A Chance to Lead
Overcoming Barriers to Sustainable Finance
Key findings

- Two things are vital to the Canadian energy sector’s survival in the sustainable finance marketplace: effective disclosure and high-integrity data.

- Sustainable finance practices should be promoted as business-as-usual, but Canada needs to quicken its pace of adoption.

- Consistent and comparable disclosure is necessary for fair, accountable financial decision-making. Right now, the field is crowded with different reporting metrics, making for inconsistent evaluations by investors and researchers.

- Canada needs an agile task force to assess the use of digital applications (such as distributed ledgers or blockchain) to make timely, climate-useful data available for governments, insurers, and bankers. This digital record-keeping system, stored in a public database and verified in real time, could be transformative for sustainable finance.

- The financial community is in a strong position to lead and work with the public sector to co-create regulation. Rather than wait for intervention through legislation, the industry should act.
As a resource-based economy, Canada has an opportunity to be a leader in sustainable finance—a deal-maker, not just a deal-taker. Evidence suggests we're not there yet.

According to global investment giant BlackRock, in 2012 global sustainable investment was US$13.3 trillion. By 2018, it had grown to US$30.7 trillion. Over that same period, Canada’s portion of that total grew from US$590 million to US$1.7 trillion. Consistently holding about 5 per cent of the total market, Canada’s role as a deal-maker improved only marginally.¹

What is sustainable finance?

It’s how the financial ecosystem supports the transition to a low-carbon economy.

According to the Expert Panel on Sustainable Finance, this involves “capital flows (as reflected in lending and investment), risk management (such as insurance and risk assessment), and financial processes (including disclosure, valuation and oversight) that assimilate environmental and social factors as a means of promoting sustainable economic growth and the long-term stability of the financial system.”²

Adapting to the new norms of a climate-constrained world requires prudence, but we still need speed. Decisions already made have determined many 2030 outcomes. Decisions made over the next five years will determine what 2050 looks like.

For Canada’s energy sector to thrive in today’s and tomorrow’s sustainable finance marketplace, two key elements need addressing: effective disclosure and high-integrity data.

¹ Gosh, “Visualizing the Global Rise of Sustainable Investing.”

We need disclosure

Disclosure is the backbone of sustainable finance. Standardization, completeness, and consistency remain major hurdles in sustainability reporting. Fund managers already incorporate environmental, social, and governance (ESG) factors into their portfolios. Yet the quality of current information remains questionable. What’s considered a green or transition activity? Are metrics and reporting systems comparable? Why aren’t all corporations disclosing?

According to TD Securities, over 50 per cent of professionally managed assets incorporate “responsible” investment strategies in Canada.3 Seven strategies are often included:

• Negative/exclusionary screening—excluding companies with poor ESG metrics or those from perceived undesirable areas, such as tobacco, weapons, or, increasingly, oil and gas production.

• ESG integration—incorporating ESG factors into financial analysis.

• Corporate engagement and shareholder action—influencing corporate behaviour to align with preferred ESG targets.

• Norms-based screening—investments based on their compliance with internationally recognized standards.

• Positive/best-in-class screening—targeting ownership to only those companies with the best ESG metrics in their sector.

• Sustainability-themed investing—investment focused on a theme or asset that addresses a specific issue, like food or clean renewable technologies.

• Impact/community investing—investing with the intent of generating measurable social and/or environmental impact, as well as financial return.

Canada relies predominantly on ESG integration, while Europe focuses on negative and exclusionary screening. For a resource-heavy economy like Canada, adopting the EU’s preference could exclude efforts made to reduce carbon footprints, carbon intensities, or other climate-positive activities.

Luckily, ESG integration is the second-most common investment strategy in the world. Advancing ESG metrics isn’t just a “nice to have” item for Canadian corporations, it’s a “need to have.”

3 Keaney, Ho, and Hulshof “Industry Insights, Equity Research.”
But as a need to have, we need to get all parts right to avoid companies with strong ESG business commitments being vilified for operating in sectors or industries perceived as undesirable by some. Key to that is the need for companies to own their ESG narrative and to talk about how they manage the risks and opportunities to deliver results.

To date, identification of sustainable assets and exposures, and standardized definitions, have come from Europe. The EU Green Bond Standard⁴ is one supportive initiative already in place there. The Expert Panel on Sustainable Finance report, however, noted that EU taxonomies lack transition activities for Canadian heavy industries in general and energy in particular. In fact, most Canadian natural resources are excluded from the European Union Taxonomy.⁵ An “across the pond” geopolitical entity determining what is and what is not green is a problem for Canada as it works to bolster its sustainable finance marketplace and support Canadian investors.

Hope is near.

The Canadian Standards Association (CSA)⁶ is creating a taxonomy focused on Canada's low-carbon transition. The CSA, well-respected for standards development, is building on accepted global work but developing a National Standard of Canada for Green and Transition Finance. Without this taxonomy and its recognition in global green and transition markets, many Canadian sectors would be at risk of exclusion.

The devil, they say, is in the details. The use of uncomparable metric systems continues to dog the financial sector. Of Canadian energy sector companies that publish ESG and/or sustainability reports, 80 per cent reference the Global Reporting Initiative (GRI).⁷ Less frequently cited is the Carbon Disclosure Project (60 per cent), followed distantly by the Sustainability Accounting Standards Board (30 per cent), Task Force on Climate-Related Financial Disclosure (TCFD) (20 per cent), and the International Petroleum Industry Environmental Conservation Association (10 per cent). While there are reasons for choosing one or more metric systems for reporting (perhaps for different objectives), investor and financial actors find comparison difficult.

Perhaps endorsement will help. BlackRock is asking investees to provide 2020 disclosures based on Sustainability Accounting Standards Board (SASB) and TCFD frameworks.⁸ As of February 2020, the more than 1,000 TCFD supporters representing all sectors had a total market capitalization of nearly US$12 trillion. The 470-plus financial firms within that group were responsible for assets in excess of US$135 trillion.⁹ That’s no longer chump change. Despite being voluntary, TCFD’s growth over two years demonstrates private sector appetite for increased transparency on climate-related risks and informed financial decision-making.

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⁴ European Commission, “EU Green Bond Standard.”
⁵ European Commission, “EU Taxonomy for sustainable activities.”
⁷ Using TD Securities list and reviewing publicly released annual ESG and/or sustainability reports for the most recent reporting year. See TD Securities, “Securities Oil & Gas E&P.”
⁸ Fink, A Fundamental Reshaping of Finance.
⁹ Szabo, “TCFD Climate Reporting Initiative Passes 1,000 Supporters.”
Robust, decision-useful data that express ESG factors simply is a lofty goal.
While major companies are disclosing, few others are. Canada’s energy sector is made up of predominantly small and mid-sized firms. This is problematic. But even when taken as a whole, a survey of all issuers (large, mid, and small cap) in 2019 found that 76 per cent disclose ESG\textsuperscript{10} information to the public, but less than half do so annually (47 per cent). In addition, less than half (45 per cent) maintain an ongoing dialogue with investors on ESG.

Disclosure is critical to sustainable finance. When disclosure isn’t available or comparable, someone will fill the void, which can create a tendency toward using self-serving and unobjective data.

Actions need evidence. And that evidence comes from accessing timely, useful data. This includes basic climate data, as well as environmental, social, and governance (ESG) data.

In its 2019 final report, the Expert Panel on Sustainable Finance found that “tools to translate data into tangible impacts to a business, city or portfolio are virtually non-existent.”\textsuperscript{11} Since the report’s release, little has changed, but the need remains.

GHG emissions and related ESG reporting suffer from a common perennial issue: time lag. Government sources for emissions data are frequently two years old. Corporate ESG and sustainability reports are generally two or more fiscal quarters behind when publicly released. Using these gathering and reporting systems to predict future behaviour poses significant challenges. As anyone who reads the small print knows, “past performance is no guarantee of future results.”

Increasingly, sustainable financial markets are aiming to identify changes in corporate behaviour that lead to positive or negative impacts. Lagging metrics don’t tell investors that. As a result, investment assessment becomes overweighted on risk at the expense of growth. As a leader in technological advancement and clean technology development, this creates a disconnect for Canada’s energy sector.

\textbf{Again, there is hope.}

\textsuperscript{10} Business Wire, “Canadian Issuers Understand the Importance of ESG.”

\textsuperscript{11} Macklem and others, Final Report of the Expert Panel on Sustainable Finance.
Distributed ledgers and blockchain can gather, track, verify, and “hand off” information in real time. Artificial intelligence (AI) holds the promise of turning data around, effectively allowing forward-looking, rather than rear-view-mirror-reflection, viewpoints. In a recent survey in the Asian market, over 80 per cent of respondents said their firm was using machine learning or other types of AI for insights and data screening to make investment decisions and to analyze ESG.12 The reason? The lack of, and unreliability of, data.

While worth pursuing, analytical technology raises a second problem. While the platitude “too much information can never be a bad thing” has followers, an overabundance of data has drawbacks. Cognitive scientists are quick to point out that we humans prefer simple explanations over complex ones.13 An adapted Occam’s razor comes into play: the simplest way of presenting information is most likely the right one. When it comes to ESG data, investors’ need for simplicity allows investment managers to present the broad, easy-to-use ratings from ESG research providers. While easy to understand, nuances that exist in energy industries and in organizational approaches to sustainability get lost. It’s something the energy industry and sustainable finance community will need to come to terms with.

Robust, decision-useful data that express ESG factors simply is a lofty goal. The current unreliability of climate data, the lag time, and the complexity of ESG reporting require quick resolution.

Inking new approaches

Sustainable finance is an ecosystem. Each actor has a role: governments through policy and regulation; issuers through effective and timely disclosure; asset owners and asset managers through strong and fair analysis; associations and support agencies through positive guidance, policy, and standards; and shareholders by keeping everyone’s feet to the fire.

All these actors recognize that climate change is a systemic risk. Quantity and quality don’t go hand in hand. Ensuring that Canada’s sustainable finance market is built on quality is paramount. Timely and transparent data and disclosure will prevent capital flight from Canada. To improve our pace of adoption, the following actions will help:

- **Create a data vision.** Our digital ecosphere continues to advance. The first step should be the creation of an agile task force with the mandate to assess digital applications that improve data flow and utilization. The creation and support for the Expert Panel on Sustainable Finance and its final report demonstrated three things:
  - A small, influential group with a common purpose can create a vision and plan.
  - Supportive public and private environments are in place.
  - Government approval is not a requisite for moving forward.

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12 Wincuinas, *Green Intelligence*.
13 Farnam Street, “Complexity Bias.”
• All actors need to collaborate to make climate-useful data available in a timely and meaningful way. A considerable portion of the energy system already collects real-time, verified emissions and environmental data. Digital solutions should be put in place to connect industry, government, and financial industry platforms. A distributed ledger—a consensually shared and synchronized database across multiple sites, institutions, and geographies—for example, would address the time it takes to release data. The current time lag is creating weak policy and skewing sustainability-related investment decision-making. Blockchain, a digital record-keeping system stored in a public database, verified in real time, could be transformative.

• **Fill the void.** Nature—humans included—abhors a vacuum. Companies lacking resources to gather data, uncertain about climate change impacts, or receiving conservative legal advice are resisting disclosure. But information vacuums get filled. All companies—large, mid, and small cap—must be incentivized to manage their sustainability narratives through disclosure.

• **Consistency.** More disclosure is better. Investors need to be able to compare climate-related exposure and ESG between companies and, sometimes, between sectors. While one standard for all may not be realistic, the disclosure metric field needs consolidating. The wide variety of reporting metrics has created an environment in which investment banks, credit-rating agencies, and think tanks inconsistently evaluate carbon risks. Continuing to publish inconsistent and incomparable data does not advance a supportive environment for sustainable finance. Having one robust, decision-useful disclosure tool may be a pipe dream, but ESG reporting and investors would benefit immensely.

• **Regulatory leadership.** Government has a role in directing the pace of adoption of sustainable finance through regulation. Current regulations on climate change and environmental reporting do require streamlining. Who decides when to undertake that? Historically, market forces alone have not produced financial reporting and accounting standards. The financial industry should learn from the legislated implementation of the Sarbanes-Oxley Act in 2002, which mandated considerable auditing and financial regulations to public company responsibilities. Post-Expert Panel, the financial community should lead and work with the public sector to co-create regulation. Rather than wait for intervention through legislation, the industry has a window to not only inform government, but to take solutions to government.
The financial community should lead and work with the public sector to co-create regulation.
Appendix A

Methodology
The Centre for a Clean Energy Growth Economy (CEGE) held a meeting in Toronto under Chatham House rules in December 2019 focused on sustainable finance. This briefing benefited from the perspectives shared by CEGE funders, asset owners, asset managers, issuers, and the energy industry guests who participated.

A literature review of the current challenges and opportunities of Canada’s developing sustainable finance industry was completed. Many anecdotal conversations with members of Canada’s financial community helped augment and target our research toward key publicly available documents and current activities.

This briefing builds on research previously published by CEGE—the Financing a Clean Energy Growth Economy series (www.conferenceboard.ca/ctei/publications.aspx).

All inputs from these efforts focused the key actions and insights presented in this briefing.
Appendix B

Bibliography


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