Mobilizing Sustainable Finance

Spotlight Brief

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What is a CBSR Spotlight Brief?

- The CBSR Spotlight Brief is a pre-read for member roundtables, and a long-term resource.
- It is packed full of research and analysis relevant to a particular subject, providing the insights and thought leadership you need to make meaningful change at your organization.
- With the support of subject matter experts, Spotlight Briefs have been thoughtfully reviewed to ensure the most up-to-date and accurate information.

- For questions, please contact info@cbsr.ca

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Context Setting

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Definitions: **Sustainable Finance**

There is no standardized definition of Sustainable Finance.

The Government of Canada refers to Sustainable Finance as **financial activities that take into account environmental, social and governance factors as a means of promoting sustainable economic growth and the long-term stability of the financial system**.

Sustainable Finance covers the standard financing fundamentals with different prioritizations:

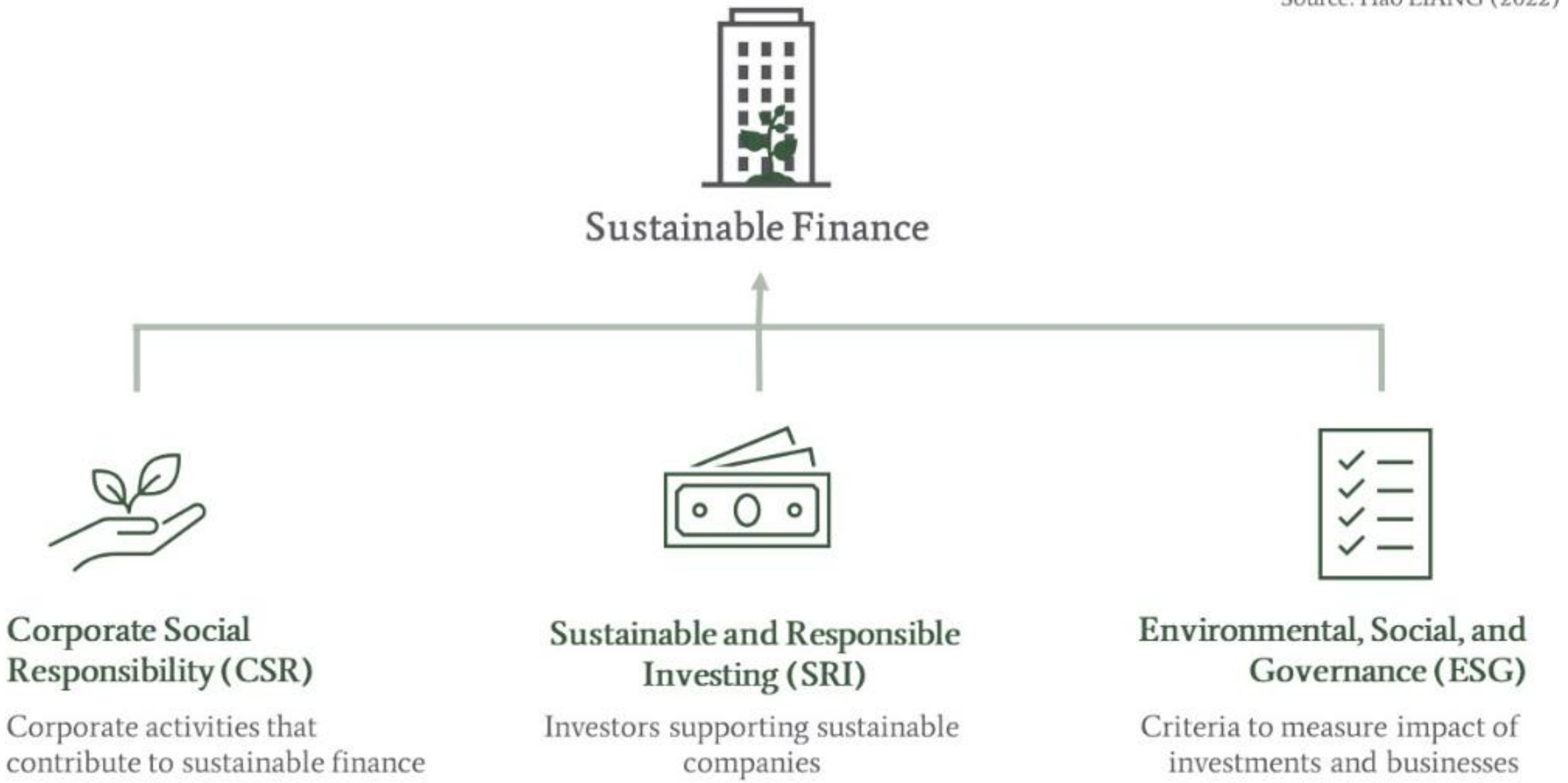
Capital Allocation	Diversification	Value Maximization	Investing
• **Traditional Finance:** How to best distribute an organization's money. • **Sustainable Finance:** How to best distribute an organization's money for long-term social and environmental sustainability.	• **Traditional Finance:** Spreading investments amongst different assets to build resiliency and lower risk. • **Sustainable Finance:** Diversify investments while avoiding investment in assets that do not align with organizational morals/ESG goals.	• **Traditional Finance:** Enable largest possible finance value/return for shareholders. • **Sustainable Finance:** Maximize the welfare of stakeholders, including the environment.	• **Traditional Finance:** Strategize investments by highest possible ROI. • **Sustainable Finance:** Strategize investments in alignment with sustainability goals.

https://www.canada.ca/en/department-finance/programs/financial-sector-policy/sustainable-finance.html
https://www.weforum.org/agenda/2022/01/what-is-sustainable-finance/
https://nbs.net/sustainable-finance-meaning-and-examples-in-business/

3 Pillars of Sustainable Finance

Design: Abby Litchfield

Source: Hao LIANG (2022)



https://nbs.net/sustainable-finance-meaning-and-examples-in-business/

Overview of the Sustainable Finance Landscape

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Overview of the Sustainable Finance Landscape: **Drivers**

The global economy is signaling a shift toward Sustainable Finance through governmental, business-related and societal perspectives.

Government	Business	Society

• **73 countries** have **carbon pricing** initiatives implemented.
 	
• Over **100 countries** have **net-zero targets.**
 	
• **Responsible investment regulations** globally have increased over **1100%** since 2000.
 	
• COVID relief packages tilted towards **green recovery** among G7 countries.
 	
• Climate among **top policy priorities** in US, Canada, EU and UK.
	• Business Roundtable issuance of the Statement on the **Purpose of a Corporation**, centering on all stakeholders.
	
	• **Corporate citizenship strategies** central to brand identity and employees and customer engagement.
	
	• Formation of **business initiatives** focused on **ESG** integration, including in insurance (e.g., UN PSI, ICLR, etc.).
	
	• Demands from the world's largest asset managers (e.g., BlackRock, Maple 8) for investee companies to **publish sustainability** and **climate disclosures** (e.g., SASB, TCFD).
	
	• Increasing number of mid-to-long-term **climate action plans** (e.g., net-zero strategies).
	
	• **Investors** are demanding more **ESG focused practices**
		• Increased **awareness** of **sustainability challenges** among employees and customers.
		
		• **78% Canadians** believe **businesses** should contribute more to the **betterment of society**.
		
		• **Evolving expectations** of the **role companies** play in society; expectations of firms to have a **purpose**.
		
		• **Purpose helps**:
		    • Employee recruitment and retention
		    • Customer loyalty
		
		• **Transparency**: beyond price and quality, consumers value transparency and want **companies to stand up for issues** they are passionate about.
		
		• **Environmental Awareness:** recent research showcases that the **pandemic has heightened environmental awareness** among consumers.

Sources in Notes section

Overview of the Sustainable Finance Landscape: **Drivers**

According to the BlackRock Sustainable Investing survey of 425 investors representing USD $25 trillion in Assets Under Management:

- **88%** ranked Environment as the priority most in focus.
- **54%** consider sustainable investing to be fundamental to investment processes and outcome.
- **75%** are currently, or considering, integrating ESG into their investment decisions.
- **65%** utilize or would consider using exclusionary screens as a mechanism for expressing their sustainability principles.

Overview of the Sustainable Finance Landscape: **Climate Disclosure Policy**

Canada's Taxonomy Roadmap: Defining Green and Transition Investments
March 2022

Context: The sustainable finance taxonomies are a set of common definitions for sustainable economic activities used to credibly and transparently define sustainable investments. The Government of Canada commissioned Canada's Sustainable Finance Action Council (SFAC) to develop a proposal for a green taxonomy with an aim to publish a robust, finalized version by the ***end of 2025*** *at the latest.*

This taxonomy aims to provide a methodology against which companies may issue financial instruments. This is an important development for a few reasons:

- The growing number of Canadian policies and initiatives related to "green" or "transition" or sustainability, like this taxonomy, show a clear trajectory for the future of business in Canada – **it is an important signal that Canadian businesses should prepare for a net-zero economy.**
- **If adopted nationally, this taxonomy would create a federal governance structure for sustainable investments and financing activity –** making it easier for corporates to participate in this type of activity, and eliminating some of the excuses for those who are choosing not to participate.
- **This taxonomy aims to create additional check-points, governance measures and accountability mechanisms which minimize greenwashing and accelerate meaningful action.**

https://www.canada.ca/en/department-finance/programs/financial-sector-policy/sustainable-finance/sustainable-finance-action-council/taxonomy-roadmap-report.html

Canada's Taxonomy Roadmap: Cont'd

The taxonomy outlines what qualifies a projec

Eligible Green Projects for issuing green financial instruments	Eligible Transition Projects for issuing transition financial instruments
• ***Summary:*** low-or zero-emitting activities (e.g., green hydrogen, solar and wind energy generation) or those that enable them (e.g., electricity transmission lines, hydrogen pipelines);	• ***Summary:*** decarbonizing emission-intensive activities that are critical for sectoral transformation and consistent with a net-zero, 1.5 ˚C transition pathway (e.g., installing lower-emitting (electric) furnaces to produce steel).

• Projects with low or zero scope 1, 2 and 3 (downstream) emissions that will likely see increased demand in the low carbon economy.	• Projects that decarbonize sectors that have historically high scope 1 and 2 emissions.
	  • These projects typically do not have viable alternatives (technically or economically) and that improve the "carbon competitiveness of activities exposed to higher carbon costs in the global low-carbon transition".
	  • These projects operate in markets expected to remain stable or grow with the transition.
	• Projects that decarbonize sectors with historically high scope 3 (downstream) emissions.
	  • These include projects with high number of alternatives and high downstream emissions are predicted to have decreasing demand in the low carbon economy.
	  • These projects should have specific project lifespans that align with 1.5-degree pathways and anticipated decline in demand.

Example: green hydrogen production, zero emissions vehicle manufacturing	Example: a steel production facility that installs an electric arc furnace Or installing world-leading carbon capture, utilization and storage (CCUS) on an existing oilsands facility

https://www.canada.ca/en/department-finance/programs/financial-sector-policy/sustainable-finance/sustainable-finance-action-council/taxonomy-roadmap-report.html

Overview of the Sustainable Finance Landscape: **Climate Disclosure Policy**

Office of the Superintendent of Financial Institutions (OSFI) Climate Risk Management Guideline

The Guideline outlines a number of disclosure expectations, some of which are expected to be implemented as soon as 2024. Some of those disclosure expectations are listed below:

Disclosure Category	Disclosure Element & Explanation	Implementation Years
Governance	a) Describe the board of directors' oversight of climate-related risks and opportunities. b) Describe management's role in assessing and managing climate-related risks and opportunities.	2024 - 2025
Strategy	a) Describe the climate-related risks and opportunities the FRFI has identified over the short, medium, and long term. b) Describe the impact of climate-related risks and opportunities on the FRFI's businesses, strategy, and financial planning.	2024 - 2025
Risk Management	a) Describe the FRFI's processes for identifying and assessing climate-related risks. b) Describe the FRFI's process for managing climate-related risks. c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the FRFI's overall risk management.	2024 – 2025
Metrics & Targets	a) Disclose the metrics used by the FRFI to assess climate-related risks and opportunities in line with its strategy and risk management process.	2024 - 2025

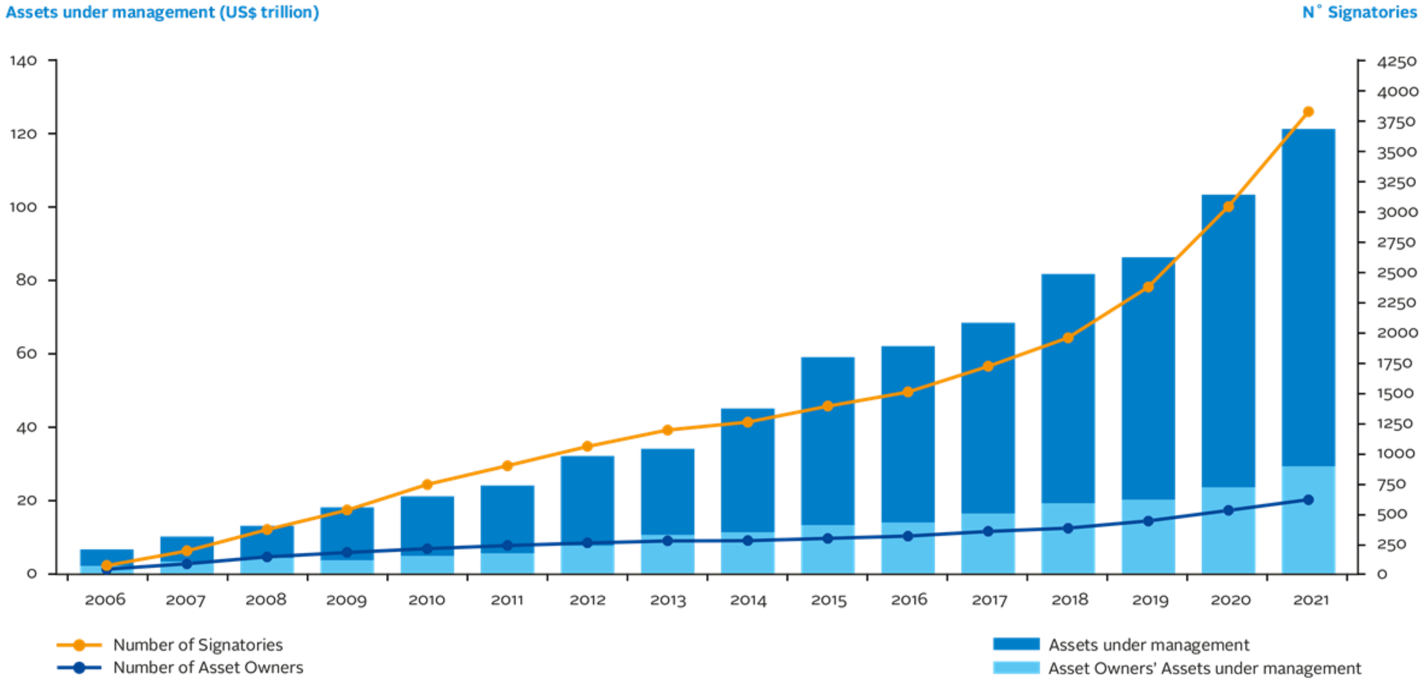
https://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/b15-dft.aspx

Overview of the Sustainable Finance Landscape: **UN PRI**

United Nation's Principles for Responsible Investing (UNPRI)
2006

The United Nations established 90-person investor group comprised of 20 persons from financial and investment institutions across 12 countries, with 70 supporting finance and investment experts.

This group developed 6 principles meant to inform responsible investing at organizations across the globe.



The number of signatories that have committed to the UNPRI has grown significantly over the past decade (see graph), showing increased interest and prioritization of sustainable practices.

https://www.unpri.org/about-us/about-the-pri#:~:text=A%2020%2Dperson%20investor%20group,since%20it%20began%20in%202006.
https://www.unpri.org/about-us/what-are-the-principles-for-responsible-investment

https://www.bcfsa.ca/media/3400/download

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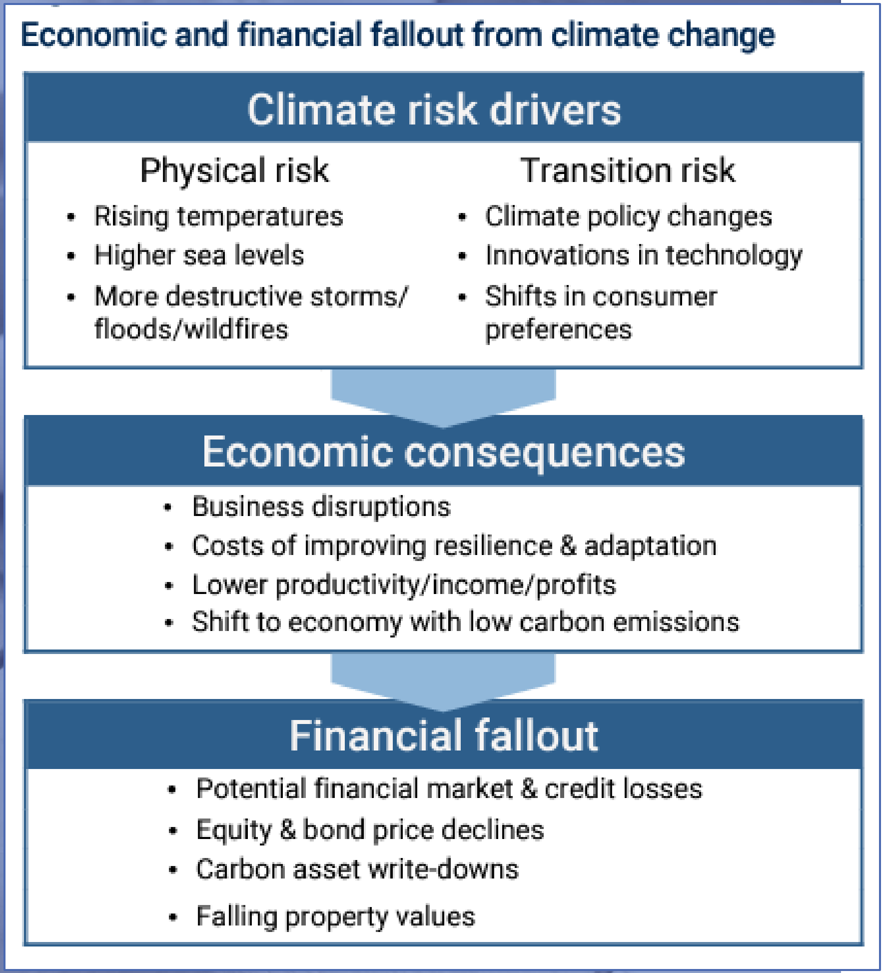


Defining Risk

Sustainable Finance is a mechanism which can be used to address two main forms of risks:

- "**Physical risks**" refer to the financial risks from:
  - the increasing severity and frequency of climate-related extremes and events (i.e., acute physical risks);
  - longer-term gradual shifts of the climate (i.e., chronic physical risks); and
  - indirect effects of climate change such as public health implications (e.g., morbidity and mortality impacts).
- "**Transition risks**" refer to the financial risks related to the process of adjustment towards a low-greenhouse gas (GHG) economy. These risks can emerge from:
  - current or future government policies, legislation, and regulation to limit GHG emissions,
  - technological advancements, and
  - changes in market and customer sentiment towards a low-GHG economy.

https://www.osfi-bsif.gc.ca/Eng/Docs/b15-dft.pdf
https://www.frbsf.org/wp-content/uploads/sites/4/el2021-03.pdf

The Historical Cost of **Physical Risk**

June 2020 Calgary, Alberta Hailstorm
- 70,000+ insurance claims
- $1.2 billion in insured damages

2023 British Columbia Fires
- 2,217 fires detected in 2023 season
- $770 million in fire mitigation

2023 Nova Scotia Floods
- 250mm of rain in July alone
- $170 million in insured damages

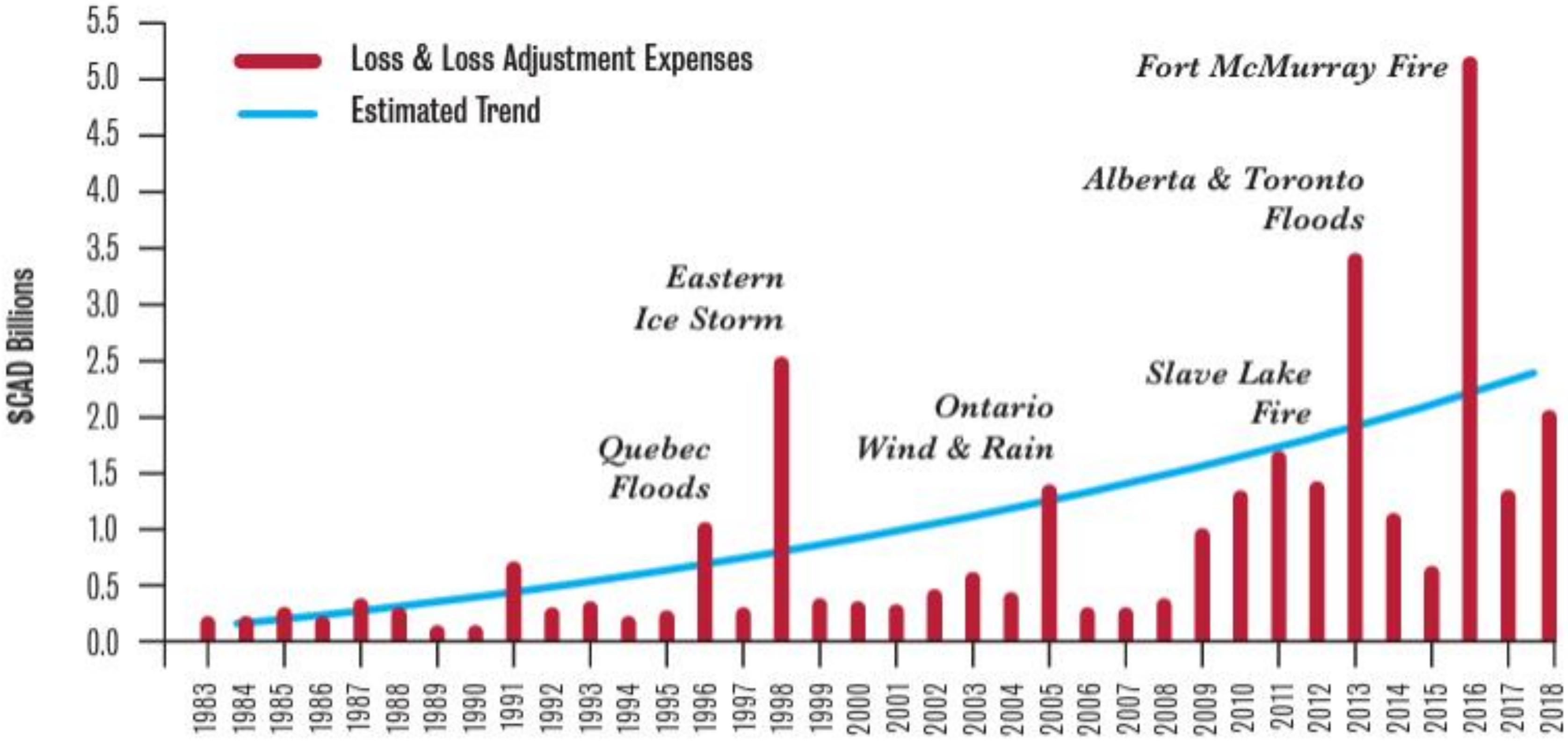
"Severe Weather in 2022 Caused $3.1 Billion in Insured Damage – making it the 3rd Worst Year for Insured Damage in Canadian History" - Insurance Bureau of Canada

https://www.canadianunderwriter.ca/insurance/how-many-claims-the-calgary-hail-storm-caused-1004194546/
https://www.cbc.ca/news/canada/british-columbia/wildfire-danger-reducing-1.6980041#:~:text=British%20Columbia-,2023%20is%20now%20officially%20the%20most%20expensive%2C%20most%20destructive%20wildfire,now%20at%20approximately%20%24770%20million.
https://globalnews.ca/news/9917184/nova-scotia-floods-170m-insured-damages/

The Historical Cost of **Physical Risk**

The Intact Centre on Climate Adaptation (ICCA) reported a significant rise in Canadian insured loss, which are a strong indication of the growing intensity of natural disasters and the changing climate. It is anticipated that these trends will continue in an upward fashion.

Figure 1: *Catastrophic Insured Losses in Canada (1983 – 2018)*

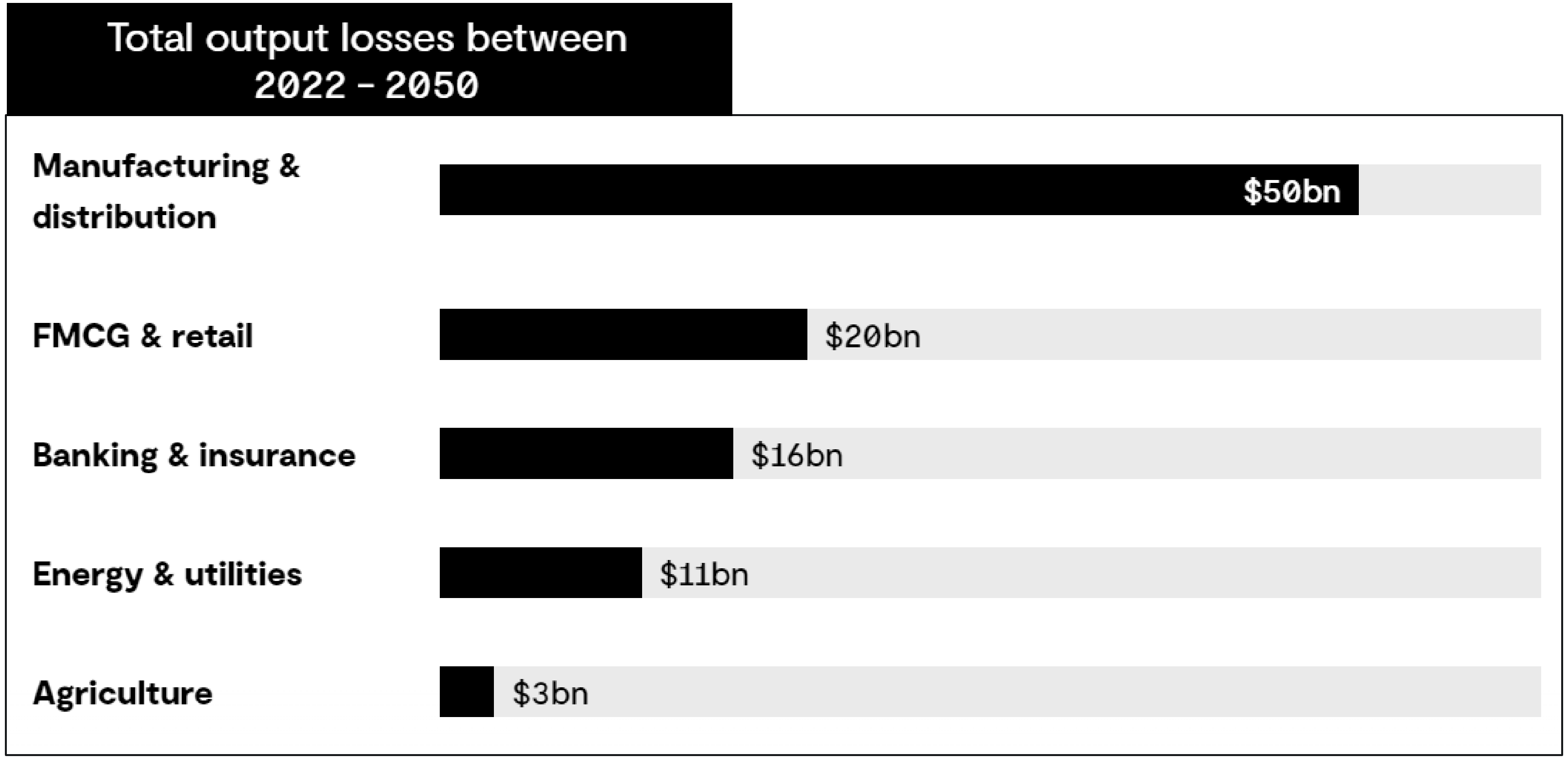


Source: *IBC Facts Book, PCS, CatIQ, Swiss Re, Munich Re & Deloitte. Values in $2018 CAN; total losses are normalized by inflation and per-capita wealth accumulation*

The Future Cost of **Physical Risk**

GHD Group, a global technical professional services firm has been working on a project called Aquanomics, which explores the economics of water risk and future resiliency.

Through their research, it is estimated that in water-related risks alone – such as storms, droughts and floods – Canada could face **$108 billion** in losses between **2022 and 2050**.



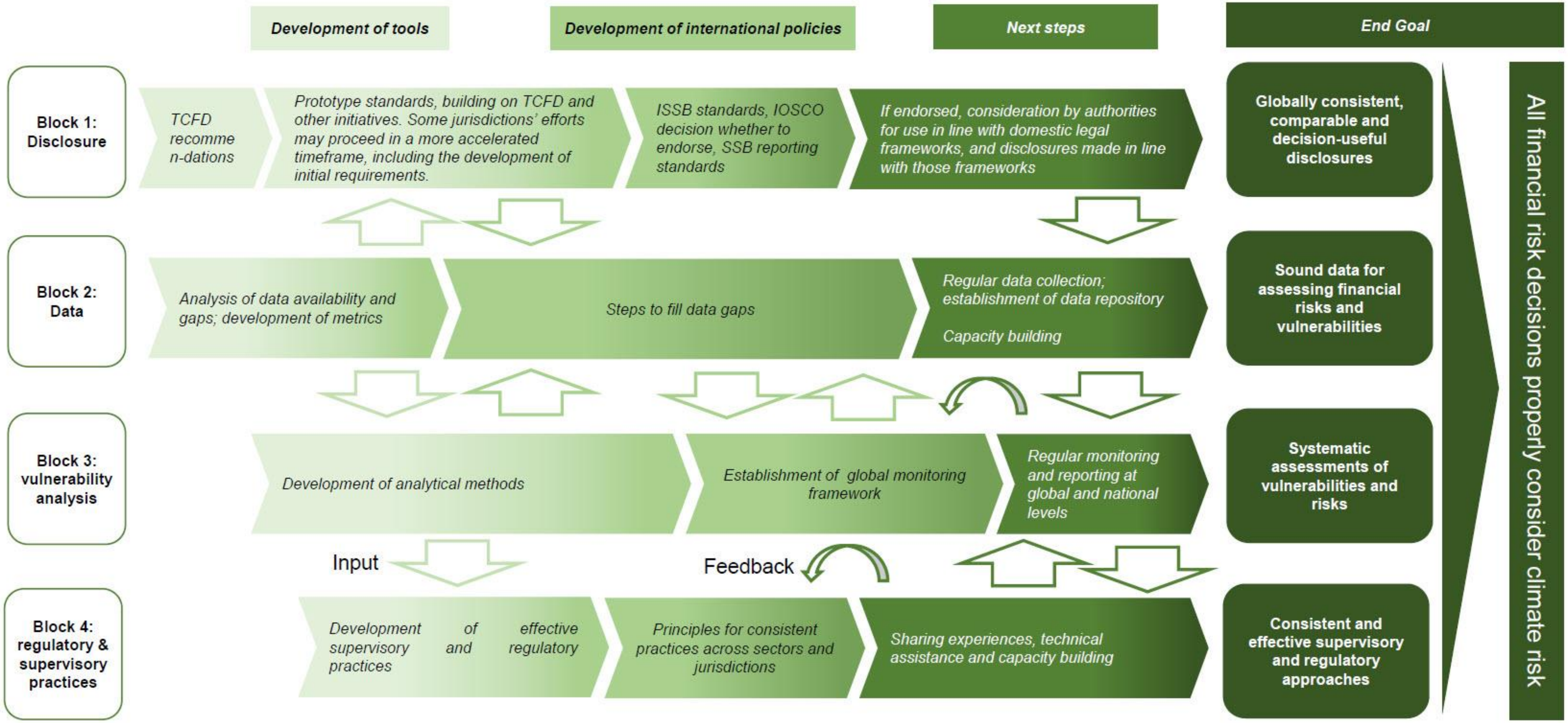
Large contributors to these predicted losses are:

- More intense weather events like storms, floods and draughts
- Aging and inefficient infrastructure

https://globalnews.ca/news/9091585/canada-climate-disasters-damage-report/

Actions to Address **Physical Risk**

The **Financial Stability Board (FSB)** has identified that climate-related physical risks could have significant implications for the global financial system and is working to coordinate a global effort to address these risks. As a result of their work and research, the FSB has created the following graph which outlines the work that is needed to address and mitigate against the physical risks of climate change.



Reporting **Physical Risks**

The valuation and quantification of financial impact of physical risks are becoming a required aspect of reporting standards, including in the IFRS S1 & S2.

Both standards will become effective starting January 1, 2024.

IFRS S2 focuses on climate-related risks & opportunities (building on TCFD), and requires that companies understand and disclose:

- How their organization is identifying, assessing, prioritizing and monitoring climate-related risks and opportunities
- How their organization integrates climate-related risks into overall risk management process
- How their organization governs climate-related risks and opportunities (ex: monitoring, managing and overseeing)
- How their organization is performing related to climate-related risks and opportunities. Are you making progress towards climate targets?

IFRS S1 focuses on sustainability-related risks and opportunities and requires that companies disclose:

- the effects of sustainability-related risks and opportunities on the entity's financial position, financial performance and cash flows for the reporting period (current financial effects); and
- The anticipated effects of sustainability-related risks and opportunities on the company's financial position, performance and cash flows over the short, medium and long term, taking into consideration how sustainability-related risks and opportunities are including in the company's financial planning.

https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/ifrs-s2-climate-related-disclosures/
https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/ifrs-s1-general-requirements.html/content/dam/ifrs/publications/html-standards-issb/english/2023/issued/issbs1/

Sustainable Finance in Practice

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Leveraging **Sustainable Finance** to meet sustainability goals

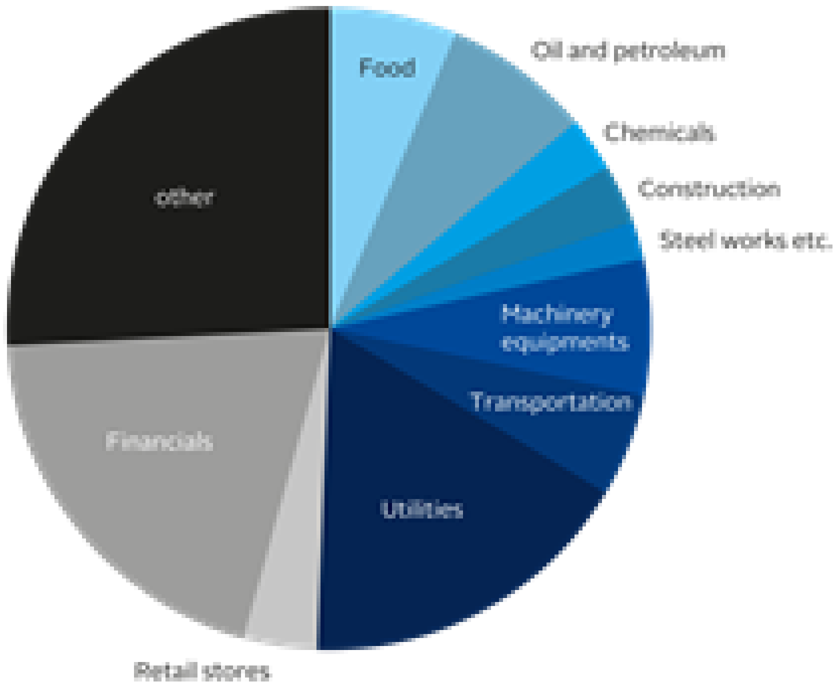
Sustainable Finance can be an important mechanism for meeting net-zero and other sustainability targets.

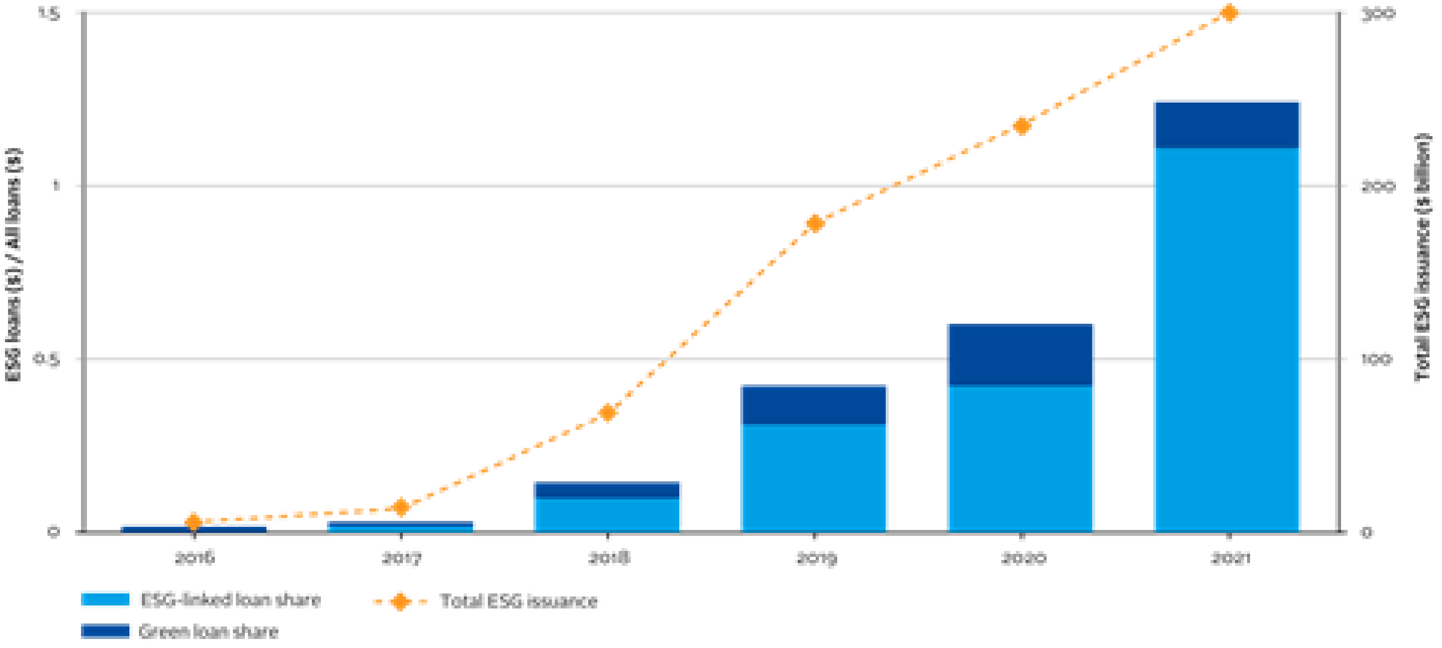
Approach	Sustainability outcomes in real economy	Mechanisms
Debt Financing	Corporate cost of capital affects firms' ability to finance capital expenditure. Sustainability performance can affect the cost of capital where investors seeking impact, or perceiving lower risks in sustainable firms, or both.	• Sustainability-linked bonds and loans, with interest rates tied to the achievement of sustainability targets • Green and sustainable bonds and loans, which can price debt differently for sustainable versus unsustainable firms or projects. • Corporate bonds and loans, bonds sold by Multilateral Development Banks (MDBs), as well as municipal bonds, including general obligation debt of countries
Investments	Restrictions on lending to unsustainable projects can constrain the supply of capital for unsustainable activities. Firms can access a broader investor base by participating in green or sustainable bond markets.	• Short-term liquidity from banks, longer-term liquidity and traditional bond markets • ESG-directed investment funds. • Private Equity & Venture Capital refer to direct investment into firms that are not publicly listed, where investors see opportunities in sustainable investing. • Initial Public Offerings (IPOs) – IPOs for green companies
Corporate practices and shareholder engagement	Creditors without shareholder voting rights can influence corporate practices through making lending conditional on the adoption of sustainable practices.	Shareholders and coalitions can press firms to adopt more sustainable practices: • Collaborative engagement with the management of publicly listed firms and private firms • Filing of shareholder resolutions and proxy voting requiring firms to adopt more sustainable policies and practices. • Signaling effects of publicized engagement with, and/or divestment from, companies that do not adequately alter, or commit to altering, corporate practices.
Policy-Based Practices	In addition to traditional command and control environmental regulation, accompanied by public spending, governments at all levels have increasingly experimented with market-based and incentive-oriented solutions.	• Carbon Pricing Initiatives include cap and trade programs as well as direct pricing systems, such as carbon taxes. • Private internal carbon pricing systems • Tax credits which provide a direct deduction against investors' federal income taxes, triggering private investment. • Guarantees and Loan programs from government institutions • Water Quality and Habitat Preservation Trading Systems

https://www.stern.nyu.edu/sites/default/files/assets/documents/Financing%20Mechanisms%20for%20Sustainable%20Business%20Practi ces%20Final%208.26.21_0.pdf
https://www.smithschool.ox.ac.uk/sites/default/files/2022-04/Sustainable-Finance-and-Transmission-Mechanisms-to-the-Real-Economy.pdf

Corporate Sustainable Finance Tools

- **Sustainability-Linked Loans (SLL)**
  - SLL are any type of loan instrument structured to incentivize the borrower to achieve ambitious, material and quantifiable predetermined sustainability performance objectives.
  - This is an ever-growing sector, having reached **$2 trillion CAD in 2022**.
  - These loans are most common in the Financial and Utilities sectors and allow organizations to credibly signal their commitments to sustainability and ESG.

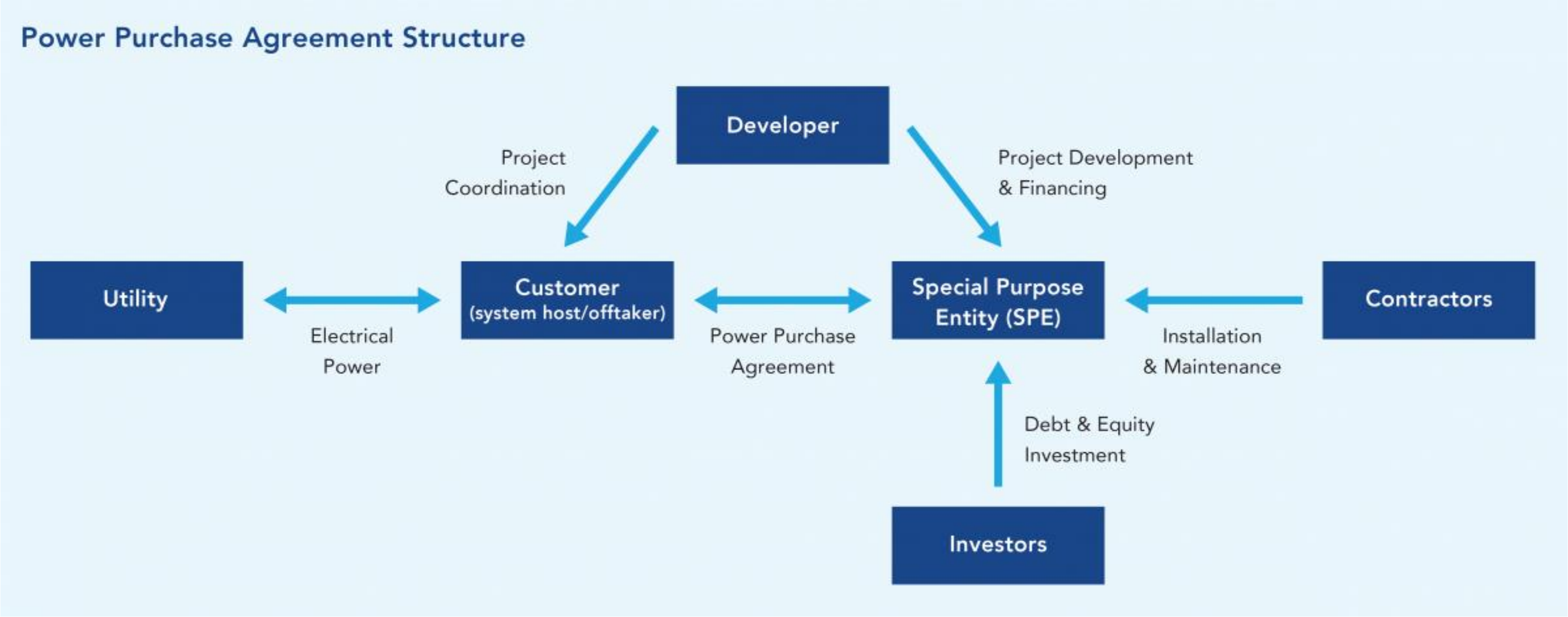




https://www.blakes.com/insights/bulletins/2023/sustainability-linked-loans-growth-of-the-sustaina#:~:text=A%20sustainability%2Dlinked%20loan%20(SLL,as%20of%20year%2Dend%202022.
https://www.unpri.org/pri-blog/sustainability-linked-loans-a-strong-esg-commitment-or-a-vehicle-for-greenwashing/10243.article

Corporate Sustainable Finance Tools

- **Power Purchasing Agreements (PPA)**
  - PPAs are an arrangement in which a third-party developer installs, owns, and operates an energy system on a customer's property. The customer then purchases the system's electric output for a predetermined period.
  - PPAs allow for low upfront costs on a more reliable energy system, most commonly renewable.
  - PPAs are an important mechanism for making renewable energy projects viable, while also offering a financial incentive (through tax credits and electricity sales) for business to invest in renewable energy systems.



Benefits of Implementing a **Sustainable Finance Framework**

Better risk management

- Improved understanding of risks through more accurate valuation of environmental and social impacts and dependencies
- More thorough evaluation of the risks associated with investment and lending decisions
- Higher credit rating and fewer reputational risk concerns

Greater access to capital

- Increased lender and investor confidence in your company's approach to risk and opportunity
- Stronger position for maintaining access to capital and realizing a lower cost of capital
- Greater access to lenders and investors who have specific ESG investment criteria

Enhanced ESG Credentials

- Better internal understanding and endorsement of the company's ESG credentials
- Improved dialogue with debt providers, investors and ESG research and rating agencies
- Enhanced credibility of your company's approach to ESG through having a transparent sustainable finance framework

https://www.accountingforsustainability.org/content/dam/a4s/corporate/home/KnowledgeHub/Guide-

Thank you

See you at the roundtable in Calgary, Alberta!