



# A Commonsense Approach to ESG Contributes to Investment Excellence

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2020 was a historic and eventful year. The COVID-19 pandemic reminded us of human fragility and resilience, prompting the acceleration of innovation and digitalization. The year also saw a burning focus on systemic inequalities and the pressing issue of our changing climate. As the first Prime Minister of independent India Jawaharlal Nehru said, “Crises and deadlocks when they occur have at least this advantage, they force us to think.” This backdrop put a renewed spotlight on the role of capital markets and Environmental, Social, and Governance (ESG) investing.

For over a decade, Sustainable Investing (often used interchangeably with Responsible Investing and ESG investing) has been ridden with complexity, jargon and a state of analysis paralysis. The last few years, this picture has changed from inaction to action, and investors doubled down on sustainable investing in 2020, with the dialogue in the corporate world moving from “do no harm” to “invest with purpose.”

The primary reason for this shift has been investor demand. This has emanated from both a focus on individuals looking to align their investments with their personal values, but also perhaps a cognizance of the relative outperformance of ESG-oriented equity funds over traditional equity funds, such that there has been little perceived “cost” for that alignment.

## Exhibit 1: Long Term Performance of Emerging Market ESG Index



Source: Bloomberg Finance LP, MSCI, as of December 31, 2020

With a world-wide interest in green recovery and climate change commitments under the Paris Agreement, we expect ESG to be a continued focus for companies, regulators and investors. In 2021, at TD Asset Management Inc. (TDAM), our focus remains on investment excellence and sustainable investing. Our philosophy has been to invest in sustainable long-term investments; accordingly, we have been attentive to ESG aspects of portfolio companies and assets both from a risk and opportunity perspective for a number of years. This journey was more formalized as far back as 2008 when TDAM signed onto to the UN Principles for Responsible Investing (UNPRI). Most recently, we have received an A+ rating in the last UNPRI reporting cycle.

From a portfolio management standpoint, ESG considerations are deemed a practical and common-sense approach in all asset classes. As outlined in [TDAM's Sustainable Investing Approach](#), our investment teams across asset classes integrate ESG considerations into their investment process to understand both the risks embedded but also the opportunities that are presented in a particular company's or asset's approach to ESG. We have grown and will continue to grow our commitment to Sustainable Investing in order to continue leading in this fast-evolving space.

For 2021, we believe that greater attention to the following areas in ESG will add significant value in seeking long-term sustainable-growing assets:

- 1 Stronger focus on board diversity in the 2021 proxy voting season**
- 2 Consistency of ESG engagement across all our asset classes**
- 3 Material ESG issues will continue to inform portfolio risks and opportunities**
- 4 Accelerated focus on climate transition across asset classes**

# Sustainable

## 1 Stronger Focus on ESG in 2021 Proxy Voting Season

We take our share ownership with a great deal of responsibility as fiduciaries for our clients. For the 2021 proxy season, we have implemented tools and guidelines that will systematically advance our approach to assessing ESG matters.

The new standard guidelines will generally recommend voting in favor of the following ESG proposals: proposals that seek standardized reporting on ESG issues, proposals that request information regarding an issuer's adoption of and adherence to relevant norms and standards, and shareholder resolutions advocating enhanced disclosure and transparency. Our ESG Research and Engagement team along with

our investment research teams will provide reviews of key proposals to help support Portfolio Management voting decisions and ensure we continue to uphold the best interest of our clients.

In 2021, TDAM will also further advance gender diversity: TDAM will vote against all incumbent members of the nominating committee if less than 30% of the board is represented by women. If there are no incumbent nominating committee members up for election or if the board does not maintain a nominating committee, TDAM will vote against all incumbent members of the board.

## 2 Consistency of ESG Engagement Across Asset Classes

We regularly engage with companies we invest in to highlight areas of concern and/or areas of potential improvements. To drive better management of ESG risks in our portfolio companies, in 2020, we engaged with 191 companies across portfolios on such topics as board composition (i.e. tenure, renewal, expertise, diversity) aligning management compensation with shareholder returns; safety and environmental impact; climate change risk and energy transition strategy; cyber security; and, efforts to establish sustainable practices through positive impacts on local communities and other stakeholders.

In 2021, our approach will be defined by consistency of engagement across all our asset classes. In our 2021 ESG Focus List, we aim to engage on systemic and material ESG issues with our largest combined

holdings across public and private markets. We will seek information from our portfolio companies on how their boards address material and systemic ESG risks and look to know more about ESG expertise on boards. We believe that the right governance structures, along with a focus on holistic value creation, keep companies profitable and resilient in the face of increasing systemic risks.

In addition to direct engagement, TDAM is also part of the Climate Action 100+, Canadian Coalition for Good Governance, Carbon Disclosure Project, the Responsible Investment Association of Canada and the UNPRI working groups, where collaborative engagement provides opportunities for influencing corporate behaviour towards adoption of best practices on ESG.



### **3 Material ESG Issues Will Continue to Inform Portfolio Risks and Opportunities**

Our focus on long-term investment relies on sound evaluation of how a business serves current and future needs, but also how well companies are managing ESG risks directly relevant or material to their long-term financial well-being. With growing consensus around sustainability reporting standards, such as the Sustainability Accounting Standards Board, financial materiality of ESG issues is gaining some consistency in the market.

In general, we are highly supportive of these standards, and believe in companies with high-quality management that are aware of key ESG risks and opportunities, communicate these transparently to their shareholders and maintain good relationships with their stakeholders.

Our integrated ESG view is embedded into all our portfolios across asset classes.

In 2021, we'll evolve our approach to ESG materiality and portfolio analysis through continued advancement of our proprietary ESG exposure scores. As well, our ESG dashboard will integrate multiple independent third-party ESG information sources with our proprietary work for greater consistency.

## 4 Accelerated Focus On Climate Transition Across Asset Classes

Climate action in 2021 will be accelerated by regulatory development across various jurisdictions and by the expectations for increased government spending around green stimulus packages set to allocate significant resources for transitioning to low-carbon economies. The European Union's Green Deal is leading the charge with €100 billion, and the U.S. is following suit. The anticipated stimulus in the U.S. far exceeds the initial expectations of early 2020 due to Joe Biden's presidential victory, with local and state funding levels also favouring climate-friendly recovery.

Another strong tailwind is regulatory developments such as the EU Taxonomy for sustainable activities and the EU Sustainable Finance Disclosure Regulation (SFDR). These are influencing other regions to put in place requirements that are similar but tailored to financial institutions, such as the Monetary Authority of Singapore's Guidelines on Environmental Risk Management for Banks. Now that we have governments committed to the Paris Agreement moving ahead with plans to decarbonize their economies, including a major manufacturing economy such as China pledging to Net Zero Emissions by 2060, many different sectors will see a secular divide between solutions-oriented companies versus the status quo.

In 2021, at TDAM, we aim to push our approach further by looking at macro sectoral effects of climate change and identifying investment risks and opportunities across different actively managed asset classes. We will continue our efforts with CDP and Climate Action 100+. We will also be participating in the United Nations Environmental Programme Finance Initiative 2021 Pilot 2 project to identify best-in-class approaches to climate risk. Other promising initiatives are on the horizon as well, and TDAM will continue to engage to move the needle on assessing both climate risks and opportunities.

Of course, investment excellence is by its nature work in progress. As data and markets reach new levels of maturity in ESG and sustainable finance, we will continue to advance our commitment to investment excellence by refining our approach on sustainable investing further, including allocating resources to deeply integrate ESG across all asset classes at TDAM, and by acting as responsible stewards of capital through engagement with companies for better sustainable outcomes.



# ESG

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