ESG

People, planet and performance: Embracing ESG

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In 2021, we witnessed markedly greater attention being paid to Environmental, Social and Governance (ESG) considerations. These concerns about the environment and social justice are affecting all aspects of life at the moment, as they drive consumer behaviour, new laws and regulations, employment choices and investment capital decisions. ESG is no longer an incidental consideration when pursuing business opportunities. In 2021, Canadian businesses began a march towards inculcating ESG considerations into their organizations.

Pressures for corporate disclosure

On all fronts, corporations are facing demands for more rigorous disclosure and achievements regarding ESG matters. Different stakeholders have different areas of interest, resulting in an overwhelming plethora of rating agencies and reporting frameworks and standards. Unfortunately, this has the effect of reducing comparability and obscuring true performance.

However, some of the standards are starting to converge. The Climate Disclosure Project (CDP), the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative, the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board (SASB) began working on a shared vision for corporate reporting that includes both financial accounting and sustainability disclosure, connected through integrated reporting. The World Economic Forum's International Business Council (WEF), in collaboration with Deloitte, EY, KPMG and PwC, made progress towards establishing universal, material and verifiable ESG metrics and recommended disclosures for corporate reporting on a consistent and comparable basis across industry sectors and countries.

Since the middle of 2021, a number of these organizations have committed to coming together to form the International Sustainability Standards Board (ISSB). The ISSB's mandate will be to develop standards that result in a high quality, comprehensive global baseline of sustainability disclosures focused on the needs of investors and financial markets. The Task Force on Climate-related Financial Disclosure (TCFD) and WEF have announced their support for the ISSB.

Corporations are not waiting for the emergence of a single standard for ESG reporting. Increasingly, corporations have been reviewing their operations through an ESG lens to meet their own needs for better information for the purpose of internal decision making. These reviews seek to identify areas of potential concern or opportunity and have begun the process of identifying key performance indicators for measurement. They also seek to provide some measure of disclosure of interest to investors. We have been assisting our clients in addressing this desire for enhanced disclosure, while taking into account the need for diligence to protect against liability. ESG disclosures are heavily scrutinized not only by investors, but also ESG activists. For further information, refer to our webinar on ESG disclosures.

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Regulators also pushed for better disclosure this year.

Diversity disclosure obligations with respect to the representation of women apply to most Canadian public issuers. Public corporations governed by the *Canada Business Corporations Act* also report on the representation of visible minorities, Aboriginal peoples and persons with disabilities in senior leadership positions. Both the Canadian Securities Administrators (CSA) and Corporations Canada are reporting on progress made. The final report of the Ontario Capital Markets Modernization Taskforce recommended in January that TSX-listed companies be required to set targets and provide disclosure on the representation on boards and in executive officer positions of women and persons that are Black, Indigenous and people of colour. Starting in 2022, NASDAQ-listed issuers will be subject to mandated diversity disclosure requirements. See our seventh annual Diversity Disclosure Report for our review of diversity and leadership at Canadian public companies in 2021.

Climate-related financial disclosure is gaining increasing attention. New Zealand and the U.K. have announced their intentions to require reporting in compliance with TCFD. The CSA has issued for comment draft National Instrument 51-107 – Disclosure of Climate-related Matters, which provides a roadmap for a phased-in approach to requiring reporting substantially in compliance with TCFD. Additional details are included in our blog post, Climate change from the corporate perspective: The CSA's proposed climate-related disclosure requirements.

Building bridges towards reconciliation

The need to repair Canada's troubled relationship with its Indigenous communities received considerable focus during 2021. Two recent reports containing guidance and recommendations on Canadian corporate governance practices highlighted the need for better engagement between Canada's business community and its Indigenous peoples. Refer to our article, Corporate governance in transition, for additional information.

Indigenous communities have become significantly more sophisticated with their investment alternatives. For example, the First Nations Finance Authority (FNFA) was formed as a statutory not-for-profit organization. It operates under the authority of *The First Nations Fiscal Management Act*. The FNFA's purposes are to provide First Nations with investment options, capital planning advice and access to long-term loans with preferable interest rates. The innovative funding approach has been honoured with the Governor General's Innovation Award.

The FNFA has provided financing for a variety of First Nations investments in a number of commercial enterprises, including energy infrastructure projects, casinos and fisheries. For example, earlier this year in a historic transaction, the FNFA provided $250 million in financing to a coalition of Mi'kmaq First Nations. The coalition invested the proceeds of the financing in a partnership with Premium Brands Holdings to purchase Clearwater Seafoods for approximately $537 million. As a result of the investment, the coalition now owns 50% of Clearwater and holds Clearwater's Canadian fishing licences within a fully Mi'kmaq owned partnership. Osler acted for the FNFA.

Federal government authority to impose minimum standards regarding greenhouse gas pricing is upheld

In March 2021, the Supreme Court of Canada released a decision upholding the constitutionality of the federal *Greenhouse Gas Pollution Pricing Act*. The Act is the centrepiece of the federal government's climate change plan, which imposes minimum carbon pricing standards on the provinces. As a result, the federal government will be able to move forward to ensure that minimum standards are applied across the country. This should dissuade businesses from engaging in arbitrage of their carbon compliance costs by transferring operations from one province to another. Additional detail on the decision is provided in our article, Supreme Court ends uncertainty over constitutionality of federal carbon pricing framework.

Sustainable finance

Investor demand for investment opportunities to further environmental progress has generated an active market in Europe for sustainable finance. A borrower's environmental performance can be reflected in a variety of sustainable financing vehicles. These can include project finance loans that incorporate the Equator Principles, green bonds or sustainability-linked bond issuances in the public or private debt capital markets, and social loans. All share a common feature in that coupon or other payment obligations are directly tied to the borrower's or issuer's performance relative to a specified ESG-oriented goal.

Sustainability-linked loans offer substantial flexibility to borrowers and provide an attractive way for investors to weigh their returns against their social investing principles. Typically, these loans embed a discount to interest rates payable by the borrower upon achievement of predetermined sustainability targets. The borrower, however, can use the proceeds of the loan for general corporate purposes, and choose where and when to make investments in order to reach the ESG targets. Additional information is provided in our Osler Update, Climate change and corporate credit: Emerging trends in sustainable-impact lending practices.

In comparison, green bonds link the borrowing to a specific eligible green project. Green bonds can offer potential reduced financing rates for projects that have a recognized positive long-term environmental impact.

In 2021, TELUS Corporation established its Sustainability-Linked Bond Framework (Framework), the first of its kind in Canada. The Framework links the interest rate payable under the bonds issued pursuant to the Framework to TELUS' achievement of a targeted percentage reduction in their scope 1 and scope 2 GHG emissions versus 2019 baseline levels. A failure to reach the established targeted reduction will result in higher borrowing costs to TELUS under those bonds. Osler represented the syndicate of agents involved in assisting TELUS in establishing the Framework and carrying out the issuance of their first sustainability linked bonds pursuant to the Framework.

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Corporate purchases of renewable energy and emission reductions

Corporations are increasingly looking to contribute to a reduced carbon footprint as well as a greener environment by financing sustainable energy and emission reduction projects. In 2021, a number of corporate off-takers completed renewable energy virtual power purchase agreements (VPPAs), physical power purchase agreements and verified emission reduction purchase and sale agreements. These spanned a variety of industries, including banking, automobile manufacturing, telecommunications, beverage, brewing, oil and gas, power generation, data and computing and cryptocurrency mining. Most of these commercial deals in 2021 were contracted in respect of renewable energy or emission reduction projects being developed in Alberta.

Industry stakeholders are carefully watching the development and implementation of the federal carbon offset regulation and associated protocols under the *Greenhouse Gas Pollution Pricing Act* as well as Ontario's *Emission*

Performance Standards regulation. The new Ontario regulation begins applying to large emitters in Ontario starting January 1, 2022. With a broadening of the landscape for these corporate commercial opportunities across Canada (and internationally), we anticipate increased attention on these tools in 2022 and beyond. Osler has drafted and advised on a number of recent renewable energy VPPAs and emission reduction purchase and sale agreements.

ESG investing

Institutional investors are facing their own pressures to allocate funds to ESG investments, especially climate-based investments. Increasingly, pension fund members are demanding to know how the pension fund investments are contributing to a better world. A greater proportion of investors in mutual funds are directing their capital toward funds that have an ESG investment focus. According to Canada's Responsible Investment Association's 2020 Canadian TI Trends Report, responsible investment assets under management in Canada grew to $3.2 trillion as at December 31, 2019, accounting for 61.8% of Canadian assets under management. The 2021 RBC Global Asset Management Responsible Investment Survey notes that 92% of institutional investors in Canada believe ESG-integrated portfolios do as well or better than non-ESG integrated portfolios.

A principal concern of ESG investors is the risk that issuers and investment opportunities may be prone to greenwashing – namely, portraying the issuer or opportunity as being more environmentally friendly than it actually is. Consistent, international standards for disclosure will help address this concern, as will the use of third-party audits of stated practices and ESG-focused infrastructure projects. Additional information is provided in our ESG Investing webinar.

Fair taxation

To address perennial complaints about corporations not paying their fair share of taxes in the jurisdictions in which they operate, in October many of the world's nations, including Canada, agreed to work on a fairer system of taxing profits where they are earned. This also includes an agreement to enforce a corporate tax rate of at least 15%. For more details, see our article, Tax planning developments: Important international tax changes.

ESG: More to come

There are many risks and opportunities in ESG – and they continue to evolve. They encompass pending new laws on carbon emissions and emissions trading, enhanced engagement with Indigenous communities, better disclosure on climate, environmental and social metrics, and new capital raising and investment opportunities. In particular, movement towards standardization across global carbon markets could bolster trading in carbon offsets and other instruments tied to environmental attributes and spur further investment in carbon reduction initiatives. In multiple ways, ESG is driving business strategy, performance assessment and sustainable value creation at Canadian corporations.

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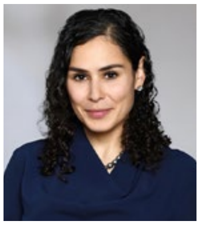

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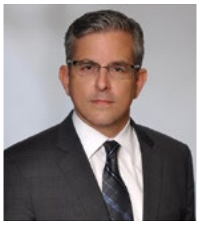

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