CANADA: AN OPPORTUNITY FOR INVESTOR LEADERSHIP ON CLIMATE CHANGE

Professor Janis Sarra, Presidential Distinguished Professor and professor of law at the Allard School of Law, University of British Columbia: "There needs to be a re-thinking on return on capital, including forceful stewardship by institutional investors."[1]

Keith Ambachtsheer, Director Emeritus, the Rotman International Centre for Pension Management: "*A new report by the international 'think-do' tank Preventable Surprises urges institutional investors to turn their climate change concerns into forceful actions. For example, investors should require the corporations they invest in to regularly disclose what they are doing to reduce climate change-related risks while protecting long-term shareholder value. The paper notes that, given their country's exposure to resources in general and to fossil fuels in particular, Canadian institutional investors should be at the forefront of these kind of initiatives. There is growing evidence this is in fact beginning to happen.*"

INTRODUCTION

Canadian institutional investors have an international reputation for good governance and long-term thinking, which makes their absence from the public discussion about climate change risk all the more puzzling. Yet there is a subtle but profoundly unsupportive national context that helps to explain this (see "The Context and the Challenge" below).

In the context of the current unsupportive federal policy environment, there is a great opportunity for Canada's institutional investment community – pension funds, insurance companies, and the country's largest banks – to lead debate and action on the financial implications of the transition to carbon neutral energy systems.

In spite of this opportunity, and the easy lessons to be learned from international best practice on carbon risk assessment and energy transition planning,[2] institutional investors and the investment management industry in Canada remains publicly committed to a high carbon investment model that risks leading us towards catastrophic climate change.[3]

There are, however, three important reasons to be hopeful about the situation in Canada:

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[1] http://www.theglobeandmail.com/report-on-business/rob-commentary/canada-must-finance-economic-strategies-solutions-to-climate-threat/article26773731/

[2] BHP Billiton's Climate Change Portfolio Analysis (2015) indicates the extent to which UK investors have demanded concrete metrics on climate risk from carbon-exposed companies: http://www.bhpbilliton.com/~/media/5874999cef0a41a59403d13e3f8de4ee.ashx. Their success raises questions about the apparent failure of the Canadian investment community to demand similar public information from Canada's most carbon-intensive companies.

[3] Covington and Thamotheram (2015): http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2551478.

1. Sub-national governments are taking the lead on climate policy and action. British Columbia was amongst first jurisdictions to put a carbon tax in place. Quebec's cap and trade system is linked with California, and Ontario is developing a cap and trade system. In addition, the recent change in government in Alberta, the heart of the fossil fuel industry, suggests that a bold change in direction may be possible elsewhere too.[4] Certainly, the Canadian public cares about climate change; a recent survey by the Angus Reid Institute found that 63% of Canadians say the country's response to climate change is "too weak"[5]. Indeed, last year Ontario, the most populous province by far, successfully phased out coal due to intense public pressure; this has been called "the single largest GHG reduction measure in North America"[6]. The challenge for NGOs, activist investors and interested foundations is to innovate and find ways to drive policy action on a low-carbon transition in the most effective way possible. This is one area where philanthropic support could increase the rate of change.

2. Changing demand profiles in the largest markets for Canadian fossil fuels – the United States and China – mean that the time is ripe for a re-evaluation of energy policy at the national and provincial level. The likelihood of reduced demand for Canadian oil sands and coal in export markets, and increasing cost-competitiveness of renewable energy, mean that Canadian fossil fuel companies must adjust their business models even in the absence of assertive climate policy action at home. The country's largest investors have not yet questioned in public how this transition will occur.

3. The recent success of the BP and Shell climate risk assessment shareholder resolutions and the anticipated implementation of Alberta climate change and low-carbon energy transition policies provide an ideal opportunity for Canadian investors and concerned stakeholders to test the *Forceful Stewardship* Protocol.[7]

A Canadian approach could usefully comprise the following 6 focus areas:

1. Positive Investment Opportunities: part of the challenge is that Canadian investors, corporations, and politicians do not have a consensus vision on how their economy might transition to and thrive in a low-carbon world.[8] More specifically, but relatedly, Canadian investors do not have a sense of what the attractive investment opportunities in such a future might be. On a personal level, investment decision-makers remain committed to their peers in the fossil fuel sector, and have not yet become champions of those CEOs who could be Canada's "Elon Musks" in the making.[9]

2. Oil Sands companies: building on the success of Aiming for A resolutions, investors could focus on the major pure-play oil sands companies with resolutions related to "low carbon business plans".[10]

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[4] The economic stimulus of a transition of Alberta's energy system towards lower carbon is significant and has been discussed for over a decade. See https://www.pembina.org/reports/greeningthegrid-report.pdf. The Premier recently announced her position that there is no long-term future for tar sands oil investments:
[5] http://angusreid.org/majority-of-canadians-call-for-more-robust-efforts-to-curb-climate-change-2/
[6] Ontario Power Authority [OPA], 2013a In Ontario's phase-out report cited in: https://www.iisd.org/publications/end-of-coal-ontario-coal-phase-out. Alberta may also consider a coal phase out plan, leading to significant stranded coal assets and associated infrastructure.
[7] http://shareaction.org/investors-challenge-bp-and-shell-disclose-business-risks-associated-climate-change
[8] Academics have suggested templates for low-carbon prosperity, but these have yet to be integrated into investment plans. See "Acting on Climate Change: solutions from Canadian scholars" (2015): http://biology.mcgill.ca/unesco/EN_Fullreport.pdf
[9] Interestingly, Elon Musk went to University in Canada at Queens and was working on Bay Street for Scotia Bank before he went to Silicon Valley. http://motherboard.vice.com/read/elon-musk-burning-fossil-fuels-is-the-dumbest-experiment-in-history-by-far
[10] See CTI Blueprint: http://www.carbontracker.org/report/companyblueprint/

3. Lobbying by Oil & Gas companies: investors could ask the major oil and gas companies to either cease any lobbying efforts aimed at delaying the introduction of measures to reduce Canadian GHG emissions or fully disclose all lobbying activities.[11]

4. Canadian Banks: investors could engage with the banks on their low carbon business plan and lending portfolio and also their stewardship role given their importance as investment managers.

5. Public Awareness: Civil society/NGOs could redouble their efforts to engage the public as citizen investors concerned with the issue of climate change, and build public support for the *Forceful Stewardship* Protocol among banks and institutional investors. Canada's largest banks are absent from public discussion on climate change, and associated investment risks.

6. Litigation: Civil society could initiate litigation against a Canadian pension fund for failing to fulfil its fiduciary duty by not assessing and addressing climate change as a systemic risk to member savings. Support for shareholder litigation against pure-play oil sands companies for misleading investors on climate change risks to their business models, and inaccurate corporate reporting is a further option.

Although discussing public awareness and litigation does not fit easily within the Canadian culture it is clear that without assertive action on these fronts, the other substantive work will move slowly. Indeed, in the recent on-line dialogue, there was strong support for the importance of litigation.[12]

THE CONTEXT AND THE CHALLENGE

A Federal Laggard with Regional Leaders

Canada is considered a global laggard on climate change and is expected to miss – by a wide margin – its current target of reducing overall emissions by 17% by 2020 relative to 2005. Environment Canada's Emissions Trends 2014 report shows that without additional measures, by 2020 Canada will only have reduced its emissions by 1.2% below 2005 levels[13]. Prime Minister Stephen Harper supports a "sector by sector approach" but has failed to regulate greenhouse gas emission in the oil and gas sector. As a result, Canada has seen increasing emissions from that sector, which has now surpassed transportation as the largest emitting sector.

Further, Canada's submitted Intended Nationally Determined Contributions (INDC) has been assessed as being "inadequate" by the Carbon Action Tracker Consortium, a research coalition[14]. It includes a target to reduce overall emissions by 30% below 2005 levels by 2030. Meeting these goals will require additional measures, particularly for emissions reductions in the oil sands, which under the current policy regime are expected to increase.

Despite the federal government's lack of commitment to a meaningful plan to reduce Canada's emissions, there are promising signs at the sub-national level:

[11] This would include lobbying of regional (e.g. http://www.vancouverobserver.com/news/alberta-oil-and-gas-millions-fuel-bc-liberal-machine) and national governments.

[12] See Q2, p131 of "Investors, Climate Risk and Forceful Stewardship: An Agenda for Action", Preventable Surprises (2015)

[13] http://ec.gc.ca/ges-ghg/E0533893-A985-4640-B3A2-008D8083D17D/ETR_E%202014.pdf

[14] http://climateactiontracker.org/countries/canada.html

- The carbon tax in British Columbia (BC) has been successful in reducing emissions while the economy continues to grow.[15]
- Alberta recently elected a New Democratic Party government, which is undertaking a public consultation to inform its strategy development in time for COP21 in Paris[16], providing the opportunity for a significant shift in climate policy.
- Ontario has phased out coal, set ambitious emissions reduction targets,[17] and is following Quebec in establishing a cap and trade system in cooperation with several US states.
- The municipality of Vancouver is developing a strategy to be 100% renewable by 2050[18].

Whether there is a change in Federal government later this year or simply a reduction in the majority of the current government, it thus appears likely that there will be a more supportive policy context, regionally if not nationally.

The Paradox of Canadian Investor Leadership on Climate

Canadian pension funds have a reputation of being some of the best-run in the world, with strong governance[19] and an active commitment to long-term investing[20]. Yet, Canada is absent from the group of global funds taking a strong leadership role on climate change. Canadian funds are amongst the most carbon intensive globally, and to address portfolio climate risk would therefore require a paradigm shift on the part of fund leaders.

For example, using the Asset Owner Disclosure Project (AODP) scoring system, the highest rating that any Canadian pension funds gets is "BBB" (there are 2) and 34% scored "X" (i.e. no effort to recognise or address climate risk). In contrast, Australia has 2 funds that scored "AAA", with only 10% scoring "X". The Netherlands also boasts 2 funds scoring "AAA", with 11% scoring "X".[21]

More practically, no major Canadian fund co-filed or pre-declared on Aiming for A resolutions.[22] And amongst commercial financial institutions, the discourse is explicitly bullish about more fossil fuels.[23] Even those investors who engage with companies around climate risk management, such as the Vancity Investment Management Corporation (VIMC), do not press companies to explicitly address climate change related investment risk in their public statements or in annual reports.

What could explain this apparent paradox between a commitment to long-termism and good governance and a lack of focus on climate risk? Here are a number of possible reasons:

- Corporate Canada is anxious about publicly acknowledging the climate science and the urgent need for action. With fossil fuel companies accounting for about 24% of the total value of the S&P/TSX60 index

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[15] http://blogs.worldbank.org/climatechange/british-columbia-s-carbon-tax-shift-environmental-and-economic-success.

[16] http://alberta.ca/release.cfm?xID=38411C197F972-D7D6-7CC8-6882AF9F5A4D74F3

[17] 37 per cent below 1990 levels by 2030, and 80% by 2050. http://news.ontario.ca/ene/en/2015/05/ontario-first-province-in-canada-to-set-2030-greenhouse-gas-pollution-reduction-target.html

[18] http://vancouver.ca/green-vancouver/renewable-city.aspx

[19] http://www.economist.com/node/21548970

[20] A good example of this is the Focusing Capital on Long Term project, one of the two co-founders is Canada's Mark Wiseman (CPPIB).

[21] www.aodproject.net

[22] http://www.lapfforum.org/LNews/FullListings-Institutional-Supporters-Resolution25-BPAGM-As-at-14thApril2015.pdf

[23] For example, the comments from the CEO of Scotiabank: http://www.bnn.ca/News/2015/4/9/Scotiabank-CEO-makes-public-push-for-more-pipelines.aspx

and extractive industries, and forestry also significant sectors, the scepticism/denialism is understandable but that will not reverse science.[24]

- Canada's largest banks,[25] are heavily involved in domestic and international fossil fuel project lending and also provide significant private equity and debt financing to the sector.[26]

- The Federal Government has a poor record on establishing and implementing climate change policy measures to reduce emissions, particularly in the oil and gas sector, where emissions continue to rise. And investors, who are in practice more short-term than they may like to admit, assume that this approach will continue for the time being.

- Federal and provincial financial market regulators have not yet identified climate risk (whether related to lack of mitigation or adaption) as a systemic risk. The political silencing of government regulators on climate risk creates an environment in which Canadian investors can claim that they have no influence on the public policy needed to address climate change. And in the absence of the appropriate market signals (e.g. effective carbon price, carbon policies), investors can rest on the excuse that they have no incentive to act before government does. A marked unwillingness to show leadership means that Canada falls further behind as financial markets in other jurisdictions, primarily the US, UK, EU, and China manage the transition towards a carbon-constrained economy.

- As in most countries, there is a close relationship among corporate, political, and investment decision-makers, particularly in the make-up of corporate boards, including pension funds. The Canada Pension Plan Investment Board, for example, has board members sitting on a number of pure-play oil sands companies, including the recently bankrupt Larcinia Energy.[27]

- In contrast to some other markets (e.g. UK, USA) the Canadian SRI retail market does not generally provide a powerful challenge to institutional investors on the issue of climate change. This is partly due to the fact that Canadian SRI investors investing in Canada use a benchmark that is heavily weighted towards fossil fuel and mining companies.[28] With the exception of NEI and a very few other firms[29], most Canadian SRI investors have not been assertive on this issue.

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[24] Canada's Carbon Liabilities: The Implications of Stranded Fossil Fuel Assets for Financial Markets and Pension Fundshttps://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office,%20BC%20Office/2013/03/Canadas%20Carbon%20Liabilities.pdf

[25] Royal Bank of Canada, TD Bank, Bank of Nova Scotia ("Scotiabank"), Bank of Montreal (BMO), Canadian Imperial Bank of Commerce (CIBC), and the National Bank of Canada.

[26] https://en.wikipedia.org/wiki/Big_Five_(banks)

[27] Prior to the bankruptcy protection filings, CPPIB had a $350 million equity investment in Laricina – giving it a 15% ownership stake — plus an additional $150 million of debt, and a CPPIB appointed board director, Adam Vigna: http://business.financialpost.com/news/fp-street/how-much-cppib-has-invested-in-laricina-energy. See bankruptcy court filings: https://www.pwc.com/ca/en/car/laricina/assets/laricina-005_033115.pdf.

[28] Preventable Surprises understands there are nascent efforts to deliver fossil free investment products.

[29] The clear market leader is NEI which has, for example, successfully engaged companies to adopt and publicly disclose on a shadow price for carbon and to publicly support the implementation of a price on carbon. NEI also engages policy makers to express investor support for smart climate policy, engaging other investors into the mix (such as the current effort, in collaboration with SHARE, aimed at the Alberta government that has attracted over 100 signatories and $2.5 trillion in AUM). Today NEI is engaging energy companies on diversification for the energy transition, through greatly increased R&D and focused innovation strategies.

One result of these conflicts of interest and self-censorship is that only five Canadian investors signed a letter to Federal Finance Minister in May 2015 to "urge" Canada to back clear emission reduction targets[30]. Another is the persistent lack of disclosure over any changes in investment and active ownership practices. And finally, as a survey conducted by the CFA Institute shows, Canadian investment professionals are 4th quartile, on par with Indian respondents, when it comes to awareness of climate risk. Interestingly, awareness of environmental issues is not low amongst Canadian investment professionals. This suggests that there is a particular mental block over climate risk.

Regulators also appear absent from the discussion. Neither the Bank of Canada nor the Office of the Superintendent of Financial Institutions (OSFI) has identified climate change as a systemic risk, despite vocal warnings from former Bank of Canada Governor Mark Carney in his role as the Governor of the Bank of England.[31]

As Murray Gold notes: "Mark Carney and the Bank of England have warned of the implications of climate change for the UK insurance sector. But the message is relevant for Canadians too and the pension sector, with similar exposures to long liabilities and a similar dependency on overall economic conditions, must consider itself similarly warned. Civil society actors, including insurers and pension funds, must work with governments to conclude a 2 degree plan in an urgent time frame."[32]

Canadian Civil Society/NGOs Have Not Adequately Challenged Investors

Canadian NGOs have not yet mobilised citizen investors, as has happened in the US, UK, and Netherlands. To generalise, Canadian foundations are not actively supporting efforts to engage the Canadian investment world. Where public education has already happened, it has been in partnership with ESG/SRI providers and even though these are "best in class" organisations in the Canadian context, this does not create public demand for *Forceful Stewardship*.

In the absence of bottom-up pressure driven by citizen-investor engagement, it is unlikely that the tightly knit investment community will permit the necessary disruptive action required to address climate change investment risks and opportunities.

There does not seem to be any overwhelming reason why the current state of affairs could not substantially evolve following the federal election and the Paris COP in December of 2015. Indeed, if Canadian philanthropists and the public both want disruptive business model change in the fossil fuel industry, there are good reasons for expecting collaboration on this to create substantial disruptions in the status quo.

THE PRIORITIES

All of the priorities referred to below require local support in Canada, likely supported by local NGOs that have a strategic objective to influence Canadian pension savers and other investors to address climate risk. A local resource would play the organisational and facilitation role that Climate Change Investor Networks play in other regions, and would coordinate global investor action in the Canadian context.

30 http://www.aimco.alberta.ca/DesktopModules/AIMCoNews/Documents/Climate%20Change%20Canadian%20Outreach%20Letter%20FINAL.pdf

31 http://www.bankofengland.co.uk/publications/Pages/speeches/2015/844.aspx

32 https://preventablesurprises.com/blog/leading-canadian-pension-lawyer-welcomes-mark-carneys-challenge/

Positive Investment Opportunities

Part of the challenge is that Canadian investors, corporations, and financial and political elites have not yet agreed upon a coherent vision of how their economy might thrive in a low-carbon world.[33] More specifically, but relatedly, Canadian investors do not have a sense of what the attractive investment opportunities in such a future might be.

What could be done?

- An assessment of current perceived barriers (aside from the obvious lack of federal policy support) to green investment as already been carried out. Valuable input could be gained from Canadian organisations focused on accelerating the growth of the green economy (e.g. Clean Energy Canada, Toronto Atmospheric Fund, Analytica Advisors, etc.).

- One approach would be to commission a study – this approach could contribute to significant changes, as evidenced by the successful coal phase-out in Ontario. Another approach would be to develop a Canadian Low-Carbon Investment Pathway (CLIP) akin to the IEA's Tracking Clean Energy Progress report[34]. Without getting bogged down in details of accurate investment flow assessment, the CLIP could identify, at a high level and with periodic updates, the following:
  a. Existing barriers to green investment;
  b. Efforts required and/or being made to remove barriers (may be related to the other priorities in this section);
  c. An overall assessment of how current investment flows are tracking relative to what is required for a low carbon economy.[35]
- This is not meant to replicate existing global initiatives such as the Low Carbon Investment Registry[36], but rather to provide a perspective on green investment flows in Canada (barriers and opportunities).

Oil Sands Companies

Building on the success of Aiming for A resolutions, investors could focus on the major pure play oil sands companies with resolutions related to "low carbon business plans", and the wind-down of the most uneconomic and carbon intensive projects. Investors could prepare the Canadian coal mining and coal fired power sector for winding up, as per the Ontario example.

What could be done?

- A local NGO with deep expertise in oil sands (e.g. Pembina) could be approached to asses which oil sands companies pose significant risks to investors (through a combination of size, leverage ratios and insufficient attention to Big Climate Risk). This information could be combined with information available from other sources (e.g. the Carbon Tracker Initiative). Canadian fossil fuel companies could also be encouraged to either join leadership initiatives like the Oil & Gas Climate initiative[37] where international benchmarking would be the norm.

[33] There have been many prompts, both from NGOs and academics, but institutional investors have thus far ignored these calls for engagement. See the March 2015 report, "Acting on Climate Change: Solutions from Canadian Scholars," (https://www.mcgill.ca/tispp/files/tispp/acting_on_climate_change.pdf) which charts a path to carbon neutral energy systems, and more recently a policy implementation plan: http://www.sustainablecanadadialogues.ca/en/scd/extendingthedialogue

[34] http://www.iea.org/etp/tracking2015/

[35] This could build on work already done: https://www.mcgill.ca/tispp/files/tispp/acting_on_climate_change.pdf

[36] http://globalinvestorcoalition.org/low-carbon-investment-registry/

[37] www.oilandgasclimateinitiative.com

LOBBYING BY OIL & GAS COMPANIES

Investors could ask the major oil and gas companies to either cease any lobbying efforts aimed at delaying the introduction of measures to reduce Canadian GHG emissions or fully disclose this work to the public.

What could be done?

- An inventory of lobbying efforts and practices exist is needed and organisations such as SHARE and NEI Investments would be well suited to lead on this. That might lead to a "Books and Records" request at target companies.

CANADIAN BANKS

Investors could engage with Canada's 5 largest chartered banks to demand the development of "low carbon business plans" and more information on the banks' respective stewardship activities in relation to climate risk given their multiple roles. This includes the importance of the sell side analysts from the Big 4 who cover high impact sectors, the powerful investment management functions of the Big 4, including their role as major players in the Canadian Coalition for Good Governance (CCGG) and the structural importance to the national economy of the financial connections between banks and the high impact companies. Preventable Surprises understands that resolutions to this effect have already been raised with the banks, but were withdrawn following negotiations with the respective institutions.[38] It is time for investors to bring forceful resolutions, and to build strong public coalitions to drive changes in corporate conduct, rather than provide tacit approval to "business as usual" conduct and dangerous, shareholder value destroying climate change.

What could be done?

- This is likely the most sensitive priority, and likely would warrant discussions at the CEO level of the large Canadian banks and the largest pension funds. A starting point would be to request informal guidance from senior individuals at the banks on how best to approach this topic.

PUBLIC ENGAGEMENT WITH INVESTORS

Civil society/NGOs could redouble their efforts to engage citizen investors on the issue of climate change, and build public support for the *Forceful Stewardship* Protocol.

What could be done?

- A working group, supported by the Toronto Atmospheric Fund (TAF), has established the "C2I Initiative" focused on helping Canadian savers call on their pension funds to address and mitigate climate risk[39]. They and other local NGOs (e.g. Sacred Spaces[40]) who are able to engage the Canadian public could be approached for ideas and collaboration. Some Canadian campus divestment campaigns appear to be open to strategies for change over and above divestment, and they may find the *Forceful Stewardship* message useful[41].

LITIGATION

Civil society could initiate litigation against a Canada pension fund for failing to fulfil its fiduciary duty by not assessing and addressing climate change as a systemic risk.

[38] Personal communication, Hamish Stewart, October 2015
[39] http://taf.ca/follow-the-leaders-de-carb-your-money/
[40] http://greeningsacredspaces.net/what-we-do/
[41] http://www.toronto350.org/divest

What could be done?

- Local law firms specializing in environmental law (e.g. West Coast Environmental Law [WCEL][42]) could collaborate with existing initiatives[43] to assess the potential merits of litigation of a pension fund. WCEL has written about the role of professionals in climate change mitigation and adaptation[44]. Consideration could be given to challenging professionals (e.g. insurance or pension actuaries) on their role in assessing and managing climate risk.

IMPLICATIONS AND CONCLUSIONS

Whilst the urge to wait to see what comes from the Federal elections and or COP21 is understandable, the reality is that what institutional investors need to do – and indeed can do – on stewardship is already clear and will not change.

To contribute to this process and play a catalyst role, Preventable Surprises will cultivate champions/ambassadors in each of the 6 different stakeholder groups identified above – individuals who are trusted and credible in their local markets, but who are willing to open doors and, in private at least, support Preventable Surprises' work and the *Forceful Stewardship* Protocol.

Given the cultural constraints on open debate, Preventable Surprises may need to work with its supporters and advocates bilaterally for some time before it is possible to create a fully multi-stakeholder advisory group. Regardless of how it works, such a group will play a critical role in defining exactly what Preventable Surprises needs to do (and not do) at any given stage in a multi-year initiative.

[42] http://wcel.org/

[43] Such as the Climate and Pensions Legal Initiative in the UK: http://www.clientearth.org/news/latest-news/pension-funds-must-confront-climate-risk-2838

[44] http://www.wcel.org/sites/default/files/publications/Professionals%20and%20Climate%20Change_0.pdf