Canadian Capital Markets

and Sustainability

Issues, Challenges and Opportunities.

Report for the National Roundtable on Environment and Economy

November 2002

Report Methodology

Global Knowledge Ventures was requested to prepare an report for internal discussion by the National Round Table on the Environment and Economy (NRTEE) Management Committee on the Canadian Capital Markets, Issues, Challenges and Opportunities.

The report provides the NRTEE with an overview of Capital markets and sustainability developments in the national and international arena and provides a basis for initial discussion by the NRTEE about their role in enhancing the progress towards sustainability through the markets.

Research for this report draws from our expertise and experience in finance for sustainable development. Conversations, meetings, research and a literature review were undertaken relating to emerging best practice approaches to sustainability, public reporting guidelines, sustainability initiatives in the capital markets, local finance sector developments and the evidence of impacts of sustainability on shareholder value.

In this report, the definition for sustainable development used was developed by the Brundtland Commission in 1987 which refers to development that "meets the needs of the present without compromising the ability of future generations to met their own needs".

The definition used for "Sustainability" refers to business strategies and processes that add economic, environmental and social value to shareholders, employees and society.

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Executive summary

Sustainability is somewhat of a new frontier for the capital markets, where the risks are high, the responsibilities great and the rewards, potentially enormous. There are now growing opportunities for capital market participants to participate and contribute to sustainable development through lending, insurance and investment activities and through developing benchmarks, indices, standards and reporting regimes.

Key economic, social and environmental drivers are influencing the development of approaches to sustainability within the capital markets. The challenge ahead is to create platforms for common dialogue and indeed common language on the issues surrounding sustainability so that the main players in the capital markets can play a more united and significant role in ensuring environmental, social and economic prosperity.

There is a need and an opportunity for the NRTEE to develop a program on the Capital Markets and Sustainability and although a number of other Canadian organizations have begun projects to engage the Canadian Finance Sector on the issue of sustainability, there is scope to include and coordinate all other actors to develop viable, actionable outcomes.

This report outlines six main options for the NRTEE to undertake a program on the capital markets and Sustainability. Key objectives of the program would be to overcome the barriers to ensuring that the functioning of the capital markets leads to more sustainable outcomes for business and society. For each option we have highlighted inherent issues, challenges and opportunities and proposed some tangible actions to undertake to make progress.

Option 1. The NRTEE articulates state of debate on Capital Markets and Sustainability

The NRTEE organize an initial series of national forums/seminars to articulate the state of the debate over the issues of sustainability and capital markets. In these forums key individuals representing the diverse stakeholder groups would present their views, outline their initiatives and share their knowledge. The forums would capture the varied expectations of stakeholders to better inform business, government and the capital markets. The NRTEE would lead the facilitation process to define the priority issues to be acted upon and the barriers to further progress. The NRTEE would use the initial forums to develop the agenda and tasks for subsequent aspects of the broader program.

Option 2. Development of common ground

The NRTEE could use the stakeholder engagement process in Option 1 to identify and prioritize where there is the greatest need to develop common ground and a common language. The NRTEE could undertake to examine all the existing metrics, standards and performance measures being used in sustainability and the capital markets and produce a report outlining the relative usage and success of these in delivering sustainability outcomes. Some of these tools and techniques could be developed and refined, with stakeholder input, so they are more customized to the Canadian situation and provide a common platform for the future.

Option 3. Communication between the investment community and the corporate community

The NRTEE could play a significant role in helping to facilitate and streamline the information flow between the corporate community and the capital markets. One way would be to develop a common public website to host company information that could be accessed by capital market participants, or the public, seeking information on company environmental and social performance. This would reduce questionnaire fatigue for companies and allow real time updating of data.

Option 4. Disclosure regulations

The NRTEE could establish a task force to investigate progress on disclosure rules on Sustainable Development in different jurisdictions, debate the issue for its implications, and make recommendations for the introduction of Canadian corporate disclosure legislation.

Option 5. Develop the Business Case Link between Sustainability and Financial Performance

To better inform the capital markets, the NRTEE could bring the senior representatives of major Canadian corporations together with their business peers in the Finance Sector to share and articulate their specific business case examples. The NRTEE could undertake to establish the specific finance sector information needs then take the business case examples of these firms and translate them into the language the capital markets understand.

Option 6. Build Knowledge and Capacity for Sustainability

The NRTEE could develop a capital market and sustainability educational program. This program could be delivered throughout the country in a number of different forms, including in-house for businesses. The program could have a number of modules specific for different segments of the capital markets and could incorporate the most relevant knowledge and evidence on the business case, investment risks, legal issues, tools, techniques, market dynamics and global and local trends and issues. The content for the program could be developed following the stakeholder engagement sessions in Option 1 and be constantly refined and updated as developments occur.

Through the implementation of a program the NRTEE is in an excellent position to bring all the relevant actors together to help catalyzing progress in incorporating sustainability into the mainstream of the capital markets.

1. Introduction

One of the greatest challenges facing the world today is integrating economic activity with environmental integrity, social concerns and effective governance systems. Sustainability of the Earth's resources, cultures and economies impacts on and applies to all sectors of the global economy.

The sustainability issues, challenges and opportunities within the international business community are new and complex but the movement to embrace sustainability has begun. Yet, sustainability is somewhat of a new frontier for the capital markets, where the risks are high, the responsibilities great and the rewards, potentially enormous.

Internationally, hundreds of companies have made unequivocal public commitments to sustainability, corporate social responsibility and triple bottom line reporting (which measures corporate performance against economic, social and environmental parameters). Highlighted in many of these public reports is the fact that, for these companies, sustainability has become a mainstream issue, core to strategy and operations, and competitive positioning.

At the World Summit on Sustainable Development in Johannesburg this commitment was clearly expressed by corporate leaders such as Mr. Philip Watts, Chairman Royal Dutch/Shell group of companies and Mr. Charles Holliday, Chairman and CEO, DuPont, as they highlighted that they are taking personal responsibility for their corporate commitment to sustainability.

Led in the 1990's by of resource and chemical industries, the adoption of approaches to sustainability has now become a significant strategic position for a growing number of Canadian Companies. Expectations for all companies to address environmental and social issues as a mainstream function of their business operations will continue to grow as consumers, governments, interest groups and investors are evaluating these issues in choosing to interact with companies.

Business has begun to argue that not only is sustainable development good for business but the solving of environmental and social problems is essential for future growth. "Markets must be mobilized in favour of sustainability, leveraging the power of innovation and global markets for the benefits of everyone". [1]

The linkage of the capital markets to sustainability is real and growing, but is in its infancy.

The providers of capital- from banks to institutional investors- hold significant power over the private business sector and are critical to engage in any debate about the future role of the capital markets in sustainability. Internationally, financial institutions have begun to respond to developments in corporate sustainability by actively participating in global forums, developing and promoting socially responsible investment products and greening their own internal operations.

There are growing opportunities for the capital market participants to participate and contribute to sustainable development through lending, insurance and investment activities and through developing benchmarks, indices, standards and reporting regimes. Fiduciary authorities, capital markets, rating agencies and those regulating the finance sector have an important role to play to reward sustainability leaders and nudge along laggards. [2]

The capital markets, and in particular mainstream financial institutions, are starting to move but there is no consensus or clarity around many issues of significance. Sustainability will continue to mean different things for different people for quite some time. The challenge now is to create platforms for common dialogue and indeed common language on the issues surrounding sustainability so that the main players in the capital markets can play a more united and significant role in ensuring environmental, social and economic prosperity.

2. Drivers for Change

Sustainability, as a business concept, has the most relevance for the capital markets when it is discussed and analyzed in the context of the broader evolution of the international economy. Therefore, in any discussion on the capital markets and sustainability, it is necessary to recognize the drivers of change and the shifts in the broader globalizing economy. The key drivers, affecting the development of approaches to sustainability within the capital markets include:

- The "victory of the market" - Fifty-one of the largest 100 economies in the world today are companies.[3] Globally business is moving to the centre of any debate about the future shape of society. Government's influence is retreating but has the crucial role of providing the policy and regulatory framework for markets and investment needed for success;

- The growth in power of civil society - On a local, national and international level the number, influence and authority of non government organizations and specialist interest groups has grown significantly. Groups such as Greenpeace are using market based campaigning to pressure companies to change behavior with the formation of new partnerships;

- The technology innovations - The adoption and innovation of new technology is continually altering the mode of interaction between business and society including the altering of the methods of servicing the market;

- The communications revolution - Innovation and imagination has transformed the way we use create and share information and knowledge. In the "CNN world" the demands for transparency and the scrutiny of corporate performance have intensified. There is no place to hide;

- Stakeholder expectations - The reputation, ethics and sustainability performance of corporations are increasingly becoming deciding factors in decisions to interact with a company: including a consumer's decision to purchase a product or service, a government's decision to grant a license to operate, an investor's decision to buy shares; and an individual's decision to seek employment in a firm;

- Mainstreaming of environment - the environment has moved from the periphery of business and government to being a mainstream issue and core societal value. There is international recognition and scientific consensus of the threats to the health of the planet such as global warming, resource depletion and biodiversity loss;

- Investor interest in sustainability - Today, more than 200 investment funds follow sustainability investment strategies. This segment is extremely dynamic and growing fast. The market leaders are doubling their investment volumes annually;

- Voluntary performance reporting - Europe followed by North America leads the world in voluntary public environmental and sustainability reporting. This disclosure has led to environmental and social performance becoming a competitive issue and has fuelled increased analysis of performance of non-reporting entities;

- Corporate Governance - The pressure for transparency and accountability is growing. Multinational companies, including the finance sector, today operate on a governance framework shared not only by company law and other regulations but also by a growing array of international conventions, market mechanisms, voluntary codes of conduct and public opinion;

- Globalization - No significant business entity can avoid being involved in global issues related to the movement of capital, the financing of development, international regulations, global standards, population growth, security, environmental degradation and poverty and human rights;

3. Canadian Capital Markets and Sustainability

3.1 Overview of the Capital markets

Discussion on the subject of Capital Markets and the link to Sustainability is a new and complex area and one where businesses, governments, universities and the general public are just beginning to investigate. In any discussion on the subject it is helpful to understand what is meant by Capital and what the capital markets are.

Capital, may be broadly defined to include first cash and financial possessions and second all the real physical goods or assets owned. Capital markets generally refer to the money or financial assets. The physical capital, which are goods, are real items such as automobiles, machinery, computers and land. It is important to note that the markets in which physical capital goods are bought and sold such as supermarkets or factories are not capital markets.

Capital markets are where those who are seeking money interact with those who have money and who are prepared to make it available- for a future profit.[4](the campaigners guide)

The general public and average family household may be considered the base level in capital markets. Households' savings are placed into companies such as banks. These companies are trusted with the financial resources they obtain from people's salaries in households. These companies, often referred to as financial institutions, reuse the financial resources in capital markets, particularly to buy and invest in other companies that produce goods and services to increase value and grow their assets.

Companies are the market players who seek money. Their primary funding comes from their "share capital", also called "equity". These publicly owned assets of a company, are often purchased or sold in capital markets. The shareholders who buy the shares own the company, elect the directors and receive a share of the profits in the form of dividends.

The shares of companies form the basic raw material of much of the financial markets. The most important owners of shares are the investment institutions, such as pension funds and life insurance companies. These institutions buy shares for long-term investment purposes, and collectively own a large proportion of the share of most companies. The specific decisions about which shares to own, and when to buy and sell them are made by fund managers – organizations and individuals specializing in equity market investment. [5]

Different financial institutions deal in company shares. Closest to the stock exchange are the stock brokers and investment banks. Their securities departments trade company shares on a short-term basis, helping to establish the price of the shares. Their analysts research companies, providing commentary and advice for other investors.

Most large companies are "publicly listed" or "quoted" on a stock exchange. This means that their shares can be bought and sold by the general public (thus they are sometimes called "public companies" – this does not mean that they are state owned).

The price at which their shares can be bought and sold is changing constantly. In the short term, the price will depend on supply and demand for their shares – if more people are buying than selling, then the price will go up, and vice versa.

There are three main types of capital markets:

1. Stock Markets: markets in which the stocks of corporations are traded such as the Toronto Stock Exchange (TSE) and the New York Stock Exchange (NYSE). Stocks are the shares of a corporation;

2. Bond Markets: markets in which the bonds of corporations and governments are traded. A bond is a legally binding obligation to pay a specified amount of money at specified future date;

3. Loan Markets: is a market in which households, firms, and financial companies make and receive, deposits, loans, and facilitate transactions for stocks, bonds and loans. Financial institutions such as banks are major players in these markets.

In terms of money flows, households pay taxes, consume and import goods and save money. Companies produce, invest and export goods and receive investments. Governments receive taxes, pay subsidies and invest. Through international markets, goods (imports and exports) are traded. Surpluses and shortages of the government, the international markets, companies and households are dealt with by financial transactions through the financial markets.[6]

Financial instruments the players use in capital markets include long tem arrangements such as bonds, certificates of deposit, stocks, and short term arrangements such as commercial paper and treasury bills. Instruments issued and traded in the capital market differ in certain characteristics, such as term to maturity, interest rate paid on the value and nominal amount in issue.[7]

The World Business Council for Sustainable Development have argued that the capital markets offer the most effective method for harnessing human creativity in favour of more sustainable production and consumption.[8] "Markets are human constructs based on human values, laws and norms. They must be built and they can always be improved." [9]

3.2 The Canadian Financial Sector and its role in sustainability

Some industries within the Canadian corporate sector, such as the mining, energy, and resource have taken a leadership position on the issues of corporate sustainability. A benchmark survey of corporate sustainability reports in Canada indicated that 57 companies published detailed environmental, social or sustainability reports in 2000 publicly stating their commitments and achievements.[10] The mainstream corporate sectors' role in advancing progress towards sustainability is critical as industry is a major player in the capital markets in Canada.

Any discussion of the capital markets should recognize that the financial sector ha s a unique and critical role as an intermediary in the market economy. The sector manages the complex financial transactions needed to fuel desirable growth and development of innovative ideas, opportunities, products, services, programs, as well as facilitate investment, provide advice and manage risk.

The Canadian Financial Sector (CFS) includes about 2,500 companies that operate on various scales both domestically and internationally and in 2000 employed over 500,000 Canadians with an annual payroll of about $24 billion. The sector represents about 5% of Canada's gross domestic product and contributes approximately $9 billion in taxes to all levels of government.[11] Appendix A gives a sectoral breakdown of the CFS and the ten largest institutions by asset size.

It is only recently that finance is being recognized as a catalyst for sustainability to meet the needs of the present and those of the future. The critical role that the financial sector plays is central to achieving broader sustainability goals.

It has traditionally been the domain of government to set and regulate environmental and social policy. However, there are both internal and external drivers forcing financial institutions to consider long term strategies that incorporate elements of sustainability in their business policies and operations.

The mainstream financial services sector has been slow to respond to the new challenges that sustainability presents, and have been skeptical about the importance of environmental and social issues.

However, sustainability issues are now beginning to impact across many functions and areas of business operations. Board directors are confronted with an ever more complex management agenda involving greater levels of transparency and disclosure. Finance directors and investor relations managers are finding that environment and sustainability issues are demanding their attention as part of the risk management process. Public affairs and external relations people are dealing with reputation and stakeholder issues, as there are increasing requirements to report on their contributions to society. Product development managers are diversifying their product range in response to market demand. Lending officials are considering environmental issues with regard to credit risk and analysts are developing new techniques for performance measurement.

Financial institutions have begun to recognize both risk and opportunity in supporting progress toward sustainability. Perhaps the most prominent example of progress is the growth in Socially Responsible Investment (SRI) which accounted for 3.2 per cent, or Can $50 billion of assets held in mutual, institutional and socially screened labour funds in Canada.[12]

Another development in the 10 years since the Rio Earth Summit, has been the signing of the UN Environment Program Finance Initiative (UNEP FI) Statement by financial institutions on the environment and sustainable development. This has now been signed by 200 companies of which 7 are Canadian.[13] Implementing the commitments in these policies is a challenging but critical first step in establishing momentum and credibility on the issue of sustainability.

3.3 Current Canadian projects on Capital Markets and Sustainability

A number of organizations have been developing and implementing Canadian initiatives that relate to capital markets and the link to sustainability. A selection of these are described below.

Environment Canada

Environment Canada have proposed a Partnership on Corporate Sustainability and Financial Performance. The proposal seeks to establish partners with Environment Canada to help "build, test, and communicate the relationship between industry sustainability practices and financial performance (the 'business case')" specifically for the financial sector. Guided by a Taskforce, the partnership proposes to include Steering, Working, and Coordinating Groups with partners that include the finance sector, Industry, academics, government, specialist sustainability organizations and other partners such as the NRTEE. The proposal is to be implemented with the partners over two years to November 2004 with stages that include research, pilot, communication and implementation projects. Discussions with potential partners are now taking place and an initial working Group meeting is planned for November 2002.

The Conference Board of Canada

The Conference Board of Canada is working on the issue of linking sustainable development (SD) and shareholder value. Through research, networks and events, the Board is helping to broaden and deepen understanding and dialogue on this issue. In 2001, the Board produced a report entitled Sustainable Development, Value Creation and the Capital Markets. This report examines the role of SD in value creation and its relationship to the capital markets. In December 2002, the Board is holding a major Toronto Executive Seminar on Linking Sustainable Development and Shareholder Value. This seminar will bring executives from leading companies together with representatives of the investment community to broaden and deepen understanding of SD as a value driver.

North American Commission for Environmental Cooperation (CEC)

The CEC addresses regional environmental concerns and promotes the effective enforcement of environmental laws consistent with the North American Free Trade Agreement. They run a program, Financing in Support of Environmental Protection and Conservation, with the objective to increase private financing measures that support environmental protection goals and to make progress in broad policy dimensions of environmental financing, market mechanisms and public-private partnerships. They are also holding a public workshop on Investing in North America's Future: Innovative Financing for Sustainable Development to be held on December 9, 2002 in Monterrey, Mexico. A Canadian speaker, to be confirmed, is scheduled to present at the session on Activities on Understanding Investment and Environmental Linkages in North America;

Toronto Capital Markets Institute

The University of Toronto Capital Markets Institute (the "CMI") undertakes and sponsors policy research and analysis to develop a comprehensive capital markets strategy for Canada. The CMI leads the effort in determining how capital markets mechanisms and institutions should be designed in order to create a superior environment for investors and issuers in a small, open market like Canada. Weekly workshops are conducted primarily for graduate students.

The Schulich School of Business

The Schulich School of Business runs the Sustainable Enterprise Academy, assisting business in the transformation to corporate sustainability by providing senior executives in business, government and civil society with the vision, education, tools and support necessary to champion sustainable development in their organizations. The Sustainable Enterprise Academy is North America's premier executive education program on sustainable development. The role of capital markets and sustainability is a discussed on a number of occasions in the Academy's flagship four day program.

International Institute of Sustainable Development (IISD)

IISD's work on trade, investment and sustainable development began in 1991 and it seeks to find those areas of synergy where trade, environment and development can be mutually beneficial, and to help policy makers exploit those opportunities. Work includes programs such as the Investment Law and Sustainable Development Program (ILSD), a program of education, research and action on the issues of investment law and sustainable development in the North American context.

The Excel partnership

The Excel Partnership gives its corporate industry members the opportunity to attend international forums with like-minded senior managers from an exclusive, cross-sector group of Canadian corporations. Current activities include a forum scheduled for November 19-20 in Washington DC that will address "Tools for Corporate Social Responsibility", together with a round table discussion on developing competitive advantage from sustainability leadership. In the up coming year the Excel Partnership is also intending on addressing "Global Capital Markets, where Excel will assist member companies with strategies that demonstrate linkages between environmental performance and shareholder value, and provide direct access to players in capital markets to influence shareholder value decision making." The program for addressing this issue is still in development.

Shareholder Association for Research and Education

SHARE works with pension trustees, plan administrators, and plan members to develop and implement sound programmes and practices that respond effectively to the needs of plan members and beneficiaries. SHARE's areas of operation include Pension trustee education, research and policy reform, proxy monitoring and shareholder action. SHARE is involved in the educating members on socially responsible investment.

United Nations Environment Program Finance Initiative- North America

The UNEP FI mission is to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations. A task force has been established in North America (NAFT) to create a critical mass of North American signatories that are able to exchange ideas and best practice. Specifically, the NATF will build the number of North American signatories to the UNEP Financial Institutions Initiative Statement on Environment and Sustainable Development to twenty five by January 2004.

4. Options for a possible NRTEE program on Capital Markets and Sustainability

It is clear from our research that there is a need and an opportunity for NRTEE to develop a program on the Capital Markets and Sustainability. There is a great deal of scope to coordinate other players and to develop viable, actionable outcomes to address sustainability and the capital markets.

The following section outlines six options for NRTEE to undertake a program that identifies ways to overcome the barriers to ensuring that the functioning of the capital markets leads to more sustainable outcomes for business and society.

Key to the success of any program will be to involve the appropriate stakeholders who can contribute knowledgeably and constructively to the solving of problems, the creation of new ideas, and the implementation of agreed plans.

For each option we have highlighted inherent issues, challenges and opportunities and proposed some tangible ways to make progress. The options can be evaluated and enacted separately although Option 1 would be a vital initial catalyst. Some options flow logically on from others while for others there may be some overlap if they were carried out simultaneously.

The Options are:

Option 1. NRTEE articulates state of debate on Capital Markets and Sustainability
Option 2. Development of Common Ground
Option 3. Communication between the Investment Community and the Corporate Community
Option 4. Disclosure Regulations
Option 5. Develop the Business Case Link between Environmental and Financial Performance
Option 6. Knowledge and Capacity Building

OPTION 1

NRTEE articulates state of debate on Capital Markets and Sustainability

Issues

There many actors who are impacted by the extent to which sustainability issues are factored into the allocation and use of capital. The debate over the issues is embryonic and many diverse stakeholders have yet to connect and engage in constructive dialogue over the options to better align the capital markets with positive social and environmental outcomes.

Much of the debate has been centered around the growth in Socially Responsible Investment or the sustainable development strategies of corporate enterprises and the relative merits of their improved environmental and social performance. Yet there has been limited dialogue between corporate executives responsible for sustainable development performance and representatives of the financial community.

There has been even less dialogue amongst other actors who could also have an influence on how sustainability is incorporated into the capital markets. These other stakeholders groups include;

- Consumers
- Government legislators- Federal, Provincial and municipal
- Pension and mutual fund managers
- Trustees
- Ratings agencies
- Stockbrokers
- Analysts
- Underwriters
- Non government organizations
- Charitable trusts and philanthropic organizations
- Academics
- Small to medium size businesses
- Business associations
- Aboriginal communities
- Youth organizations
- Overseas aid development authorities and the
- Media

These diverse stakeholders would identify with key issues with differing levels of priority and varying degrees of emphasis on economic, environmental and social dimensions. However to effectively articulate the where the issue is in Canada today it is important to get the input of these varied perspectives.

Representatives of each of the respective stakeholder groups could inform other participants of the issues and barriers as they see it. These discussions and interactions will be necessary to enable a clear picture to evolve as to the priority areas to for the NRTEE program to progress.

As indicated in section 3.3 a number of organizations have begun to catalyze networks and initiatives to look at the capital markets and sustainability issues in Canada. The programs largely focus on the interaction amongst the business and financial community. Some key elements of the planned work, especially Environment Canada and the Conference Board of Canada, will progress the knowledge of the link between financial performance and sustainability performance. It would be important to include representation of people from these groups who have gone through the process with the capital market players to input what they have learnt into the NRTEE program.

Some of the proposed discussion points, subject matter and content of the NRTEE program to articulate the state of the debate are discussed in greater detail in the following sections. An indication of the subject matter to be discussed may include:

- The business case for sustainability
- The fiduciary duties of Trustees and Fund managers
- Standard metrics and benchmarks for investment analysis
- Public sustainability reporting frameworks
- Communication between corporations and the financial community
- Financial products related to sustainability eg SRI
- New Disclosure Legislation
- Investor accountability to society

Challenges

The diverse perspectives of stakeholders would mean the initial agenda would be broad. However the consultation process will greatly inform future decision making.

The language used to discuss economic, environmental and social dimensions of sustainability and the capital markets would be quite different between stakeholder groups. Effective outcomes will require the NRTEE to be the “translator” amongst the stakeholders. This is discussed further in Option 2.

A key challenge will be to balance the divergent views on the short and long term interests, especially in regards to investment time horizons. A consequence of the initial consultations would be that separate groups are established to focus on issues of significance where there is greatest synergy. If appropriate money managers with similar investment time horizons could work on similar initiatives.

It would be prudent to ensure government efforts in this field are coordinated and representation in the NRTEE program accurately reflects the relevance of the issues to the respective government entities.

A significant challenge, critical to the success of the NRTEE program, will be to engage, at the senior level, representatives from the financial services sector. The ability to bring the relevant executives form the banks, in particular, will help ensure relationships are built and progress is made through the initial dialogue.

Opportunities

Through a NRTEE program new networks and partnerships could be created. The networks amongst the aforementioned stakeholder groups do not exist around the issue of sustainability and the capital markets. As the networks do not exist then formalizing them would allow constructive, ongoing dialogue.

A key differentiator of the NRTEE program would be that it involves a wide cross-section of the community. In particular public input to the process brings an important dimension to the debate. Similarly NRTEE could play a vital role as the link between government departments, Federal and Provincial.

Effective, transparent communication to all key audiences is a prerequisite to extracting value from initiatives and strategies related to sustainability.

The ability to distill the priority areas for action and the broad stakeholder input up front will allow for greater support for initiatives as they are implemented subsequently.

Recommendations

The NRTEE organize an initial series of national forums/seminars to articulate the state of the debate over the issues of sustainability and capital markets. In these forums key individuals representing the diverse stakeholder groups would present their views, outline their initiatives and share their knowledge. The forums would capture the varied expectations of stakeholders to better inform business, government and the capital markets. The NRTEE would lead the facilitation process to define the priority issues to be acted upon and the barriers to further progress. The NRTEE would use the initial forums to develop the agenda and tasks for subsequent aspects of the broader program.

Option 2

Development of common ground

Issues

The financial performance of business is judged by globally agreed methods and rating systems. The language of the financial markets is universal. However other aspects of business performance, also recognized as being central to business success, do not have universally agreed criteria to enable consistent valuation. These include intangible assets such as brands, intellectual property, knowledge and reputation.

Environmental and social performance of companies also suffers from a lack of comparable metrics and consistent valuation methods. Agreed performance measures and standards for evaluating sustainability performance do not exist.

Although there are over 200 investment funds that incorporate sustainability dimensions to their investment strategy, there is still wide discrepancies in the terminology used to describe these funds as well as great variations on their investment approaches.[14]

In any discussion on sustainability and the capital markets there will be enormous variations in the language and the verifiability of performance.

Meeting the expectations of stakeholders is now a critical aspect of business survival. To effectively deliver economic, environmental and social outcomes an organization must be able to have the effective dialogue with its stakeholders and clearly understand their expectations.

In the development of environment and sustainability reporting (discussed further in Option 3) attempts are made to communicate sustainability performance to a diverse stakeholder groups. One significant group that has been overlooked when producing these reports has been the capital markets. Without the tools and ability to analyze and evaluate environmental and social performance the markets have largely ignored sustainability performance.

The development of standardized, internationally recognized metrics, accounting and reporting protocols are a priority if the measuring, monitoring and reporting transactions costs associated with the move to sustainability are to be reduced.[15]

The tools and techniques to translate the language of the business for sustainability into the language of the financial markets have only just begun to emerge. There is an attempt to standardize the reporting of sustainability initiatives through initiatives such as the Global Reporting Initiative (GRI). The goal of this initiative is to make sustainability reporting as routine and credible as financial reporting in terms of comparability, rigour, and verifiability. Specifically, the GRI's goals are to elevate sustainability reporting practices worldwide to a level equivalent to financial reporting.[16]

Canada’s Imagine Program has developed a Corporate Social Responsibility (CSR) Assessment Tool. The CSR Assessment Tool is a self-assessment tool that will provide "one stop shopping" for companies that need a comprehensive management assurance tool to assess their CSR performance. Drawing from the major international codes, standards and statements of principles, the CSR Assessment Tool is uniquely tailored to the Canadian business context. The findings of the assessment can be used to manage performance, communicate practices and performance and create business value.[17]

The work undertaken by NRTEE on the development of eco-efficiency indicators was also a good example of the progress being made to allow useful dialogue and permit easy comparison between divisions, companies and business sectors.

Many projects are currently being undertaken at the international level relating to the development of sustainability indicators. See Appendix B for a list of standards that are being developed for the assessment of sustainability.

Most of the development of standardize reporting and communicating is related to company reporting. From a Capital Market valuation point of view the development of common approaches is not as advanced. For the capital markets to evaluate the sustainability performance of companies there are there are no common analytical frameworks.

Challenges

For companies, investors, consumers and governments it has been difficult to know which of the emerging sustainability guidelines, principles, standards or benchmarks to adopt. The growing variety of tools and techniques being developed are adding to the options.

Opportunities

Dialogue, consultation and a well designed engagement strategy with key audiences is critical in building an understanding of their expectations as well as informing the Canadian capital markets of issues and aspects that may have a positive or negative impact on sustainability performance, reputation or market share.

NRTEE could advance the debate significantly if the Capital markets program is conducted in language that is both clear and precise to all stakeholders.

One area where there is the potential for NRTEE to clearly establish some clear common ground is in the legal sphere as mandatory legislative requirements relating to sustainability can be defined.(see Option 4)

An interesting development to signal that common ground can be found has been the recent strategy of campaigning organizations to lobby companies and financial institutions. They have used the language of capital markets to lobby investors to exert pressure so as to stop environmentally-damaging and socially inequitable projects.[18]

Recommendations

The NRTEE could use the stakeholder engagement process in Option 1 to identify and prioritize where there is the greatest need to develop common ground and a common language. The NRTEE could undertake to examine all the existing metrics, standards and performance measures being used in sustainability and the capital markets and produce a report outlining the relative usage and success of these in delivering sustainability outcomes. Some of these tools and techniques could be developed and refined, with stakeholder input, so they are more customized to the Canadian situation and provide a common platform for the future.

The NRTEE could establish an ongoing forum where the public and civil society groups could engage directly with key actors from the capital markets. The dialogue could be facilitated to develop constructive new approaches and engagement strategies to better inform business on an ongoing basis of heightened stakeholder expectations.

Option 3

Communication between the investment community and the corporate community

Issues

There is growing interaction and communication between the investment community and the corporate community on sustainability issues.

One significant factor driving the increased dialogue is the growth in SRI funds which require some form of interaction to research and ascertain the sustainability performance of the company.

Conversely, another factor is the desire for corporations to communicate their sustainability performance to the market.

SRI funds make up only a small percentage of the capital markets but their influence on corporate behavior outstrips their shareholdings. Companies benefit in their reputation if they are rated highly by sustainability indices and indeed attract capital if they are included in SRI funds.

One form of interaction being employed by fund mangers is shareholder advocacy. This involves constructive engagement involving direct interaction with companies over their performance. Shareholder advocacy or investor engagement of companies on sustainability issues is set to increase. [19]

Alongside the growth of SRI has been the development of "alternative" rating methods. Some of the main international rating agencies and indices are the Dow Jones Sustainability Group Indices, Innovest Strategic Value advisors, FTSE4GOOD, and Canada's Michael Jantzi Research Associates. All of these methods require the exchange of information.

If legislation, SRI and other factors are driving increased investor engagement with companies over sustainability issues then it becomes more imperative that the communication is clear and the information requirements understood.

SRI is still a niche area of investing. The key mainstream analysts in the capital markets are not interested in sustainability performance measures. Companies are making significant investments in sustainability and sustainability reporting but that return is not being maximized as the financial markets are not giving those companies sufficient reward for their efforts.

The communication of sustainability performance is not in the language that the financial markets understand and therefore it does not get acted upon.

Challenges

Currently information requirements on companies from SRI analysts, rating agencies, reputation assessors, interest groups, shareholders and the media are increasing. There are significant numbers of questionnaires and surveys landing on the desk of companies requesting assessment of their respective environmental, social and economic performance. The questionnaires are extremely variable. Many of the questionnaires, from different capital market entities, ask for the same information to be provided, but often in different ways

Questionnaire fatigue is a problem. The company resource requirements in terms of personnel and time in responding to such questionnaires is significant. Some sections of industry believes that there is a danger inherent in the continuation of the questionnaire driven process that companies who have few resources will spend less time in providing information and the quality of information will therefore be reduced.[20]

There are also concerns from industry that relate to the lack of transparency in methodologies employed by the SRI analysts and rating agencies. Environmental and social criteria, including positive and negative screens, are chosen without adequate explanation of the methodology. Given the important role such indices can play in directing investment flows there is need for much greater rigour in the methodologies.

Although sustainability reporting has increased, the concern over environmental and social reports is that they do not contain the accounting data to make them of interest to mainstream analysts or investors. The relevance of environmental and social reporting to financial analysts is questionable. For the capital markets to make an accurate assessment of the financial impact of sustainability, financial data is required. With few exceptions, the disclosure of environmental and social data is more qualitative, descriptive and suffers from lack of comparability. The publication of these reports separately from the annual report confirms the perception of mainstream investors that sustainability issues are not core to business success.

Opportunities

There is a growing desire for both the corporate community and the capital markets to engage in dialogue and communicate their sustainability performance. Effective methods of facilitating this process and making it more efficient would be welcomed.

Industry considers that there is a large scope for questionnaires to be streamlined either by companies or by the financial community. This would reduce the workload for companies and would focus the financial community on developing better ways to access quality information

Recommendation

The NRTEE could play a significant role in helping to facilitate and streamline the information flow between the corporate community and the capital markets. One way would be to develop a common public website to host company information, that could be accessed by capital market participants or the public seeking information on company environmental and social performance. This would reduce questionnaire fatigue and allow real time updating of data.

The NRTEE could develop a framework for Sustainability reporting that would help improve the quantity and quality of company non-financial information available to the financial sector, with input from all major stakeholders. Drawing from the major international codes, standards and statements of principles, the Sustainability Reporting Framework would be uniquely tailored to the Canadian business context.

Option 4

Disclosure Regulations

Issues

Government regulatory measures and voluntary initiatives are bringing sustainability into the mainstream of business concerns and investor engagement. Several specific pieces of legislation, particularly in the UK, have required of business, greater disclosure of non-financial aspects of business operations and performance. Accountability and transparency issues are also being incorporated into voluntary agreements, codes of conduct and industry association forums.

Following recent corporate scandals with Enron and WorldCom, the capital markets are becoming more demanding of companies in terms of disclosure and transparency. The globalization of capital has produced an upward pressure to improve standards of reporting and management to cover corporate governance and social and environmental factors.

The UK Pension Act mandated that all pension funds must disclose the extent to which social environmental or ethical considerations are taken into account in the selection, retention and realization of investment.[21] From this year all publicly-quoted firms in France will be required to include data on environmental and social impacts in their annual financial reports. In Australia the Australian Product Disclosure Legislation closely mirrors the UK legislation but is specifically designed to protect consumers of financial products and give them more information about the investment strategies of their fund managers.[22] .

Regulation and guidelines such as these, are forcing investor engagement on sustainability issues as they look for evidence of how company management are effectively managing non financial risks such as social, environmental and ethical matters. Due to these regulatory changes, fund managers, have begun to identify how companies are putting commitments to social and environmental issues into practice.

Canadian companies operating in a global market place are now being impacted by these legislative changes.

In Canada, at this time there, is no specific mandated requirement to report on environmental and social performance. But one of the most relevant pieces of legislation that drives reporting requirements for federally regulated institutions is the changes passed as part of Bill C-8 in June 2001. The reforms require Public Accountability Statements for institutions with equity in excess of $1 billion to publish annual Public Accountability Statements.

From a legal perspective there is an increasing focus on the interrelationship between environmental issues and fiduciary issues. A study done by the Rose foundation found that “in some cases fiduciaries are actually under a legal obligation to consider environmental issues and, in some cases, to act on them.” [23]

The Conference Board 2002 suggests that “perhaps the most significant achievement of the UK Pension fund amendments is that they enable Sustainable Development to be factored in to the investment process without compromising fiduciary responsibility. It is now arguable that investment decisions made without assessing the environmental, economic and social practices of companies may compromise fiduciary responsibility”.[24]

Poor disclosure or lack of disclosure of environmental liabilities can depress shareholder value. When corporations understate or do not disclose environmental liabilities, investors are hampered in their ability to assess future earnings growth.[25]

Challenges

In Canada, the Provinces have jurisdiction over institutional fiduciary responsibility. A coordinated policy development approach would be difficult to develop and implement.

Keeping in abreast of the changes in legislation and non-mandatory requirements in the geographies of operation for CFS is a major challenge. Ensuring compliance and a “license to operate” will continue to bring sustainability issues to the fore in financial institutions.

Evaluating environmental and social risks by capital market participants is not mandatory as current federal legislation states that “credit and investment decisions are strategic business decisions that are not be dictated by government. Each financial institution has developed its own risk assessment and investment policy frameworks”. [26]
Accurate reporting of environmental risks and liabilities will not occur unless the government makes enforcement of environmental disclosure a priority.

Opportunities

It is likely the development such as the UK pension fund amendments will impact on Canadian institutional investors and lead them to incorporate sustainability as an investment criterion.

An opportunity exist to influence the drafting of federal and/or Provincial legislation to establish the responsibilities and disclosure requirements for capital market players in their investment strategies, leading to better sustainability outcomes.

Recommendation

The NRTEE could establish a task force to investigate progress on disclosure rules on Sustainable Development in different jurisdictions, debate the issue for its implications, and make recommendations for Canadian corporate disclosure legislation.

Option 5

Develop the Business Case Link between Sustainability and Financial Performance

Issues

Over the last decade, a number of large multinational corporations, such as DuPont, BP, Shell, Alcan and Ford have refined their business models to integrate Sustainable Development principles into their core business strategies, values and performance measures. The rationale is that they are likely to generate sustainable growth in shareholder value over the long term.

The business case for sustainability is now being made by many sustainability advocates by demonstrating that shareholder value can be protected and created by reducing risks, improving the license to operate, increasing productivity and improving efficiencies, attracting and retaining employees and customers, attracting capital and accessing new markets.

Yet the business case has still not been made adequately in financial terms and these companies are often frustrated that the mainstream analysts and capital markets do not understand their strategy for growth related to Sustainable Development.

The question whether there is link between sustainable development performance and financial performance is a current discussion point amongst many people in business, community and the capital markets.

A considerable amount of evidence is now available that purports to identify a positive relationship between financial performance and corporate sustainability. A recent publication “Walking the Talk” launched at the World Summit on Sustainable Development in Johannesburg by the World Business Council on Sustainable Development identifies 67 solid case studies that provided evidence of corporate sustainability performance.[27]

Business school professors at Harvard and University of Michigan recently summarized the empirical work of 95 studies that examined the relationship between social and environmental performance to financial performance. Three quarters of the studies showed the relationship of social and environmental performance to financial performance to be neutral or positive while virtually no research showed a negative impact on financial performance. In summary, there is little evidence that sustainability strategies do not have financial impact and a growing body of evidence that suggests they do.

Some prominent funds and indices indicate that investment portfolios composed of companies committed to Sustainable Development generally matched or outperformed their benchmarks. Examples highlighted in the Conference board of Canada’s report on “Sustainable Development, Value creation and the Capital Markets” include the Domini Social Equity Fund, The Dow Jones Sustainability Group Index, Sustainable Value (Pension) Fund®, Jantzi Social index™ and EcoValue 21™ performance rating model. The report suggests that “consistent with the performance of these funds, SD continues to gain recognition within the capital markets as a performance measure appropriate for use in portfolio construction”.[28]

Challenges

A significant barrier to further developments of mainstream capital market participation in Sustainable Development is the prevailing view that environmental and social factors are not material to company financial performance.

No generally accepted method for quantifying environmental and social risks have yet been agreed upon, and consensus on how to link environmental and social risk to economic performance in an objective and comparable fashion has not been reached.

Mainstream financial analysts have difficulty obtaining environmental and social information in the manner and form they are used to. Questions are not being asked of CEOs about their environmental and social performance because most mainstream analysts and investors do not believe these are issues that affect stock performance.

Sustainable Development practices are not defined in parameters consistent with mainstream financial valuation.

Opportunities

If mainstream capital markets are to be convinced that there is a link between environmental and social performance and financial performance, then a key step is to demonstrate *how* sustainability strategies create shareholder value.

NRTEE can incorporate the work other organizations are doing in the area of linking financial performance and shareholder value with sustainability performance and help communicate the results to a wide audience.

Recommendation

To better inform the capital markets, the NRTEE could bring the senior representatives of major Canadian corporations together with their business peers in the Finance Sector to share and articulate their specific business case examples. The NRTEE could undertake to establish the specific finance sector information needs then take the business case examples of these firms and translate them into the language the capital markets understand.

The NRTEE could take some of the commonly reported sustainability practices and establish the metrics in the form the capital markets understand. For example energy efficiency investments and improvements could be converted into a quantifiable figures useable by the markets and comparable across industries. A new process of translating SD practices into financial language could be established.

The NRTEE could provide a link to the wider investment community and educate them on the business case for sustainability, the financial viability of sustainability funds and the options they have to choose financial products that have social and environmental dimensions. The recipients of that knowledge could include Pension fund Trustees, financial advisors and independent professional investors.

Option 6

Build Knowledge and Capacity for Sustainability

Issues

Knowledge is the currency of the future. Today it is recognized that the most valuable asset of an organization is usually embedded in the minds of its people. For an enterprise to survive and prosper in the 21st Century they must accelerate the acquisition of new capabilities and broaden the networks and perspectives of their people.

Sustainability issues have become high priority business agenda items for boards and executive managers of all companies competing in a global marketplace and knowledge required to successfully integrate social and environmental considerations into core strategy, to manage new risks and to deliver financial bottom line outcomes has become a key competitive advantage.

The demand for this knowledge is growing as companies seek to add shareholder value by protecting their reputation, enhancing their brand, ensuring a license to operate, improving efficiencies and attracting, retaining and motivating staff and importantly, winning new business.

Organizations that can creatively acquire, utilize and leverage this vital new knowledge will be in a position to serve changing market needs and to create solutions that support sustainable business growth.

Some sectors such as the mining industry, oil and gas, energy, chemical and motor vehicle industries have, in recent years, been building the skills of their people but despite an increasing level of community concern about environmental issues there is a lack of awareness of the relevance of environmental and social issues within the capital markets. Sustainability is somewhat of a new frontier for the capital markets.

Although there are a growing number of seminars, conferences, and roundtables on the subject of sustainability, very few have been specifically targeted at the capital markets. Education is the key to accelerate the involvement of capital markets in sustainability.

Challenges

The development of sustainable business strategies that deliver tangible bottom line benefits are a significant challenge for today's Board's and CEOs. An agreed definition and understanding of the principles of sustainability, and its relevance and importance to the Canadian Capital markets will be critical first steps in establishing actions and innovation on this issue.

Engaging the mainstream capital markets on sustainability is always a challenge. As in other segments of society that have addressed sustainability, engagement and dialogue is required with key decision makers to get buy-in. For change to occur, key decision-makers need to be armed with the best available and most appropriate tools to manage the risks and capitalize on the opportunities the movement to sustainability presents.

Opportunities

The NRTEE can bring in a wide variety of people to share knowledge. The ability to incorporate the views and perspectives of a diverse group of stakeholders and broker the emerging global knowledge base will put the NRTEE a unique position to educate the market.

The NRTEE can also harness the tools and techniques to educate the capital markets and customize them for the various audiences. These tools could include scenario planning techniques for the strategy people, analytical techniques for valuing companies sustainability performance for fund managers, risk assessment processes for lending officials and software products to capture data for facility managers.

Many tools and techniques, such as the sustainability investment research and assessment methodologies used in SRI, are still in development but are helping to increase the knowledge base within the capital markets. The best innovative approaches are contributing to the development of the skills and competencies required within financial institutions to address “what” and “how” they can improve environmental and social performance in line with continued growth in profitability.

Recommendation

The NRTEE could develop a capital market and sustainability educational program. This program could be delivered throughout the country in a number of different forms, including in-house for businesses. The program could have a number of modules specific for different segments of the capital markets and could incorporate the most relevant knowledge and evidence on the business case, investment risks, legal issues, tools, techniques, market dynamics and global and local trends and issues. The content for the program could be developed following the stakeholder engagement sessions in Option 1 and be constantly refined and updated as developments occur.

5. Conclusion

The NRTEE has an opportunity to bring key actors from the capital markets, government, business and the community together to initiate a program that will have profound long term outcomes. Providers of capital are catalysts for sustainability and providing them with education, tools, techniques and relationships will greatly accelerate the potential to incorporate sustainability into the mainstream of their products and services.

The NRTEE can leverage off all the work that others have begun and bring it all together for the benefit of program participants. Dialogue and engagement will lead to education. Knowledge will be gained and the legacy of the program will be profound.

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Appendix A

Table 1: Overview of the Canadian Financial Services Sector

Sector	No. of Companies	Employment 000's people	Assets $billion
Banks	63	235	$1,080
Mutual fund companies*	80	90	$419
Life and health insurance companies*	120	110	$267
Credit unions/caisses popularizes	1,772	56	$122
Securities dealers*	190	39	$158**
Property and casualty insurance companies	230	90	$58
Non-bank trust companies	25	n/a	$52**
Finance and leasing companies	100	n/a	

Source: Department of Finance, June 2002

- Includes companies owned by banks and credit unions/caisses

Table 2: Ten Largest Canadian Financial Institutions by Asset Size.

Company	Total assets[1] ($ millions)
Royal Bank of Canada	360,046
TD Bank Financial Group	287,838
Canadian Imperial Bank of Commerce	287,474
The Bank of Nova Scotia	284,425
Bank of Montreal	239,409
Manulife Financial Corporation[2]	137,819
Sun Life Financial Services of Canada Inc.[2]	128,872
Great-West Lifeco Inc.	59,159
Mouvement des caisses Desjardins[3]	80,493
National Bank of Canada	75,762

Appendix B

Current reporting initiatives

- The Global Reporting Initiative: www.globalreporting.org The Global Reporting Initiative (GRI) is a long-term, multi-stakeholder, international undertaking whose mission is to develop and disseminate globally applicable sustainability reporting guidelines for voluntary use by organisations reporting on the economic, environmental and social dimensions of their activities, products and services.
- The International Institute for Sustainable Development compendium of sustainable development indicator initiatives and publications: http://iisd1.iisd.ca/measure/default.htm
- Corporate Social Responsibility Europe: "Communicating Corporate Social Responsibility: Guidelines for Action." www.cseurope.org/csr_europe/Activities/activitiesframes.htm?content=Programmes/CommsReporting/communications.htm
- Coalition for Environmentally Responsible Economies www.ceres.org
- World Business Council for Sustainable Development (WBCSD) Eco-efficiency indicators project www.wbcsd.com/newscenter/reports/2000/MeasuringEE.pdf
- World Business Council for Sustainable Development (WBCSD) Reporting Project www.wbcsd.com/projects/pr_sustreport.htm
- Imagine and the Conference Board of Canada's Canadian Centre for Business and the Community CSR benchmarking program www.ccp.ca/imagine/CSR-program.html
- EPI-Finance 2000: www.epifinance.com/project.htm This site focuses on the development of indicators to measure the environmental performance of financial institutions, and applies the environmental performance standard ISO 14031 as a guideline.
- SPI-Finance 2001: www.spifinance.com This site focuses on the development of social performance indicators for the finance sector.
- AccountAbility - Institute of social and ethical accountability: www.AccountAbility.org.uk The site features the AA1000 standard which has been developed to improve the accountability of organisations by increasing quality in social and ethical accounting, auditing and reporting.