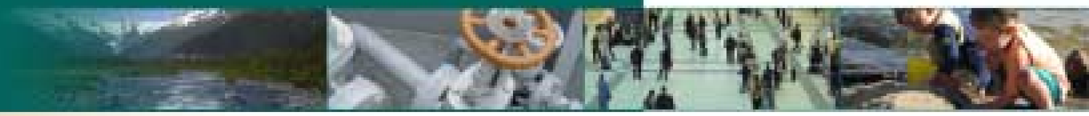

Corporate Disclosure and Capital Markets

Demand and Supply of Financially Relevant Corporate Responsibility Information

December 22, 2004

Stratos
strategies to sustainability

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Submitted to:

David Myers
Capital Markets and Sustainability Program
NRTEE

December 22, 2004

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Table Of Acronyms

ACCA	Association of Chartered Certified Accountants
AMWG	Asset management working group
BMO	Bank of Montreal
CAPP	Canadian Association of Petroleum Producers
CBA	Canadian Bank Association
CBCA	Canadian Business Corporations Act
CBRA	Community based risk assessment
CIBC	Canadian Imperial Bank of Commerce
CICA	Canadian Institute of Chartered Accountants
CPPIB	Canada Pension Plan Investment Board
CR	Corporate responsibility
E3	Environmental Excellence in Exploration
EA	Environmental assessment
EH&S	Environmental, health and safety
EMP	Environmental management plan
EPs	Equator Principles
ESA	Environmental site assessment
ESC	Environmental, social and corporate governance
FTSE	Financial Times Stock Exchange
GHG	Greenhouse gas
GRI	Global Reporting Initiative
ICC	International Chamber of Commerce
IFC	International Finance Corporation
IPO	Initial public offerings
MAC	Mining Association of Canada
MD&A	Management's discussion and analysis
NRTEE	National Round Table on the Environment and the Economy
OMERS	Ontario Municipal Employees Retirement System
RBC	Royal Bank of Canada
RI	Responsible investment
RoB	Report on Business
SEC	Securities and Exchange Commission
SEE	Social, environmental and ethical
SRI	Socially responsible investment
TD	Toronto-Dominion Canada Trust
TSM	Towards Sustainable Mining
UNEP FI	United Nations Environment Programme Finance Initiative
USS	Universities Superannuation Scheme

Executive Summary

Study Purpose

This study has been commissioned by the National Round Table on the Environment and the Economy (NRTEE) Capital Markets and Sustainability Program to provide a characterization of the current demand for and supply of sustainability or corporate responsibility (CR) information. Its focus is on Canadian practice, but the study also draws on leading practices and guidance developed in Europe and at the international level.

The study addresses two main questions:

- What role can corporate disclosure play in capital markets to link corporate sustainability and financial performance in Canada?
- How can public policy best promote the kind of corporate disclosure that will help capital markets value responsible corporate practices in Canada and therefore encourage responsible investment?

For the purpose of this study, capital markets are characterized according to five segments: commercial banking, investment banking, investment management, pension fund management, insurance and re-insurance and indices.

Demand Side Findings

On the demand side, a number of conclusions are drawn:

- Demand for CR information is evolving rapidly in scope amongst certain capital market segments but growing relatively slowly among mainstream elements of the capital markets.
- Leading organizations in all segments of the capital markets are requiring or seeking a broad range of financially-relevant environmental, social and ethical information from investment targets; they have systematic processes for analyzing at least qualitatively and in some cases quantitatively the environmental management and performance information of companies they invest in or lend to.
- The depth of this capacity in each segment of the capital markets is limited and interest in these issues varies significantly even among organizations in similar capital market segments and lines of business.
- Most segments of the capital markets pay at least some attention to specific environmental issues faced by a company or project and how prepared the company is to manage these, where they can see the link to shareholder value.
- Environmental or social issues of corporate performance are important only in terms of risk to the company’s financial health, and therefore to capital market

financial decision-making. High risk is discounted, but business opportunity from good CR performance is not given a premium in mainstream decision-making.

Among the most important factors limiting mainstreaming is the prevailing emphasis within the capital markets on short-term considerations such as quarterly results, and the strong belief that CR management is primarily relevant to the long-term value of a company. Where the markets do pay attention to CR issues, a premium for good environmental or social performance is not paid, but penalties may be delivered for not managing risks in these areas. Limited awareness of the potential linkages between CR and business value, poorly developed analytical techniques, and lack of consistent, financially-relevant CR metrics also hinder the use of and demand for CR information.

Supply Side Findings

On the supply side, the study reviewed the disclosure of five Canadian companies in each of three sectors, with a focus on a key "representative" CR issues selected to permit more in-depth analysis. These issues are not intended to indicate that other CR risks do not bear on capital-market decision-making for these sectors:

- Oil and gas – climate change disclosure;
- Mining – biodiversity disclosure;
- Financial services – disclosure of environmental and social risk considerations for lending and project financing; and
- Compliance disclosure across the sectors.

OIL AND GAS	MINING	FINANCIAL SERVICES
Imperial Oil	Barrick Gold	Bank of Montreal
Nexen	Falconbridge-Noranda	Bank of Nova Scotia
Petro-Canada	Inco	Canadian Imperial Bank of Commerce
Shell Canada	Inmet Mining	Royal Bank of Canada
Suncor Energy	Teck Cominco	Toronto-Dominion Bank

OIL AND GAS		
Company	**Stock Symbol**	**Web site**
Imperial Oil	IMO	http://www.imperialoil.ca
Nexen	NXY	http://www.nexeninc.com
Petro-Canada	PCA	http://www.petro-canada.ca
Shell Canada	SHC	http://www.shell.ca
Suncor Energy	SU	http://www.suncor.com

Oil and Gas: The five large oil and gas companies reviewed for this study all disclose publicly a considerable amount of information related both to their positions regarding climate change and to the steps they are taking to reduce their own emissions. They disclose this information using different vehicles such as sustainability reports, annual reports (including Management's Discussion and Analysis [MD&A]), annual information forms, corporate websites, investor information briefings and executive speeches. Each of the companies recognizes that climate change poses some type of risk to their ongoing sustainability. Overall, however, they present very different strategies for addressing climate change, and provide considerably more detail about their internal GHG reduction and offsetting activities and performance, than about strategic plans to assess investments or other actions relating to the potential long-term implications of a carbon-constrained future.[1]

MINING		
Company	**Stock Symbol**	**Web site**
Barrick Gold	ABX	
Falconbridge-Noranda	FL NRD	http://www.falconbridge.com http://www.noranda.com
Inco	N	http://www.inco.com
Inmet Mining	IMN	http://www.barrick.com
Teck Cominco	TEK	http://www.teckcominco.com

Mining: Each of the reviewed mining companies emphasizes the importance of environmental issues to their ongoing success. They all describe environmental governance processes, management systems, monitoring and audit or assurance processes. In some cases the companies represent leading current practice in the disclosure of risks related to environmental liabilities. In general, however, there is only

[1] For a full description of current financial reporting and corporate disclosure requirements for public companies in Canada and the extent to which these requirements may be expected to provide disclosures about social, environmental and ethical (SEE) issues, see the Canadian Institute of Chartered Accountants report (CICA) prepared for NRTEE, *Financial Reporting Disclosures About Social, Environmental and Ethical (SEE) Issues*, November 2004.

limited disclosure of information on biodiversity risks in the public information provided by the companies. Indeed, none of them provides a detailed description of how the potential significance of biodiversity issues are assessed and are being managed. This contrasts to the practices of some of the leading multinational mining companies, which are starting to report extensively on biodiversity impacts and management.

FINANCIAL SERVICES		
Company	**Stock Symbol**	**Web site**
Bank of Montreal	BMO	http://www4.bmo.com/
Bank of Nova Scotia	BNS	http://www.scotiabank.com
Canadian Imperial Bank of Commerce	CM	http://www.cibc.com
Royal Bank of Canada	RY	http://www.royalbank.com
Toronto-Dominion Bank	TD	http://www.td.com

Financial Services: All the banks reviewed have policy commitments related to the environmental risk assessment in their lending practices, and state that they have standards or procedures in place to assess existing or potential exposure to environmental liability. Some have also adhered to commitments related to the management of environmental and social risks under various international and domestic initiatives (the Equator Principles, the United Nations Environment Programme Finance Initiative [UNEP FI], the International Chamber of Commerce [ICC] Business Charter for Sustainable Development, and the work of the Canadian Bankers Association's Environmental Issues Group). However, the almost complete lack of disclosure about how they are managing social risks in their financial services and products invites the conclusion that they are not addressing CR in a systematic manner. This contrasts with the information learned from leading banks in the demand side analysis of this report.

Compliance as a Cross-cutting CR Risk Measure: There is a strong focus on compliance, reinforced by detailed disclosure, primarily by the resource sector companies reviewed in this study. The major focus of compliance disclosure is on environmental, health and safety (EH&S) issues, with little or no disclosure on compliance to social regulations or obligations, such as those contained in regulatory approvals or benefit-sharing agreements. Even with respect to EH&S, however, the companies reviewed use a range of indicators, inhibiting efforts to compare performance.

Recommendations

Materiality is a central concept linking capital markets with corporate responsibility. The interpretation of what is material is expanding rapidly through leading disclosure practices of some companies, and through guidance provided by professional bodies such as the Canadian Institute of Chartered Accountants (CICA). Companies should consider this broader definition of materiality in their disclosure practices and regulators should enforce the disclosure of material risks.

Capital Markets

- Learn from and adapt the recommendations of international bodies and initiatives including the UNEP FI Asset Management Working Group process.
- Broaden the use of international guidance such as the Equator Principles, through financial industry associations and corporate leadership.
- Build CR awareness and tools for investment professionals.

Disclosure by Companies

- Full disclosure of material risks.
- Statement of business value in CR.
- Standardized formats and metrics to meet the needs of investment analysts.
- Transparency of performance related to environmental, broader economic, social and ethical risks.
- Application of the Global Reporting Initiative as an emerging international standard.

Public Policy

- Stimulate market demand through measures such as:
    - A survey of capital market analysts on their current level of understanding and application of non-financial risk analysis;
    - Improved communication between environmental and financial regulators;
    - Reviewing legal or guidance constraints such as prevailing interpretations of fiduciary duties.
- Facilitate market response through measures such as:
    - Stricter enforcement of existing environmental disclosure requirements by securities regulators;
    - Promoting the development and adoption of standardized or commonly accepted financially relevant CR metrics.
- Mandate disclosure by encouraging capital market bodies to provide clear CR disclosure practice standards.
- Mandate CR disclosure by regulation.

1 Introduction

1.1 Overview

There is increasing pressure from the capital markets on companies to operate in an accountable and transparent manner - whether it is shareholder pressure on banks to disclose ethical risks, or institutional investors demanding climate risk disclosure. Credible disclosure on all aspects of a company's performance – financial, economic, environmental, social and ethical – is increasingly becoming an important way to enhance corporate accountability and transparency and inform the capital markets.

The National Round Table on the Environment and the Economy (NRTEE) is engaged in a multi-year program to explore the relationship between capital markets, financial performance and sustainability in Canada. With the Capital Markets and Sustainability Program, the NRTEE hopes to facilitate a strong, neutral and independent multi-stakeholder debate on responsible investment (RI) and corporate responsibility (CR) by exploring the links between CR (comprising environmental and social issues) and financial performance in Canada. [2]

This study is intended to support the NRTEE Capital Markets and Sustainability Program by providing a characterization of both the current demand for and supply of CR information in Canada and elsewhere. On the demand side, Section 2 provides a characterization of the capital markets (pension funds, investment management companies, etc.) and an overview of the types of CR information the various segments of the capital markets are starting to request. On the supply side, Section 3 describes the types of information selected companies in the oil and gas, mining and financial services sectors are disclosing on some key issues: climate change for oil and gas, biodiversity for the mining sector, and environmental and social risk in lending and project financing for the financial services sector. The section also briefly summarizes how companies in each of these sectors disclose information about regulatory compliance. Based on these findings, Section 4 then provides preliminary recommendations for the capital markets and for reporting companies, as well as recommendations with respect to ways in which public policies could promote corporate

SHAREHOLDER PERSPECTIVES

Canadian public survey research conducted in 2003 captured shareholder perspectives on issues related to the capital markets and corporate disclosure:

- **90%** of Canadians support "requiring companies to publicly report their social and environmental performance"
- **84%** of Canadian shareholders believe that the "financial community should pay more attention to social and environmental performance when valuing companies"
- More than **80%** of Canadians support "requiring pension funds to publicly report whether or not they take the social and environmental performance of the companies they invest in into consideration" (GlobeScan, 2003 & 2004)

[2] For more information on the NRTEE program, see: http://www.nrtee-trnee.ca/eng/programs/Current_Programs/Capital-Markets/Capital-Markets_E.htm

disclosure to help capital markets value responsible corporate practices in Canada, and therefore encourage responsible investment.

"Full disclosure of material information by publicly owned companies is obviously crucial for the efficient functioning of capital markets and for the protection of investors..."
Robert Repetto, Stratus Consulting

"Better disclosure builds confidence."
Deb Abbey, President, Real Assets Investment Management Inc.

1.2 Methodology and Terminology

1.2.1 Methodology

The study presented in this report was based on the following main steps:

First, we reviewed publications that address the sustainability information demands of stakeholders in the capital markets. We used this information to map the types of sustainability information the various segments of the capital markets (e.g. Carbon Disclosure Project, reports from the UNEP Finance Initiative (FI), etc. - See References). We used this information to map the types of sustainability information the various segments of the capital markets are demanding.

Second, we interviewed a small number of stakeholders in the capital markets (e.g. investment analyst, credit risk analyst, rating agency analyst, pension fund manager) to determine the kinds of sustainability information capital markets value and that Canadian corporations should be reporting. Appendix 1 provides the questionnaire used.

Thirdly, to understand how companies are disclosing information on specific issues, we reviewed the publicly available information produced by corporations in selected sectors. This review covered a range of disclosure mechanisms, including sustainability reports, annual reports (including Management's Discussion and Analysis), audited financial statements, annual information forms, investor bulletins and corporate websites. It is important to emphasize that this study is based on a review of published information by companies. The findings presented therefore reflect what companies are disclosing, and may not necessarily include references to all of the policies, management systems and activities the companies reviewed may actually be engaged in.

The study team selected the five Canadian companies in each sector that met the largest number of the following criteria:

1) Companies were first screened using the Globe and Mail's, Report on Business (RoB) *Top 1000 Companies* listing[3] for the largest publicly traded Canadian corporations measured by assets.
2) These companies were then screened based on the availability of a current sustainability report, or an annual report with at least five pages of environmental and/or social information, as well as specific performance data.
3) The third screening criterion was the comparability of each company's operations to those of other companies within the sector. Comparable operations facilitate the identification of relevant material issues.
4) The fourth screening criterion was recognition as a sustainability leader through the company's inclusion on the Dow Jones Sustainability Index, the Jantzi Social Index or the FTSE4Good Index.

Use of these criteria inevitably results in a focus on leading companies within a sector. The following table lists the companies included in the study.

OIL AND GAS	MINING	FINANCIAL SERVICES
Imperial Oil	Barrick Gold	Bank of Montreal
Nexen	Falconbridge-Noranda	Bank of Nova Scotia
Petro-Canada	Inco	Canadian Imperial Bank of Commerce
Shell Canada	Inmet Mining	Royal Bank of Canada
Suncor Energy	Teck Cominco	Toronto-Dominion Bank

In order to conduct the analysis of the supply of sustainability information, we used a tool[4] designed to facilitate a high-level assessment of how companies are disclosing information against key elements related to the effective management of the study issues, including the performance indicators used. The four key disclosure elements reviewed include: Policy and Strategy, Governance Structures, Management Systems, and Performance and Assurance and Reporting. Appendix 2 describes this approach in more detail.

1.2.2 Terminology

There are various terms used to describe a company's performance in non-traditional financial areas. Social, environmental and ethical (SEE) issues are often referred to. Sustainability and corporate responsibility also connote beyond traditional financial performance, encompassing broader economic performance (e.g. direct economic impact to communities), social performance (e.g. workplace relations or business ethics) and environmental performance. For purposes of this study we use the terminology

[3] Source: http://www.globeinvestor.com/series/top1000/tables/companies/2004/

[4] Stratos adapted the methodology developed by Insight Investment in the report *Protecting Shareholder and Natural Value*, 2004.

sustainability, CR and non-traditional financial information interchangeably when referring to a company's economic, environmental, social and ethical performance.

2 Demand for Corporate Responsibility Disclosure

2.1 Capital Markets Characterization

For the purpose of this study, the capital markets can be divided into a number of segments, each of which provides distinct services such as credit and loans, risk underwriting, property and casualty insurance and equity investment.[5] Figure 1 provides a characterization of these different segments in Canada, including their market profile and assets under management.

Figure 1: Characterization of Canadian Capital Markets

Segment	Market Profile	Assets
Commercial Banks	Accept deposits and extend credit to serve consumer and corporate needs for capital.	The Canadian banking industry includes 19 domestic banks, 30 foreign bank subsidiaries and 23 foreign bank branches. In total, these institutions manage almost $1.8 trillion in assets (Canadian Bankers Association, 2004).
Investment Banks	Generally focus on equity investments. Generate revenue by charging a fee for transactions, which include Initial Public Offerings (IPO), mergers and acquisitions, divestitures, liquidations, private placements, etc. Unlike commercial banks, tend to have little or no stake in long-term transactions.	
Investment Management Companies	Raise capital for investing in financial instruments including stocks, bonds and money markets. Mutual fund unit holders pay a fee to have their money managed. Each mutual fund is established with a specific investment strategy and objectives. A small, but growing number of investment management companies focus on socially responsible investment (SRI), applying screens to exclude or favour certain companies based on social, environmental and ethical criteria.	Mutual fund industry assets were $391B as of December 2002 (Department of Finance, 2004). Total SRI assets managed in Canada reached $51.4B – 3.3% of the retail mutual fund and institutional investment market - in the same time period (Social Investment Organisation, 2003).
Pension Funds	A means for individuals to save for their retirement. In defined contribution plans the employee/ employer puts aside a set amount each pay period. Defined benefit plans guarantee the employee a set benefit upon retirement. Tend to have a longer-term investment horizon because of relatively stable inflows (contributions) and outflows (benefits).	Approximately $600B in assets under management (Statistics Canada, 2002)

[5] The lines separating the various types of institutions have become increasingly blurred; as for example insurance companies often have an investment arm of their business.

Segment	Market Profile	Assets
Insurance and Re-insurance Companies	a) Property and Casualty Insurance: Underwrites risk, investment management. Composed of three categories – primary insurers, re-insurers and "excess" insurer. Re-insurers and "excess" insurers take a more global approach both in geographic markets and products, to spread risk. b) Life Insurance: Sell life insurance policies to consumers and invest the funds from the premiums of these policies. Generate revenue by charging premiums calculated to exceed claims and from capitals and interest from its investments. One of the largest pools of investment capital in the world.	a) Property and Casualty Insurance: Control assets of more than $80 billion (Insurance Bureau of Canada, 2004). b) Life Insurance: At the end of 2002, Canada's life and health insurers held $279.5B in assets on behalf of policyholders. Most was invested in Canada's economy, primarily in government bonds ($63.5B), corporate bonds ($56.5B), stocks ($37.2B), mutual funds ($41.5B), commercial mortgage loans ($22.5B), and residential mortgage loans ($17.5B).
Index Providers	Provide an index tool for investors and asset managers to identify and invest in companies that meet a CR or sustainability benchmark. Criteria often differentiated by sector.	

2.2 Characterization of Information Demands

There is a growing understanding among the different actors within these segments of the capital markets – lenders, fund managers, institutional investors - that CR/sustainability performance and management can affect shareholder value both positively and negatively. A 2003 report involving nine of the largest stock brokerage firms in the world concluded that environmental, social and corporate governance criteria are relevant to long-term shareholder value (UNEP FI AMWG, 2004). Similarly, 79 percent of the European fund managers and financial analysts surveyed in a 2003 study stated that the management of social and environmental risks has a positive impact on a company's market value over the long-term (CSR Europe, Deloitte, Euronext, 2003).

"The Canada Pension Plan Investment Board believes that responsible corporate behaviour – in such matters as the environment, employee practices, stakeholder relations, human rights, respect for domestic and international laws, and ethical conduct – generally contributes to enhanced long-term investment returns. Therefore, investment analysis, due diligence and monitoring of Canadian and foreign investments should take corporate behaviour into account."

Canada Pension Plan Social Investment Policy

The demand for improved CR information and for more systematic use of that information by the capital markets is coming from seven main sources:

- *Socially responsible investment (SRI) or responsible investing (RI) funds* are responsible for much of the increased salience of CR information. Nearly 50% of Europe's financial institutions now offer RI products (CSR Europe, 2003). In Canada RI funds have grown with total RI assets managed in Canada in 2003 being $51.4 billion - 3.3% of the retail mutual fund and institutional investment market

(Social Investment Organisation, 2003). Most projections suggest that although fast growing, RI will remain a relatively small segment of the overall investment community.

- *Financial indices* that incorporate environmental and social criteria are increasing in number. Examples include: the Dow Jones Sustainability Indices, the FTSE4Good, and the Canadian-based Jantzi Social Index. The profile of these indices is also increasing, as companies want to be listed in order to gain recognition as sustainable performers. Some companies are responding to this demand by improving their CR performance reporting. Others are including social responsibility as a topic in investor briefings.
- *Shareholders have been filing resolutions* in escalating numbers, as well as increasingly supporting resolutions that demand disclosure of social and/or environmental performance information from companies. In Canada this increase in shareholder activism is attributed in part to amendments to the *Canadian Business Corporations Act* (*CBCA*) which allow shareholders to communicate more freely regarding the development of resolutions, provide greater scope for minority shareholder resolutions, and narrow the rules permitting companies to exclude resolutions (Hebb, 2004, p. 7). Certain sectors have been specifically targeted by shareholder action. For example, the oil and gas sector has been targeted on climate change disclosure and renewable energy strategies, and at least seven Canadian banks have faced resolutions demanding disclosure on social, ethical and environmental risks (SHARE, 2004).
- *Financial institution initiatives* are bringing together the influence of enormous sums of investment funds to create pressure for improved performance and enhanced disclosure on specific issues. Under the Carbon Disclosure Project, for example, institutional investors, representing $10 trillion in assets are demanding disclosure of the financial risk of carbon emissions from the Fortune 500 companies. Participating investment firms in Canada include the Ontario Teachers Pension Plan Board, Acuity Investment Management Inc. and CI Mutual Funds. Similarly, thirteen major public pensions in the U.S., representing over $800 billion U.S., recently asked the U.S. Securities and Exchange Commission to require corporate disclosure of global warming risks. Other such initiatives are focused on specific practices in specific sectors (child labour in the garment industry, for example).
- *Oversight bodies and regulators* in both Europe and North America have initiated measures to enhance the impact of existing disclosure requirements. In 2001 the U.S. Environmental Protection Agency began efforts to share more environmental performance data with securities regulators in an effort to raise awareness of the "materiality" of this information (U.S. EPA, 2001). In 2001, the European Commission also issued stricter but non-binding guidelines for the disclosure of environmental costs and liabilities. And in November 2002, the Canadian Institute of Chartered Accountants (CICA) published a voluntary guidance document emphasizing the importance of including all material risks as well as environmental and social performance drivers in the Management's Discussion and Analysis (MD&A) filing, which is usually included in the annual report. A new area being

addressed by the CICA and international accounting standards setting bodies, is how to account for and report on transactions related to greenhouse gas reductions, emission allowances, and other climate change exposures – whether market-based or regulatory (Willis, 2004).

- *New regulatory obligations* related to disclosure are being introduced by a growing number of jurisdictions. The *Sarbanes-Oxley Act* requires CEOs in the U.S. to sign-off on the accuracy of the statements they make in corporate and annual reports, including those related to environmental and social aspects of business practice. As of September 1, 2004, a new rule from U.S. Securities and Exchange Commission (SEC) came into force requiring mutual funds to disclose their proxy voting records to shareholders online or in paper form, as requested (U.S. SEC, 2004). The SEC will also make the information available on its website. The Canadian Securities Administrators have proposed a similar rule to require investment funds to establish policies and procedures for voting proxies and to maintain a proxy voting record, available to unit holders on request. This rule was disseminated for consultation in the summer of 2004, and could come into force early in 2005. Various European countries have also added new requirements to disclose environmental, social and ethical considerations (UK pension fund legislation, French security legislation). Most recently, the Italian government passed legislation requiring pension funds to disclose the non-financial considerations they take into account to make investment decisions. In Canada, *Public Statements of Accountability Regulations* require additional social and economic disclosure from some financial institutions (see Section 4.3 for further discussion).
- Finally, a wide variety of organizations, ranging from the United Nations Environment Programme Finance Initiative (UNEP FI), to various civil society initiatives to the ongoing NRTEE initiative, have developed numerous *awareness raising initiatives.*

Each of these sources has influenced the increasing disclosure and consideration of non-traditional financial information. An analysis of the demand by capital markets for such disclosure, and the supply of financially relevant CR information by corporations are presented in the following sections.

2.3 Analysis of Information Demands from Capital Markets

"Many Canadians believe that there is more to share ownership than supporting profit-making to improve short-term share price. We agree…In addition, we believe that disclosure is the cornerstone that allows investors to better understand long-term risks. Consequently, we support reasonable shareholder resolutions that ask companies to make full disclosure on issues that relate to social responsibility, ethical behaviour, sustainable development and corporate citizenship"

Canada Pension Plan Investment Board[6]

[6] (CPPIB-2 2004, p. 7).

This section analyzes, by example, the types of corporate responsibility (CR) information being sought by the different capital market segments as part of the financial analyses they make in their business decision-making. Appendix 3 provides a more detailed mapping of these demands.

2.3.1 Commercial Banks

In Canada, commercial banks are demanding a relatively limited scope of corporate responsibility information. These information demands primarily relate to credit and lending risk assessment and decision-making, including lender liability. In terms of CR considerations used by leading banks, environmental risks appear to be more systematically assessed, compared to social risks, which are more qualitatively assessed. Demands focus mainly on environmental risks related to property contamination and compliance issues. A company's exposure to environmental, legal and major event risks (e.g. impending regulation) is a consideration in most commercial bank credit and lending decisions. Most banks are viewing climate change as an increasingly important issue in the oil and gas sector, but there is a view that a regulatory framework needs to be in place to assess this comprehensively.[7]

Some commercial banks in Canada are signatories to the Equator Principles, which incorporate environmental and social considerations into large project financing decisions. The Equator Principles include social considerations such as the human rights risks in a country where the proponent project is to be located (see Figure 2). One large Canadian bank applies the Equator Principles to project financing as an internal policy requirement, using a threshold below the $50M project size specified in the principles.

Figure 2: Summary of Equator Principles[8]

STATEMENT OF PRINCIPLES

Note: this is a general summary of the Principles and excludes some specific details.

1. We have categorised the risk of a project in accordance with internal guidelines based upon the environmental and social screening criteria.
2. The borrower has completed an Environmental Assessment (EA).
3. In the context of the business of the project, as applicable, the EA report has addressed:
    a) assessment of the baseline environmental and social conditions
    b) requirements under host country laws and regulations, applicable international treaties and agreements
    c) sustainable development and use of renewable natural resources
    d) protection of human health, cultural properties, and biodiversity, including endangered species and sensitive ecosystems
    e) use of dangerous substances
    f) major hazards
    g) occupational health and safety
    h) fire prevention and life safety

i) socioeconomic impacts
j) land acquisition and land use
k) involuntary resettlement
l) impacts on indigenous peoples and communities
m) cumulative impacts of existing projects, the proposed project, and anticipated future projects
n) participation of affected parties in the design, review and implementation of the project
o) consideration of feasible environmentally and socially preferable alternatives
p) efficient production, delivery and use of energy
q) pollution prevention and waste minimization, pollution controls (liquid effluents and air emissions) and solid and chemical waste management

Note: In each case, the EA will have addressed compliance with applicable host country laws, regulations and permits required by the project.

4. The borrower or third party expert has prepared an Environmental Management Plan (EMP), which draws on the conclusions of the EA.
5. We are satisfied that the borrower or third party expert has consulted, in a structured and culturally appropriate way, with project affected groups, including indigenous peoples and local NGOs.
6. The borrower has covenanted to:
   a) comply with the EMP in the construction and operation of the project
   b) provide regular reports, prepared by in-house staff or third party experts, on compliance with the EMP, and
   c) where applicable, decommission the facilities in accordance with an agreed Decommissioning Plan.
7. As necessary, lenders have appointed an independent environmental expert to provide additional monitoring and reporting services.
8. In circumstances where a borrower is not in compliance with its environmental and social covenants, such that any debt financing would be in default, we will engage the borrower in its efforts to seek solutions to bring it back into compliance with its covenants.
9. These principles apply to projects with a total capital cost of $50 million or more.

2.3.2 Investment Banks

Similar to commercial banks, investment banks in Canada take a risk management approach and therefore focus on compliance issues and major crisis events. There is little documentation on the specific information demands of this segment of the capital markets. In an interview, an investment bank analyst for the mining sector explained that investment banks emphasize information related to risks associated with an investment prospect's environmental and social performance. The key consideration appears to be whether the investment prospect is well placed to manage social and environmental risks (e.g. environmental regulatory approvals, labour disputes, forced resettlement, reclamation). If not, the investment bank may either decide to give a higher discount rate to lending or extend the time-frame analysis needed to complete the project which affects the rate of return and the lending decision itself.[9]

[7] Study interviewee, commercial bank risk analyst.
[8] To view the Equator Principles in their entirety see http://www.equator-principles.com/principles.shtml
[9] Study interviewee, investment bank analyst.

Thus for this institution, environmental and social issues for project financing are considered, in so far as they have a direct bearing on the financial analysis of the project – for example likely timing of project approval affecting project rate of return. Environmental and social risks are considered both for the project proponent seeking financing (e.g. strength of its environmental policies, management systems, compliance record or reputation for community relations) and for the host country/region context and conditions (e.g. record of timely or slow permitting processes, human rights considerations).

This financial institution will discount the financial return and therefore its lending decisions based on these factors. But it will not "pay a premium" for good environmental or social performance. However, it does refuse to lend to, or take an equity interest in projects in countries it deems to be politically unstable or too risky in terms of human rights and security concerns.

2.3.3 Investment Management Companies

There is some indication that mainstream investment management companies are beginning to make environmental and social information demands on companies, in order to develop new specialty investment products. For example, Goldman Sachs has created an Energy Environmental and Social Index, in which it accounts for issues such as climate change, pollution, human rights, management of diversity, safety and transparency etc. (UNEP FI AMWG 2004, p. 27). In the U.K., Morley Fund Management has taken a more integrated approach to environmental and social issues in their investment process. Morley has stated that it expects all of the Financial Times Stock Exchange (FTSE) 100 companies to publish a comprehensive environmental report or it will vote against the resolution to adopt the company's annual report and accounts at the annual general meeting (ACCA 2004, p. 12).

From a Canadian perspective, investment management companies have not been as active in demanding CR information from the companies in which they invest. There are a small number of companies that are either focused entirely on SRI or that have developed specific SRI products. Acuity Investment Management, for example, is involved in the UNEP FI Asset Management Working Group (AMWG).

Responsible investment funds are also considered under this segment of the capital markets. As discussed earlier, information demands from this group are increasing and can be very specific in nature. For example, ISIS Asset Management in the U.K. seeks specific information related to biodiversity from the extractive industries in which it invests (ISIS, 2004).

2.3.4 Pension Funds

In Canada, pension funds are currently focussed on issues of corporate risk, particularly corporate governance, however there is a growing indication that environmental and social considerations are being included in some pension fund investment analysis.

In Canada, the Canada Pension Plan Investment Board (CPPIB) is an important capital market player because of its large and growing market influence. Currently, CCPIB owns, on average, between two and three percent of more than 300 of Canada's largest public companies. Within the next decade, ownership is expected to increase to six or seven percent, positioning the CPPIB as a very influential shareholder of companies with widely dispersed shareholders (CPPIB-2, 2004, p. 5). The CPPIB has a detailed Social Investment Policy which addresses issues such as environment, employee practices, stakeholder relations, human rights, respect for domestic and international laws, and ethical conduct (CPPIB-1, 2004, p. 2). Similarly, the Statement of Investment Policies and Procedures for the Ontario Municipal Employees Retirement System (OMERS) "supports the notion that companies should publish and update in their annual reports their policies and procedures with respect to social, ethical and environmental issues that materially affect performance" (OMERS 2004, s. 6.0). Specific issues referenced include: respect for employees, the environment, communities and human rights.

Pension funds use engagement with their investment target as the primary method to interact with companies they invest in, rather than submitting shareholder resolutions (Hebb, 2004). Increasingly, however, pension funds are supporting resolutions submitted by other parties on disclosure of environmental and social performance information, and various pension plans have revised their proxy voting guidelines to allow them to do so.

The objective of pension funds is to maximize their rate of return with the least risk. Within this context, a growing number of pension funds are recognizing and stating their understanding that environmental and /or social issue management by a company can impact the long-term rate of return positively or negatively. Using financial statements as the main source of information, pension plan investors assess investment opportunities based on factors that may affect the likely long-term rate of return. Although social and environmental factors tend not to dominate such analysis, their salience varies from sector-to-sector (e.g. more likely to be considered in mining than in retail).[10] An interview with one pension fund analyst provided indication that the large pension fund which he advises systematically assesses the social and environmental risk potential to affect long-term rate of return for companies operating in high-impact resource sectors such as mining and oil and gas. This pension fund analyst seeks information on how the company manages CR risks (including for example climate change, human rights, waste management, community relations), has discussions with outside interests, including NGOs or host governments for the company's projects to obtain perspectives on their CR-related concerns, and then makes a balanced assessment of whether the social or environmental risks are currently, or in the future, manageable in terms of impact on financial return and share price. This same fund has flagged "ethical behaviour" of companies in the financial services sector as a rapidly emerging risk area for investors.

[10] Study interviewee, pension plan analyst.

As is discussed in the following section, recent work commissioned by the NRTEE concluded that current interpretations of the fiduciary duties of pension fund managers may unnecessarily constrain their ability to address the full range of relevant corporate responsibility considerations related to prospective investments. This is likely a contributing factor to CR reviews not yet being mainstreamed in pension fund risk assessments.

2.3.5 Insurance and Re-Insurance Companies

The Canadian insurance industry as a whole has been less active in this area than both some of their foreign counterparts and compared to some other institutional investors (Hebb, 2004, p. 7). In the U.K., the largest body representing insurers, the Association of British Insurers (ABI), released disclosure guidelines that encourage companies to disclose information relating to the Board's responsibilities of social, environmental and ethical (SEE) matters, and specific policies, procedures and verification of SEE matters (no specific sub-issues are identified) (ABI, 2004, p. 40).

Internationally, the re-insurance sector, which is responsible for, among other things, covering losses associated with natural disasters, has become most interested in the climate change risk. As an example, Swiss Re has indicated that companies could find themselves losing protection against climate change-related liability claims for senior executives should they fail to adequately adopt climate change policies. Swiss Re is including questions on firms' climate change policies in the renewal notices that it sends out for directors' and officers' liability insurance (Nicholls, 2002).

2.3.6 Index Providers

Index providers rate companies on their performance, and companies want to be included in a range of indices to ensure that they have access to the widest number of potential shareholders. Responsible Investment Indices ask for very specific information and will also often indicate "the more the better" when it comes to corporate responsibility disclosure. This is because the more information a company discloses, the more information RI index providers have available for assessing a company's quality of management for environmental and social factors it deems important (in the form of rating criteria). The feeling is that the less they have to ask companies for additional information, the less likely it is that "survey fatigue" will occur.[11] Many RI index providers support the idea of all companies producing standardized sustainability reports based on the Global Reporting Initiative (GRI) *Sustainability Reporting Guidelines*.

Many of the RI indices examined as part of this study request specific information on a range of issues, including: sustainability governance, stakeholder engagement, environmental management systems, greenhouse gas emissions and other air emissions, biodiversity, investment in intellectual capital, community investment, human

[11] Study interviewee, RI index provider analyst.

resource management, diversity, human rights, compliance, and the independent verification of information. RI Index providers are the only capital market segment found that are asking companies to disclose performance and management information for specific environmental and social indicators.

2.4 Convergence of Demands

While it is hard to generalize about the precise type of disclosure demands being made by the Canadian capital markets as a whole, some trends and cross-cutting demands are emerging.

- It is clear that demands are evolving rapidly, and that there is an increasing interest in general in CR related information.
- Most segments of the capital markets pay at least some attention to specific environmental or in fewer cases, social issues – faced by a company or project and how prepared the company is to manage these – if these issues are linked to financial return (project rate of return, or share value or shareholder earnings).
- Environmental or social issues of corporate performance are important only in terms of risk to the company's financial health, and therefore to capital market financial decision-making. High risk is discounted, but business opportunity from good sustainability performance is not given a premium in mainstream decision-making.
- Leading capital market players (i.e. those which are most progressive in terms of CR) in all segments have systematic processes for analyzing at least qualitatively and in some cases quantitatively the environmental management and performance information of companies they invest in or lend to. In some cases, processes are also in place for analyzing social management and performance, in qualitative terms, and incorporating it into financial decision-making.
- However, the depth of this capacity in each segment of the capital markets is limited and interest in these issues varies significantly even among organizations in similar capital market segments and lines of business.

In summary, there appears to be a fairly widespread, but only general, understanding of the negative implications of poor CR management. As a result, the predominant focus of the capital markets is on the ability of the organizations in which they are considering investing to manage environmental and – to a lesser degree – social risks. With relatively few exceptions, the capital markets do not account for the potential opportunities that may be associated with pro-active management and performance on CR issues.

The significance of capital market demands for CR disclosure in most cases appears to be only modest. A survey of CEOs carried out in 2002 by the World Economic Forum asked business leaders to identify the stakeholder groups that created the greatest pressure or incentives for their corporate citizenship activities. Investors ranked only seventh, indicating that they were not viewed as a primary driver (World Economic Forum and The Prince of Wales International Business Leaders Forum, 2004, p. 5).

Some of the main impediments to the more systematic use of CR-related information by the capital markets include:

- Prevailing interpretations of fiduciary duty;
- The dominant focus on short-term opportunities, with the exception of Pension Funds and Responsible Investment Indices
- A widespread lack of awareness and understanding of the potential positive and negative linkages between CR management and corporate success over time; and
- The lack of standardized indicators, which impedes efforts to assess and compare performance among companies.

Nonetheless, there appear to be emerging key CR issues which have financial relevance, which may vary on a sector-by-sector basis. Section 4 discusses four such issues: climate change for the oil and gas sector, biodiversity for the mining sector, environmental and social risk related to lending and project financing in the financial services sector, and compliance across all sectors.

2.5 Challenges Related to Information Demands

Despite the growing awareness and emerging demand for sustainability performance information on the part of certain members of the capital markets, overall demand by investors and others for CR performance and management information remains limited. In many cases, it appears that fund managers, analysts, investors and lenders rely on this information primarily in a negative sense. Poor social and environmental practices are seen as triggers for suspicion, whereas less than half of the respondents in a survey of European fund managers and financial analysts reported systematically seeking out evidence of good CR management or attributing a premium to companies with good CR performance (CSR Europe, Deloitte, Euronext, 2003). "The market does not pay a premium for good sustainability or environmental performance, but delivers a penalty if you do not [demonstrate competence in this regard]."[12] In short, for many capital market actors, engagement in CR issues is seen as a proxy for good management, but does not stand on its own alongside financial results.

There are various reasons for the apparent lag in the demand for CR information relative to the understanding of its potential relevance to financial performance. Among the most important factors is the prevailing emphasis within the capital markets on short-term considerations such as quarterly results, and the strong belief that CR management is primarily relevant to the long-term value of a company. However, most financial analysts appear to believe that CR management, if it is relevant, is only relevant in the

[12] Study interviewee, investment bank analyst.

short-term and from a negative perspective: whereas almost 80% of the fund managers and analysts surveyed in the 2003 CSR Europe study indicated that CR management has no positive impact in the short-term, 59% indicated that an environmental or social crisis can have an adverse short-term impact, primarily in terms of reputation. The same survey reported that sell-side analysts are more sceptical about the impact of non-financial risks on share values than are fund managers and analysts (43% of sell-side analysts against55% of fund managers and analysts believe non-financial risks impact share values) (CSR Europe, Deloitte, Euronext, 2003).

Legal requirements also appear to play an important role in limiting the scope of consideration the various elements of the capital markets give to CR management. In 2003, the UNEP FI assembled the Asset Management Working Group (AMWG), a coalition of 12 asset managers from around the world. The AMWG undertook to explore and document the materiality of environmental, social and corporate governance considerations and criteria as they relate to the portfolio management of mutual and other institutional funds. The AMWG's report concluded that capital markets should pay greater attention to corporate sustainability management and performance, but that, among other things, the current definitions of the terms "fiduciary duty" and "financial materiality" may inhibit demand for and use of that information. The AMWG report therefore recommended that governments and oversight bodies should revise the definitions of these terms "to incorporate consideration of environmental, social and corporate governance criteria" (2004, p. 5).

Other studies have come to similar conclusions. A study on environmental disclosure conducted by the U.S. General Accounting Office surveyed investor organizations, financial analysts and other experts that use disclosure information. Over 75% of the respondents agreed that the guidance on assessing the likelihood of an environmental liability, determining when it must be disclosed and estimating its value, is probably or definitely inadequate and therefore either probably or likely contribute to inadequate disclosure (U.S. GAO, 2004, pp. 53-54). As is noted above, recent work commissioned by the NRTEE and focused on pension funds produced similar findings. A related meeting of pension fund trustees and other practitioners convened by the NRTEE Capital Markets and Sustainability Program concluded that there is a need to clarify, in regulation, that the consideration of social, environmental and ethical (SEE) issues is not in conflict with established fiduciary duties of pension fund managers and trustees (NRTEE, 2004, p. 1). In the same meeting, one participant in particular argued that new standards imposed by the accounting and actuarial professions and reinforced by regulators are unintentionally driving pension fund investment strategies increasingly to the short-term.

Limited awareness of the potential linkages between CR and corporate value, and poorly developed analytical techniques, also hinder the use of and demand for CR information. Even the most enthusiastic proponents of increasing the importance of CR considerations in capital markets acknowledge that demonstrating and quantifying the linkages between CR and corporate value is challenging. A recent Conference Board of

Canada report observes that this is because CR performance correlates with a multitude of corporate activities that can affect share price, and because of the lack of a common analytical framework (CBoC, 2003, p. 10). Assessing these linkages requires information about relevant issues, current performance and management capacity – each of which requires expertise and specialized analytical tools. Moreover, the risks and benefits associated with CR issues and management are not uniform across all companies or sectors (ABI, 2004), making it difficult to understand which companies are most affected by sustainability issues and which are most effective at managing those issues. Fortunately, some financial institutions are hiring or developing in-house expertise with the specific environmental and/or social "questions" and information to seek related to specific sectors of activity.

The corollary of low demand is the fact that most companies are just learning how to communicate all relevant CR issues and practices in a way that is meaningful for the capital markets. Numerous studies in the past five years have documented widespread under-reporting of "material" environmental risks in financial reports in a wide range of sectors (Repetto 2004, Repetto and Henderson, 2003; Austin and Sauer, 2003; U.S., 2003; Kiernan, 2003; ABI, 2004). Similarly, the growing profile of the GRI *Guidelines*, and the many initiatives to encourage greater and more standardized reporting of various sustainability issues, suggests nascent but growing interest in learning how to communicate a set of issues that is only recently being recognized as material.

Information is material if it would be considered important by an investor, acting reasonably, in making a decision to invest or continue to invest in the company. Management's determination of materiality applies not only to financial results but also to all information, qualitative as well as quantitative…
Canadian Institute of Chartered Accountants[13]

> The British organization AccountAbility and others have initiated various efforts to try to redefine the scope of material information that should be included in a sustainability report. AccountAbility recommends reporting on: short-term, direct financial impacts; performance against the company's own policies; business peer based norms; societal norms (regulations and emerging issues); and stakeholder concerns on issues that are reasonably likely to influence stakeholder behaviour (Zadek & Merme, 2003).

As discussed, investors are moving beyond short-term financial and technical risk for the basic reason that a wide range of issues can affect long-term financial performance. Tangible, existing environmental liabilities such as the decommissioning costs associated with an aging mine site or liabilities associated with harmful products may and do have a direct impact on the value of a company. A wide range of other risks may have a direct impact on the value of a company. These may also include, for example: the potential costs of non-compliance with existing environmental and social requirements; the possible implications of

[13] Canadian Institute of Chartered Accountants. 2002. *Financial Reporting Disclosures About Social, Environmental and Ethical (SEE) Issues*. Toronto: CICA. para. 230.1.

emerging requirements; and social or political risks such as human rights questions or community unrest in countries where a company operates.

Without adequate information, investment markets cannot operate efficiently, and there is growing evidence that the financial community is not adequately accounting for these issues. A review of the implications of climate change for institutional investors concluded, for example, that "climate risks are, in all probability, not being captured by existing financial analysis and so can provide additional information not currently captured in a firm's valuation" (Mansley and Dlogolecki, 2001, p.40). Similarly, studies show that companies facing significantly different environmental risks may have similar share prices because the market is unaware of the risk differentials (Repetto and Austin, 2002). Recognizing these shortcomings, slightly over half of the European fund managers and financial analysts surveyed in the 2003 CSR Europe study predicted that social and environmental considerations would become a significant aspect of mainstream investment decision-making in the next two years. In Canada, and North America more broadly, there is no good picture or understanding of such latent demand.

3 Supply of Sustainability Information – Selected Disclosure Practices

3.1 Introduction

"It stands to reason that the best-managed companies deliver the best performance with regard to social and environmental issues and their interaction with the general business community. It is not surprising that they manage these issues as well as they manage the other more traditional success factors."[14]

This is the common and widely held view of how the CR performance of companies is linked to financial performance through different disclosure mechanisms.

We strongly believe in full and consistent disclosure of CSR data by companies so that they can be included in fundamental company analysis, where we believe that they belong. We see such issues as being an integral part of successful management in the modern world and that they should be taken into account in financial analysis and therefore investment considerations."
Anthony Ling, Co-Director of Research, Europe, Goldman Sachs[15]

This view represents the emerging recognition that "quality of management" is not sufficient to assure financial success in the future. Financially relevant CR information will need to become an integral part of financial analysis as both internal business needs and external business conditions and societal expectations come to bear on a company's success.

[14] (UNEP FI AMWG, 2004, p. 28).
[15] (UNEP FI AMWG, 2004, p. 26).

To gain a better understanding of how companies are responding to these demands, publicly available information provided by selected companies in three sectors was reviewed for their disclosure practices on specific issues. The issues selected for analysis were: climate change for the oil and gas sector, biodiversity for the mining sector, and environmental and social risk in lending and project financing for the financial services sector. Disclosure of regulatory compliance was assessed across all sectors. These are considered "representative" CR issues for the purposes of the analysis undertaken in this report. The key CR issue or broader risk area selected for each sector is not intended to indicate that other CR risks do not bear on capital-markets decision making for these sectors.

An analysis was conducted of company information pertaining to how key elements of the selected issues are managed. The analysis was conducted on publicly available information in the following areas provided by companies:

- Policy and strategy;
- Governance structures;
- Management systems; and
- Performance, assurance and reporting.

Appendix 3 describes the design of this review in more detail.

This section discusses:

- Trends in disclosure on the specific issues;
- Best practices;
- What demands are being met and how;
- What demands are not being met; and
- Characterization of challenges for why demands are not being met.

3.2 Oil and Gas Sector Disclosure of Climate Change Information

"The increased focus on climate change and corporate governance, together with the rise of socially responsible investment-managed money and non-governmental organisation activity, is taking place at a time when the energy industry is undergoing profound structural changes: the globalisation of the gas industry, the ability to invest on a truly global basis, and the creation of a more competitive and complicated industry with the rise of a new world order of emerging market players. This could be seen as either a threat or an opportunity, and we believe the responses of the companies to these issues will have a growing impact on performance and valuation."[16]

[16] (UNEP FI, AMWG 2004, p. 28).

Climate change issues are of obvious significance for the oil and gas sector for two main reasons. First, as a highly energy intensive industry, the sector faces growing financial and regulatory pressure to reduce the greenhouse gas (GHG) emissions associated with its production activities. Companies in the sector are responding to this pressure through a combination of measures to enhance energy efficiency, utilize lower emitting or renewable forms of energy and invest in carbon sequestration and offset projects. Second, although not so immediate a concern, the possibility of significant public policy interventions to stimulate a transition away from carbon-based fuels probably poses an even greater risk to long-term shareholder value.

Reflecting the salience of this issue for the sector, the five large oil and gas companies reviewed for this study all disclose publicly a considerable amount of information related both to their positions regarding climate change and to the steps they are taking to reduce their own emissions. Overall, however, they each provide considerably more detail about their internal GHG reduction and offsetting activities and performance than about strategic plans to assess investments or other actions taken to address the potential long-term implications of a carbon-constrained future. Companies reviewed were: Imperial Oil, Nexen, Petro-Canada, Shell Canada and Suncor.

Policy and strategy – Although none of the five companies reviewed has a formal policy on climate change, each has some form of environmental policy that includes commitments to prevent pollution or minimize emissions generically, and each describes the company's position regarding climate change. All five companies describe ongoing commitments to reduce GHG emissions from their own operations. All five also state that they are involved in initiatives to help shape future public policy regarding climate change, although none provide specifics as to the precise policy positions they are advocating. Four of the five companies (Imperial Oil being the exception) state that they recognize that addressing climate change may require a long-term shift in the global energy mix. And three of the five describe ongoing commitments to seek out investment opportunities in non-carbon based energy markets. Imperial Oil is the major exception to this approach. It has posted a number of publications on its website regarding its position on climate change and its views on future energy demands. Its position on climate change is that the demand for energy will continue to grow, and will continue to be met largely by fossil fuels for the foreseeable future. It states that addressing climate change will require a concerted, long-term effort to develop technologies that are more energy efficiency or that use alternative fuels. As a result, Imperial Oil has very little public documentation regarding efforts to diversify its role as supplier of carbon-based fuels. Rather, it states that its efforts are focused on reducing its own emissions and in investing (primarily through its parent company ExxonMobil) in technological research and development regarding cleaner energy and more efficient processes.

Although not specifically disclosed by the selected companies, Canadian Association of Petroleum Producers' (CAPP) member companies are required to collect and report data related to GHG emissions as part of CAPP's Stewardship Initiative.

Governance – All of the companies disclose information on well-defined structures and processes for managing environmental impacts, including GHG emissions. Four of the five describe ongoing efforts to integrate climate change considerations into key decision-making points and processes, including business planning and risk evaluation and investment decision-making. Three of the companies also describe Board level governance mechanisms specifically focused on climate change.

"In a rapidly globalizing, knowledge-based economy, sources of value creation in business are shifting from tangible assets such as land and equipment, to intangibles such as intellectual, human and social capital. While the relative importance of various assets is open to debate, we believe that relationships between a firm, its employees and other stakeholders constitute an important and yet undervalued business asset."[17]

Stakeholder engagement is a key aspect of sustainability management. Corporate disclosure of stakeholder engagement tends to focus on local issues, and each of the companies we reviewed disclose information on local engagement processes with respect to ongoing environmental management issues. With respect to climate change activities (in terms of both reduced emissions and diversification strategies), however, the role that stakeholder engagement can play is very different. Most of the companies reviewed describe their involvement in the ongoing development of public policies around climate change. Some describe their involvement in collaborative processes involving other businesses or NGOs to get "ahead" of policies. Shell Canada has an expert advisory panel focussed specifically on climate change. This represents a strategic management effort to understand the impact of climate change.

Management systems – By stating their belief that global efforts to address climate change may entail a long-term shift in the global energy mix, four of the five companies reviewed acknowledge that climate change represents a major business risk to be managed. Three of the companies reviewed also describe processes they have in place to quantify and account for these risks with respect to ongoing and new investments. Suncor provides an estimate of the impact of Kyoto compliance on its ongoing operations. The business press reported this estimate widely when Suncor first made it public earlier this year. Nexen also discloses the potential cost of Kyoto compliance on its Long Lake Oil Sands Project.

All five companies describe mechanisms in place or being developed to integrate the management of GHG reduction activities into ongoing operational management and assurance practices.

[17] (Svendsen, et al., 2002, p. 1).

All five also describe programs to enhance employee awareness and to train employees in techniques and opportunities to enhance energy efficiency and reduce GHG emissions from operations.

Performance monitoring, reporting and assurance – All five of the companies provide reports of GHG emissions and plans to the Voluntary Challenge Reporting Registry. Each is also an active participant in the various ongoing activities within the sector to develop standardized units of measure for energy intensity and GHG emissions. As a result, there is general comparability around reporting on absolute and normalized GHG emissions among the companies. Each of the five companies reports absolute GHG emissions (in kilotonnes of CO2 equivalents). Four of the five also report normalized emissions either in terms of tonnes of CO2 equivalent per barrel of oil equivalent of production or per cubic meter produced. Four of the five use the Salomon Energy Intensity Index for reporting the energy intensity of downstream operations. Similarly, four of five use the CAPP Production Energy Intensity indicator for upstream operations. Each also reports a quantitative target for energy efficiency and either a quantitative or qualitative target for GHG emission reductions. Finally, three of the five (Suncor, Petro-Canada and Shell) compare their performance to benchmarks, a reporting practice that helps readers understand the significance of the performance data being provided.

Two report third party verification of their GHG emissions data. Two others state that they are working towards third party verification. Two also describe external audits of climate change issue management. Finally, four of the five companies report that they arrange some form of internal audit of their environmental health and safety management systems on a regular basis.

Summary – A growing number of observers are arguing the importance of oil and gas companies addressing climate change. A report by former Chase Investment Bank director Mark Mansley, for example, concludes that ExxonMobil's (Imperial Oil's parent company) hard-line stance on global warming is exposing the company to unnecessary risk and leading it to forfeit valuable opportunities (Mansley, 2002).

Each of the companies reviewed for this study recognizes that climate change poses some type of risk to their ongoing sustainability. Each provides a range of information about their policies, strategies, activities and management of these risks. Each is actively attempting to manage and reduce GHG emissions through improved energy efficiency. In addition, all but one provides general information about their cautious attempts to explore opportunities to diversify in anticipation of a possible carbon constrained future. Oil and gas companies disclose this information using different mechanisms such as: sustainability reports, annual reports (including MD&A), annual information forms and corporate websites, including speeches. For example, Suncor and Nexen are the only oil and gas companies reviewed that disclose information about climate change risk in their annual information forms (or 10K form depending on the company).

3.3 Mining Sector Disclosure of Biodiversity

Mining activities have significant impacts on land and on biodiversity. Mining companies face various legal obligations to manage issues such as tailings and land reclamation. More generally, however, failure to manage biodiversity issues can be a business risk to extractive sectors. The ability of mining companies to obtain a "license to operate" from the local community – something that is over and above any formal legal obligations – is becoming increasingly important. Among other things, access to new resources is increasingly becoming conditional on addressing heightened concerns about impacts on neighbouring land and its biodiversity.

The effective management of biodiversity impacts can pose significant challenges to mining companies. Their operations inevitably have direct adverse impacts on land and biodiversity, and mining companies have little control over where they operate as their location is determined by the placement of the reserves. A recent WRI report notes "three quarters of active mines and exploratory sites overlap with areas of high conservation value and areas of high watershed stress" (Miranda et al., 2003).

Following demands for prohibition of extractive activities in protected areas by NGOs such as WWF, the IUCN World Conservation Congress recommended a moratorium on 'all exploration and extraction of mineral resources in specific IUCN Protected Area Management Categories. The International Council of Metals and Mining has been engaged in a dialogue with the IUCN, and has adopted biodiversity as a key issue. International mining companies such as Rio Tinto, Anglo American and BHP Billiton, have agreed 'not to explore or mine in World Heritage properties' (ICMM, 2003). Biodiversity is also one of the next key reporting issue being addressed by the Mining Association of Canada's *Towards Sustainable Mining* initiative, illustrating its increasing relevance to the mining industry.

In addition to these informal pressures, mining companies face the prospect of future legislation related to issues of access and biodiversity-related liability. The European Union Environmental Liabilities Directive contains references to biodiversity liabilities, and proposes to make operators bear the cost associated with the implementation of measures necessary to prevent or remediate environmental damage as a result of their activities (ISIS, 2004). More generally, as implementation of the requirements of the 1992 Convention of Biological Diversity and its various work programs proceed, there may be a trend toward significant new regulations in numerous jurisdictions around the world.

Reflecting the importance of biodiversity to the sector, a multi-stakeholder process established under the Global Reporting Initiative has developed specific criteria that it believes companies should address in their public reports (see Figure 3). A Mining Sector Supplement is also under development and proposes some variations on the indicators below, including specific additional indicators, such as the number/percentage of sites identified that require biodiversity management plans, and sites with plans in place.[18]

[18] For more information see http://www.globalreporting.org/guidelines/sectors.asp.

Figure 3: GRI Biodiversity Criteria

<table>
<tr><th colspan="2">Biodiversity</th></tr>
<tr><td rowspan="2">EN6. Location and size of land owned, leased, or managed in biodiversity-rich habitats.
Further guidance on biodiversity-rich habitats may be found at www.globalreporting.org (forthcoming)</td><td>EN23. Total amount of land owned, leased, or managed for production activities or extractive use.</td></tr>
<tr><td>EN24. Amount of impermeable surface as a percentage of land purchased or leased.</td></tr>
<tr><td rowspan="5">EN7. Description of the major impacts on biodiversity associated with activities and/or products and services in terrestrial, freshwater, and marine environments.</td><td>EN25. Impacts of activities and operations on protected and sensitive areas.
(e.g., IUCN protected area categories 1-4, world heritage sites, and biosphere reserves).</td></tr>
<tr><td>EN26. Changes to natural habitats resulting from activities and operations and percentage of habitat protected or restored.
Identify type of habitat affected and its status.</td></tr>
<tr><td>EN27. Objectives, programmes, and targets for protecting and restoring native ecosystems and species in degraded areas.</td></tr>
<tr><td>EN28. Number of IUCN Red List species with habitats in areas affected by operations.</td></tr>
<tr><td>EN29. Business units currently operating or planning operations in or around protected or sensitive areas.</td></tr>
</table>

Unlike the oil and gas sector's treatment of climate change, the mining companies reviewed for this project are not yet disclosing detailed on the risks associated with their biodiversity impacts and their management of those risks. The disclosure documents by Barrick Gold, Falconbridge-Noranda, Inco. Inmet Mining and Teck Cominco were reviewed.

Policy and strategy – While each of the companies discloses an environmental policy, none provides any explicit commitment regarding biodiversity, and only one (Teck Cominco) explicitly addresses land use management in its policies, committing to undertake progressive reclamation of operating and dormant sites. Similarly, none of the five companies reviewed clearly describes a specific biodiversity strategy that sets out the company's key impacts, activities and objectives to drive performance related to biodiversity. Most commit in general terms to continuous improvement in environmental or sustainability management. Inco commits to continuous improvement in terms of land use practices including using native species as part of reclamation. Falconbridge/Noranda describes its sustainable development framework with a specific step to restore land to a useable state and ensure integrity. The company also references the use of the Environmental Excellence in Exploration (E3) guide developed by the Prospectors and Development Association of Canada, which offers guidance on internationally accepted field operations. The report, where this information is disclosed, does not specifically identify that E3 covers aspects of biodiversity.

Each of the five companies reviewed are members of the Mining Association of Canada. MAC's *Towards Sustainable Mining* (TSM) initiative has developed Draft Principles that include a commitment to minimizing operational impacts on the environment and biodiversity. Only Barrick and Inmet disclose that the company participates in the TSM. The others refer to their participation in MAC, but not to TSM specifically. Although not specifically disclosed by the companies reviewed, each is participating in public performance reporting of TSM indicators. These currently include a set of indicators on tailings management systems, and indicators specific to biodiversity are under development. Of the five companies reviewed, only Inmet and Falconbridge-Noranda allow their data to be presented by company, rather than just being incorporated into the sector roll-up.

Governance – Consistent with the high priority given to effective environmental management by the mining sector, each of the companies reviewed provides fairly detailed descriptions of the overall way in which the company has allocated accountability and responsibility for environmental issues. However, none explicitly refers to accountability or management responsibilities for biodiversity.

A number of Canadian mining companies have active stakeholder engagement processes, ranging from local, community-based interactions to interactions with specific constituencies such as Aboriginal groups, to partnerships with national NGOs. As such, most of the companies reviewed disclose information on the importance of stakeholder engagement and provide examples of the various processes in which they are involved. Nonetheless, only two of the five report on stakeholder engagement processes specifically focused on biodiversity issues. Falconbridge-Noranda describes a process focused on the protection of a particular waterway, and Inco describes its involvement in the "Mining Sector Protected Areas Consultation," an initiative that brought together the mining industry, government and environmental organizations to discuss issues related to biodiversity.

Management systems – Each of the companies discloses information on its environmental risk management systems. Most also describe site-specific environmental management plans. Each describes various mechanisms in place to integrate or account for environmental issues in general into key decision-making procedures. Several describe processes for considering environmental priorities (including reclamation) at the start of the project cycle. Most describe their efforts to integrate environmental costs into their accounting processes, and environmental obligations and reclamation into the overall life of the asset.

Teck Cominco specifically describes the integration of biodiversity and wildlife habitat considerations in its site reclamation program, and comments on how new tools have helped to improve this integration. Barrick also refers to habitat stewardship initiatives and wildlife protection programs. Overall, however, the five companies describe few explicit commitments, procedures and processes that provide confidence that biodiversity is explicitly and systematically integrated into their operations. This contrasts with the detailed disclosure that some multinationals are starting to provide on biodiversity issues (see Rio Tinto text box).

Unlike the five Canadian mining companies reviewed in this report, **Rio Tinto** comprehensively reports on its impact on biodiversity. Results are presented on a survey the company carried out in 2001 "which built up an accurate picture of what Group businesses know about biodiversity on the land they manage, and what management actions they take on biodiversity issues." Reported results include the % of operations that had undertaken a survey of biodiversity and the % that are monitoring biodiversity. More information is provided on the interpretation of survey results, the survey itself, the company's biodiversity strategy and its biodiversity program (Rio Tinto, 2002).

To handle the issue of elevated levels of metals in the surface soils at its Port Colborne operations, Inco developed the Community Based Risk Assessment (CBRA) process - "... a pioneering community-based approach that is designed both to be highly transparent and to allow generous opportunities for public input." The Inco CBRA approach includes specific biodiversity-related issues, such as studies on quality and diversity of plants and animals in the area.

Each of the five companies reviewed describes training programs, but none provide enough information to enable the reviewer to understand the scope of training and awareness initiatives.

Performance monitoring, reporting and assurance – Four of the companies disclose some type of land use indicator. Inmet does not provide a land use performance indicator, but does disclose its financial liabilities associated with land use and reclamation. None provides targets related to biodiversity, and none disclose their impacts on protected and sensitive sites or on the types of habitat their activities have disturbed. Barrick is the only company wildlife impacts from its operations.

Figure 4 presents some of the indicators the mining companies reviewed are using to disclose reclamation costs and liabilities in their annual reports. In some cases, these represent leading current practice in the disclosure of risks related to environmental liabilities.

Figure 4: Mining Company Reclamation Cost and Liability Indicators

Falconbridge-Noranda	*Barrick*	*Inmet*	*Inco*	*Teck Cominco*
• Reclamation provisions (Falc.) --------- • Reclamation and other environmental provisions • Depreciation, amortization and reclamation expenses (Nor.)	• Amortization and reclamation costs • Reclamation and closure costs	• Reclamation costs • Reclamation liabilities	• Remediation, demolition and other related expenses • Operating costs associated with ongoing environmental and reclamation programs • Estimated reclamation and closure costs	• Environmental and reclamation obligations

All of the companies describe various assurance processes. Four describe an internal audit function for environmental issues. Three also describe external audit programs for their environmental management activities, and one (Barrick) describes the third party assurance process for its environmental report. Inmet discloses a summary of its various audit findings against a rating indicating whether the finding is likely to have an adverse financial impact on the company. Biodiversity is not generally identified as being incorporated into company assurance processes, although Barrick and Inco do disclose audits related to reclamation.

Summary – Each of the companies reviewed emphasizes the importance of environmental issues to their ongoing success. They all describe environmental governance processes, management systems, monitoring and audit or assurance processes. In general, however, there is only limited disclosure of information on biodiversity risks in the public information provided by the five mining companies reviewed for this study. Indeed, none of them provides a detailed description of how the company assesses the potential significance of the biodiversity issues the company faces and how it manages those issues.

This contrasts to the practices of some of the leading multinational mining companies, which are starting to report extensively on biodiversity impacts and management. Leading companies are also demonstrating the integration of biodiversity into internal and external audit protocols, including into ISO 14001 audits as a significant aspect (Insight, 2003, p. 31). Canadian companies' could consider disclosing information more comprehensively on biodiversity, and drawing from biodiversity criteria within the GRI *Guidelines* and sector supplement, where relevant.

3.4 Financial Services Sector Disclosure of Environmental and Social Risk Considerations Related to Lending and Project Financing

In 1990, a U.S. court decision related to lender liability raised the awareness of financial institutions about the environmental risks related to providing capital. The court found Fleet Bank liable for the environmental contamination that occurred as a result of its lending practices under the Superfund legislation.[19] Although there have been subsequent amendments to the legislation, this case was the impetus for lenders to start to consider the incorporation of environmental risk into their lending decisions. Similarly, the significant public attention focused on the environmental and social impacts of major development projects such as the Three Gorges Hydroelectric Power Scheme also demonstrated to financial institutions the importance of balancing financial interests with the social and environmental responsibilities of their lending decisions. In response to this growing recognition of the importance of environmental and social risks in lending practices, multilateral funding agencies such as the International Finance Corporation (IFC) of the World Bank Group have played a significant role in the development of environmental and social lending and investment guidelines.

The Equator Principles (EPs) represent a specific framework promoting environmental and social responsibility in project financing at financial institutions. The EPs draw from IFC guidance. A number of financial institutions around the world, including two of the companies reviewed, RBC and CIBC, are signatories. The EPs commit signatory financial institutions to use the leverage of their project financing to influence project design and performance, and to hold clients accountable for meeting environmental and social performance standards. An NGO coalition recently criticized the EP banks for financing projects that do meet EP standards, and for a lack of transparency about implementation of the EPs (BankTrack, 2004).[20]

Another initiative in the financial services sector that is attempting to raise awareness of non-traditional risks to lending (and other issues) is the United Nations Environment Programme Finance Initiative. Among other things, the UNEP FI has produced the Statement by Financial Institutions on the Environment and Sustainable Development. Canada's six largest banks, one investment management company and the national Export Development Corporation have signed the UNEP FI Statement, recognizing that the identification and quantification of environmental risk should be part of the routine process of financial risk assessment and management (see Figure 5).[21] A similar statement also exists specific to the insurance industry.[22]

[19] For more information on this decision see http://www.lad.org/TPJ/14/superfund.html.
[20] For more information on the Equator Principles see http://www.equatorprinciples.com.
[21] For a list of signatories see http://www.unepfi.org/signatories/index.html?&no_cache=1.
[22] See http://www.unepfi.org/signatories/statements/ii/index.html.

Figure 5: UNEP Statement by Financial Institutions on the Environment and Sustainable Development

As revised - May 1997

We members of the financial services industry recognize that sustainable development depends upon a positive interaction between economic and social development, and environmental protection, to balance the interests of this and future generations. We further recognize that sustainable development is the collective responsibility of government, business, and individuals. We are committed to working cooperatively with these sectors within the framework of market mechanisms toward common environmental goals.

1. Commitment to Sustainable Development

1.1 We regard sustainable development as a fundamental aspect of sound business management.

1.2 Believe that sustainable development can best be achieved by allowing markets to work within an appropriate framework of cost-efficient regulations and economic instruments. Governments in all countries have a leadership role in establishing and enforcing long-term common environmental priorities and values.

1.3 We regard the financial services sector as an important contributor towards sustainable development, in association with other economic sectors.

1.4 We recognize that sustainable development is a corporate commitment and an integral part of our pursuit of good corporate citizenship.

2. Environmental Management and Financial Institutions

2.1 We support the precautionary approach to environmental management, which strives to anticipate and prevent potential environmental degradation.

2.2 We are committed to complying with local, national, and international environmental regulations applicable to our operations and business services. We will work towards integrating environmental considerations into our operations, asset management, and other business decisions, in all markets.

2.3 We recognize that identifying and quantifying environmental risks should be part of the normal process of risk assessment and management, both in domestic and international operations. With regard to our customers, we regard compliance with applicable environmental regulations and the use of sound environmental practices as important factors in demonstrating effective corporate management.

2.4 We will endeavor to pursue the best practice in environmental management, including energy efficiency, recycling and waste reduction. We will seek to form business relations with partners, suppliers, and subcontractors who follow similarly high environmental standards.

2.5 We intend to update our practices periodically to incorporate relevant developments in environmental management. We encourage the industry to undertake research in these and related areas.

2.6 We recognize the need to conduct internal environmental reviews on a periodic basis, and to measure our activities against our environmental goals.

2.7 We encourage the financial services sector to develop products and services which will promote environmental protection.

3. Public Awareness and Communication

3.1 We recommend that financial institutions develop and publish a statement of their environmental policy and periodically report on the steps they have taken to promote integration of environmental considerations into their operations.

3.2 We will share information with customers, as appropriate, so that they may strengthen their own capacity to reduce environmental risk and promote sustainable development.

3.3 We will foster openness and dialogue relating to environmental matters with relevant audiences, including shareholders, employees, customers, governments, and the public.

3.4 We ask the United Nations Environment Programme (UNEP) to assist the industry to further the principles and goals of this Statement by providing, within its capacity, relevant information relating to sustainable development.

3.5 We will encourage other financial institutions to support this Statement. We are committed to share with them our experiences and knowledge in order to extend best practices.

3.6 We will work with UNEP periodically to review the success in implementing this Statement and will revise it as appropriate.

We, the undersigned, endorse the principles set forth in the above statement and will endeavor to ensure that our policies and business actions promote the consideration of the environment and sustainable development.[23]

Non-governmental organizations have recognized the influence that financial sector organizations have on business, and have begun to target banks' investment and lending practices. This is illustrated by the campaign in the U.S., which has successfully targeted Bank of America and Citigroup, resulting in their release of public policies and commitments on climate change and forest investments.[24]

"Banks urged to disclose ethical risks."

Canada's big banks received resolutions in 2002 from Real Assets to issue reports discussing the social, environmental and ethical risks "that may significantly affect the company's short and long-term value and how they might impact on the business" and the policies and procedures they have in place to manage these risks. More recently, asset management firms, such as ISIS, have engaged Canada's big five in discussions related to environment and project finance (ISIS, 2004).

In Canada, there has been a regulatory driver for improved disclosure on corporate responsibility through the *Public Accountability Statements Regulations* (2002) that require banks and other financial institutions with equity of $1 billion or more to publish an annual statement describing their contributions to the Canadian economy and society.[25] Between Stratos' two benchmark surveys on corporate sustainability reporting (2001 and 2003), the number of sustainability reporters in this sector increased sharply from four to 19 (Stratos Inc., 2003, p. 4). Corresponding increases in other sectors were much smaller. In addition, the quality of disclosure by Canadian financial institutions has improved over this period.

[23] See http://www.unepfi.org/signatories/statements/ii/index.html.
[24] See http://www.ran.org/ran_campaigns/global_finance/.
[25] See http://laws.justice.gc.ca/en/B-1.01/SOR-2002-133/.

The GRI has also provided an additional important development with respect to bank disclosure of these issues. The GRI has developed a sector-specific supplement to assist financial institutions in their sustainability reporting practices.[26]

As a service industry, banks are keenly aware of the importance of their reputation in the local community and society at large. Reputation of the organization is also important for employee attraction and retention. European banks and financial institutions in particular, are engaging more actively in environmental and social agendas, and they are becoming more public in terms of their transparency on their activities, recognizing that these impact on their reputation – and therefore on their client base.

To understand how Canadian banks are responding to the issue of disclosure related to lending and project financing, we looked at five of Canada's largest banking institutions – Bank of Montreal (BMO), Canadian Imperial Bank of Commerce (CIBC), Royal Bank of Canada (RBC), Scotiabank and Toronto-Dominion Canada Trust (TD).

Policies and strategy – All the banks, other than TD, disclose having a general Environmental Policy in place that includes specific commitments related to the environmental risk assessment of their lending practices. In addition to their general Environmental Policies, CIBC, RBC and Scotiabank describe more specific environmental risk lending policies. Although BMO does not disclose that it has such a policy, the commitments in its general Environmental Policy are broader than the other banks, claiming that it considers ethical, political, social and economic factors in addition to normal lending considerations, as well as articulating a position related to financing military equipment purchases.

None of the banks disclose having a strategy in place that sets specific goals or targets related to incorporating environmental and social risks into lending and project financing decision-making. However, both CIBC and RBC are signatories to the Equator Principles, which does provide a framework for the incorporation of environmental and social aspects into large project financing projects. All the banks have well-developed procedures around credit risk.

> CIBC and RBC are the only Canadian banks to identify the establishment of specific Environmental Risk Management divisions to analyze environmental risks inherent in lending and investment activities.

Governance – All the banks report that they evaluate environmental risks in lending transactions. However, only CIBC and RBC describe having specific Environmental Risk Management divisions. RBC reports that the mandate of its Environmental Risk Management Group has expanded over time to cover more than just environmental credit risk, but corporate sustainability, new products, and reputational risk. All the banks reviewed have senior management committees (often more than one with different responsibilities related to

[26] For more information see http://www.globalreporting.org/guidelines/sectors.asp.

risk management), as well as Board level committees that oversee risk. Many banks also have specific credit and market risk committees – often chaired by the President and CEO – that review large individual credits, industry concentrations and major policy issues involving credit or market risk (e.g. TD). All of the banks are fairly clear in disclosing the accountabilities and reporting relationships around risk. CIBC, RBC and BMO provide more explicit descriptions of the various accountabilities for environmental risks related to lending.

The process by which companies develop policies and strategies and manage specific issues is important. Incorporating the views of key stakeholders in this process is increasingly seen as an effective tool to identify and elucidate potential risks and opportunities. Beyond some general information from CIBC about launching an external environment website to communicate information (including information on environmental risk), the banks do not disclose information on the engagement of stakeholders related to environmental risk. This is an area that could be improved. At a minimum, one would expect to see information from CIBC and RBC related to engagement based on the Equator Principles.

Management systems – All the banks studied provide reasonably clear descriptions of their risk management processes for managing credit risk, including reporting relationships. RBC, CIBC and BMO are more explicit than Scotiabank and TD in specifically addressing environmental risk management related to lending (in their Public Accountability Statements and websites). None explicitly describe how they incorporate social and ethical risk into management systems, however. Interestingly, in the discussions of credit risk in their annual reports, only CIBC, Scotiabank and BMO explicitly mention environmental risk. This illustrates a lack of integration on the part of some of the banks between information in their Public Accountability Statements and the information in their annual reports, which are their primary financial disclosure document. Consistency in messaging across different disclosure mechanisms is essential to demonstrate commitment to a specific issue and the extent to which it is integrated into the company's business.

Based on the information reported across the different disclosure vehicles, CIBC and RBC are the most explicit in describing the process of how environmental risk is integrated into lending decisions. However, this process discussion does not specifically address application of the Equator Principles to large financing projects. Beyond a general commitment to the Principles, neither bank describes how they implement the Principles.

Only RBC, CIBC and BMO are explicit in outlining the specific environmental risk factors they consider in assessing credit risks. All except Scotiabank describe the different tools they use to conduct environmental evaluations, such as questionnaires, checklists, Phase I Environmental Site Assessments (ESAs) and Phase II ESAs. The type of borrower/business, and the size of the loan trigger the use of these different tools. RBC breaks down management system information by credit activities. Scotiabank is the only bank to report a specific example of integration of environmental factors into lending practices.

All the banks have endorsed the UNEP FI Statement on the Environment and Sustainable Development. Nonetheless, none of them disclose specifically what they have done to meet the UNEP FI commitments. RBC and CIBC also disclose that they are signatories of the International Chamber of Commerce (ICC) Business Charter for Sustainable Development, but similarly do not disclose what they have done to meet the Charter's commitments. Similarly, while Scotiabank and TD disclose that they are involved in the Canadian Bank Association's (CBA) Environmental Issues Group, they do not describe the results of their involvement.

Ensuring that the bank employees have the appropriate levels of awareness and competencies related to managing environmental and social risk in their lending processes are essential to illustrate the bank's effective management of these issues. Only CIBC and BMO specifically describe the training they provide to employees related to the integration of environmental risk into lending decisions. CIBC has created an online training program and specific guidance documents, and BMO has incorporated environmental risk training into a broader skills development program.

Performance monitoring, reporting and assurance – All the banks disclose a fairly standardized set of credit risk indicators (e.g. credit risk concentration, provisions for credit loss, etc.). Only CIBC discloses performance indicators specific to the integration of environmental risk into lending decisions. The specific performance indicators used by CIBC include:

- Number of credit inquiries determined to be high risk and subject to further evaluation;
- Number of credits requiring subsurface investigation to determine presence, degree and extent of contamination;
- Number of credits involving sites requiring further action as a result of CIBC's due diligence investigation; and
- Number of site inspections and assessments performed by CIBC Environmental Risk Management.

Without disclosing specific performance data related to how environmental risk is considered in bank lending practices, the capital markets cannot ascertain the degree to which a bank has integrated these considerations into its processes.

Well-developed assurance processes tend to be an indicator of a relatively mature management system. In their discussions of accountabilities, each bank is clear on the oversight function that various committees have to ensure credit risk policies and procedures are being applied systematically and that credit risk is being managed. Only BMO discloses on the use of internal audit to confirm that it is adhering to its guidelines related specifically to environmental risk, however. None of the banks disclose the use of external audit related to environmental credit risk, and none describe the use of third party verification regarding the environmental credit risk information in their disclosures. Each of the banks describe the use of standard financial statement verification. This would cover overall credit risk data, but it is unclear if they incorporate environmental credit risk in this verification process.

Summary – All the banks have policy commitments related to the environmental risk assessment of lending and state that they have standards or procedures in place to assess existing or potential exposure to environmental liability. Some have also signed commitments related to the management of environmental and social risks under various international and domestic initiatives (the Equator Principles, the UNEP FI, the ICC Business Charter for Sustainable Development, and the work of the Canadian Bank Association's Environmental Issues Group). Nonetheless, the relatively poor disclosure of performance information limits an investor's ability to assess the extent to which each of these banks is managing environmental risks systematically. And the almost complete absence of information about how they are managing social risks invites the conclusion that they are not addressing this issue in any sort of systematic manner.

3.5 Compliance Disclosure Across Sectors

Compliance with legal obligations is critical to the ongoing success of a company. It is also a common criteria or factor used by all segments of the capital markets in assessing quality of management to help inform investment decisions. Non-compliance can result in fines and approval delays. In cases of extreme negligence or deliberate criminal activities, non-compliance can lead to the incarceration of senior executives. Non-compliance incidents can impair a company's reputation and undermine shareholder confidence.

In most cases, compliance entails conforming to applicable domestic statutory and regulatory requirements. Increasingly, however, stakeholders, including some leading investors, are calling on Canadian and other multinational companies operating abroad to comply with Canadian rules in overseas operations where the host country does not have relevant rules of the same rigour.

All of the 15 companies reviewed disclose information on commitments and management systems related to regulatory compliance. In almost all cases, the companies provide much more information about their systems and performance related to compliance with environmental, health and safety (EH&S) legal requirements than with respect to social policy requirements, such as employment equity or human rights.

The five mining companies and five oil and gas companies disclose a similar range of issues related to their EH&S obligations. The five banks differ from their resource counterparts. Instead of managing compliance to regulations related to the direct impacts of their activities, the banks manage conformity with applicable legal restrictions on the types of loans they can make and with policies which guide their lending and investment decisions. As a result, while the ten resource companies all disclose much the same type of compliance related information; the five banks disclose quite a different set of information.

Policies and strategy – All 15 companies have formal policy commitments to meet or exceed relevant legal requirements.

Governance – All also describe either board-level or senior management oversight and accountability mechanisms related to compliance. All of the resource companies identify and account for the costs of complying with various EH&S compliance obligations, particularly with respect to remediation in the case of the mines, and air emissions and remediation in the case of oil and gas companies. Most also discuss the potential compliance costs associated with anticipated new legal requirements.

Management Systems – All ten of the resource companies describe variants of EH&S management systems that are intended, among other things, to ensure compliance with relevant legal obligations. Each of the banks, by contrast, describes management systems for implementing lending guidelines and for dealing with risks such as non-compliance with the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*.

Each of the resource companies also describes ongoing training and awareness programs and activities designed to ensure, among other things, that employees are aware of and able to comply with relevant EH&S obligations. Only TD provides any specific information related to organization-wide compliance training, although CIBC identifies that a Legal and Compliance Intranet site is available for employees.

Performance monitoring, reporting and assurance – Each of the resource companies discloses various performance data related to compliance with EH&S regulatory and corporate standards (e.g. % compliance with regulatory permits for air and water emissions, fines paid, number of non-compliance events, etc.). Inmet as an example, discloses comprehensive information including the number of: convictions, fines, violations, exceedances, as well as reportable spills by site (including closed properties). The company also discloses the number of regulatory inspections undertaken. The banks do not disclose specific performance information as to whether they are in compliance with all relevant legislation. Each resource company describes programs for internal or external auditing or both. Information from the banks on internal and external audit programs related specifically to regulatory compliance is less comprehensive. TD illustrates best practice reporting by discussing its annual compliance review process, including a letter submitted by the senior management of each business unit whether they are in compliance with applicable regulatory requirements, or whether gaps and weaknesses exist. If weaknesses exist, it is disclosed that an action must be established and implemented. BMO is the only bank that discloses the use of external audit related to social compliance. BMO states that a Canadian Human Rights Commission audit concluded that the bank is in compliance with all the statutory requirements related to the *Employment Equity Act*.

Summary – There is a strong focus on compliance, reinforced by detailed disclosure, primarily by the resource companies in this study. The major focus of compliance disclosure is on EH&S issues, rather than on social obligations. Even with respect to EH&S, however, the companies reviewed use a range of indicators, inhibiting efforts to compare performance.

4 Conclusions and Recommendations

Corporate responsibility seeks convergence between creating value for a company and for its stakeholders in environmental, social and economic terms. In the short-term, it can entail the effective management of broader economic, social, and environmental impacts and risks in order to reduce costs and enhance reputation. Over the longer-term, it provides business value - addressing CR effectively can mean the prosperity of both the individual company and the society on which it depends – in ongoing access to natural, human, and social capital.

The various drivers for CR include:

- *Public expectations*. Canadian expectations that corporations should act responsibly.
- *Stakeholders*. Stakeholders may include employees (who must be hired, retained and motivated), communities (which play a critical role in providing an informal “license to operate), and advocacy groups (which have become increasingly effective at using market campaigns such as product boycotts).
- *Investor awareness and action*.
- *Government laws, policies and exhortations*.

Currently, awareness of CR issues exceeds the provision, demand and use of relevant information. The following recommendations focus on options for overcoming that disparity, particularly with respect to the role that capital markets should play in promoting CR.

Materiality is emerging as a central concept in linking the capital markets with corporate responsibility. The interpretation of what is material – information which is considered important in making investment decisions - is expanding rapidly, both through guidance provided by professional associations such as the Canadian Institute of Chartered Accountants, and through the practices of companies in their non-financial (or CR) disclosure.

Building on this, leading Canadian companies in such sectors as chemicals, utilities and oil and gas, are providing information on their CR practices in investor briefings. This is done in cases where CR fits with a company’s business strategy – for example a focus on long-term acquisitions or raising capital in European markets, situations where social and environmental risk factors may be better considered by the markets, or where they can demonstrate their management of concrete risk aspects such as environmental regulatory compliance. This can build operational confidence through demonstrating quality management and through transparency in providing the real picture on their operations.

4.1 Recommendations for Capital Markets

Various processes sponsored by or involving organizations and individuals from the capital markets have provided recommendations about the steps capital market actors can take to gain access to better information about the capacity of organizations in which they have invested or in which they are considering investing to manage CR issues. These recommendations also address possible steps capital market actors can take to enhance their ability to utilize that information.

The UNEP FI AMWG process identified ten indicators of well-functioning capital markets:[27]

Investors:

- Government and multilateral agency pension funds and their selection consultants integrate consideration of environmental, social and corporate governance (ESC) criteria into their investment mandates.
- Trustees and their selection consultants integrate ESC issues into the formulation of their investment mandates and the selection of investment managers.
- Institutional investors specify ESC guidelines within their proxy voting policies.

Asset managers:

- Asset management firms actively request mainstream brokerage house research on ESC criteria in fundamental analysis.
- Asset management firms have internal ESC research capacity.
- Asset management firms incorporate ESC criteria into their portfolio management process.

Capital markets:

- Brokerage houses are appropriately equipped to integrate ESC criteria into fundamental company analysis.
- Stock exchanges include ESC criteria in their listing and disclosure requirements for companies.
- Accounting standards boards and rating agencies integrate ESC considerations into their frameworks.
- Financial analysts training and certification programs integrate ESC considerations.

[27] See www.unepfi.org/work_programme/investment/rcmi/index.html.

Starting this year, the AMWG is planning to use this set of indicators to track global integration of environmental, social and corporate governance criteria into the work of investors, asset managers and capital markets on an annual basis (UNEP FI AMWG, 2004, p. 5).

Other processes have resulted in similar recommendations, some focused on CR generally, and others focused on specific issues. For example, the U.K. Universities Superannuation Scheme (USS) Fund recently sponsored a discussion paper that provided recommendations on the steps institutional managers like USS should take to manage their exposure to investment risks associated with climate change (Mansley and Dlugolecki, 2001). The paper was prepared, in part, by the past President of the UNEP Insurance Industry Initiative. Among other things, it recommends that institutional investors should:

- Review their portfolio's direct property investments for climate change risks and identify measures to mitigate risk exposure.
- Engage with investee companies to encourage them to report on their climate change exposures and the management's response.
- Produce a statement of what the fund considers to be broad principles of good practice for managing climate change risks in investee companies in terms of assessment of climate change risks, corporate strategy and reporting.
- Request that sell-side brokers comment on a company's relative exposure to climate related risks and the management's capabilities and approach to managing those risks.
- Enhance their own management capabilities for dealing with climate change by undertaking a program of internal awareness raising and learning.

Building on emerging leading practices by capital market players, as well as the recommendations developed through international initiatives, the following recommendations are put forward to strengthen the demand side of the CR disclosure equation in Canada.

1. **Broadening the Use of International Guidance:** Industry associations such as the Canadian Bankers Association could encourage their membership to more broadly integrate such international norms as the Equator Principles into the lending and project investment decisions, as is the case for its leading members. These principles provide a series of risk-based questions to improve the quality of investment analysis.

2. **CR Awareness Building and Tools:** Professional associations such as the Canadian Investment Institute can aid its members through awareness building for better understanding of non-traditional financial information related to environmental and social risks, which bears on capital markets investment analysis. The application of such raised awareness can be assisted through the development of CR risk questions in the form of simple information gathering templates or checklists.

4.2 Recommendations for Disclosure by Companies

As the main suppliers of information about their CR goals, management and performance, companies can make important contributions towards the improved integration of that information by the capital markets. This section identifies five key recommendations.

1. Full Disclosure of Material Risk:
At a minimum, companies need to ensure that they comply fully with existing requirements to disclose all information that is "material" to the company's well being. A number of recent studies have documented a wide disparity in the degree to which companies in the same sectors disclose the same types of environmental risks (Repetto, etc.). The CICA MD&A guidance document provides information on accounting for such material risks related to environmental and social drivers of the business. Further, Canadian securities regulators' requirements for Annual Information Forms provide further guidance, such as to provide information on environmental liabilities for mining companies. A succinct summary of non-traditional material risk requirements and guidance would both make such requirements more transparent to the capital markets and provide guidance on how to disclose such information.

2. Statement of Business Value:
To the extent to which companies are addressing corporate responsibility issues as opportunities and not just as risks to be managed, companies can clearly explain their objectives, strategies and approaches for managing these issues. In order for capital markets to begin rewarding companies for pursuing these types of proactive strategies, companies need to demonstrate to the capital markets that the opportunities they are seeking are significant, that they are well positioned and managed to attain those opportunities and that they add business value.

3. Standardized Formats and Metrics Recognized by Analysts:
Companies need to ensure that the information they are providing is presented in a form that is useful to the capital markets. In order for information about CR to meet this test, it needs to have the same, well-understood characteristics as the type of financial and compliance-related information that publicly traded companies have long generated. One of the key features that is absent at present is consistency or comparability. A number of sectors have developed standardized indicators for various aspects of their environmental, health and safety performance. Most of the oil and gas companies reviewed in section 3.2 of this report use standardized metrics for downstream and upstream energy intensity developed either by the Canadian Association of Petroleum Producers and the Canadian Petroleum Producers' Institute, respectively. The development and use of more such standardized indicators to address the full range of CR performance issues relevant to a sector would greatly enhance the degree to which the capital markets are likely to make use of CR information.

4. Transparency of Performance:
Companies need to ensure that they disclose information candidly on both successes and challenges, and that they address the same issues in a consistent manner from year-to-year. Disclosures that lack candour will inevitably be suspect, particularly when addressing a challenging and ill-defined set of issues such as CR.

5. GRI as an Emerging International Reporting Standard:
Finally, for reporting company sustainability reports or integrated reports, companies should consider following the international guidelines that are being developed by the Global Reporting Initiative. The GRI has developed guidance for generic corporate sustainability reporting, and is in the process of developing a series of sector-specific guidance documents. In a very pronounced trend, the best sustainability reporters internationally are increasingly modeling their reports on the GRI in an effort to ensure that they address a standard set of key issues that has been identified by a concerted multi-stakeholder effort over the past several years. Significantly, analysts at 17 leading GRI firms recently came together to recommend companies use the GRI as the common standard for expanded reporting (SIF, 2004).

4.3 Public Policy Recommendations

To date, the government approaches towards promoting the incorporation of CR considerations into capital market decision-making taken by governments in Europe, the United States and Canada have mirrored their approaches to social and environmental policies in general. A number of European countries have articulated strong government roles that include both clear policy guidance and the growing use of mandatory disclosure requirements. Public policy in the U.S. has been much less well defined and more reactive, albeit with examples of concerted shareholder interventions and litigation and some modest legislative reforms. Canada has seen limited industry response to market demands and public pressures with some tentative government-industry collaboration, but no strong policy signals.

There are numerous options for public policies that Canadian governments could adopt without necessarily falling into either the U.S. or European models. Other reports have described the wide range of things Canadian governments could do to stimulate the development of CR in general (smart regulations, procurement policies, etc.). Within that overall set of options, this section describes three categories of possible government actions to enhance the role of capital markets.

1. Stimulate Market Demand:
Governments could stimulate market demand by measures such as:

- Encouraging environmental regulators to communicate information about non-compliances to financial regulators and to the financial community.
- Supporting efforts to raise awareness of participants in the capital markets of the linkages between CR and financial performance.

- Surveying capital market analysts to determine the current level of understanding of non-financial risks.
- Encouraging and supporting the development of guidelines and standards (such as the International Code of Ethics for Canadian Business) that set a benchmark for good performance to which investors, lenders and analysts will expect companies to disclose information and demonstrate performance against.
- Enhancing capacity within the capital markets community by helping develop and disseminate analytical tools that can help analysts assess the risks and benefits to which a company is exposed as a result of its particular CR profile.
- Reviewing and revising as appropriate, legal constraints (such as the prevailing interpretations of fiduciary duties) that may impede the willingness or ability of pension and other investment fund managers to account for CR considerations.

2. Facilitate Market Responses:
Governments can facilitate a market response by measures such as:

- Stricter enforcement by securities regulators of existing environmental disclosure requirements.
- Providing information to Canadian companies on the business case for implementing CR.
- Conducting and disseminating market research that helps identify emerging CR expectations, practices and opportunities in various markets that are of interest to Canadian businesses.
- Enhancing companies' capacity to manage and report CR through training programs, the development and dissemination and promotion of the use of key tools, such as environmental management systems, social auditing, etc.
- Helping develop or promote the development and adoption of standardized performance metrics that hep companies measure their own performance and benchmark themselves against their peers.

3. Mandatory Disclosure by Standards:
Canadian governments can work in concert with securities exchanges, and with such standard setting bodies as the CICA, to raise the bar on expectations and guidance on expected practices for disclosure of – and use in analysis of – financially relevant CR factors by publicly-traded companies, and the capital markets industry.

4. Mandatory CR Disclosure:
Finally, governments could consider whether there is a role for expanding the scope of existing legal disclosure requirements. As the UNEP FI recently observed: "Governments can reduce barriers to environmental, social and corporate governance analysis by mandating and standardizing the inclusion of these criteria in national and international disclosure frameworks" (UNEP FI 2003, p. 7). The measures taken through the *Public Accountability Statements Regulations* for the financial services sectors provide one possible model. Pension Fund social, environmental and ethical disclosure requirements in other countries provide another possible model.

Appendix 1 – Interviewee Questionnaire

Interview Questionnaire

Stratos provided the objectives and context for the research as part of the NRTEE Capital Markets and Sustainability Program to interviewee prior to conducting a short telephone interview.

1. Can you please describe your business and the types of information you collect from corporations to do your business?

2. What types of non-traditional corporate financial information do you consider to be material or more generally of use to your work?
   - Information related to risk?
   - Information related to business opportunity?
   - Environmental information?
   - Social information?
   - Governance information?

3. What environmental or social issues matter in your decision-making or the advice you give to your clients:
   - From a risk point of view?
   - From a business opportunity point of view?
   - Specific to certain sectors?

4. Do you collect or see a need for:
   - Quantitative information – what types?
   - Qualitative information – what types?

5. How can companies better disclose non-financial or sustainability or corporate responsibility information which has value to your business?

Appendix 2 – Supply Study Design

The study will collect information that corporations in the selected sectors are providing to the capital markets, through a range of disclosure vehicles. For the agreed sustainability issue in each sector, the types of information to be collected include:

Policy & Strategy

- Policy: The company makes a policy commitment to understand and manage issue risks.
- Strategy: A strategy is in place that sets out the company's key impacts, activities and objectives to drive issue-related performance.

Governance

- Responsibilities: Accountability and responsibility for issues is assigned at all levels.
- Stakeholder engagement: Engagement from key stakeholders is undertaken to inform understanding of issues and impacts and possible responses.

Management Systems

- Risk management: Management acknowledges the business risks associated with operations and demonstrates that they have reviewed their own operations as a result of this knowledge and identified key areas of risk and impact. Risks related to issues have been factored into risk evaluation for normal business operation and changes in operations. The company has made a commitment to understand and manage its impact.
- Integration: Issue risks and opportunities are integrated at key decision-making points, including business planning and risk evaluation, investment decision-making, business development and projects, operational management and the assurance process.
- Site and facility level management: Issues are managed either through integration of the issues into site management plans or through the development of Issue Action Plans for all sites and facilities.
- Partnerships: Evidence of local, national and international partnerships to identify and manage issue impacts and risk.
- Competencies and employee awareness: Key staff competency are ensured by recruitment or training. Mechanisms are in place to raise awareness of employees in key positions on issues.

Performance Monitoring, Reporting & Assurance

- Key performance indicators: The company monitors and reports on its performance and progress in managing risks around issues.
- Internal audits: Internal reviews are conducted on the extent to which issue risks are being managed at all levels of the business.
- External audits: Independent external reviews are conducted on the extent to which issue risks are being managed at all levels of the business.
- Third party verification: A third party verifies the company's performance and/or reported information regarding issues management.

Appendix 3 – Capital Market Demands For Corporate Responsibility Information

Please note: the information in this table is drawn from a limited literature review and a small number of interviews conducted with individuals in the capital markets.

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
General Overview	• Values related to CR a significant part of assessment for financing decisions (NRTEE Ottawa p. 5) • Incorporate environmental assessments into credit and lending decisions • Quality of management, access to funds (not just environment)		• Environmental, social and corporate governance criteria affect shareholder value both in the short and long term (UNEP FI 2004) • ESC criteria affect both company risk and return. Risks are identified more frequently than returns with risk being considered in 91% of the sector studies by brokerage house analysts conducted as part of the study (UNEP FI 2003, p. 9)	• Pension plan proxy voting guidelines give the directors and officers of companies in which the pension plan owns shares guidance on how the pension plan is likely to vote on issues put to the shareholders • Several pension plans have released proxy voting guidelines that include environmental and social responsibility elements (e.g. Canada Pension Plan Investment Board – Proxy Voting Principles and Guidelines, February 11, 2004)	• CR relevant both as it relates to investment decisions and risk management (NRTEE Ottawa p. 5)	<u>DJSI</u> • Uses a combination of weightings between company questionnaire results, quality and public availability of information and truthfulness of information • Sector specific requirements apply (we looked at O+G and Mixed – because the requirements are proprietary we did not provide the specifics in all cases) <u>JSI</u> • Uses a combination of exclusionary and qualitative social screens (e.g. tobacco, weapons, nuclear; and consistently poor relationship with aboriginal communities,	<u>FTSE4Good</u> • General criteria areas include: environmental sustainability; positive relationships with stakeholders; and human rights • Certain businesses screened out (e.g. tobacco, weapons, nuclear, uranium) • Requirements vary depending on if company has low, medium or high impacts • In some areas a company needs only to meet a combination of requirements and not all • Continuity and consistency in reporting

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
						undertake questionable or fraudulent business practices, have consistently poor employee relations record, have a consistently poor environmental performance compared to industry counterparts, have experienced significant problems at their operations outside Canada, manufacture unsafe products (information drawn from public presentations and therefore are not comprehensive, requirements proprietary)	
Board Governance as it relates to Sustainability[28]			• "Corporate Management in the New World" component of Goldman Sachs energy analysis (UNEP FI, 2003, p. 27)		• Association of British Insurers (ABI) have disclosure guidelines that encourage companies to disclose information relating to Board responsibilities of	DJSI • Existence of CSR/SD Board committee • Board diversity	JSI • Corporate governance covered

[28] Please note: general corporate governance is not covered in this study other than sustainability-related aspects (e.g. diversity of Board members). Code of conduct information is captured under Social – Ethics.

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
					social, environmental and ethical (SEE) matters		
Risk and Crisis Management	• Exposure to environmental, legal and major event risks (e.g. impeding regulation) • If risk is well mitigated • Direction of the sector as a whole and the company in the next 3-5 years (environmental risks and opportunities)	• Mining – permitting, how long and if company can get permit for exploration, at what cost (e.g. forced resettlement affects risk of getting permit) • Social risks – e.g. union labour dispute • Country risk assessment (e.g. civil unrest no go b/c might not honour mineral title) • All risks screened as affects financial return	• Real Assets Investment Management Inc. challenged Canada's five largest banks in 2002 to disclose how they manage ethical, social and environmental risks	• Risks and strategies of companies and how they deal with risks		<u>DJSI</u> • Key responsibilities for CR and reporting relationships • Strategy for reducing/managing carbon risk • Use of EIA/SIA • Materiality	<u>FTSE4Good</u> • Identification and description of main environmental impacts • Integration of human rights concerns into risk assessment procedures <u>JSI</u> • Legal/Regulatory Risk (environmental accidents, spills, convictions, fines, citations, remediation liabilities, torts, product) • Financial Risk – operating costs (clean-up, raw materials) and capital costs (product redesign, waste treatment) • Market Risk (life cycle, carbon tax, Kyoto) • Reputation Risk (boycotts, market share, brand destruction)

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
Business Value	• How company rates in terms of competitiveness, key success factors					DJSI • Value generation or competitiveness enhancement derived from corporate sustainability strategy (e.g. improved access to capital, talent attraction, innovation trigger, license to operate, reducing environmental footprint and future business creation)	
Stakeholder Engagement	• Equator Principles include a requirement that borrower has consulted with project affected groups, including indigenous peoples and local NGOs	• Mining – community relations		CPPIB • Investment analysis, due diligence and monitoring of investments takes into account corporate behaviour in stakeholder relations		DJSI • Mechanisms of external stakeholder engagement • Existence of system to track the satisfaction and/or complaints • Project types where local community informed, consent sought and mechanisms used • Compensation to local communities when relocation required	FTSE4Good • Public disclosure of stakeholder dialogue • Commitment to stakeholder involvement JSI • Community engagement covered

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
Environmental							
Environmental Management Systems	• Incorporate environmental assessments into credit and lending decisions • Evaluate general environmental management, does company have environmental policy, process for checking compliance, and environmental insurance • Look at environmental issues in a systematic way according to a rigorous framework • Equator Principles - borrower must develop an environmental management plan based on the results of the environmental assessment and provide regular reporting	• Policies on various environmental issues • Track record in various jurisdictions • Environmental management plan • Independent engineering advice	• Morley Fund Management expects all the UK's FTSE 100 companies to publish a comprehensive environmental report or Morley will vote against the resolution to adopt the company's annual report and accounts at the AGM (ACCA p. 12) • "Transparency and vision" component of Goldman Sachs energy analysis (UNEP FI, 2003, p. 27)	<u>CPPIB</u> • That companies should disclose the full results of shareholder votes at shareholder meetings • That boards should report back no later than the next annual meeting on the implementation or non-implementation of resolutions that received shareholder approval • That "disclosure is the cornerstone that allows investors to better understand long-term risks. Consequently, we support reasonable shareholder resolutions that ask companies to make full disclosure on issues that relate to social responsibility, ethical behaviour, sustainable development and corporate citizenship." (CPPIB-2 p. 7)	• ABI disclosure guidelines that encourage companies to disclose information relating to policies, procedures and verification of environmental matters • No specific issue identification	<u>DJSI</u> • Existence of environmental policy and scope of application • Existence of certified environmental management system • Existence of established environmental targets and related public disclosure <u>JSI</u> • Existence of environmental policy and breadth, objectives and targets • Existence of certified environmental management system • Management structure and responsibilities • Training and communication • Auditing framework – internal/external • Performance objectives • Voluntary programs • Life cycle sourcing	<u>FTSE4Good</u> • Commitment to public reporting + quantitative data and performance measured against targets • Existence of environmental policy that covers all key issues and is publicly available • Responsibility for policy at Board or department level • Commitment to the use of targets • Commitment to monitoring and audit • Existence of certified environmental management system + specific EMS indicators + public disclosure of EMS outline • Existence of established environmental targets and related public disclosure (specific issue areas not defined)

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
				<u>OMERS</u> • Companies should publish and update in their annual reports their policies and procedures with respect to social, ethical and environmental issues that materially affect performance" (OMERS 2003, s. 6.0) • Environment as specific issue are mentioned			
Energy	• Equator Principles include a requirement that borrower's environmental assessment address the efficient production, delivery and use of energy					<u>DJSI</u> • Energy indicator • Percentage share of renewable energy production (see Key Financials)	
Climate Change	• Key issue for O+G sector • Raw GHG emissions data does not matter, but need to know what kind of liability it is, if the company has forecasted it • Need regulatory framework in place to		• Component of Goldman Sachs energy analysis (UNEP FI, 2003, p. 26) • Annual, audited report to shareholders on companies' initiatives to reduce GHG	• Corporate disclosure of financial risks related to climate change (Investor Network on Climate Risk) • Investor Guide to Climate Risk lays out an action plan for companies including	• Adoption of climate change policies related to protection against climate change-related liability claims	<u>DJSI</u> • Total direct GHG emissions (tCO2e) • O+G CO2 intensity (kg/t of production) • Target for reducing GHG emissions • Organizational coverage of GHG inventory and scope	<u>JSI</u> • Total GHG emissions (tCO2e) • GHG (PCI) – normative data, trends, % change

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
	assess comprehensively		emissions (Real Assets Management and Ethical Funds proxy to Imperial Oil, Petro-Canada, and Nexen)	– accountabilities, risk assessment, declaration of position, identification of material risks, emissions inventory and targets using GHG Protocol and have data independently verified, stakeholder engagement on the issue, integration into strategic business planning, set goals to increase efficiency and purchase clean energy of offset emissions, and support government actions (Investor Network on Climate Risk)		(e.g. direct, indirect) • Identification of independent organization verifying GHG inventory • Strategy for reducing/managing carbon risk • Volume of CO2 or CO2e traded through internal or external emissions trading schemes	
Air Emissions	• Equator Principles include a requirement that borrower's environmental assessment address air pollution		• "Pollution" component of Goldman Sachs energy analysis (UNEP FI, 2003, p. 26)			DJSI • Refining capacity upgraded to meet clean fuel requirements (sulphur-content less than 10ppm) • Sales volume of low emission fuels	JSI • Nitrogen oxide emissions • Sulphur dioxide emissions • Particulate matter • Polycyclic Aromatic Hydrocarbons (PAHs) • Benzene • Mercury

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
Water	• Water sustainability as it relates to funding companies with overseas operations in water constrained locations (					DJSI • Water use indicator	
Waste	• Equator Principles include a requirement that borrower's environmental assessment address waste minimization	• Mining – tailings management				DJSI • Waste indicator	
Spills	• Number and magnitude of spills • Equator Principles include a requirement that borrower's environmental assessment address pollution prevention and major hazards					DJSI • Spill indicator • Release indicator	
Effluent	• Equator Principles include a requirement that borrower's environmental assessment address liquid effluents	• Mining – effluent standards and if company will meet them					
Biodiversity	• Equator Principles include a requirement that borrower's environmental assessment address biodiversity, including	• Mining – reclamation plan	Extractive Industries (O+G & Mining) • Specific public policy statement on biodiversity which explicitly states			DJSI (Construction, Mining and Energy industry-specific) • Existence of defined biodiversity policy	

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
	endangered species and sensitive ecosystems + land acquisition and use		position on protected areas • Integration of biodiversity within EMS but should publish specific information about how biodiversity risks are relevant to business and how they are being managed • Publicly report progress on biodiversity and report against targets • Work with industry-wide initiatives on biodiversity to identify and mitigate risks for the sector; in particular, assess and report on exposure to protected areas including IUCN categories I-IV (ISIS 2004)			• Existence of evaluation of biodiversity impact • Existence of biodiversity monitoring procedures • Existence of policy to guarantee site rehabilitation; externally communicated • Adoption on international guidelines to define 'no-go' areas • Percentage share of operations at which monitoring systems to prevent habitat contamination are implemented • Percentage of assets (operated and non-operated) within IUCN management areas	
Economic							
General	• Equator Principles include a requirement that borrower's environmental assessment address socioeconomic impacts					DJSI • Environmental profit and loss accounting	

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
Key Financials						DJSI • Various CR-related financial indicators (e.g. related to renewables) • Sales volume of sulphur-free and ultra-low sulphur fuel + biofuels • Production capacity of renewables portfolio (GJ)	
Brand Management						DJSI • Specific indicators related to brand management • Identification of key responsibilities	
Investment in Intellectual Capital			• "Investment in the Future" component of Goldman Sachs energy analysis (UNEP FI, 2003, p. 26)			DJSI • Evidence of management and indicators related to human capital development	FTSE4Good • Evidence of training and employee development systems – annual training reviews for staff (more than 25% of staff) – data on time and money spent on training JSI • Employee training and education

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
Wages and Benefits						DJSI • Indicators related to performance based pay and the linkage to CSR/SD performance • Availability of SRI component to private pension plan	FTSE4Good • Maternity or paternity pay beyond the legal requirements - considered a component of equal opportunities systems JSI • Ownership program • Profit sharing • Pension plan (no details)
Community Investment						DJSI • Indicators related to philanthropic spending • Existence of system to measure impact on contributions	FTSE4Good • Charitable donations in excess of £50,000 • Operating payroll giving scheme • In-kind gifts or staff secondments • Senior manager responsible for community investment
Customers						DJSI • Indicators related to customer satisfaction	
Investor Relations						DJSI • Evidence of material used to communicate with analysts and investors about company sustainability issues	

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
						• Number of face-to-face investor meetings held to discuss sustainability strategy and performance	
Social							
General	• Look at social issues related to lending in a subjective way – depends on the analysis				• ABI disclosure guidelines that encourage companies to disclose information relating to policies, procedures and verification of social matters • No specific issue identification beyond ethical	DJSI • Social reporting – public reporting on implementation of labour standards, employment practices, human rights policy • Public endorsement of charters/frameworks (e.g. UN Declaration of Human Rights, ILO, OECD Guidelines for MNEs, etc.)	FTSE4Good • Social reporting • Commitment to UN Declaration of Human Rights • Commitment to ILO core standards or alternatively be signatories to UN Global Compact/ SA8000/ OECD Guidelines for MNEs
Social Management Systems							
Human Resource Management and Employee Relations		• Employee retention	• "Workforce" component of Goldman Sachs energy analysis (UNEP FI, 2003, p. 27)	CPPIB • Investment analysis, due diligence and monitoring of investments takes into account corporate behaviour in employee practices OMERS • Respect for employees mentioned as specific issue in		DJSI • Indicators related to employee satisfaction and retention • Existence of regular performance appraisals - % employees which receive	FTSE4Good • Evidence of systems to maintain good employee relations including consultative arrangements (covering more than 25% of staff) JSI • Employee relations covered • Work/family balance

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
				Statement of Investment Policies and Procedures			• Participative management program • Job security initiatives and programs • Redeployment, retraining, and/or outplacement services
Health and Safety	• Equator Principles include a requirement that borrower's environmental assessment address occupational health and safety, and fire prevention and life safety		• "Safety" component of Goldman Sachs energy analysis (UNEP FI, 2003, p. 27)			DJSI • Existence of established indicators and related public disclosure focused on health and safety • External verification of occupational, health and safety targets	FTSE4Good • Public disclosure of accidents • Evidence of health and safety systems – awards – health and safety training JSI • Formal health and safety/wellness management system • Policy on occupational health and safety • Health and safety audits/inspections • Performance objectives and targets • Health and safety training and communication • Health and safety record – lost-time injury – recordable incident – fatalities

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
							– safety convictions – safety fines
Diversity and Discrimination			• "Management diversity and incentives" component of Goldman Sachs energy analysis (UNEP FI, 2003, p. 27)			<u>DJSI</u> • Existence of established indicators and related public disclosure focussed on diversity <u>JSI</u> • Diversity in the workplace covered	<u>FTSE4Good</u> • Commitment to ILO core standards – one of which is equal opportunities • Adoption of equal opportunities policy and/or public commitment to equal opportunities or diversity • Evidence of equal opportunities systems – monitoring of policy and workforce compensation – flexible working arrangements and family benefits – more than 10% of managers being women or proportion of managers who are women or from ethnic minorities exceeding 2/5 of their representation in the workforce
Freedom of Association		Social risks – union labour dispute				<u>DJSI</u> Existence of established indicators and related public disclosure	<u>FTSE4Good</u> Commitment to ILO core standards – one of which is freedom of

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
						– % employees represented by trade union or covered by collective agreement – consultations/ negotiations with trade unions over organizational changes	association/collective bargaining Evidence of systems to maintain good employee relations including union recognition agreements (covering more than 25% of staff)
Child and Forced Labour	• Equator Principles – Child and Forced Labour IFC screening criteria					DJSI • Existence of established indicators and related public disclosure	FTSE4Good • Commitment to ILO core standards – one of which is related to forced and child labour
Human Rights	• Human rights risks are part of country-risk assessment done under the Equator Principles		• Component of Goldman Sachs energy analysis (UNEP FI, 2003, p. 27)	CPPIB • Investment analysis, due diligence and monitoring of investments takes into account corporate behaviour in human rights OMERS • Human rights mentioned as specific issue in Statement of Investment Policies and Procedures		DJSI • Commitment to UN Declaration of Human Rights • Scope of Code of Conduct and whether it includes security JSI • Human rights covered (no details)	FTSE4Good • Human rights policy which is publicly disclosed • Strategic responsibility for human rights policy with Board member(s) or senior manager(s) who report directly to the CEO • Commitment to UN Declaration of Human Rights • Guidelines governing the use of armed security guards • Monitoring of the implementation of the human rights policy + procedures to remedy

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
							non-compliances • Employee training in human rights policy • Consultation with local stakeholders on human rights concerns • Evidence of human rights impact assessment • Public disclosure on performance against human rights policy
Layoffs						DJSI • Existence of established indicators and related public disclosure – number of employees laid off in last year – consultations/ negotiations with employees over organizational changes	
Ethical				CPPIB • Public disclose of corporate codes of business conduct and corporate ethics, and conflict of interest management procedures • Formal review of such policies on at least an annual basis by the	• ABI disclosure guidelines that encourage companies to disclose information relating to policies, procedures and verification of ethical matters	DJSI • Evidence of management of corruption and bribery, etc.	FTSE4Good • Adoption of Code of Ethics or Business Principles and public disclosure JSI • Ethical business practices covered (no details)

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
				Governance committee of the board • CPPIB investment analysis, due diligence and monitoring of investments takes into account corporate behaviour in ethical conduct OMERS • Ethics in management			
Indigenous Peoples	• Equator Principles include a requirement that borrower's environmental assessment address impacts on indigenous peoples and communities, and that indigenous peoples are consulted					JSI • Aboriginal relationships covered	FTSE4Good • Stated commitment to respecting indigenous peoples' rights
Supply Chain Management						DJSI • Existence of established guidelines for the selection and evaluation of suppliers covering which areas • Integration of social and environmental issues – environment;	

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
						labour practices; H&S; human rights • Existence of external audits of suppliers	
Compliance	• Incorporate environmental assessments into credit and lending decisions and look specifically at compliance – does borrower comply with all environmental laws and regulations applicable to them, does the company have any orders against them, charged or prosecuted • Fines related to spills specifically looked at • Equator Principles include a requirement that borrower's environmental assessment address requirements under host country laws and regulations, applicable international treaties and agreements		• Investment manager identified that risk related to the regulatory environment is a key area (NRTEE Calgary p. 3)	CPPIB • Investment analysis, due diligence and monitoring of investments takes into account corporate behaviour in respect for domestic and international laws		JSI • Safety convictions over the last five years • Safety fines over the last five years • Environmental accidents, spills, convictions, fines, citations	FTSE4Good • Public disclosure of non-compliance, prosecution and fines

Sustainability Issue	Commercial Banks	Investment Banks	Investment Management Companies	Pension Funds	Insurance and Re-Insurance Companies	Index Providers (a)	Index Providers (b)
Independent Verification			• Annual independent third party audit on companies' initiatives to reduce GHG emissions (Real Assets Management and Ethical Funds proxy to Imperial Oil, Petro-Canada, and Nexen)			DJSI • Assurance processes used for environmental and social reporting • External verification of occupational, health and safety targets	FTSE4Good • Public disclosure of independent verification

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