July 4, 2017

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Alison Walker
British Columbia Securities Commission
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Re: Climate Change Disclosure Review Project

Dear Ms. Rose and Ms. Walker:

We are writing in response to the Canadian Securities Administrators' (CSA) announced Climate Change Disclosure Review Project. We welcome CSA's attention to a disclosure issue that we believe is material to the needs of all Canadian investors.

With approximately C$6 billion in assets under management, NEI's approach to investing incorporates the thesis that companies can mitigate risk and take advantage of emerging business opportunities by integrating best Environmental, Social and Governance (ESG) practices into their strategies and operations. In practice, this means that our investment process involves the analysis of key ESG information to inform our actions as a fiduciary, from the decision to invest (or not invest) in corporate securities to our proxy voting and corporate engagement activities once we are invested. It is in this light that we provide the following comments.

<u>Disclosure on strategic environmental, social and governance issues</u>

It is critical to our investment process that listed companies should provide regular updates on environmental, social and governance (ESG) issues, as well as financial information. We are not alone in seeking this information. In 2015, 38% of Canadian assets were managed under some form of responsible investment mandate.[1] Globally, an increasing number of investment institutions are adopting responsible investment practices and beginning to consider ESG risks and opportunities in their decision-making. Almost 1700 investment institutions representing assets of US$62 trillion are signatory to the UN Principles for Responsible Investment, which include a commitment to advance ESG reporting.[2]

Many of Canada's largest publicly-traded companies already provide corporate responsibility reporting, or integrate corporate responsibility information to their annual report, on a voluntary basis. Corporations under the *Bank Act*, the *Insurance Companies Act* and the *Trust and Loan Companies Act* are already required to publish Public Accountability Statements including information on specified corporate responsibility matters.[3] Under the U.K. *Companies Act*, larger publicly-traded companies

[1] Responsible Investment Association (2016). 2016 Canadian Responsible Investment Trends Report. https://www.riacanada.ca/trendsreport/
[2] http://www.unpri.org/about-pri/about-pri/
[3] Public Accountability Statements (Banks, Insurance Companies, Trust and Loan Companies) Regulations

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must publish an annual strategic report including information on a range of environmental, social and employee issues.[4] In 2014 the European Union adopted a directive on disclosure of non-financial information that will apply to around 6000 of Europe's largest companies and groups, reporting from 2017 onwards.[5]

We anticipate that investor demand for ESG disclosure will only increase as will national and international instruments that mandate disclosure. We believe this is particularly true for climate-related disclosure. The CSA should consider this larger context as it makes a determination on incorporating climate-related disclosure requirements into its guidelines.

ESG Materiality Assessment – Critical First Step

We believe that the key to promoting better ESG disclosure at the specific issue level – e.g. climate change risks – is to require better ESG disclosure at the strategic level. At the strategic level, we believe companies should be *required to disclose* if and how they are identifying and prioritizing the ESG issues that are material to their specific circumstances, and the outcome of this ESG materiality assessment. In essence, we are asking a company to explain to investors what, if any, ESG issues it believes are material to the company and a brief explanation of how it came to these conclusions.

Any material ESG issues identified should then be integrated to the description of the company strategy. We believe that a majority of companies would be compelled to address climate change as a material risk. We believe requirements generating strategic ESG content would provide important information for investor decision-making and engagement with issuers, enable issuers to report more effectively on ESG matters at the specific topic level under principles-based requirements, and create a contextual framework for understanding the significance of those disclosures. Prescriptive requirements may be appropriate for strategic ESG disclosure. In this context, we would like to draw attention to the Integrated Reporting <IR> initiative, which focuses on holistic disclosure on business strategy.[6]

However, in regard to climate change risks and climate-related disclosure, we believe it is unique among ESG risks faced by companies. The systemic risks associated with climate change require investors to think beyond the exposure of individual equities and to consider a broader assessment of risk across their portfolio. Unmitigated climate change will have a negative impact across all sectors and asset classes, and investor returns will suffer regardless of which equities they are exposed to. There are no equivalent ESG risks with a similar profile. As such, the CSA's emphasis on climate-related disclosure – i.e. above general ESG disclosure – is justified in respect of the systemic nature of climate-related risks.

Treatment of Systemic and Universal ESG Issues

Most ESG issues are industry or company specific, and requirement for investor-facing disclosure under securities regulation should be based on a materiality assessment. The *Environmental Disclosure* guidance NI 51-333 discusses the need for companies to assess the materiality of environmental

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SOR/2002-133. http://laws-lois.justice.gc.ca/eng/regulations/SOR-2002-133/FullText.html
[4] The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 http://www.legislation.gov.uk/uksi/2013/1970/contents/made
[5] European Commission (2014). Statement. http://europa.eu/rapid/press-release_STATEMENT-14-291_en.htm
[6] Integrated Reporting <IR>. http://integratedreporting.org/

information for possible disclosure under NI 51-102 requirements.[7] We would like to see a requirement for all companies to *disclose* on their ESG materiality assessment and its outcome (these requirements can probably be "comply or explain"). If an issue is identified as material, the existing framework under NI 51-333 requires that a company should provide certain types of disclosure. There may be a need to review NI 51-333 to ensure suitability to address these ESG issues adequately, but minimally, there is a need for updated guidance on ESG disclosure under NI 51-333.[8]

Climate change belongs to a limited group of ESG issues where we would like to see requirements to disclose certain basic information on the issue, *whether or not* the company has assessed the issue to be material as part of its ESG materiality assessment. These issues have either or both of the following characteristics:

- Systemic issues – such as climate – whereby all companies operate within the system, are impacting or impacted by the system, and investors seek to understand the role of every company in relation to the system
- Universal issues – such as diversity – whereby the issue is relevant to all companies

In these instances understanding why the issue is immaterial to the company (or is not being addressed) is valuable information for investors. This is unlike other ESG issues whereby investors need not know that an ESG issue (such as impact on water) is not material, its absence in the final materiality assessment is enough. In the case of a systemic issue like climate change, investors require an explanation of how and why the company has come to that conclusion. For companies where climate has also been identified as a material issue through the materiality assessment, we would expect additional disclosure (discussed in detail under *Specific Climate-Related Disclosures,* below).

Comply or Explain

The CSA addressed the issue of diversity through a "comply or explain" disclosure expectation in the 2014 amendments to National Instrument 58-101 *Disclosure of Corporate Governance Practices*.[9] We believe this is an interesting precedent to base climate-related disclosures on. While it is still to be determined if the amendments have directly contributed to an increase in board or executive diversity at Canadian issuers, it is our perspective that we can definitively state that we are better informed on the strategy, or lack thereof, that the companies we own are utilizing to enhance the diversity of their board and executive teams. The requirement to disclose on not only the existence of a diversity policy, but on the steps taken to ensure its effective implementation, has resulted in some clear delineation between companies. This information has informed and shaped our corporate engagement priorities, from our proxy voting decisions to our direct dialogue with company boards.

Specifically, the information provided by companies as a result of the amendments to NI 58-101 has been used to guide our voting decisions on director elections, where we have withheld our vote from the chair or members of the nominating committee in those instances where we are unsatisfied with the board's response. Similarly, we have used the information provided on diversity to tilt the balance to a "for" vote in instances where the disclosure has provided assurance. Further, we have followed up with companies in the former category to initiate an informed engagement with boards on the topic of board diversity.

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[7] http://www.osc.gov.on.ca/documents/en/Securities-Category5/csa_20101027_51-333_environmental-reporting.pdf
[8] We note that social disclosure was not addressed back in 2010 but should probably be considered in any review of the guidance.
[9] http://www.osc.gov.on.ca/documents/en/Securities-Category5/20141211_58-101_amd-governance-practices.pdf

We are acting on the information provided by the NI 58-101 amendments as a matter of fiduciary duty - we believe that a lack of board diversity presents unnecessary financial risk. Similarly, we believe companies that are materially exposed to climate-related risks, and not working to mitigate those risks, will expose investors to negative financial impacts. Thus the results of a “comply or explain” expectation on climate-related risks would provide similarly useful, and actionable, data. Climate-related disclosure would be used to inform and guide our engagement work, from proxy voting to corporate dialogue.

Note that we already use climate-related disclosure (or the lack thereof) to make buy or sell investment decisions for funds that have an explicit ESG mandate (such as our Ethical Funds branded products). Greater disclosure on exposure to climate-related risks and on strategies to mitigate those risks would allow us to make more informed decisions in this regard. In fact, an across-the-board improvement in climate-related disclosure would likely allow us to broaden the universe of eligible companies that meet our ESG expectations. For some companies, increased disclosure on strategy and risk management frameworks in place to address climate-related risks would likely increase their access to capital.

If a company has demonstrated that it has undertaken a materiality assessment of climate-related risks and determined that either a) it is not significantly exposed or contributing to negative impacts or b) the negative impacts are significantly lower than other ESG risks, there should be an expectation that reporting this outcome represents the full extent of the reporting responsibility. We do not believe that this approach will add substantively to the current burden of disclosure. If a company does not disclose detailed information because it is much less exposed to climate risk than might be expected in the sector, it should explain its unique circumstances; if it does not disclose because it has not yet set up data collection, it should indicate what is being done to remedy this gap. However, a boilerplate response that provides no context on the assessment of materiality is not acceptable.

Avoiding the use of boilerplate language should be an explicit expectation for any climate-related disclosure guidance. Currently, we have fairly broad disclosure on climate risks in high-carbon sectors such as the energy sector. However, these disclosures are often devoid of specific company context. This type of disclosure brings no value to investors. As such, explicit guidance should be given on the imperative to avoid boilerplate language when providing climate-related financial disclosures.

<u>Specific Climate-Related Disclosures</u>

CSA’s backgrounder on the Climate Change Disclosure Review Project refers to several voluntary disclosure frameworks that it will review in the course of assessing current trends in respect to climate-related disclosure.[10] We believe all of the named frameworks have something useful to add to the discussion, but will focus on the final recommendations of the Financial Stability Board’s Task Force on Climate-Related Financial Disclosures (Task Force).[11] We believe the Task Force recommendations will in time be broadly incorporated across all voluntary and mandatory reporting regimes and as such the CSA should focus on aligning any new expectations with the final Task Force recommendations as far as possible.

[10] http://www.securities-administrators.ca/aboutcsa.aspx?id=1567#Backgrounder
[11] https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf

The core areas of governance, strategy, risk management and metrics/targets that constitute the Task Force framework broadly cover the key climate-related information we require. Armed with the knowledge obtained from companies that met the spirit of the Task Force recommendations we believe we would be able to discharge our fiduciary duty to assess climate risk in our portfolio.

Not all of the Task Force recommendations will apply equally to all of the companies reporting under CSA regulations. However, the Task Force recommendations naturally lend themselves to a materiality assessment, or "comply or explain" approach that creates a cascading set of expectations. Companies should be expected to respond to overarching questions about governance and risk management as they pertain to climate change. At minimum investors should know how and if company boards are providing oversight to the issue and if they are, what risks they have identified. As noted above, companies should be required to respond to these questions regardless of the company's assessment of the materiality of climate-related risks.

The disclosure from these questions should lead naturally to questions about strategy, scenario analysis and metric/targets. If a company has determined that it does not face any substantive risks from climate change then further information is unlikely to be required. If however it has determined that climate change brings material risks to the company we would expect a discussion on company strategy to mitigate these risks. Assessing performance on strategy will, in part, require the disclosure of relevant metrics and targets. We would expect that any company with a robust plan to address climate risk would also be aware of its actual greenhouse gas (GHG) emissions footprint.

Fundamentally, investors need to have measurable data on the GHG emissions footprint of the companies they invest in that are exposed to climate-related risks. Current data on emissions is spotty and not standardized. Perhaps most importantly, not all companies provide intensity disclosures (e.g. tonnes CO_2 per barrel of oil equivalent) and investors are left to estimate these on their own, with varying degrees of success. Further, the Task Force recommends that investors perform carbon footprinting of their portfolios. Meeting this recommendation with the current level of disclosure on corporate GHG emissions entails significant guesswork and uncertainty. Mandated disclosure of GHG emissions would reduce this uncertainty and allow investors to meet the expectations of the Task Force in a meaningful way. Whether there should be a "de minimis" level (e.g. market cap or absolute emissions) below which companies would not be expected to provide emissions data should be discussed.

Scenario Analysis

Scenario analysis (2°C scenario analysis specifically) is a core component of the strategy section of the Task Force recommendations, and one that has generated some resistance from corporate issuers. However, for those companies that are materially impacted by climate change developments, it is a forward-looking exercise that has tremendous value. We note that several Canadian companies have either published the results of scenario analysis or committed to do so.[12] In the U.S., shareholder resolutions asking companies to perform scenario analysis work have gained significant shareholder support, generally achieving over 40% support and in the case of Exxon Mobil and Occidental

[12] Specifically, Suncor Energy has provided disclosure on its scenario analysis work in its low-carbon resiliency report (http://www.suncor.com/~/media/Files/PDF/Investor%20Centre/Annual%20Reports/2016%20AR/English/Climate-Report-EN.ashx?la=en-CA), while Cenovus Energy has committed to provide similar disclosure in 2018 (see Schedule D of the company's 2017 proxy circular: http://www.cenovus.com/invest/docs/2017/proxy-circular.pdf)

Petroleum, gaining majority support (62% and 67% respectively).[13] This is an indication of strong shareholder support for the concept of scenario analysis for companies with a material exposure to climate risk.

It is also accurate to state that scenario analysis disclosure is in its early days, and investor expectation on what constitutes adequate scenario analysis disclosure will evolve. We believe the "comply or explain" approach will be able to address this evolving situation. Companies should be able to state if they are currently using scenario analysis or not. If not, they can explain why not. If they are, they should be able to provide details on the process in line with the Task Force recommendations. Specifically, they should provide a description of the parameters and assumptions used in the scenario analysis, and a high-level explanation of the outcomes of the exercise. While the standards around scenario analysis are still evolving, we believe this level of disclosure will provide investors with actionable information that will guide our efforts to address climate-related risks within our portfolios.

Carbon Price Scenario Planning

Internal carbon pricing is another aspect of the strategy section of the Task Force recommendations that is currently underreported yet would provide investors with material information. Specifically, we refer to the practice of utilizing a "shadow price on carbon" against internal decisions on capital expenditures. This would ideally incorporate disclosure of the range of prices used in the scenario planning (e.g. $15 - $70 per tonne of CO2e), discussion of how this information feeds into capital spending decisions, and a broad discussion of the materiality of the impacts of a price on carbon on the business. Essentially, we are looking for evidence that the company is stress-testing its long-term projects against the backdrop of a steadily rising price on carbon. Note that this should not be confused with asking the company to project what the price on carbon itself will be. Rather, we want to know the resilience of the company against a plausible range of carbon prices. Similar to scenario analysis, a "comply or explain" approach would be a reasonable request of companies and would not burden companies who are not currently using an internal price on carbon for capital expenditures.

Regulatory Burden

We are aware that CSA is seeking comments on reducing regulatory burden for non-investment fund reporting issuers.[14] We are generally supportive of any efforts to ensure that the disclosure burden facing companies is commensurate with a perceived benefit in regard to investor protection or capital market efficiency. We believe that particular attention should be paid to the intent of disclosure requirements and whether currently mandated disclosure is meeting the original expectations of the regulator. New or existing disclosure requirements should be tied to an explicit expectation or outcome. If the desired or expected outcome is not being achieved then the disclosure requirement may be surplus to needs.

In regard to climate-related disclosure, we believe the same standard should be applied when determining any new expectations. As noted already, current issuer disclosure on climate-related risks is not meeting investor needs and may lead to systemic risk to capital markets if left unaddressed. In this case new disclosure requirements should be focused on addressing the current information gap. We believe these new expectations would not constitute an undue burden in light of the serious nature

[13] https://insideclimatenews.org/news/31052017/exxon-shareholder-climate-change-disclosure-resolution-approved
[14] https://www.securities-administrators.ca/aboutcsa.aspx?id=1570https://www.securities-administrators.ca/aboutcsa.aspx?id=1570

of the risks being addressed. However, the results of any new disclosure expectations should be assessed at regular intervals to ensure the intent of the new expectations is being met.

Contact

In conclusion, we would like to commend the CSA for seeking input on its approach to climate change disclosure and reiterate our belief that the issue is of the utmost importance to investors. We would be glad to engage further on any of the issues covered in this submission. For follow-up, please do not hesitate to contact me at jbonham@neiinvestments.com, 604 742 8328.

Sincerely,
NEI Investments

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