Your ESG integration

partner in capital markets

Montreal, January 18, 2022

Me Philippe Lebel
Corporate Secretary and Executive Director, Legal Affairs
Autorité des marchés financiers

Via email: consultation-en-cours@lautorite.qc.ca

RE: Millani's response to the consultation report on Proposed National Instrument 51-107 Disclosure of Climate-related Matters

As Founder and President of Millani, an ESG advisory firm involved with investors, corporate issuers, Boards of Directors and various capital markets financial institutions across Canada, I feel that it is important for our organization to respond to this effort of the CSA regarding the Proposed National Instrument 51-107 Disclosure of Climate-related matters.

Before sharing our point of view on some of the recommendations of the report, we would like to say a few words about the work we do at Millani in the field of sustainable finance and explain why our understanding of the needs of various types of clients in Canada and our market knowledge can bring a unique perspective to the mandate you have been given.

As a Canadian ESG advisory firm, we have a team of capital markets and sustainability experts who have extensive expertise in the fields of asset management, responsible investing, and corporate sustainability. Millani is highly regarded for its ability to engage Canadian investors. We interview institutional investors from across Canada and around the globe on a regular basis, allowing us to maintain a deep understanding of investors' practices and perspectives across many markets and maintain a global network. The work we do with corporate issuers is based on developing ESG disclosure and engagement strategies, focused on attracting financial stakeholders and ensuring access to capital.

Additionally, Millani publishes research papers and holds webinars on a regular basis, and I am frequently invited to participate in conferences and roundtables on matters related to ESG and sustainable finance. Over the past five years, Millani has been delivering "MarketTrends" sessions across the country to investors and issuers, providing information on key trends in responsible investing, gathered from continuous research and engagement with capital markets participants and corporate issuers. We also publish a Semi-Annual Sentiment Study of Institutional Investors that summarizes the most current insights on sustainable finance.

With that in mind, we are pleased to share our comments to the questions that we feel we can provide our unique insights to assist in the assessment and contemplation of the Proposed Instrument.

Experience with TCFD recommendations

4. ***Under the Proposed Instrument, scenario analysis would not be required. Is this approach appropriate? Should the Proposed Instrument require this disclosure? Should issuers have the option to not provide this disclosure and explain why they have not done so?***

   Investors globally are increasingly considering it best practice for corporate issuers to include scenarios in their risk management processes. Considering that scenario analysis is a process to consider the potential "What If's" and not forecasts, predictions of the future or a full description of the future. Thus, including scenario analysis is becoming part of the building of a solid and stable global infrastructure for the financial sector and the global economy. Having aligned global regulatory standards for ESG disclosure, including scenario analysis, is an important part of the development of the stability the market is looking to create.

   As such, it is extremely important to consider that if Canada does not include scenario analysis in its requirements for Canadian issuers, it could mean that Canadian issuers will fall behind competitively from a lack of capital being made available for growth or to transition their businesses to a lower-carbon economy. Canada and the CSA have an opportunity to demonstrate to the world that we understand the implications of this transition to a lower-carbon economy and that we will be an active participant in building the infrastructure required to deliver it.

   In both of Millani's Semi-Annual Sentiment Studies of Institutional Investors in June[1] and December 2021 [to be published in February 2022][2], we heard from investors that the current status of climate-related scenario analyses by issuers are not meeting investors' needs for decision-useful information. As such, our recommendation is to require the disclosure of scenario analysis results but also to provide guidance on what an acceptable scenario analysis might be.

   As noted by the Canada Expert Panel on Sustainable Finance ("Expert Panel")[3], and from our experience of working with issuers, the anticipated legal implications of disclosing scenario analysis results keeps issuers hesitant to disclose. We feel that the "safe harbour" provision, suggested by the Expert Panel, would enable businesses to take the preliminary steps needed to work through, and subsequently publish, these scenarios, without fear of legal implications.

5. ***The TCFD recommendations contemplate disclosure of GHG emissions, where such information is material.***

   - ***The Proposed Instrument contemplates issuers having the option to disclose GHG emissions or explain why they have not done so. Is this approach appropriate?***

     In our view, it is appropriate. Under the Sustainability Accounting Standards Board (SASB) framework, which is evidence-based and widely used by investors, 70 of the 77[4] sectors in the framework indicate that climate change is a financially material issue.

     As many of our clients are in the early stages of understanding climate-related risks and opportunities, we have witnessed there are some organizations for which climate change is not the most financially material issue, in the short-term. This may be the case where there has been a significant pivot by the organization in certain industries. There is no doubt however, that the topic is becoming material for all businesses in the medium to long-term.

1 Millani, *Semi-Annual Sentiment Study of Canadian Institutional Investors: Climate Change & TCFD-Aligned Reporting*, July 7, 2021
2 Access to Millani's reports
3 Government of Canada, *Final Report of the Expert Panel on Sustainable Finance*, 2019
4 Sustainability Accounting Standards Board (SASB), *Response to the Draft Guidance for apply Enterprise Risk Management (ERM) to Environmental, Social and Governance (ESG)-related risks*, Jun 30, 2018

In these instances, we frequently advise our clients to begin a formal process to calculate and assess their GHG emissions, as many investors are currently seeking low-carbon emitting portfolio companies. Completing this assessment may become an advantage for the issuer, making the organization more attractive to investors, but only if the exercise has been completed and the data has been verified. As such, we support asking all issuers to undertake the exercise of calculating and disclosing their GHG emissions.

In our December 2021 Semi-Annual Sentiment Study [to be published in February 2022][5], investors indicated that the biggest challenge when calculating the carbon footprint of their portfolio remains the lack of available climate data, in particular as it relates to small and mid-cap issuers. The following are two direct quotes from these interviews to provide additional context:

> "Calculating the carbon footprint of the portfolio involves some estimates and some blanks, because there is a lack of direct reporting even for Scope 1 emissions."
> Asset Manager (December 2021)

> "The challenge is the availability of data on GHG emissions (Scope 1 and 2), especially for small-cap companies, as there are only one or two companies from which we can get GHG emissions numbers from data providers."
> Asset Manager (December 2021)

- ***As an alternative, the CSA is consulting on requiring issuers to disclose Scope 1 GHG emissions. Is this approach appropriate? Should disclosure of Scope 1 GHG emissions only be required where such information is material?***

Many companies do not directly control their own power production so their emissions would not be included in Scope 1, and would only be accounted for in Scope 2 emissions. Depending on the nature of the sector in which a company operates, some organizations have therefore very few Scope 1 emissions (i.e. software or service-oriented issuers) with much of their impact only being indicated through Scope 2 emissions. As a result, for an investor to conduct a thorough assessment of an issuer, the disclosure of Scope 1 emissions alone is not sufficient.

We proactively surveyed institutional investors in Canada on this point in our Semi-Annual Sentiment Study in June 2021[6]. 100% of the investors interviewed stated they are looking at the disclosures of both Scope 1 and 2 emissions. Moreover, our most recent study in December 2021 [to be published in February 2022][7] indicates that the number one disclosure investors are looking for in climate reporting is carbon emissions.

- ***Should disclosure of Scope 2 GHG emissions and Scope 3 GHG emissions be mandatory?***

As noted above, our work with investors and issuers indicates that the disclosure of Scope 1 and 2 emissions should be mandatory, with the suggestion that the disclosure of Scope 3 emissions should also be gradually implemented.

Our research shows that investors expect issuers to report on their GHG emissions, whether this is regulated or not. In regard to the mandatory disclosure of Scope 3 emissions, in recent interviews with investors, one asset manager highlighted the importance of providing Scope 1, 2

[5] Access to Millani's reports
[6] Millani, *Semi-Annual Sentiment Study of Canadian Institutional Investors: Climate Change & TCFD-Aligned Reporting*, July 7, 2021
[7] Access to Millani's reports

and 3 emissions. This provides context to investors and allows for a full assessment of the organizations' potential impacts, risks, and opportunities.

> "Companies might have a high carbon footprint, when considering Scope 1 and 2 emissions, but their products and services reduce Scope 3 emissions. We need to consider Scope 3 emissions because [if we only look at Scope 1 and 2 emissions] these companies would probably not get the investment to [continue operating and] solve bigger problems." Asset Manager.

We understand that implementing mandatory disclosure of Scope 3 emissions may be challenging for many issuers in the immediate term. For example, in the early stages of a mandate with an issuer, it was determined that it would be impossible to calculate and disclose Scope 3 emissions. However, once the issuer was able to calculate and assess its Scope 1 and 2 emissions, it was natural to continue to make efforts to understand its Scope 3 emissions. Within a two-to-three-year period, the issuer was in fact able to provide partial Scope 3 emissions. As such, our recommendation would be to move towards a requirement of partial Scope 3 emissions in disclosures, with a consideration that this can be implemented over time. This requirement should focus on Scope 3 emissions that are linked to high-emitting activities. For example, a company operating in the oil and gas industry could focus on the disclosure of Scope 3 emissions from its downstream fossil fuel products and not necessarily from emissions from its corporate travels.

- ***For those issuers who are already required to report GHG emissions under existing federal or provincial legislation, would the requirement in the Proposed Instrument to include GHG emissions in the issuer's AIF or annual MD&A (if an issuer elects to disclose these emissions) present a timing challenge given the respective filing deadlines? If so, what is the best way to address this timing challenge?***

  Given our work across multiple industries across Canada, we have witnessed these issues and it is valid. While we do not have a particular recommendation on how to implement this so that there is comparability across all sectors, it does highlight the need for the mapping and engagement by all entities across the financial infrastructure in Canada to align on the reporting requirements of companies and issuers across various departments and capital markets.

  We recommend that the CSA brings this issue to the attention of the respective regulatory agencies to see if some alignment might be possible in the future.

6. ***The Proposed Instrument contemplates that issuers that provide GHG disclosures would be required to use a GHG emissions reporting standard in measuring their GHG emissions, being the GHG Protocol or a reporting standard comparable with the GHG Protocol (as described in the Proposed Policy). Further, where an issuer uses a reporting standard that is not the GHG Protocol, it would be required to disclose how the reporting standard used is comparable with the GHG Protocol.***

- ***As issuers have the option of providing GHG disclosures, should a specific reporting standard, such as the GHG Protocol, be mandated when such disclosures are provided?***

  We believe it is vital that only one standard be used, to allow for consistency and comparability of data being disclosed. It is important that these efforts or standards that are put into place by the CSA drive the market towards standardization and verification of data.

- ***Is the GHG Protocol appropriate for all reporting issuers? Should issuers be given the flexibility to use alternative reporting standards that are comparable with the GHG Protocol?***

For consistency and comparability, one standard for disclosing GHG emissions should be used by all issuers. It should be acknowledged however, that the resources required to use the GHG Protocol may be excessive for small and mid-size enterprises (SMEs). Having financial support available to organizations for the development, strategic thinking, planning and implementation of these topics could be considered by various governmental agencies to assist issuers in the preparation of their preliminary disclosures, so that Canadian issuers can remain competitive on a global basis. For example, in the province of Quebec, the Fonds Écoleader[8] offers financial assistance, in the form of a grant, to Quebec-based companies that hire experts to help them implement environmentally responsible business practices or prepare for the acquisition of clean technologies. Moreover, to enable smaller companies to align with the GHG Protocol, a phased-in approach could be adopted.

- ***Are there other reporting standards that address the disclosure needs of users or the different circumstances of issuers across multiple industries and should they be specifically identified as suitable methodologies?***

  Based on our research, the GHG Protocol is what the majority of issuers and investors have already adopted in many of their financial models. Moving away from this standard could be considered a step backwards.

  However, we have noticed that in the financial sector specifically, another methodology that is used is the Partnership for Carbon Accounting Financials (PCAF)[9].

7. ***The Proposed Instrument does not require the GHG emissions to be audited. Should there be a requirement for some form of assurance on GHG emissions reporting?***

   If the goal of these efforts is to create a global standard for investors globally to assess Canadian issuers (and if we wish to continue to attract capital, which is an important consideration), then we believe that some form of assurance of GHG emissions is required.

   Over the past 24 months, we have witnessed a significant shift by investors away from solely using third-party rating agency data and inputs for their financial models. We have seen a significant move towards the use of proprietary modelling, which is a strong indication of the depth to which investors are now considering these ESG issues. For investors to evolve, they need data, and they need to have assurance that the data they are using in their modelling, similarly to financial data, is solid.

   It is, therefore, in our view, necessary for emissions data to be audited, as with any other financially material data. We understand that this will again require additional financial resources, which could represent a challenge for small and mid-cap issuers. As such, we suggest a phased-in approach to allow issuers time to fully comply with this requirement.

8. ***The Proposed Instrument permits an issuer to incorporate GHG disclosure by reference to another document. Is this appropriate? Should this be expanded to include other disclosure requirements of the Proposed Instrument?***

   Given the time and resources required to prepare and produce GHG-related data, we believe that it would be prudent to allow a reference to other documents, as long as the data and information can be retrievable from SEDAR.

Usefulness and benefits of disclosures contemplated by the Proposed Instrument

[8] More information can be found on Fonds Écoleader's website
[9] More information can be found on PCAF's website

9. What climate-related information is most important for investors' investment and voting decisions? How is this information incorporated into these decisions? Is there additional information that investors require?

- ***What climate-related information is most important for investors' investment and voting decisions?***

  As noted in response to question 7, we have witnessed a significant shift in investors' assessment of GHG and climate-related data as they move towards proprietary financial models and away from third-party research. Given the nature of our mandates, we are engaging with investors globally on an ongoing basis. Our June 2021 Semi-Annual Sentiment Study[10] provides valuable and up-to-date responses to this question:
  - Investors wish to receive information relating to both absolute emissions and emissions intensity, the links between climate change and its impact on financial statements and capital allocation decisions.
  - Investors also expressed desire for disclosure aligned to the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD), grouped according to the four following areas - 1) Governance, 2) Strategy, 3) Risk Management, 4) Metrics and Targets.
  - Investors also suggested that providing data alone is insufficient. Adding context to the data is equally important so that they can understand how the organization interprets the data and how this is integrated in strategy and risk management processes.

10. What are the anticipated benefits associated with providing the disclosures contemplated by the Proposed Instrument? How would the Proposed Instrument enhance the current level of climate-related disclosures provided by reporting issuers in Canada?

- We continue to hear from investors that the main impediment to calculating the climate impact or emissions in their portfolio is the lack of data from portfolio companies. The main benefit contemplated by the Proposed Instrument is the availability of relevant data.
- More broadly, climate disclosures are intended to help link climate risks and opportunities to corporate assets and liabilities. According to a study by Carbon Tracker[11], it was indicated that even with growing regulatory pressures, of 107 global companies, over 70% did not consider climate matters when preparing their 2020 financial statements. This means that this data is not being considered as part of the liabilities on the balance sheets of organizations. If the market considered this data to be financially material, then investors expect it to be indicated as such.
- Based on our market knowledge, with increased scrutiny of investors practices relating to responsible investing, there is a desire to move away from the appearance of any potential "greenwashing" in their products. To do so, investors are deepening their processes and practices, as they build proprietary investment approaches. However, to combat what might be considered greenwashing practices, investment management firms and other market participants need data. In the absence of such data, the market cannot evolve, and the broader population may become disillusioned regarding ESG or responsible investment funds. It is therefore vital that measures such as what is proposed in this instrument be put into place, to solidify and prepare for the scrutiny that regulators such as the CSA need to put into place to safeguard and protect the average investors. The proposed instrument is highly connected to the integrity of the financial markets and the products made available.
- As indicated recently by the IEA report[12], as well as the results of the pilot study of the Bank of Canada and OSFI[13], Canada's economy will face significant issues related to the transition to a lower-carbon economy. As such, the ability of issuers in Canada to have access to the amount of required capital needed to transition their businesses will be essential to the economic prosperity

[10] Millani, *Semi-Annual Sentiment Study of Canadian Institutional Investors: Climate Change & TCFD-Aligned Reporting*, July 7, 2021
[11] Carbon Tracker, *Flying blind: The Glaring Absence of Climate Risks in Financial Reporting*, September 16, 2021
[12] Bloomberg, Canada to face challenge in remaining major oil power, IEA warns, January 13, 2022
[13] Bank of Canada, Using Scenario Analysis to Assess Climate Transition Risk, 2022

of our country. For our issuers to have access to global capital, they will need to meet and possibly surpass global standards of climate disclosure. The Proposed Instrument is essential to the viability of our corporations and the social impact they provide, as well as the overall prosperity of Canada.

The third-party ESG rating agencies are heavily relied upon by the passive investment market, which is estimated to grow by 9% annually over the next five years – compared to a 6% annual growth rate for total global assets under management (AUM) over the same period – to represent as much as 25% of global AUM in 2025, compared to 21% in 2020[14]. A benefit associated with the contemplated Proposed Instrument is the replacement of assumptions being made by third-party ESG rating agencies. In the absence of climate-related disclosures, ESG rating agencies rely on industry benchmarks and estimation methodologies. The results are that these estimates may not accurately reflect the emissions performance of companies. As a result, the rating agencies penalize companies that are effective at managing their climate risks and opportunities but may not be disclosing them publicly. A disclosure requirement as proposed here should help improve the quality of information made available to investors by ESG rating agencies, which in turn may ensure that the growing passive market is representative of real data, rather than assumptions.

Costs and challenges of disclosures contemplated by the Proposed Instrument

11. ***What are the anticipated costs and challenges associated with providing the disclosures contemplated by the Proposed Instrument?***

The anticipated costs and challenges associated with providing the disclosures contemplated by the Proposed Instrument for issuers are mainly time and additional financial resources, which include the costs of collection, assurance, audit, employees with the adequate expertise, etc.

An additional challenge is that Boards of Directors, and especially those who sit on Audit Committees, often do not have sufficient knowledge of climate-related issues and how they can or should be integrated into financial reporting. As such, they rely heavily on the accounting industry to provide assurance of the data. However, the accounting industry is also in a growth stage with respect to the talent and knowledge available to provide the level of assurance needed for the short-term. This challenge will resolve itself in the next few years as both parties are educated, and talent is trained appropriately.

The issue of the Audit Committee is leading to another challenge. There is a noted reluctance of issuers to provide forward-looking information on climate-related disclosures. As recognized by the Canada Expert Panel[15], a safe harbour provision could be considered for climate-related disclosures. The safe harbour provision would encourage companies to provide forward-looking information on metrics to provide investors with decision-useful information, which can then be supported by context.

12. ***Do the costs and challenges vary among the four core TCFD recommendations related to governance, strategy, risk management, and metrics and targets? For example, are some of the disclosures more (or less) challenging to prepare?***

The costs and challenges do vary among the four core TCFD recommendations. The preparation and disclosure of climate-related scenario analysis, the metrics and targets and the strategy – more specifically the development of plan and the capital allocation – will require more time and resources. However, it should be taken into consideration that the scenario analysis efforts will not be something that will need to be executed on a yearly basis.

In general, it is recommended to monitor the scenarios on an ongoing basis and to review them when significant changes arise that might impact the company's operations and strategy. As such, much of

[14] BCG, Global Asset Management 2021: The $100 Trillion Machine, July 2021
[15] Government of Canada, *Final Report of the Expert Panel on Sustainable Finance*, 2019

these costs would not be annual. However, the effort to calculate and report the GHG data will need to be reviewed and assured on an ongoing basis, which may represent significant recurring costs for most organizations, similar to ongoing reporting of financial data.

13. ***The costs of obtaining and presenting new disclosures may be proportionally greater for venture issuers that may have scarce resources. Would more accommodations for venture issuers be needed? If so, what accommodations would address these concerns while still balancing the reasonable information needs of investors? Alternatively, should venture issuers be exempted from some or all of the requirements of the Proposed Instrument?***

While we understand the specific challenges for venture issuers, we do not believe that accommodations should apply, as this information is becoming as important as other financial data to investors. We do, however, believe there may be an opportunity to provide support from federal and provincial governments to provide some type of financing to assist SMEs to comply with the disclosure requirements. For example, as mentioned in sub-question #5, in the province of Quebec, the Fonds Écoleader[16] offers financial assistance, in the form of a grant, to Quebec-based companies that wish to hire experts to help them implement environmentally responsible business practices or prepare for the acquisition of clean technologies. These types of government programs can enable companies to make progress on various sustainable initiatives and help them be competitive on a global basis.

While we recognize this is not within the purview of the CSA, we do recognize that the CSA does have an influential role that it can play in the overall development of a sound and solid financial infrastructure in Canada. As such, these recommendations are being made to demonstrate how the CSA might use its own influence to engage with other parties in the Canadian financial sector, as well as federal and provincial governments and regulatory authorities.

Guidance on disclosure requirements

14. ***We have provided guidance in the Proposed Policy on the disclosure required by the Proposed Instrument. Are there any other tools, guidance or data sources that would be helpful in preparing these disclosures that the Proposed Policy should refer to?***
    - No comments

15. ***Does the guidance set out in the Proposed Policy sufficiently explain the interaction of the risk disclosure requirement in the Proposed Instrument with the existing risk disclosure requirements in NI 51-102?***
    - No comments

Prospectus Disclosure

16. ***Form 41-101F1 Information Required in a Prospectus does not contain the climate-related disclosure requirements contemplated by the Proposed Instrument. Should an issuer be required to include the disclosure required by the Proposed Instrument in a long form prospectus? If so, at what point during the phased-in implementation of the Proposed Instrument should these disclosure requirements apply in the context of a long form prospectus?***

Given the nature of our work, we have already had the opportunity to work with private companies that plan to file a long form prospectus and become public. Many companies are already in preparation mode and as such, we believe that climate-related disclosures, as well as those related to other environmental, social and governance topics, should be included in the long form prospectus. The phased-in implementation approach based on non-venture or venture status could be applied and financial support should also be a consideration for this group.

[16] More information can be found on Fonds Écoleader's website

Phased-in implementation

17. ***The Proposed Instrument contemplates a phased-in transition of the disclosure requirements, with non-venture issuers subject to a one-year transition phase and venture issuers subject to a three-year transition phase. Assuming the Proposed Instrument comes into force December 31, 2022 and the issuer has a December 31 year-end, these disclosures would be included in annual filings due in 2024 and 2026 for non-venture issuers and venture issuers, respectively.***

- ***Would the transition provisions in the Proposed Instrument provide reporting issuers with sufficient time to review the Proposed Instrument and prepare and file the required disclosures?***

  We believe that the mid-to-large cap market in Canada is already advanced sufficiently to be able to meet the timelines proposed in this instrument and suggest that this time frame may in fact be too generous. We would consider that it could be phased in based on market capitalization. However, many large-cap issuers are already well advanced on these disclosures. The question that remains might well be the limited expertise in the market for assurance of the data. With the allowance of limited assurance and a safe harbour clause, this challenge could be alleviated.

- ***Does the phased-in implementation based on non-venture or venture status address the concerns, if any, regarding the challenges and costs associated with providing the disclosures contemplated by the Proposed Instrument, particularly for venture issuers? If not, how could these concerns be addressed?***
  - No comments

Future ESG considerations

18. ***In its comment letter to the IFRS Foundation's consultation paper published in September 2020, the CSA stated that developing a global set of sustainability reporting standards for climate-related information is an appropriate starting point, with broader environmental factors and other sustainability topics to be considered in the future. What broader sustainability or ESG topics should be prioritized for the future?***

As experts in the ESG space, with a particular focus on Canadian investors and issuers, we are pleased to see the CSA contemplate developing a global set of sustainability reporting standards. We frequently assist our clients in the identification and articulation of their financially material ESG topics for disclosures.

As well as climate change being assessed by SASB as financially material for 70 out of 77 sectors (as noted earlier), we see other topics that remain relevant in the consideration of financial materiality through our ongoing work with issuers and investors. We see ongoing developments in the following areas that might be important for consideration by the CSA:

- Cybersecurity and Data Privacy
- Talent and Human capital
- Biodiversity and Natural Capital

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partner in capital markets

We would like to thank you for the opportunity to provide our comments and share our insights for consideration in your deliberations and the outcomes on this Proposed Instrument.

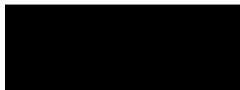
I am pleased to attach our June 2021 Semi-Annual Sentiment Study of Institutional Investors report as support and reference to our comments. We will be releasing this year's version of the study publicly on February 9, 2022 and would be pleased to provide you with a copy when available. Please contact us for an up-to-date version if there is an interest.

Should you be interested in learning more about our views or experiences, we would welcome the opportunity to speak with your representatives.

We look forward to seeing the outcomes of your valuable work.

Best regards,

Milla Craig
Founder and President
Millani Inc.



Semi-Annual Sentiment Study of Canadian Institutional Investors: Climate Change & TCFD-Aligned Reporting

July 7, 2021

In May/June 2021, Millani conducted its Semi-Annual Sentiment Study of Canadian Institutional Investors, with investors managing assets over $4.4 trillion[1]. This study is conducted to understand key trends for environmental, social and governance (ESG) integration and to capture a uniquely Canadian perspective over time.

Given global pressure to advance the quality and coverage of climate-related financial disclosures, along with recent indications that reporting in alignment with Task Force on Climate-Related Financial Disclosures (TCFD) may become mandatory, this sentiment study seeks to provide insights on investors' needs in the evaluation of climate-related risks and opportunities, using the TCFD as a reference.

This report can be read in conjunction with Millani's June 2021 publication, "TCFD Disclosure Study: A Canadian Perspective", in which Millani examined the extent to which the S&P/TSX Composite Index constituents align with the TCFD recommendations. Millani found that only 23% of issuers are currently reporting in alignment with these recommendations. This implies that most Canadian issuers are exposed to the risk of diminishing their access to capital and, by extension, limiting investors' access to their returns.

1. Approximate amount calculated from public sources.

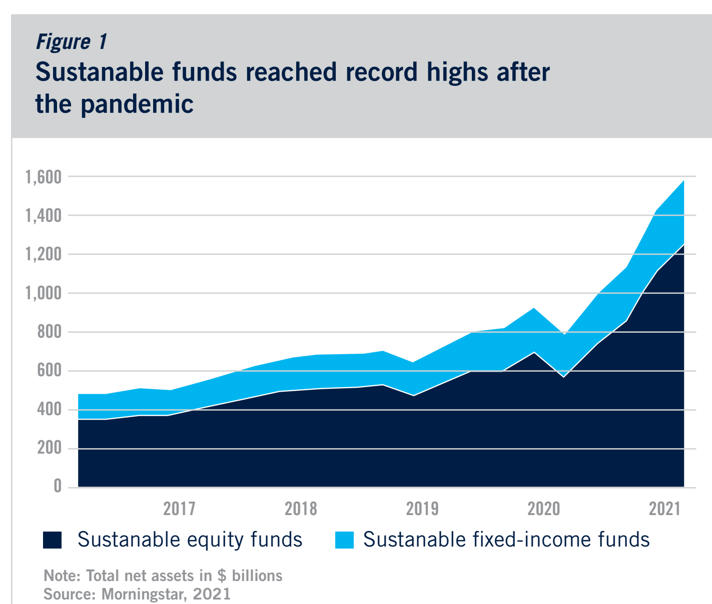
Millani

Sustainable investing attracts record flows

In May 2020, during the height of the COVID-19 pandemic, Millani conducted a sentiment study with Canada's largest institutional investors to gather their views on the impact of COVID-19 on ESG practices and sustainable finance. At the time, 74% of the interviewees believed that the pandemic would have a positive impact on sustainable investing. They were right.

Over the last year, investments in sustainable funds have more than doubled since the pandemic-related market dip. In the first quarter of 2021, sustainable funds drew a record global inflow of US $185.3 billion, leading to a record-breaking total of US$1.6 trillion in sustainable funds worldwide[2].

Figure 1
Sustainable funds reached record highs after the pandemic



Note: Total net assets in $ billions
Source: Morningstar, 2021

The accelerating inflow of capital to sustainable funds implies that good ESG performance and disclosure can translate to better access to capital and more favorable financing terms. As well, the trends indicate that the focus of asset owners is shifting from traditional finance towards sustainable finance.

An accelerated pace of change

When asked what was most surprising in the field of sustainable finance over the last six months, most respondents referred to the accelerating pace of change around ESG integration – including regulations, fund flows, and net zero commitments. As the financial impacts of managing ESG issues become clearer, governments and investors are increasingly focused on the breadth and depth of ESG disclosures.

In early June, the G7 nations endorsed mandatory TCFD-aligned financial disclosures aimed at reinforcing government efforts to meet net zero commitments[3]. Support for mandatory disclosures may be extended by G20 countries as well[4].

When asked in June about the pace of regulatory change and what should be expected of governments over the next few years, Mark Carney, UN Special Envoy on Climate Action and Finance, advocated for mid-term policy targets and frequent disclosure of progress towards those goals, to provide clear signals for companies and investors on how best to allocate capital. Notably, Carney expects that the pace of regulatory change will remain constant or increase in the foreseeable future[5].

Canadian investors are also surprised by the pace at which US and Canadian governments are adopting policies on ESG and climate change. At the end of May, President Biden signed the Executive Order on Climate-Related Financial Risks[6], which requires the advancement of clear and comparable disclosures of climate-related risks of different federal agencies and their regulated entities. Notably, the Financial Stability Oversight Council (FSOC), chaired by US Secretary of the Treasury Janet Yellen, is directed to provide recommendations on how US federal financial regulators can assess and manage climate-related risks.

In mid-June 2021, the US House of Representatives passed legislation that would require public companies to report on ESG topics. If approved by the Senate, listed entities will be required to disclose specific ESG metrics and how they are integrated into the long-term strategy of the firm, including pay equity, executive compensation, tax liabilities, political expenditures, and climate risks[7].

In January 2021, the Ontario Capital Markets Modernization Taskforce recommended that Canadian entities should be mandated to align with the TCFD recommendations. This was supported by Canada's 2021 federal budget which included new requirements for Canada's Crown corporations to disclose climate-related information in alignment with the TCFD recommendations. In May 2021, the Sustainable Finance Action Council was launched, with the aim of advancing the recommendations of Canada's Expert Panel on Sustainable Finance, which include the adoption of TCFD for Canadian corporations and financial institutions.

2. Reuters, "Sustainable fund inflows hit record high in Q1 – Morningstar", April 30, 2021
3. Reuters, "G7 backs making climate risk disclosure mandatory", June 5, 2021
4. Reuters, "G20 to endorse deal on global minimum corporate tax - draft", June 22, 2021
5. Mark Carney, "2021 RIA Conference - Keynote Address", June 9, 2021
6. White House Briefing Room, "Executive Order on Climate-Related Financial Risk", May 20, 2021
7. US Congress, "H.R.1187 - Corporate Governance Improvement and Investor Protection Act", Introduced Feb 18, 2021

There is clear and growing support for the TCFD recommendations in jurisdictions around the world. However, Millani's June 2021 publication, "TCFD Disclosure Study: A Canadian Perspective", indicates that only 23% of Canadian issuers currently report in alignment with the TCFD, led by the Extractives & Minerals Processing and Infrastructure sectors. This implies that there are many issuers in Canada who are facing the need to prepare their first climate report.

What's expected from a first-time climate reporter?

When asked for advice for first-time climate reporters, many suggested to start with what can be reported for now, and to think about how the reporting journey can be iterative and progressive. Many interviewees noted that their own stakeholders expect them to publish climate reports as well and that they were empathetic to the challenges of TCFD reporting for corporate issuers.

"Don't let perfection be the enemy. Sometimes less is more, especially with first time responders." – Asset Owner

Millani asked interviewees to provide issuers with some additional insights on their thoughts and expectations on climate reporting. The highlights of their responses are provided below.

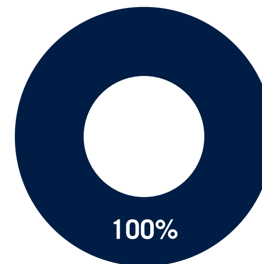
Should issuers disclose on Scope 1, 2 or 3 GHG emissions?

Scope 1 emissions are direct greenhouse (GHG) emissions from sources controlled or owned by an organization. Scope 2 emissions are indirect GHG emissions associated with the purchase of electricity, steam, heating, or cooling. All respondents indicated that they are reviewing and assessing both Scope 1 & 2 emissions.

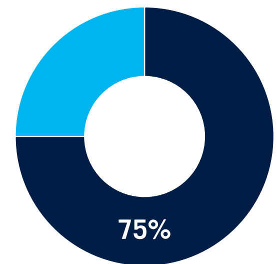
"Scope 1 & 2 are now table stakes." – Asset Owner

Figure 2
Which GHG emissions scope do investors look for?

Scope 1 and 2



Scope 3



Scope 3 GHG emissions are indirect emissions that occur in an organization's value chain, including both upstream (e.g., vendors) and downstream (e.g., product use) emissions. Here, the investor's views were more ambivalent. Most recognized the value of this metric and why it should be taken into consideration. Although a number of investors questioned the current methodology for the calculation of Scope 3 emissions and the reliability of data currently being published, there was still strong desire to have issuers work towards disclosing Scope 3 emissions.

"Scope 3 is most important, as companies have decision power and can control a full range of elements in their value chain." – Asset Owner

According to data compiled by the Carbon Disclosure Project (CDP), a company's supply chain emissions are typically 5.5 times its operational emissions[8]. Given the significance of Scope 3 emissions, some investors indicated that with the growing number of net zero emission targets by organizations globally, Scope 3 emissions will be increasingly requested and accounted for. Respondents believed that one of the most surprising trends of the 2021 proxy season – already full of surprises - was the level of support for climate-related proposals, including shareholder approval of setting Scope 3 emission targets for Chevron[9] and ConocoPhillips[10].

8. CDP, "CDP Supply Chain: Changing the Chain", 2020
9. Reuters, "Chevron investors back proposal for more emissions cuts", May 26, 2021
10. Reuters, "ConocoPhillips shareholders back proposal to set Scope 3 targets", May 11, 2021

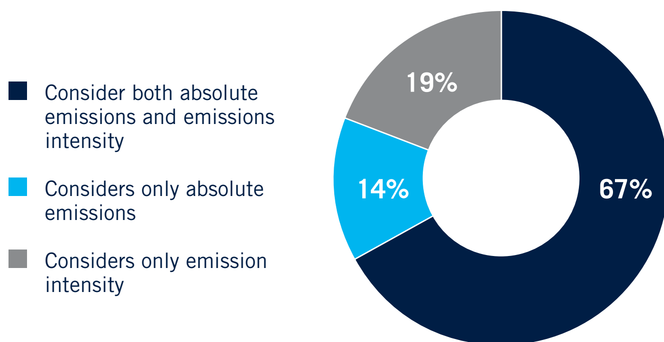
Should issuers disclose on absolute emissions intensity?

"We prefer absolute emissions, because we can calculate our own intensity measures." – Asset Owner

When evaluating emissions, most investors desired disclosure of both absolute emissions and emissions intensity, because each data type can be used for different purposes. Absolute emissions refer to the total quantity of GHG emissions being emitted – useful for evaluation of progress towards long-term targets – whereas emission intensity normalizes the absolute emissions over some unit of economic output, allowing for a comparable assessment against peers in the shorter term.

"We are assessing both, absolute and intensity, as we are interested in understanding the underlying narratives of each metric." – Asset Owner

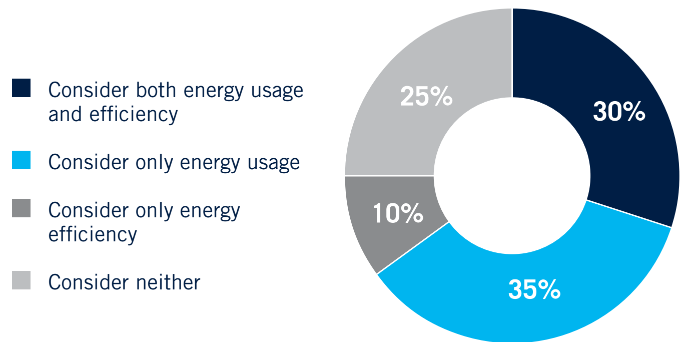
Figure 3
Do investors consider abolute emissions or emission intensity?



Should issuers disclose energy usage or energy efficiency?

When asked about whether investors looked for disclosure on energy usage (total energy consumed) or energy efficiency (total energy consumed per unit of economic output), responses were balanced. As noted by one of the respondents, "In sectors where energy usage is significant, we want to understand the energy source mix such as percentage of fossil fuel versus renewable. Having that disclosure is helpful." Another investor noted that the energy source of the power grid will determine the relevance of assessing this metric – for example, when a company's power source is highly dependent on coal, it will be more important to understand the company's energy usage and exposure to carbon pricing.

Figure 4
Do investors consider energy usage or energy efficiency?



Are disclosures on scenario analysis meeting investors needs?

When asked about scenario analysis, most participants agreed that pertinent information used to assess the impact of climate change on company financials is often missing, making the exercise less valuable than originally anticipated. It was noted that large companies have more resources than smaller ones, for whom the process can be burdensome, complicated and time consuming. Crucially, investors would like to see more granular information on how the company's capital expenditures are linked to the outcomes of scenario analysis.

Understandably, there are some reservations by issuers to disclose on these scenarios, given the potential legal consequences of forward-looking statements. As noted in the final report of the Canada Expert Panel on Sustainable Finance, a potential solution to this issue is a safe harbor provision to protect and encourage companies for more authentic climate-related disclosures[11]. This solution was also suggested by the head of the Securities Exchange Commission (SEC), Elad Roisman, while addressing challenges in moving to mandatory ESG disclosures[12].

"TCFD scenario planning shows us how viable their business will be in a future towards net zero and that they're taking it seriously, and integrating it into their future business strategy."
– Asset Manager

Net zero commitments

Since the beginning of 2021, there have been many announcements of net zero targets by public issuers. When asked about their reaction to this trend, our participants indicated that net zero commitments are being viewed as a positive development. However, what investors desire most are interim targets that are linked to the company strategy. Some respondents also indicated that they welcome the opportunity to engage with management and to discuss plans to meet these targets.

"Net zero targets are nice to see, but in isolation, not sufficient."
– Asset Manager

Transition and physical risks

Investors are moving their focus away from just transition risks and are assessing physical risks too. Transition risks imply the risk of moving towards a lower-carbon economy, while physical risks refer to the potential costs associated with climate change. An emerging concern by some respondents was that there is not enough focus on physical risks, and they would like to see a shift in focus.

"Improving disclosure on the location of the assets is going to be increasingly critical, as the progress of the economic transition is very slow."
– Asset Owner

Climate-linked executive compensation

Most of the interviewees encourage disclosing a link between executive compensation and climate-related targets. Many suggested that they would find a link meaningful if targets were linked to longer-term bonuses, especially if targets are financially material for the business. Although most agreed that it would demonstrate accountability, some questioned the impact of such a measure, given the complexity of executive compensation schemes.

"It would be interesting to see how compensation ties to a 2025 or 2030 target. The link needs to be substantive enough so that executives feel it."
– Asset Owner

Conclusion

Since the beginning of the year, the pace and scale of progress in the climate and ESG space has surprised many in the investor community. As the financial impacts of these topics becomes clearer, the pace is likely to accelerate.

"Companies are underestimating the growing importance of climate change disclosure in the next 5 years. Their reputation and credibility are on the line."
– Asset Owner

The investor community is mindful that ESG reporting can be burdensome. When referring to TCFD-aligned reporting, most respondents advised to start with the most critical aspects and demonstrate commitment to improve, rather than trying to meet all recommendations. A well-articulated strategy can be instrumental in successfully managing the narrative directed to stakeholders.

11. Government of Canada, "Final Report of the Expert Panel on Sustainable Finance", June 2019
12. SEC Commissioner Elad L. Roisman, "Putting the Electric Cart before the Horse: Addressing Inevitable Costs of a New ESG Disclosure Regime", June 3, 2021

Targets alone are difficult to assess. However, targets backed by a clear strategy, interim milestones, and a pathway towards net zero brings credibility to the commitments.

***"Don't be overly concerned about whether you can tick all of the boxes of the 11 recommendations, it's about transparency and sharing perspectives on the issues."
– Asset Manager***

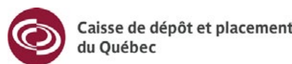
As noted in Millani's 2021 MarketTrends report[13], mandatory ESG and climate-related disclosures are around the corner. Given growing market needs and expectations, failure to disclose on material ESG and climate-related issues could expose corporate issues to reduced, or more costly, access to capital. To avoid this risk, issuers should begin now to understand their ESG issues and start their ESG disclosure journey.

If you would like more information on this topic, please send an email to info@millani.ca or call 514-507-8010.

13. Millani, "Millani's 2021 MarketTrends", February 2021

Contributors

Thank you to our contributors who took the time to provide their insights on TCFD-aligned disclosures. Our contributors represent 23 of Canada's largest institutional investors, some of which are listed below.



About Millani
Millani provides advisory services on ESG integration to both investors and companies. For the past 13 years, Millani has become the partner of choice for institutional investors. By providing advisory services on integrating material ESG issues into their investment strategies and decision-making processes, we help our clients reduce risks, increase returns, and create value. Millani is also leveraging this expertise and its experience in ESG consulting to help reporting issuers improve their ESG disclosure to financial stakeholders and optimize their market value.

For more information, contact us at: info@millani.ca or visit our website: www.millani.ca