the investment lifecycle.

The Responsible Investment and Information Security groups work hand-in-hand in identifying investments with high cyber risk and factoring cybersecurity risks and opportunities into our investment decisions. The collaboration and complementary roles of these two groups proved to be critical when considering a co-investment in a specialized player in the cybersecurity space presenting ESG risks. Throughout our due diligence, the groups worked closely together to identify the actions needed to mitigate risks, the capacity of the company's management team to address the gaps, and the quality and expertise of our partner in ensuring that there were no deficiencies going forward. Satisfied with the findings, our Private Market team proceeded with the investment.

# Active ownership of public companies

We use our ownership positions to promote good corporate governance practices, exercising our proxy voting rights and actively engaging with companies on material ESG issues. Board responsiveness, ESG performance and management of controversies are monitored to inform our voting decisions and prioritize our engagement activities.

## Materiality as the basis for engagement

To encourage positive change and steer capital toward value creation opportunities, we rely on constructive, continuous and objectives-driven engagement to understand a company’s management approach and strategies for managing emerging trends and mitigating potential risks over time.

We may choose to engage with companies either directly, through our global stewardship service provider, or collaboratively with other investors. The engagement strategy is tailored to the relevant issues, and whether they are specific to PSP or core to the investment strategy. Insights from our engagement activities are shared among our internal teams as part of our integrated responsible investment process and used to inform our proxy voting activities.

Our engagement strategy is focused on the most material ESG risks and opportunities. We look to engage with the public companies in which we have an equity or debt position that offer the highest potential for successful outcomes and long-term value creation, taking into account the size of our holding and the materiality of the ESG issues.

## Engagement selection process



In fiscal year 2021, we engaged either directly, with the assistance of a global stewardship service provider, or in collaboration with like-minded investors or organizations such as the Canadian Coalition for Good Governance, with 882 publicly listed companies whose securities we hold.

Our engagements were undertaken globally and covered a broad range of industries. These engagements were initiated by us or by companies in our portfolio to address specific ESG factors or themes, or in the context of our proxy voting activities.

## Case study

### Treating people fairly and with respect

*Engagement themes: labour and environmental practices*

Collaboratively with our global engagement service provider, we have been engaging with a household products company for a number of years on strategy, risk and communication. Following a successful collaborative engagement in which we provided guidance on investor communications best practices, the company's board hosted its first shareholder engagement day. Under new leadership, the company also embarked on a strategic transformation that drove a culture change and a greater focus on corporate responsibility and sustainability.

While the company had a reputation for being hard on its suppliers, we became more comfortable over the course of our engagement that they were indeed treating suppliers fairly. We continued our engagement throughout the pandemic and were pleased to see the new leadership team monitoring its suppliers and offering support.

In 2020, the company received accreditation as a living wage employer, which requires employers to make commitments regarding the number of hours worked and the security of those hours. We also addressed the importance of monitoring environmental impacts, particularly in the areas of pollution and waste. The company has publicly announced a plastics reduction target and now measures and discloses its plastics footprint, providing a regularly updated breakdown of plastics used across its product packaging. Going forward, we will continue to monitor the company's progress, but are encouraged by the direction taken.

## Case study

### Growing importance of climate change

*Engagement themes: climate change and human rights*

We joined our global engagement service provider in engaging with a publicly listed emerging markets company specializing in the design, development and manufacturing of communication technologies.

The growing importance of climate change commitments by global customers is a material issue for this sector, especially for companies with complex supply chains—as evidenced by the number of large customers setting targets to decarbonize their supply chain as early as 2030 and ultimately achieve net zero emissions by 2050. The materiality of this issue has helped us engage with the company on setting long-term GHG emissions targets to maintain its competitive position over the long term. We were pleased when the company adopted a low carbon transition strategy and we will continue to engage with them on the execution of their strategy. On human capital management, we were pleased to see the company commit to undertaking a review of any potential links to forced labour in sensitive regions.

## Case study

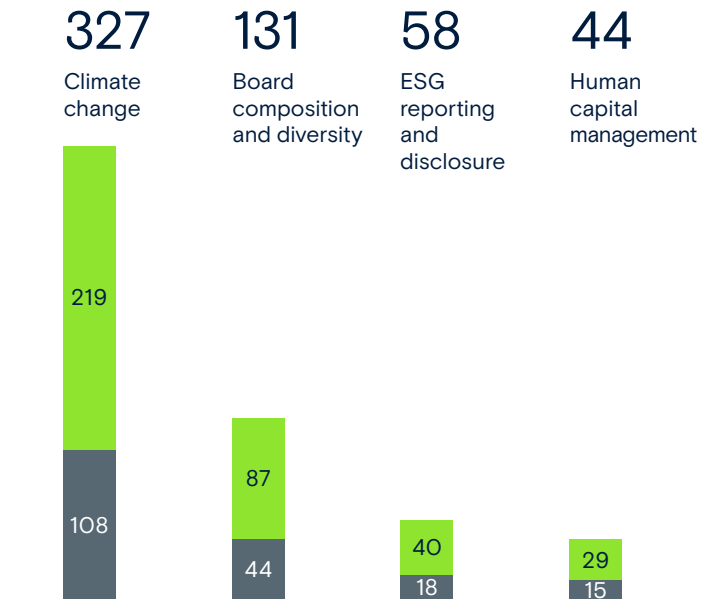
### Engagement statistics

At the start of fiscal year 2021, our priorities included increasing our focus on social factors (including human capital management, and diversity and inclusion); assessing risks and opportunities associated with climate change; and monitoring ESG key performance indicators, disclosure and best practices. Our collaborative engagement activities have led to marked progress across multiple geographic regions over the past year.

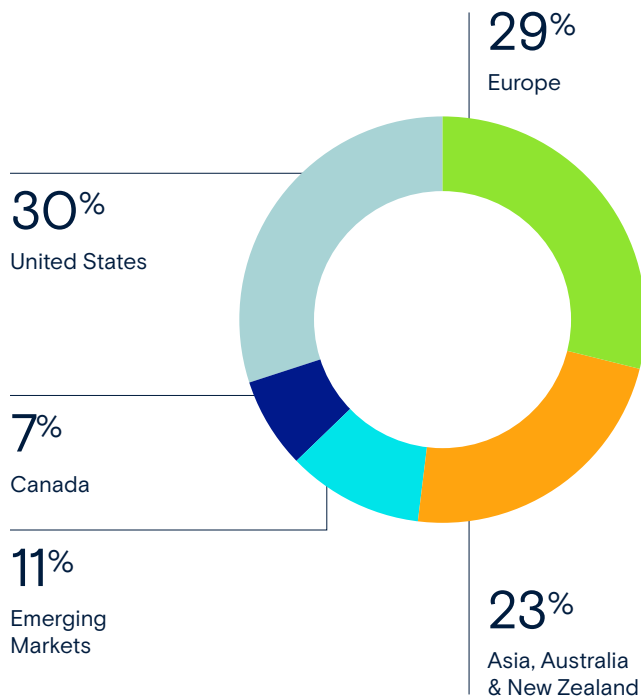
Over the longer term, our focus will remain on corporate governance and sustainability management practices, to support effective management of material environmental and social factors, and on comprehensive risk management systems that can adapt to emerging risks and opportunities, while supporting long-term resilience.

## Engagement progress in FY2021

Positive change  
No change



## Companies engaged – by country or region (FY2021)



## Proxy voting

Our [Proxy Voting Principles](#) (Principles) are implemented with flexibility in support of the long-term success of the companies in which we invest.

Our Principles outline our expectations with regard to the corporate governance and sustainability practices of public companies in which we invest. They identify the topics on which we may vote from time to time and inform our voting decisions. Each year, ahead of the proxy voting season, we review our Principles, supporting guidelines and procedures to ensure that emerging trends and practices are appropriately addressed.

The review conducted in fiscal year 2021 reinforced our belief that boards should have appropriate levels of diversity in the backgrounds, experience and competencies of their directors, as well as policies supporting diversity. We also intend to take a more proactive approach to supporting shareholder proposals in favour of timely disclosure of ESG performance and practices that have a material influence on investment risks and returns, including those related to climate change.

In fiscal year 2021, we responded quickly to the unexpected circumstances presented by COVID-19. This included adapting our approach to proxy voting in support of business continuity; for example, by adopting exceptional measures to allow virtual annual meetings for the public companies in which we have ownership positions and, in some cases, supporting the re-election of directors deemed essential to navigating the crisis.

Subsequent to implementing these measures, we engaged with portfolio companies through a proxy letter campaign to deepen our understanding of their management practices during the pandemic. As part of our post-proxy season engagement process, we used an artificial intelligence screening tool to monitor the potential impact on the resilience of companies where employee health and safety or labour practices were at heightened risk due to the pandemic. This tool enabled us to surface trends and insights into implications of the pandemic on key ESG factors such as social impact, labour and supply chain.

## Resolutions voted – by topic (FY2021)



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43%	Board & committee composition
17%	Financial & auditor
13%	Capital structure
10%	Compensation
7%	M&A and anti-takeover
4%	Amendments to articles
4%	Shareholders' resolutions
2%	Other

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We voted at 5,903 meetings on a total of 62,006 management and shareholder resolutions in all regions of the world in fiscal year 2021. This included votes by exception at more than 420 meetings on topics such as diversity, virtual shareholder meetings, director tenure and executives on board. We followed up on these actions with engagement letters to more than 100 individual companies.

Details of our proxy voting records are available on our website.

## Asset management in private markets

With transactional activity muted in the first few months of the year as the pandemic took hold, many private market investors shifted their attention to the ownership phase of the investment lifecycle and, in particular, to managing the ESG aspects of their investments. Given the considerable health and safety risks of the pandemic, many asset owners sought to minimize the harmful impacts on people's lives as best they could and to adapt to a rapidly evolving situation.

As the crisis unfolded, government officials around the world introduced lockdown measures, physical distancing and other isolation measures to suppress transmission of the virus, causing the global economy to slide quickly into a recession. A significant number of businesses had to shut down, which led, among other things, to a reduction in the number of hours worked and to job losses. While the crisis affected industries, businesses and workers in different ways, it also exposed certain pre-existing imbalances, notably related to diversity and inclusion, which spurred global investors to rethink what's important and start measuring and managing with more scrutiny.

At PSP, we looked at this challenging period as an opportunity to further embed the integration of ESG factors into our asset management. We evolved our active ownership practices by increasing the measurement and management of ESG outcomes resulting from our activities and operations. Key activities in fiscal year 2021 included: improving our proprietary ESG monitoring framework for private markets, particularly for real estate; actively engaging with our portfolio companies and external partners on how they were integrating material ESG considerations throughout the entire investment life cycle; enhancing our approach to managing and monitoring ESG risks and opportunities by leveraging new data sources and analytics; and requiring companies to provide consistent and decision-useful ESG information aligned with disclosure standards such as SASB and TCFD.

### Monitoring ESG key performance indicators across our total fund

In private markets, we monitor ESG factors and practices throughout the life of our internally managed investments. We leverage our access to portfolio companies' management teams and our typically larger ownership stake, which often includes board representation, to influence a company's ESG practices. The aim is to encourage sustainable corporate conduct and enhance long-term corporate performance.

While our engagement approach is tailored to the investment type, our goal remains the same: to achieve greater alignment between financial returns and sustainable corporate behaviour, and to clarify PSP's expectations with respect to specific ESG factors.

We generally hold private assets for the long term and are increasingly focused on monitoring KPIs, including those that expand beyond traditional financial metrics, to identify the various levers of risk mitigation and value creation. These KPIs include environmental metrics related to energy, waste, water and GHG emissions, as well as metrics for health and safety, labour conditions and Ei&D. By measuring the impact of our investments through ESG KPIs, we can benchmark portfolio companies and share leading practices.

Over the past year, for our real estate asset class alone, we assessed 39 real estate partners globally and gathered asset-level data for 1,090 properties across various sectors and geographies through our proprietary real estate ESG assessment tool. The roughly 200,000 data points from our partners focus on all material items linked to risk and value creation, which are informed by empirical evidence and best market practices including GRESB and other well-recognized standards such as SASB and the TCFD. The initiative has provided us with high-quality data that we can use to generate asset-level, sector-level and portfolio-level insights through the lens of both risks and opportunities.



## ESG disclosure and best practice

With the deployment of climate change toolkits, we provided asset class-specific guidance and resources to our investment professionals to support their assessment of climate change in investment decisions.

Our engagements with our portfolio companies on their ESG performance in fiscal year 2021 revealed a number of notable ESG practices and trends for each asset class as shown here:

### Real Estate

- Increased focus on health and wellness in buildings, tenant and community engagement initiatives, including long-term care homes.
- Identification and monitoring of climate change physical risks including implementation of asset resiliency plans in regions where assets could be negatively impacted by climate hazards.
- Detailed monitoring of resource consumption and intensity data for environmental metrics (e.g., energy, waste, water, GHG emissions) and benchmarking of performance at the asset and portfolio levels.
- Greater focus on technology and sustainability-related solutions (also known as proptech)—similar to the way fintech focuses on the use of technology in finance, proptech uses digital innovation to address the needs of the property industry.

### Infrastructure

- Increased focus on labour practices and employee health and safety to ensure workers are protected from the COVID-19 virus.
- Assessment of how companies could be affected by the rapidly evolving regulatory environment on climate-related matters.
- Greater focus on the risks and opportunities associated with the transition to a low-carbon economy.
- Uptick in collaboration and knowledge sharing with an emphasis on ESG strategy and development of frameworks to identify, manage and reduce operational risks.

### Natural Resources

- Increased focus on understanding risks and opportunities associated with climate and climate change on specific agricultural commodities and regions.
- Enhanced usage of climate change scenario analysis and modelling to assess climate-related physical risks.
- Rising interest in forest conservation, reforestation, and sustainable land management practices in light of current and expected carbon pricing dynamics and use of offsets.
- Greater focus on labour practices and employee health and safety measures.

### Private Equity and Credit Investments

- Heightened focus on business ethics, product quality and safety, resilient supply chains, cybersecurity and data privacy.
- Increased focus and efforts on board and company-wide diversity, equity and inclusion.
- More TCFD-related disclosure as climate-related risks and opportunities are materializing across sectors and industries.
- Greater interest among portfolio companies in developing sustainable business strategies.

## Case study

### Responsible, resilient real estate

PSP increased its exposure to the life science sector in 2020 by committing to BioMed's Core+ Fund managed by Blackstone. BioMed is a leader in the life science real estate sector with a portfolio concentrated in the leading innovation markets of Boston, San Francisco, San Diego, Seattle and Cambridge, UK.

With the world seeking vaccines and treatments for COVID-19, investment in this sector has surged amid the pandemic—and it's expected to grow even further, driven by an aging population and the accelerated pace of innovation.

Investing in the BioMed fund supports delivery of the state-of-the-art real estate needed by life sciences and biopharma companies. Through the incorporation of leading-edge technologies and sustainability solutions, coupled with dynamic tenant engagement methodologies, BioMed provides tenants with safe, environmentally-friendly spaces to drive research and innovation. These spaces support positive community health outcomes while minimizing impact.

Prior to investing, we engaged with the sustainability team of Blackstone, the owner of the BioMed Fund, to better understand their evolving ESG integration practices and monitoring of ESG key performance indicators.

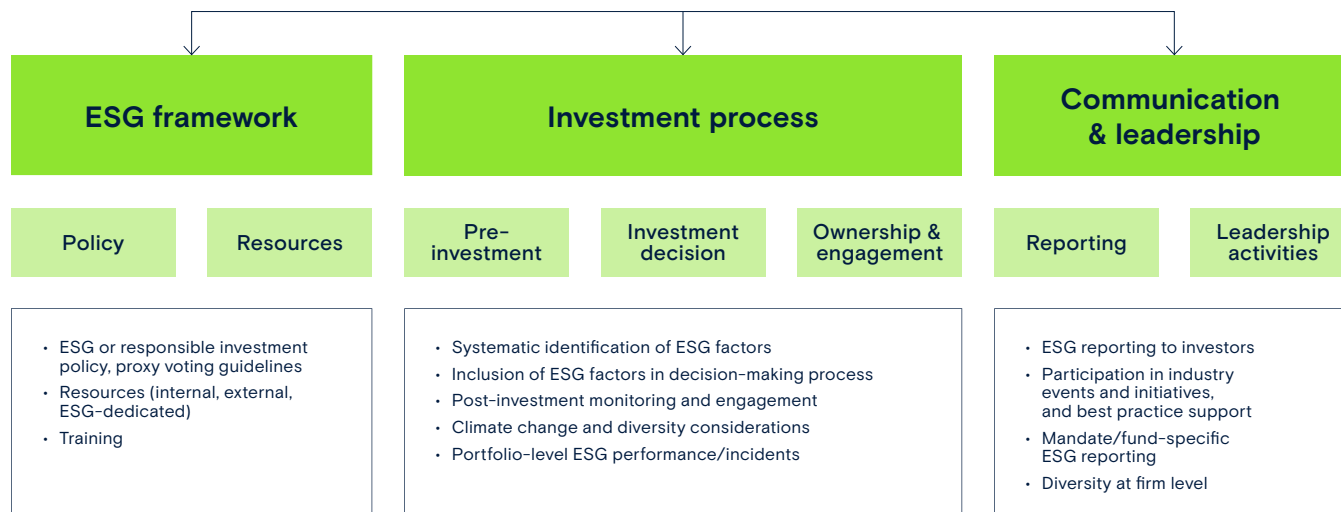
# ESG integration for externally managed investments

We allocate a portion of our capital to externally managed mandates and fund investments across our public and private market portfolios. Forging the right relationships is critical in these situations and we engage regularly with our external partners on ESG topics throughout the investment lifecycle.

## Investment opportunity

To ensure that the ESG integration approach for each externally managed mandate and fund investment is consistent with our [Responsible Investment Policy](#) and expectations, we have an in-house proprietary assessment framework that evaluates our external managers' and general partners' ESG practices across more than 35 indicators and three key pillars:

### What our in-house framework evaluates



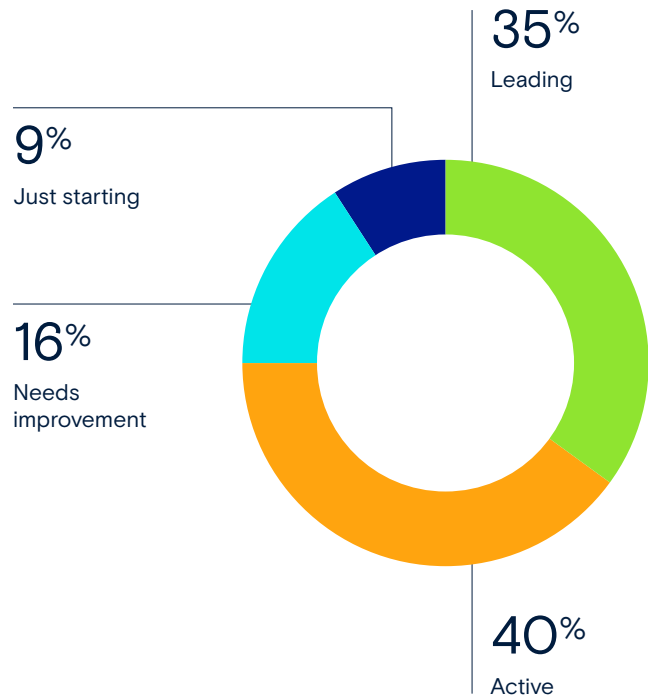
Given how responsible investment practices have evolved over the past year, we are in the process of revamping our assessment framework to incorporate emerging practices, enhance tracking of both broad KPIs that are relevant across diverse geographies and assets and custom ESG KPIs for certain investments (both at the fund and portfolio levels), and increase our focus on TCFD-related disclosures.

## Investment decision-making and asset management

In fiscal year 2021, we assessed the ESG integration practices of 35 fund investment opportunities and five new externally managed mandate opportunities. In keeping with our objective of encouraging ESG best practices, we completed the benchmark assessment update of our third- and fourth-quartile external managers for Public Markets with a view to monitoring changes in their practices. Through this exercise, we reviewed six managers, of which four made progress on their PSP ESG quartile score. We engaged with each manager as part of our benchmark assessment update and provided a customized report highlighting KPIs and best practices. Notable progress was achieved in the implementation of new responsible investment policies in emerging markets and the systematic integration of ESG factors in some quantitative strategies.

Having systematically assessed our external partners' practices over the past three years, we have learned that ESG is moving to the mainstream. Approximately 75% of our externally managed investments are with general partners who have leading or engaged approaches to integrating ESG factors and applying ESG principles firm-wide.

## ESG benchmark for externally managed committed investments



## Engaging with partners

ESG practices are evolving rapidly among our external partners. Through our fiscal year 2021 assessment process, we gained insight into notable ESG practices that we believe will soon become commonplace. A few of these trends are outlined below<sup>1</sup>:

### Public markets

- Robust integration of climate change-related data into financial modeling.
- Company scoring on quality of climate-related risks disclosure, in line with the TCFD recommendations.
- Analysis of company ESG profiles using industry-specific ESG frameworks similar to SASB.
- Use of unstructured data and artificial intelligence tools to complement company disclosure.
- Development of quantitative models that integrate ESG factors alongside other traditional factors.
- Integration of material ESG factors in investment review of sovereign issuers.
- Formal and integrated ESG engagement process with engagement outcomes affecting the investment decision-making process.

### Private markets

- Increased focus on post-investment activities with ESG integration into value-creation plans and training of board nominees on ESG topics.
- Monitoring of ESG KPIs that are material to portfolio companies and use of tools that enable ESG data to be collected alongside financial metrics.
- Fund-specific ESG reporting including ESG metrics.
- Diversity and inclusion initiatives at both the partner and portfolio company level.
- Increased focus on climate change-related risks and opportunities to guide investment decisions.
- Increased focus on social factors (e.g., employee health and safety, labour practices).

<sup>1</sup> For the purposes of this report, these are general trends and thus may not be applicable across all asset classes or investment strategies.

# TCFD reporting

The TCFD was established by the Financial Stability Board of the G20 to develop a consistent framework for climate-related financial disclosures. These disclosure recommendations are intended to help the financial community understand material climate change risks. Since its inception, the number of organizations expressing support for the TCFD has grown to over 1,500 organizations globally, including over 1,340 companies with a market capitalization of \$12.6 trillion and financial institutions responsible for assets of \$150 trillion<sup>1</sup>.

At PSP, we believe that climate change is a long-term structural trend that may have a material impact on investment risks and returns across sectors, geographies and asset classes. As stated in our [Responsible Investment Policy](#), we integrate climate change risks and opportunities in our investment due diligence and asset management processes across all asset classes. We have adopted a multi-year, fund-wide climate change approach based on three pillars:

**Integration** of climate change factors into our investment decisions, at the total portfolio, asset class and individual asset levels.

**Monitoring** of the portfolio's exposure to climate change as part of our asset management processes.

**Engagement** with portfolio companies for better climate change-related financial risk disclosures.

We support the TCFD recommendations and believe their implementation will foster improved transparency on climate change-related financial risks and opportunities in capital markets. To that end, we encourage enhanced disclosure on climate change risks by all companies in which we invest. As an asset owner, PSP is committed to steadily enhancing disclosure about how we manage climate change-related financial risks and opportunities. These efforts are aligned with the statement of the CEOs of Canada's eight largest pension plan investment managers, including PSP, to require increased transparency from companies, notably by reporting relevant material ESG data in a standardized way.

In the coming months, we will be reviewing and updating our climate change approach, mainly to further support integration of climate change risks and opportunities in our investment processes and establish a stronger link with our overall ESG and corporate strategy. We will also advance work to increase the robustness of our disclosure practices.

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<sup>1</sup> Source: [https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD\\_Status-Report.pdf](https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD_Status-Report.pdf)

# Governance

## Disclose the organization's governance around climate-related risks and opportunities

PSP believes that climate change is a long-term structural trend that will likely have a material impact on investment risks and returns, across different sectors, geographies and asset classes. Given the broad implications of climate change across PSP's investment activities, operations, risk management, audit and reporting, the level of board and senior executive oversight of our efforts to understand and manage climate-related risks and opportunities has significantly increased over the years.

The Responsible Investment group, which is housed in PSP's Chief Investment Office (CIO) group, is responsible for coordinating the development, and overseeing the implementation, of PSP's climate change approach in collaboration with investment groups and business partners. The Responsible Investment group reports regularly to the Board, the Board's Governance Committee and senior management on ESG matters, including climate change. New objectives and priorities are established annually in line with our multi-year climate strategy, to maintain progress and adapt to evolving climate-related trends.

Beyond the Board and senior management, presentations are regularly delivered to investment groups to keep them informed of key climate change trends and risks, and of our progress in implementing PSP's climate change approach. In fiscal year 2021, we conducted several workshops with investment groups on our new and proprietary climate change toolkit, which supports the implementation of our climate change approach.

In the past few months, the Responsible Investment group has started updating the corporate view on climate change to strengthen the link between PSP's climate change commitments and its overall ESG and corporate strategy. The climate change corporate view, which we originally developed in 2018, articulates our view on investment risks and opportunities related to climate change and our approach is anchored in three pillars: (i) integrating climate change considerations in our investment decisions; (ii) investing in companies and assets that will be resilient to climate change and will grow and prosper in a low-carbon economy; and (iii) engaging with portfolio companies to influence their disclosure on climate change. This climate change approach applies across all asset classes in PSP's portfolio, and is readily adapted for different investment strategies and industry sectors.

# Strategy

## Disclose, where material, the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy and financial planning

We understand that climate change risks and opportunities impact industries in very different ways. They can act as a risk amplifier and, more generally, trigger paradigm shifts by challenging conventional business models and traditional industries.

As a long-term investor, we have a fiduciary obligation to proactively address climate change risks and opportunities as part of our investment strategy. This entails developing and implementing investment policies and processes to make our total fund strategy more resilient to the impacts of climate change.

From a strategic asset allocation perspective, our multi-year climate change approach includes climate scenario analysis and stress-testing, which help us understand how climate change can influence investment performance in both the short and long term and what steps could be taken to protect and position our portfolio of assets. Conducted annually, this exercise improves our understanding of the impacts of climate change physical and transition risks on our long-term asset allocation.

In conducting our scenario analysis, we consider three different scenarios across three different time horizons (2030, 2050 and 2100). We assume 2°C, 3°C and 4°C warming scenarios, and factor in both transition risks—including GHG emissions policies for high-emitting sectors—and physical risks, such as extreme weather events. Based on this analysis, we estimate the average “climate impact on annual return” at the total Reference Portfolio and Policy Portfolio levels, as well as at the asset class and industry sector levels. Our most recent results confirmed the overall resilience of our long-term asset allocation across all three scenarios, with some variations in potential impacts.

From a bottom-up perspective, we focus on incorporating climate factors across the investment cycle, including performing in-depth climate change vulnerability studies at the inception of an investment, and as part of our ongoing asset management activities and exit strategy. Our key objective is to understand how an organization, or an asset, is likely to perform in a range of future environments, including in a low-carbon transition.

Recently, we have begun to assess new opportunities as a means of raising capital for either new assets that can positively contribute to the low-carbon transition or for improving the ESG performance of our existing assets. As the world strives to achieve net-zero carbon emissions, PSP aims to participate in the climate transition by proactively incorporating ESG trends into our investment theses and development of new strategies. We have also engaged with key players in the sustainable finance and the taxonomy of green activities to inform our go-forward strategy with respect to low-carbon investments.

# Risk Management

## Disclose how the organization identifies, assesses and manages climate-related risks

Through our analysis of climate change risks and opportunities, we seek to understand the consequences of climate change on our ability to generate long-term positive returns. Climate change-related risks are assessed as part of our annual review of our corporate and investment risks and are reviewed by our Board. We also conduct an annual, enterprise-wide risk and control self-assessment exercise to identify and evaluate key risks, including climate change, and to assess the adequacy and effectiveness of our mitigation activities.

Climate change risks can manifest in different ways across investment portfolios. For example, physical risks from extreme weather events and long-term shifts in climate patterns can disrupt businesses and negatively impact local and regional economies and real assets. Transition risks, on the other hand, are those induced by societal responses to avert the worst impacts of climate change, including shifts in policy, legislation, technology and markets resulting from climate change mitigation and adaptation measures. In this regard, the transition to a low-carbon economy is driving innovation and growth in low-carbon solutions in many sectors, creating new opportunities for long-term investors. To take into account the world of tomorrow, we factor these climate risks into our investment processes—with a view to enhancing performance, steering capital toward more attractive areas and mitigating potential issues.

We integrate climate change risks into our investment decisions, at the total portfolio, asset class and individual asset levels. For example:

- At the total portfolio level, we perform climate change scenario analysis as part of our portfolio construction process to assess the resilience of our long-term asset allocation. This assessment informs which asset classes or sectors may present higher exposure to climate change transition and physical risks. The results have confirmed the overall resilience of our long-term asset allocation.
- At the asset class level, we analyze the exposure of our real estate, infrastructure and natural resources assets to physical risks of climate change, which could manifest themselves as acute or natural weather events such as hurricanes, wildfires or droughts. Together with some of our Canadian pension fund peers, we are currently collaborating to further enhance a tool to assist in the appraisal of climate change physical risks. This online platform tool will enable us to assess physical risks for multiple asset classes (e.g., public and private equities, fixed income, real assets) and asset types (e.g., equity/debt, corporate/sovereign). It also covers climate hazard data for any location in the world. One of the key benefits is that it translates climate change physical risks into real financial impacts at the asset, company and portfolio level.
- At the asset level, we evaluate material climate change risks and opportunities across the investment cycle. For each investment, we consider whether climate change could have a material impact on the company, based on the sector and geography in which it operates. Relevant physical and transition risks, as well as opportunities, are then assessed during due diligence. Where relevant, we engage external advisors to support the assessment of climate change risks for potential investment opportunities that present a higher exposure to these risks. In fiscal year 2021, we launched a proprietary climate change toolkit to investment professionals, which helps ensure that change risks and opportunities for new and existing investments are assessed in an effective and systematic manner. The climate change toolkit provides guidance on typical climate-related risks and opportunities by asset class, including potential financial impacts, based on location. It also includes recommended due diligence scoping questions, a list of available resources, a directory of climate change reports, and tools enabling us to monitor PSP's portfolio carbon footprint and avoided emissions.
- Lastly, to ensure that we align with industry best practices in assessing climate change risks and opportunities at the investment level, we often leverage our relationships with external consultants and industry experts. In fiscal year 2021, for example, we routinely engaged with external climate experts on topics such as water rights and licensing, wildfire management, carbon offset systems, regenerative agriculture and sustainable forestry. We strive to continuously improve our understanding of the potential downside risks associated with climate change, as well as potential benefits and opportunities across key industries. The transition to a low-carbon economy is driving innovation and growth in many sectors, creating tremendous opportunities for long-term investors like PSP.

# Metrics and Targets

Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities, where such information is material.

PSP began measuring the carbon footprint and carbon intensity of its assets under management in fiscal year 2017, and last year publicly disclosed those numbers for the first time. We published our methodology, including formulas and scope of coverage, in an effort to inspire and encourage better climate-related disclosure by like-minded investors and/or partner organizations. We continue to focus our efforts on making improvements to our in-house carbon footprint management framework, including continuous evolution of our tools and systems to monitor portfolio carbon metrics of various asset classes on a quarterly basis.

We see tremendous value in having a global, standardized GHG accounting and reporting approach to allow for better comparability of data and greater adoption of the TCFD recommendations. We recognize that the quality and availability of climate-related data is still an area for improvement, and we continue to seek Scope 1, 2 and 3 emissions data from

the companies in which we invest. We encourage disclosure and participation to the CDP (formerly known as Carbon Disclosure Project) and enhanced climate-related disclosures, in accordance with the TCFD's recommendations. Where appropriate in our proxy voting activities, we support shareholder proposals seeking enhanced climate-related disclosures. Beyond this, we are actively engaging with external experts and consultants to obtain insights on the implications of emerging trends related to climate change metrics and targets.

As part of our commitment to steadily enhance disclosure about how we manage climate change-related financial risks in line with the TCFD, we are disclosing our portfolio's carbon footprint and weighted average carbon intensity (WACI) over the past six years, based on equity ownership as demonstrated in the table below.

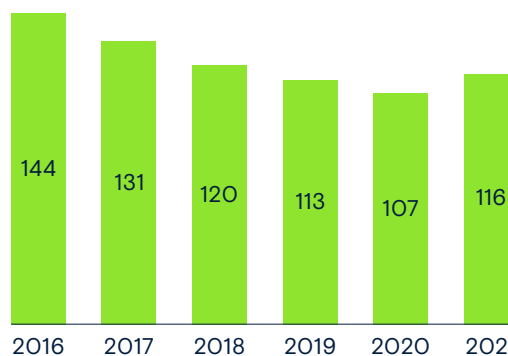
## PSP portfolio carbon footprint metrics

	Carbon footprint	Weighted average carbon intensity
<b>Metric</b>	Total carbon emissions for PSP portfolio normalized by the market value of PSP portfolio (tons CO2e/\$ million invested)	PSP portfolio exposure to carbon-intensive companies (tons CO2e/\$ million revenue)
<b>Carbon accounting equation</b>	<p>1. Calculate portfolio carbon emissions:</p> $\sum_i^n \frac{\text{Holding NAV}_i}{\text{Issuer}'_i \text{ Mkt Cap}} * \text{Issuer}'_i \text{ GHG emissions}$ <p>2. Divide by PSP portfolio NAV</p>	$\sum_i^n \frac{\text{Holding NAV}_i}{\text{PSP portfolio NAV}} * \frac{\text{Issuer}'_i \text{ GHG emissions}}{\text{Issuer}'_i \text{ revenues}}$

**Carbon footprint**  
As of March 31



**Weighted average carbon intensity**  
As of March 31





This year, our portfolio carbon footprint trended slightly downward, from 106 to 101 tons of CO<sub>2</sub>e per million dollars invested. This 5% year-over-year decline is in part due to a reduction in carbon-intensive sectors and an increase in low-carbon investments. PSP's green assets now stand at 12.6B\$ as of March 31, 2021. This includes investments in sustainable infrastructure, renewable energy, green buildings and certified sustainable forestry. PSP's weighted average carbon intensity has increased by approximately 8% this year, while still being down by about 19% compared to our 2016 starting point. PSP's exposure to emerging markets, combined with a decline of average issuer's revenues in those markets, have caused the carbon intensity to increase this year.

The last 12 months have been a time of significant change globally, with COVID-19 impacting real GDP growth, unemployment, valuation of currencies and commodities, and the day-to-day operation of firms in both public and private markets. Moreover, recent sector rotation in global equity indices away from low-emitting sectors, including information technology, consumer staples and health care, and toward traditionally higher-emitting sectors, including energy and materials, has also contributed to upwards pressure on PSP's weighted average carbon intensity.

## Methodology

We include scope 1 and scope 2 emissions in our portfolio carbon footprint metrics. At this stage, Scope 3 emissions are excluded from the calculation because the comparability, coverage, transparency and reliability of scope 3 data is generally insufficient in the marketplace. We intend to include greater amounts of Scope 3 data as it becomes available.

Scope 1 emissions are direct emissions from owned or controlled sources at our portfolio companies. Scope 2 emissions are those associated with purchased energy. Scope 3 covers other indirect emissions such as the extraction and production of purchased materials and fuels, outsourced activities, business travel and waste disposal.

We use emissions data from a third-party, which are combined with market data and PSP's positions to calculate the portfolio carbon footprint and WACI.

We recognize that companies use different methodologies to calculate and report their carbon emissions. For those companies that do not report their carbon emissions, we use a waterfall approach for estimating carbon emissions, which is consistent across our public and private market portfolios:

1. Company-reported emissions (28% of NAV)
2. Estimate based on company-specific factors (5% of NAV)
3. Proxy based on sub-industry average emissions (67% of NAV)

## Scope

This section lists the asset classes and instrument types included in the portfolio carbon footprint metrics, which represent 76% of our net assets as of March 31, 2021.

### Public markets

- In-scope: shares in long-only public equity strategies, securities held through market indexes or exchange traded funds (ETFs), externally managed investments
- Out of scope: government bonds, cash and money market instruments, non-equity derivatives

### Private markets

- In-scope: direct and fund investments in private equity, infrastructure, real estate and natural resources
- Out of scope: any balances associated with working capital, cash or debt instruments, credit investments, fund of funds.

## **PSP Forward**

In November 2020, CEO's from Canada's leading eight pension funds released a statement calling on companies and investors to help drive sustainable and inclusive economic growth. Looking forward, we will seek to establish a more robust evidence and data set to guide our investment decision-making and position our total portfolio favourably in a low-carbon environment. PSP will continue to improve and refine its carbon footprinting methodology, which will include placing more emphasis on obtaining additional company specific data, particularly from the largest emitters across the portfolio. We will further increase our engagement with portfolio companies and partners on decarbonization planning and active asset management strategies aligned with targets based on climate science, to ensure business plans are resilient in the face of a changing climate.

## Business offices

### MONTRÉAL

(main business office)  
1250 René-Lévesque Boulevard West,  
Suite 1400  
Montréal, Québec  
Canada H3B 5E9  
Phone: +1.514.937.2772

### NEW YORK

450 Lexington Avenue, Suite 3750  
New York, New York  
USA 10017  
Phone: +1.212.317.8879

### LONDON

10 Bressenden Place, 8<sup>th</sup> floor  
London, United Kingdom  
SW1E 5DH  
Phone: +44 20 37 39 51 00

### HONG KONG

Suites 01-05, 22<sup>nd</sup> floor  
Prosperity Tower  
39 Queen's Road Central  
Central, Hong Kong  
Phone: +852 91616063

## Head office

### OTTAWA

1 Rideau Street, 7<sup>th</sup> floor  
Ottawa, Ontario  
Canada K1N 8S7  
Phone: +1.613.782.3095

[info@investpsp.ca](mailto:info@investpsp.ca)