

Climate Change and Investment Risk:

Best Practices for Canadian Pension Funds and Institutional Investors:

A report on the Climate Change and Investment Risk Workshop,
March 11, 2004 in Toronto



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Institutional Investors

EXECUTIVE SUMMARY

Recognition of the importance of climate change has begun to challenge the nature of international business practices. This is perhaps most apparent among pension funds and other institutional shareholders, which are using their clout to press for greater corporate accountability and transparency on global warming.

In 2001, major shareholders filed global warming resolutions with seven companies. In 2002, that number had nearly tripled, as proponents filed 19 resolutions.¹ On November 1, 2003, 87 institutional investors with assets of over \$9 trillion under management wrote to the 500 largest publicly traded companies in the world asking for the disclosure of investment-relevant information concerning their greenhouse gas emissions.² A March 2002 study released by the Investor Responsibility Research Center and the Social Investment Forum confirmed the expansion of shareholder advocacy and found that the fastest-growing area of focus for shareholder activism is climate change.³

In Canada the federal government has made a strong commitment to sustainable development in the recent Speech from the Throne, and to incorporating key environmental indicators including emissions reduction into its decision making. "Accurate, credible, up-to-date information on GHG emissions is essential to making the right policy decisions for our economy and for our environment,"⁴ said David Anderson, Minister of the Environment.

In keeping with the desire expressed by stakeholders during consultations in 2003, the federal,

¹ *Value at Risk: Climate Change and the Future of Governance*, CERES Sustainable Governance Project Report (prepared by Innovest Strategic Value Advisors), April 2002.

² Michelle Chan-Fishel, *Second Survey of Climate Change Disclosure in SEC Filings of Automobile, Insurance, Oil & Gas, Petrochemical, and Utilities Companies*, Friends of the Earth, 2003

³ *Value at Risk: Climate Change and the Future of Governance*, CERES Sustainable Governance Project Report (prepared by Innovest Strategic Value Advisors), April 2002.

provincial and territorial governments will continue to collaborate in developing a harmonized, “single-window”, domestic mandatory reporting system, and to implement it in orderly phases. “A comprehensive system to track and publish greenhouse gas emissions is a basic part of any long-term strategy to address climate change,” said Matthew Bramley, Director of Climate Change with the Pembina Institute for Appropriate Development. “This is a good start, and we look forward to working with all stakeholders as the reporting system is expanded and refined in the future.”⁵

Across Canada, nearly 800 organizations from all sectors of the Canadian economy have developed voluntary action plans to reduce their greenhouse gas emissions (GHGs), and registered these plans with the Voluntary Challenge and Registry Inc. (VCR Inc.) and EcoGEstE, two non-profit partnerships between industry and governments. Of these organizations, more than 360 have produced progress reports to document their successes in reducing GHG emissions. The success of VCR Inc. and EcoGEstE is just one indication of the willingness of Canadian companies to join in the national effort to reduce GHG emissions.⁶

Yet awareness of the issue is still at a very nascent stage in the institutional investment community. In spite of the fact that four Canadian companies (IPSCO, Petro-Canada, EnCana and Imperial Oil) faced shareholder resolutions on climate change in 2003, very few institutional investors have been calling for increased climate change risk disclosure.⁷

The Social Investment Organization, with funding from Environment Canada and in partnership with KAIROS and Aberdeen Asset Management, organized a one-day workshop on March 11, 2004, offering perspectives on climate change and investment risk to representatives of major Canadian institutional investors, investment consultants, asset management firms and other interested parties.

The goal of the workshop was to help raise awareness within the financial community of climate change risk, and to engender greater corporate disclosure on climate change. This included encouraging participants to sign on to the Carbon Disclosure Project, advising institutional investors and pension fund managers to vote their proxies in support of climate-change related shareholder resolutions and using new securities regulations and emerging accounting and financial reporting guidance to assess companies on global warming risk and opportunity.

⁴ New Reporting Requirements Enhance Canada’s Capacity to Track and Report Progress on GHG Emissions, Government of Canada, Ottawa, March 2004.

⁵ New Reporting Requirements Enhance Canada’s Capacity to Track and Report Progress on GHG Emissions, Government of Canada, Ottawa, March 2004.

⁶ *A Discussion Paper on Canada’s Contribution to Addressing Climate Change*. Government of Canada, 2002.

⁷ Social Investment Organization, www.socialinvestment.ca

This paper is a summary of that discussion. It also draws on the ideas and proposals that have already come forward from provinces, business, environmental groups and other experts. It offers recommendations that, in the opinion of the Social Investment Organization, represent best practices for assessing and managing climate risk.

SIO-Recommended Best Practices for Pension Funds and other Institutional Investors for Assessing and Managing Climate Change Risk

Based on proceedings of Climate Change and Investment Risk: a workshop for pension funds and institutional investors, Toronto, March 11, 2004

- 1.** Canadian institutional investors should become signatories to the Carbon Disclosure Project. This project is an important disclosure mechanism aimed at obtaining carbon risk data from the 500 largest companies in the world. As of 2003, 87 signatories were members of the CDP, only 5 of which were Canadian. Greater Canadian participation in this important initiative would help to build awareness of climate change risks by the corporate sector and the financial community in this country.
- 2.** Canadian institutional investors should vote their proxies in support of reasonable climate change related shareholder proposals. Voting shares is considered a critical financial asset as well as an important fiduciary responsibility. Supporting reasonable shareholder action on issues of climate change disclosure and policy would encourage corporate management to disclose risks and implement appropriate policies and practices on climate risk. The aim is to improve climate risk disclosure and practice broadly across the Canadian economy.
- 3.** Canadian institutional investors should use emerging regulatory requirements and financial reporting disclosure guidance to assess companies in their portfolios on climate risk issues. Securities regulators require disclosures of significant risks and known uncertainties. Also, the Canadian Institute of Chartered Accountants has recommended a Management's Discussion and Analysis disclosure framework, encompassing social and environmental issues. Other international disclosure guidance will soon become the norm. These will provide an opportunity for institutional investors to better assess companies in their portfolio from a climate risk perspective.

INTRODUCTION

In order for investors to exercise appropriate judgment and for fiduciaries to act responsibly, disclosure of the potential economic risk posed by climate change is essential.⁸ Investors recognize that environmental risks are threaded throughout their portfolios.

Leading reports on the issue state that climate risk will have a very large impact on the following sectors: Agriculture, Electric Power, Fisheries, Forestry, Health Care, Insurance, Manufacturing, Oil and Gas, Real Estate, Tourism, Transportation and Automobiles and Water. A recent CERES report showed that a diversified portfolio of more “sustainable” companies earned 1.5-2.4% (150-240 basis points) more than its competitors. In certain high-risk sectors, such as chemical and petroleum, the gain was as great as 500 basis points. Markets for energy produced from renewable sources, such as solar and wind, are expected to grow \$1.9 trillion by 2020.⁹

Most mainstream financial institutions are either unaware of the business relevance of climate change or have adopted a ‘wait and see’ attitude.

From *UNEP Finance Initiatives, CEO Briefing*. A document of the UNEP FI Climate Change Working Group, New York City, 2003

In 2001, the Universities Superannuation Scheme, the third-largest pension fund in the United Kingdom, commissioned a report titled “Climate Change-A Risk Management Challenge for Institutional Investors” which stated:

Climate change is a major emerging risk management challenge for institutional investors. Institutional investors, and pension funds in particular, aim to provide pensions and other benefits through long-term investment. They can also be seen as ‘universal investors’ in that, due to their size, they commonly invest across the whole economy. If climate change threatens economic development, and especially if there are many or significant impacts, it will also therefore be likely to undermine the ability of pension funds and other institutional investors to fulfill their aims, so it is in their interests to see that risks associated with climate change are minimized.¹⁰

One major stakeholder group that has been at the forefront of this issue is the religious sector. By virtue of their pension and endowment funds, and in respect of their social mission, investors situated within religious institutions have been in the forefront of the ever-mounting demands that corporate conduct be pushed in positive directions. As a matter of witness and self-critical consciousness, churches, as institutions, endeavor to bring their responsibility as investors into consonance with their social teachings. That is to say, they too live in a global society where corporations are increasingly significant actors which have immeasurable, and in some cases irreversible, social, economic and environmental impacts. In this sense, churches speak from the experience of their members and partners as “stakeholders” seeking and advocating sustainable communities.¹¹

⁸ Investor Call for Action on Climate Risk, November 21, 2003, New York City, Investor Network on Climate Risk

⁹ Climate Change and the Future of Governance, Climate Risk Facing Investors, CERES, 2003.

¹⁰ M.Mansley and A.Dlugolecki. 2001. “Climate Change-A RiskManagement Challenge for Institutional Investors.” Universities Superannuation Scheme.

¹¹ Principles for Global Corporate Responsibility: Bench Marks for Measuring Business Performance, KAIROS, 2002.

CLIMATE RISK

Environmental risk can be defined by the environmental performance of a company (e.g. emissions) and its environmental management system and long-term strategy.¹² When greenhouse gases, (GHGs), such as carbon dioxide are released into the atmosphere, they trap the sun's rays and subsequently cause a warming effect on the earth's surface. As the earth warms, its climate system changes. The major sources of carbon dioxide are electricity generation, transportation and manufacturing.¹³ The GHGs, which create the problem, persist for many decades. To stabilize atmospheric concentrations at just twice the pre-industrial level would require current emission levels to be cut by 60%. There is, therefore, a growing sense of urgency to act in a meaningful fashion.¹⁴ Leadership in this sense involves taking a progressive approach to climate change management so that company standards become industry standards.

In the environmental realm, mandatory disclosure programs have been notably successful as a tool to promote sustainable development, a prominent objective of the North American Free Trade Agreement. As a direct result, it has provided a strong stimulus for companies generating reportable quantities of toxic substances to reduce their generation and release.¹⁵ In Canada, the National Pollutant Release Inventory (NRPI) has had a similar success, prompting many companies to embark on accelerated pollution prevention and reduction programs, especially when also under some regulatory threat.¹⁶

Increasingly, corporations must take responsibility for

There are 4 main barriers holding back financial institutions from a more proactive stance:

Cognitive barriers: The lack of connection between climate change and 'planning-horizon' financial risk, and the currently slow pace of price discovery of carbon, means the financial sector cannot see any value in climate action.

Political barriers: There has been considerable delay in creating the political conditions under which international carbon management and climate adaptation measures can be assigned a durable value by financial and insurance companies. For example, a lack of clear targets for renewable energy supplies is a definite impediment to potential investors in this sector.

Analytical barriers: There is a low awareness of climate change among key finance and insurance sector advisors, resulting in insufficient analysis and information being provided. Poor data availability on corporate climate change strategies makes the analysis of potential company risks very difficult.

From *UNEP Finance Initiatives, CEO Briefing, A document of the UNEP FI Climate Change Working Group*, New York City, 2003

¹² 2004 Report on Environmental Risk Ranking in the Canadian Oil and Gas Sector, Preliminary Version, Groupe Investissement Responsable, www.investissementresponsable.com

¹³ Climate Change and the Future of Governance, Climate Risk Facing Investors, CERES, 2003.

¹⁴ From: UNEP Finance Initiatives, CEO Briefing, A document of the UNEP FI Climate Change Working Group, 2002.

¹⁵ A. Fung and D. O'Rourke. 2002, "Reinventing Environmental Regulation from the Grassroots Up: Explaining and Expanding the Success of the Toxics Release Inventory," *Environmental Management* 25:155-27.

¹⁶ K. Harrison and W. Antweiler. 2003, "Incentives for Pollution Abatement: Regulation, Regulatory Threat, and Non-Governmental Pressures," *Journal of Policy Analysis and Management* 22(3): 361-82.

the cradle-to-grave effects that their operations and products have on land, water, and air. If they do not, the costs of environmental degradation do not disappear, they become downloaded onto local communities and residents (through contaminated air, water and soil), or governments (through health care costs, disposal costs or clean-up costs).¹⁷

Friends of the Earth advocates that although all companies in these sectors should provide climate change disclosure as a matter of the shareholders' right to know, savvy investors still may be able to distinguish the strategically-managed and well-governed firm from the corporate laggards by the provision or lack of climate-related disclosure.¹⁸

Recently, the investor-environmentalist coalition CERES released a report authored by Innovest Strategic Value Advisors titled *Value at Risk: Climate Change and the Future of Governance* that concluded:

Compelling evidence now exists that the competitive and financial consequences for individual companies under 'business-as-usual' scenarios will be immense. Both the impacts of climate change itself and the need to cut greenhouse gas emissions will create new risks. Indeed, even within the same industry sector, corporate exposures to the risks of climate change can vary greatly according to, for example, companies' 'greenhouse gas intensity.'¹⁹

There is, however, a significant "information deficit" for investors. Very few of the financial service companies surveyed have systematic, portfolio-wide information concerning both the absolute and relative levels of company-specific risk. From a fiduciary perspective, this is a significant concern.²⁰ Projected climate-related damage for these industries ranges from marginal to hundreds of billions of dollars over the next few decades. Sensitivity varies greatly with global placement and capacity. In other words, addressing global warming will create financial winners and losers. Well-positioned companies will see new markets and business in a future world that will be seeking cleaner energy production and use. Poorly positioned companies will lose market share and miss opportunities to enhance shareholder value.²¹

¹⁷ Principles for Global Corporate Responsibility: Bench Marks for Measuring Business Performance, KAIROS, 2002. www.kairoscanada.org

¹⁸ Second Survey of Climate Change Disclosure in SEC Filings of Automobile, Insurance, Oil & Gas, Petrochemical, and Utilities Companies, Friends of the Earth, November 2003.

¹⁹ Value at Risk: Climate Change and the Future of Governance, CERES Sustainable Governance Project Report (prepared by Innovest Strategic Value Advisors), April 2002.

²⁰ Carbon Finance and the Global Equity Markets, Innovest Strategic Value Advisors, 2003.

²¹ Institutional Investor Summit on Climate Risk, November 21, 2003, UN Headquarters, New York City

THE CONVERGENCE OF THE CORPORATE GOVERNANCE AND CLIMATE CHANGE AGENDAS

A group of institutional investors (representing assets in excess of US \$9 trillion) released the groundbreaking Carbon Disclosure Project (CDP), which is a survey of the largest 500 global companies. The report, the largest survey ever to assess and provide hard data on financial exposure to climate change, found that while 80 percent of respondents acknowledge the importance of climate change as a financial risk, only 35-40 percent were actually taking action to address the risks and opportunities.

The Carbon Disclosure Project was launched in May 2002 to encourage corporate reporting of greenhouse gas (GHG) emissions, which include carbon dioxide (CO₂) as well as four other gases that scientists believe contribute to global warming. CDP participants include 87 major institutional investors, such as Connecticut Retirement Plans and Trust Funds (CRPTF), Credit Suisse Group, and the Universities Superannuation Scheme.²²

Pressure Brings Results: Environmental Reporting Progress

Responsible companies communicate with external stakeholders through standard, public environmental reports that are verified independently and released annually. Fifteen years ago, such a high expectation seemed absurd. Noranda Forest (now Nexfor) was one of the first companies in Canada to feel the pressure of mounting stakeholder power. In 1990, a shareholder group organized by the Taskforce on the Churches and Corporate Responsibility exerted significant pressure on its Board and senior managers. The following year, the company produced an environmental report, the first of its kind in Canada. Over the last decade, Noranda has continued to produce annual environmental reports, and in 1996, it received the Financial Post's 1996 Award for Excellence in Corporate Environmental Reporting.

Principles for Global Corporate Responsibility:
Bench Marks for Measuring Business
Performance, KAIROS, 2002.

As a party to the United Nations Framework Convention on Climate Change (UNFCCC), Canada must meet international reporting obligations related to greenhouse gas emissions inventories, and carbon sources and sinks. Additional, more robust reporting requirements will come into force under the Kyoto Protocol.

The Carbon Disclosure Report reveals that industry sectors vary widely in their degree of risk exposure and the levels to which companies, in response, develop their risk management capabilities. Those at greatest risk were not necessarily those with the strongest risk management architecture.

GHGs and what firms do about them are affecting investment portfolios. Progressive investors are starting to look at their investments through a new lens: what's coming invisibly out of a firm's smokestack or that of the energy plants that power it.²³

In recent years, the demonstration that screened portfolios often provide risk-adjusted returns superior or equal to unscreened benchmarks has encouraged investors to allocate at least a portion of their assets to the environmentally screened portfolios. This development has reinforced financial market demand for relevant environmental information.²⁴

²² *Carbon Disclosure Project Informs Investors of Climate Change Risks and Opportunities*, Building a Clean Energy Economy, Climate Solutions, see www.SocialFunds.com

²³ Cameron Burns, *Carbon Disclosure Project Looks at Businesses and Climate Change*, Energy Pulse, see www.socialfunds.com

²⁴ *Environmental Disclosures in Financial Statements, New Developments and Emerging Issues*, UNEP, 2003.

However, two key barriers have helped to slow progress on awareness of climate change risk by institutional investors:

- Investors are currently hampered in their ability to assess and respond to the financial risks of global warming because existing rules on disclosure relating to material liabilities are not adequately enforced, fund management firms generally are not conducting sufficiently thorough analysis, and many companies are failing to adequately disclose relevant information related to potential danger to their long-term revenues and assets.²⁵
- Currently, there exists a lack of certainty due to clear legislative, regulatory or case law guidance in Canada. Even though global surveys of chief executives have consistently identified climate change as a major challenge to their businesses, companies are not disclosing their substantial material risks related to climate in their securities filings. This non-compliance is likely to trigger enforcement actions by government and shareholders.²⁶ It has been a challenge to encourage companies to disclose, regardless of standards, and more importantly, to stop them from being so vague.

Yet, there has been a global attempt to address this issue and in turn, public policy makers have begun to act on this on an international scale. The adoption of a widely recognized reporting initiative and the utility of these frameworks is gaining international momentum. Pension funds and major institutional investors internationally are raising questions as to how climate change will impact upon their investments, as tracking carbon risk is a bottom line major risk issue. Innovest has concluded that carbon related issues affect companies in three ways: via brand or reputation, direct cash flow and capital risks.²⁷

The accelerating convergence of the corporate governance/fiduciary agenda with the drive towards greater corporate responsibility on environmental and social issues will place additional pressure on fund managers, trustees and company officers to understand carbon risks, and to report on them where prudent to do so.²⁸

²⁵ *Investor Call for action on Climate Risk*, Investor Network on Climate Risk, November 21, 2003, New York City

²⁶ *Ibid.*

²⁷ See www.innovest.com

²⁸ *Carbon Finance and the Global Equity Markets*, Innovest Strategic Value Advisors, 2003.

CERES Climate Change Governance Checklist

This report identifies 14 specific actions that companies are taking to implement governance responses to climate change.

Board level:

1. Assign a committee of directors with direct oversight responsibility for environmental affairs.
2. Conduct a formal board-level review of climate change and monitor company response strategies.

Management level:

3. Place the chief environmental officer in a position to report directly to the chief executive officer or the CEO's executive committee.
4. Make attainment of greenhouse gas targets an explicit factor in employee compensation.
5. Have the CEO issue a clear and proactive statement about the company's climate change response and greenhouse gas control strategy.

Reporting:

6. Include a statement on material risks and opportunities posed by climate change in the company's securities filings.
7. Issue a sustainability report based on the Global Reporting Initiative or comparable "triple bottom line" format, which includes a discussion of climate change and a listing of the company's greenhouse gas emissions and trends.

Emissions data:

8. Calculate and register greenhouse gas emissions savings or offsets from company projects.
9. Conduct a system-wide inventory of the company's emissions and report the results directly to shareholders.
10. Establish an emissions baseline (dating back at least 10 years) by which to gauge the company's emissions trends.
11. Make projections of future emissions and set firm, company-wide targets to manage and control them.
12. Hire a third party auditor to certify there are no material misstatements of the company's emissions data/

Other actions:

13. Participate in an external voluntary greenhouse gas emissions trading program.
14. Purchase and/or develop renewable energy sources.

Investors will find the Climate Change Governance Checklist a useful starting point for evaluating companies, and the actions they are taking to respond to global warming. The checklist is by no means exhaustive. Pursuit of its objectives does not guarantee emissions reductions by corporations or financial rewards for investors. However, the checklist does lay the necessary groundwork for achieving these goals in a carbon-constrained world.

CLIMATE RISK WORKSHOP LEARNINGS

The purpose of the workshop on March 11, 2004, was to educate staff, portfolio managers and consultants of pension funds and other institutional investors on climate risk, and to provide practical strategies for assessing and managing climate risk. The dialogue explored the roles and responsibilities of Canadian institutional investors and pension fund managers.

BEST PRACTICES

At the workshop, there was consensus that the following represent best practices by institutional investors for assessing and managing climate change risk. The business case has been established to support that environmental performance does affect competitiveness, profitability and share price performance.²⁹

At this critical stage, it is the financial and quality of life issues that need to be addressed, as we are seeing a mainstream attempt for disclosure and a higher profile of climate risk in North America. As Dan Pigeon, Director of Investor Relations at TransAlta Corp., said: “To exhibit environmental leadership in short, medium and long-term approaches will continue to be a good investment and will result in competitive difference.”

Best practices include signing on to the Carbon Disclosure Project, encouraging institutional investors and pension fund managers to vote their proxies in support of climate-change related shareholder resolutions and using new accounting standards to assess companies on global warming risk and opportunity.

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Based on proceedings of *Climate Change and Investment Risk: a workshop for pension funds and institutional investors, Toronto, March 11, 2004*

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2. Canadian institutional investors should vote their proxies in support of reasonable climate change related shareholder proposals. Voting shares is considered a critical financial asset as well as an important fiduciary responsibility. Supporting reasonable shareholder action on issues of climate change disclosure and policy would encourage corporate management to disclose risks and implement appropriate policies and practices on climate risk. The aim is to improve climate risk disclosure and practice broadly across the Canadian economy.
3. Canadian institutional investors should use emerging regulatory requirements and financial reporting disclosure guidance to assess companies in their portfolios on climate risk issues. Securities regulators require disclosures of significant risks and known uncertainties. Also, the Canadian Institute of Chartered Accountants has recommended a Management’s Discussion and Analysis disclosure framework, encompassing social and environmental issues. Other international disclosure guidance will soon become the norm. These will provide an opportunity for institutional investors to better assess companies in their portfolio from a climate risk perspective.

²⁹ See www.fairvest.com

CARBON DISCLOSURE PROJECT

According to workshop speaker Martin Whittaker, Managing Director of Innovest Strategic Value Advisors, a specialist research investment research provider, companies need to develop climate change risk strategies because policymakers require it, shareholders are asking for it and society expects it.

Innovest has reported that more than 50% of FT 500 companies have already recognized climate change as a serious issue and are developing strategies to reduce greenhouse gas emissions. Yet, many companies may be unprepared for climate policy changes, taking into consideration that risks are potentially significant. An analysis of corporate “carbon beta”- the differentials in company risk exposure implies that future threats to shareholder value differ significantly. Whittaker reported that companies are seeing opportunities to create top line revenue growth from products and services predicated upon a low carbon future.

Innovest recommends that prospective Carbon Disclosure Project Signatories review the following questions when evaluating their position on greenhouse gas emissions:

1. Do you see climate change as posing potential risks and/or opportunities to your company?
2. What is the quantity of annual emissions of the main greenhouse gases produced by your operations?
3. Have you begun to measure the quantity of emissions generated by the use and disposal of your product?
4. Have you begun to measure the quantity of emissions generated by your supply chain?
5. Do you have emission reduction programs and targets in place?
6. Are you engaged or do you intend to engage in greenhouse gas emissions trading?

To conclude, Mr. Whittaker ended on an encouraging note by emphasizing that as carbon regulation will become more of a reality in North America, and as shareholder resolutions are growing in number, the issue of carbon disclosure will be better understood by Canadian fiduciaries.

VOTING PROXIES

According to workshop speaker Debra Sisti, Vice President, Fairvest Corp.,³⁰ it is essential for investors to consider how Canadian corporations are managing the opportunity to enhance value through appropriate responses to financial, operational and market risks. More importantly, it is important to consider how these corporations are strategically planning for a future that takes account of all of these external factors. Such criteria can be used to guide investors on voting their

“In global warming, we are facing an enormous risk to the U.S. economy and to retirement funds that Wall Street has so far chosen to ignore...investors need to pay more attention to corporate practices that affect long-term value”

Phil Angelides
California State Treasurer
November 2003

³⁰ Fairvest Corporation is the leading provider of Canadian corporate governance research and related services to institutional investors.

shares on climate risk related shareholder proposals.

To determine whether a company has an effective environmental risk management system – it must entail planning and policy, implementation and monitoring, and necessary measuring and reporting, so that research analysts, investment managers and investors can make informed decisions on the basis of publicly available, reliable, relevant and comparable information.

According to Fairvest, the following are specific criteria that investors can use when assessing companies on climate change risk:

- Adoption of a particular widely recognized reporting framework like that provided by the Global Reporting Initiative or GHG Protocol Initiative.
- Identification of a senior officer to the position of Environmental Officer and a committee of the board charged with the responsibility for oversight of environmental risk management.
- A description of the company's environmental policy containing the company's strategic response to climate change and GHG emissions.
- A comprehensive environmental report either as part of a sustainability report or in the Annual Report containing the following information:
 1. The company's environmental management systems.
 2. An assessment of environmental risks and opportunities.
 3. Specific emissions data-measured using a baseline that would permit peer-company and Kyoto compliance comparison.
 4. Short-term and long-term emissions reduction targets.
 5. Third-party verification of emissions data (for the same reason that financial measurements are to be audited)
 6. Emissions trading activity.
 7. Disclosure on the company's investments in renewable energy sources and energy-use reduction initiatives.
 8. Environmental reports should also reference voluntary participation in climate-change research and education groups or memberships in environmental associations.

In conclusion, Fairvest Corp., advocates that a desired outcome of the verification or audit process

Sample Resolution Summary

Topic: Energy and Environment

Issue: Report on Greenhouse Gas Emissions

In response to the real and serious threat of global warming, the shareholders propose that the board of directors of the company prepare a report on what actions and research the company is taking to reduce emissions; its financial exposure due to the likely costs of reducing emissions and potential liability for damages associated with climate change; and company or affiliate actions promoting the view that climate change is exaggerated or may be beneficial.

Resolution summary: The shareowners request that the company evaluate the impact on global warming resulting from its project financing.

Sample resolution from the US Shareholder Action Network.
See: WWW.ShareholderAction.org

is the use of a commonly- accepted framework for reporting that would permit meaningful comparison within and maybe even between industries. Comparison is ultimately the means of evaluating any company's success.³¹

USING ACCOUNTING DISCLOSURES TO ASSESS CLIMATE RISK

In her presentation to the workshop, Julie Desjardins, a consultant acting as Program Director for the Canadian Institute of Chartered Accountants, outlined the emerging Management's Discussion and Analysis disclosure framework and commented on its use for social and environmental issues, including climate risk issues. Such disclosures can be used by investors to assess companies in their portfolios to help determine appropriate weightings.

There is an emerging reporting environment where external reporting related to GHGs includes: MD&A (Management's Discussion and Analysis) disclosures and financial statement disclosures. In general, there is an increasingly aggressive regulatory environment, and audit committees and boards of directors are exercising more active oversight of corporate disclosures.³²

MD&A is a regulatory filing that according to Form 51-102F1 of the Canadian Securities Administrators (CSA), is "a narrative explanation, through the eyes of management, of how your company performed during the period covered by the financial statements, and of your company's financial condition and future prospects." According to securities regulators and MD&A Guidance published by the Canadian Institute of Chartered Accountants, the MD&A report should communicate information that helps users understand past performances and future prospects.

CSA requires filers of MD&A reports to discuss important trends, events, uncertainties and risks that are reasonably likely to have an effect on company business. Further, the MD&A report must discuss material information that may not be fully reflected in some financial statements - environmental, social or cultural matters, for example.

An important principle is that the Board of Directors has responsibility for approving annual and interim financial statements and annual and interim MD&As. Desjardins also noted that the CICA recommends that companies disclose key performance drivers, including environmental and social issues, where material to an understanding of the past performance and future prospects of the company.

In terms of CEO and CFO certifications, both annually and quarterly, CEOs and CFOs must certify that their filings: "fairly present in all material respects the financial condition, results and operations and cash flows of the issuer." As well, annually and quarterly, CEOs and CFOs must certify that their filings: "do not contain any untrue statement of material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading." Further, CEOs and CFOs must certify that they are responsible for establishing, maintaining and evaluating disclosure controls and procedures in addition to being held responsible for establishing and maintaining internal control over financial reporting.

³¹ Debra Sisti on behalf of Fairvest Corp.

³² Julie Desjardins on behalf of the Canadian Institute of Chartered Accountants.

In addition, Desjardins cited a recent draft interpretation by the International Financial Reporting Interpretations Committee (IFRIC) on the recording of GHG emissions rights on company balance sheets and income statements.

In conclusion, Desjardins noted that there are important changes afoot regarding accounting and financial reporting disclosures about climate change strategies and exposures. Investment fiduciaries have an important role to play in shaping these changes and using the resulting disclosures in their risk and investment models.

SUMMARY

In the absence of effective government or regulatory action, neither transparency nor capital market efficiency has yet spread beyond disclosures about environmental risks. An opportunity still beckons to use existing securities regulations to stimulate fuller disclosure of material environmental information to financial markets and investors, thereby simultaneously promoting improved environmental performance by the private sector while protecting investors, promoting capital investment and increasing capital market efficiency. Taking advantage of this opportunity does not require new legislation or regulation but merely more vigorous application of existing rules.³³

The chances for this opportunity to be acted upon beneficially can be further enhanced by two other courses of action that are certainly available in Canada.

The first would be to increase awareness of financial executives of the potential advantages of better evaluation of their companies' prospects by investors and analysts arising from more complete, timely and relevant environmental disclosures about matters beyond just site remediation costs and liabilities. Projects planned under a loose partnership by the National Round Table on the Environment and the Economy, the Conference Board of Canada, the Canadian Institute of Chartered Accountants, Environment Canada, and the US EPA (Environmental Protection Agency), all aim to engage business and capital market participants in ways likely to foster this greater understanding and its implications for finance and disclosure.³⁴

It has been recognized by the participants of the Climate Risk Workshop that the skills of reporting climate risk are lacking, and it is the responsibility of the Canadian investment community to evaluate these issues, hence, launching a policy framework to evaluate climate risk. More importantly, a proactive strategy on climate change needs to be adopted by the Canadian investment community. Investors need to understand the issues as fiduciaries to better assess climate risk within their portfolios and to manage the risks identified.

The Social Investment Organization wishes to thank all participants and contributors to the workshop. It is our hope that the dialogue and actions learned at this workshop will serve as a collaborative initiative in Canada within the pension fund and institutional investment sectors to deepen our understanding of climate risk.

³³ Environmental Disclosures in Financial Statements, New Developments and Emerging Issues, UNEP, 2003.

³⁴ Ibid.

APPENDIX 1:

AGENDA FOR MARCH 11, 2004 WORKSHOP

- 9:00** **Introductory Remarks-** Eugene Ellmen, Executive Director, Social Investment Organization
- Meredith Miller, Assistant Treasurer, Policy, State of Connecticut Pension Fund**
Meredith Miller will provide an overview of climate change risk assessment at the State of Connecticut Pension Fund, and provide background on the recently formed Investor Network on Climate Risk.
- David Russell, Advisor, Responsible Investment, UK Universities Superannuation Scheme**
Steering Committee Member, Institutional Investors Group on Climate Change (IIGCC). David Russell will explain the approach taken on climate risk at USS and review the work of the IIGCC.
- Michael Jantzi, President, Michael Jantzi Research Associates**
Michael Jantzi will provide an overview of the climate change issue for publicly listed companies in Canada. MJRA is the leading provider of social investment research and services to financial institutions.
- 10:45** **Martin Grosskopf, Investment Analyst and Manger of Sustainability Research, Acuity Investment Management**
Martin Grosskopf will provide a look at portfolio analysis from a climate change point of view, including the risk factors and market opportunities that Acuity uses in its sustainability analysis.
- Francois Meloche, Analyst, Groupe Investissement Responsable**
Francois Meloche will review results of a recent GIR study ranking the environmental impacts of oil and gas companies in Canada.
- 1:30** **Dan Pigeon, Director, Investor Relations, TransAlta Corp.**
Dina Palozzi, Senior Vice-President, Bank of Montreal
Dan Pigeon and Dina Palozzi will explain how climate change will affect their business prospects in future years.
- 3:15** **Renee Arnold, Vice President of Aberdeen Asset Management,** will moderate this session, aimed at delivering practical advice and strategies on the assessment and management of climate change risk.

Martin Whittaker, Managing Director and Head of Climate Change Practice, Innovest Strategic Value Advisors

Martin Whittaker will review the activities of the Carbon Disclosure Project and explain how Canadian institutional investors can participate in this initiative.

Debra Sisti, Vice President, Fairvest Corp.

Debra Sisti will review Fairvest's methodology for reviewing shareholder proposals on climate change, and formulating voting recommendations on the issue.

Julie Desjardins, Program Director, Canadian Institute of Chartered Accountants

Julie Desjardins will speak about climate change disclosures in MD&A filings and emerging accounting standards on greenhouse gas emissions. She will also provide some guidance on using climate change disclosures in evaluating portfolio risk and opportunity.

APPENDIX 2

Participants

The following individuals participated in and supported the dialogue and discussion:

Jane Ambachtsheer

Mercer Investment Consulting

Keith Ambachtsheer

KPA Advisory Services Ltd.

Renee Arnold

Aberdeen Asset Management

Andrika Boshyk

Social Investment Organization

Ian Bragg

Michael Jantzi Research Associates

Isla Carmichael

University of Toronto

Julie Cays

Hospitals of Ontario Pension Plan

Peter Chapman

Shareholder Assoc. for Research & Education

Bill Davis

Kairos

Julie Desjardins

Consultant on behalf of Canadian Institute of Chartered Accountants

Eugene Ellmen

Social Investment Organization

Ivan Fraser
Metro Credit Union

Martin Grosskopf
Acuity Investment Management

Tessa Hebb
Oxford University

Anne Jackson
Philips, Hager & North

Philip Jessup
Toronto Atmospheric Fund

Joy Kennedy
Kairos

Francois Meloche
Groupe Investissement Responsable

Dina Palozzi
Bank of Montreal

Dan Pigeon
TransAlta Inc.

Don Raymond
CPP Investment Board

Jeanine Scarfone
Association of Treasurers of Religious Institutes

Larysa Sikorska-Baloi
Aon Consulting Inc.

Glorianne Stromberg
Independent

Martin Whittaker
Innovest Strategic Value Advisors

Tavia Grant
Media

Sayma Hai
York University

Joe Hornyak
Benefits and Pensions Monitor

Michael Jantzi
Michael Jantzi Research Associates Inc.

David Kennedy
Alcan Inc.

Carol Liu
York University

Meredith Miller
State of Connecticut

Morrie Paul
Environment Canada Climate Change Bureau

Vaughn Quinn
Oblate Fathers

David Russell
Universities Superannuation Scheme

Julie Scott
Independent

Debra Sisti
Fairvest Corp.

Walter Whiteley
York University Pension Fund

Alan Willis
Alan Willis & Associates

APPENDIX 3

S.H.A.R.E

Shareholders Association for Research and Education

Recommendations for Pension Fund Managers

Implementing Socially Responsible Investment Policies and Practices in Your Pension Plan

A: Investment Guidelines

1. Amend the governing documents of the pension plan to provide explicit direction to pension trustees to engage in socially responsible investment practices.
2. Develop a Statement of Investment Principles and Guidelines that include guidelines for socially responsible investment.

It is advisable to include the following points in drafting guidelines:

- Explicit authorization to consider non-financial criteria;
 - Appropriate diversification levels in accordance with any statutory or common law requirements; and
 - Discretion for trustee's to not apply socially responsible investment guidelines where it would result in harm to plan beneficiaries.
3. Develop and follow written procedures for developing investment policies and guidelines, selecting investments, advisors and agents, consulting with beneficiaries, and making other investment-related decisions.
 4. Establish procedures for the implementation and timely review of investment policies.
 5. Unless the pension plan's Statement of Investment Principles and Guidelines provides otherwise, ensure that all alternative investments are commensurate with rates of return of non-screened investments with similar risk characteristics.
 6. Ensure adequate diversification within the plan's investment portfolio.

B: Proxy Voting Guidelines

7. Develop proxy voting guidelines that clearly identify voting criteria, and provide voting instructions regarding social and environmental issues.

8. If the pension plan does not vote its proxies itself, obtain the services of a proxy voting service and ensure that the pension plan's Statement of Investment Principles and Guidelines and Proxy Voting Guidelines are applied in voting proxies.

C. Consultations with Beneficiaries

9. Provide disclosure of all holdings and proxy voting records to plan beneficiaries.

10. Establish processes for consulting with beneficiaries and allowing for input and feedback from members and beneficiaries. The mechanism should provide pension trustees with a way to determine the interests of plan beneficiaries (e.g. conducting a representative poll).

D. Expert Advice

11. Select qualified financial managers and expert legal and financial advisors that have an understanding and appreciation of socially responsible investment.

12. Always ensure that, where necessary, current independent and impartial expert advice is obtained prior to developing policies or making specific investment decisions.

13. Always make independent decisions regarding investment policies based on current legal and financial advice and in accordance with the plan's statement of investment principles and guidelines.

Fully document all information considered, processes followed, and decisions made with respect to plan investments.

APPENDIX 4: BEST PRACTICES FOR INVESTORS

So what can institutional investors do to better manage the risk and opportunities associated with climate change? The following ten actions identified by the Universities Superannuation Scheme in Climate Change-A Risk Management Challenge for Institutional Investors, develop a range of activities that address it. These are summarized here, along with broader governance and engagement activities, and at the strategic level, active and positive involvement in the development of responsible public policy on climate change.

Action point 1

Review the portfolio's direct property investments for climate change risks and identify measures to mitigate risk exposures. These could include cost effective energy conservation strategies and procedures for assessing new developments or acquisitions, which might include considering the life cycle investment case for innovative climate-friendly buildings.

Action point 2

Engage with investee companies, particularly on the need to report on their climate change exposures and the management's response. Establish procedures for: selecting companies to engage with; following up with companies; and handling weak performance.

Action point 3

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 risk exposures, corporate strategy (including involvement in public policy and political decision-making), and reporting.

Action point 4

Institutional investors should request that sell-side brokers comment on a company's relative exposures to climate related risks (environmental, product-related and policy-related) and the management's capabilities and positioning on climate change.

Action point 5

Examine the asset allocation of the fund to see if there is significant over-weighting towards stocks with high climate change risk exposures. Consider the scope for 'win-win' action such as specialized 'pro-climate' investment opportunities that meet investment objectives while also reducing climate change risk exposures.

Action point 6

Enhance their own management capabilities for dealing with climate change by undertaking a program of internal awareness- raising and learning on climate change.

Action point 7

Adopt a statement on climate change, possibly as part of any statement on socially responsible investment. This could cover some or all of the measures outlined here.

Action point 8

Institutional investors need to engage as a broad-based, long-term voice in the development of policies and measures that seek to mitigate climate change.

Action point 9

Institutional investors should work with policy-makers on how to make climate-friendly investments, such as low carbon technologies and infrastructure, acceptable to investors.

Action point 10

Institutional investors should seek to involve other investors and develop joint action on the point above. They should investigate the potential for a multi-investor initiative, with a mandate to address climate change policy. This will increase effectiveness while reducing costs.

APPENDIX 5

The United Nations Environment Program Finance Initiatives affirms that:

Financial institutions will therefore have a key role to play.

RECOMMENDATIONS FOR FINANCIAL INSTITUTIONS³⁵

- Help to structure and monitor an efficient market system by working with securities and exchange regulators, actuaries, accountants and others;
- Create other conditions crucial to the formation of an efficient emissions trading system (i.e. a standardized 'commodity'; standardized trade characteristics including monitoring, verification and certification requirements; organized exchanges; clear market prices; adequate supply);
- Provide products and services that contribute towards adaptation and mitigation efforts (such as trading, banking and insurance for carbon credits; project finance for 'low-carbon' energy (e.g. renewables); weather derivatives; catastrophe bonds; micro-finance);
- Manage their own property risks arising from extreme weather events;
- Pursue environmental management leadership in areas such as water consumption, recycling and energy efficiency within their own property portfolio (including tenants); and

Engage with stakeholders to work towards solutions on the climate change issue.

³⁵ From: *UNEP Finance Initiatives, CEO Briefing, A document of the UNEP FI Climate Change Working Group, 2002.*

APPENDIX 6

UNEP Recommendations to asset managers, pension funds and financial analysts

- Develop more robust, quantitative tools to assess the potential implications of climate change and GHG regulations on equity prices, corporate earnings and relative sector risk.
- Use these tools to conduct portfolio-wide assessments of risk exposures arising from equity and debt holdings and asset allocation decisions.
- Extend engagement with companies to include climate change-related issues and encourage them to improve disclosure of potential carbon assets and liabilities.
- Search for reasonable and prudent ways to participate in the market for clean technologies and low GHG-intensity products and services.
- Many companies and investors also recognize that positive and proactive measures to address global warming can also reap significant benefits to shareholders³⁶

³⁶ From: *UNEP Finance Initiatives, CEO Briefing, A document of the UNEP FI Climate Change Working Group, 2002.*

³⁷ Gil Yaron, *The Responsible Pension Trustee, S.H.A.R.E.*, 2002

APPENDIX 7:

SIGNATORIES TO THE CARBON DISCLOSURE PROJECT LETTER OF MAY 31 2003 INCLUDE:

Abbey National plc	Aberdeen Asset Managers
ABP	Acuity Investments*
AMP Henderson Global Investors	Asahi Life Asset Management Co., Ltd
ASN Bank	AXA
Bank Sarasin & Cie AG	BNP Paribas Asset Management
Calvert	Catholic Superannuation Fund (CSF)
Central Finance Board of the Methodist Church	CERES
Commerzbank	Connecticut Retirement Plans and Trust Fund
Co-operative Bank	Cooperative Insurance Society
Credit Agricole Asset Management	Credit Suisse Group
Deutsche Asset Management, UK	Development Bank of Japan
Dexia Asset Management	Domini Social Investments
Dresdner RCM Global Investors	Environment Agency Pension Fund, UK
Ethical Funds*	First Swedish National Pension Fund, AP1
Fleet	Fortis Investments
Gartmore Investment Management plc	Henderson Global Investors
Hermes Investment Management	HSBC Holdings
HVB Group	ING Investment Management Europe
Insight Investment	Interfaith Centre on Corporate Responsibility
ISIS Asset Management plc	Jupiter Asset Management
KBC Asset Management	Local Authority Pension Fund Forum
Lombard Odier Darier Hentsch et Cie	London Pension Fund Authority
Meritas Financial Inc*	Merrill Lynch Investment Managers
Mitsubishi Securities	Morley Fund Management
Munich Re	Neuberger Berman
Newton Investment Management Limited	Ontario Teachers Pension Plan*
Pax World Funds	PGGM
Public Sector Superannuation Scheme/ Commonwealth Superannuation Scheme	Rabobank Group
Real Assets Investment Management Inc.*	Railpen Investments
Rockefeller & Co Socially Responsive Group	Robeco
Sanlam Investment Management	SAM Sustainable Asset Management
Societe Generale Asset Management UK Ltd.	Sanpaulo Wealth Management
State Street Global Advisors Limited	Sogeposte
Storebrand Investments	State Treasurer of Vermont
Treasurer of the State of Maine	Swiss Re
Triodos Bank	Trillium Asset Management
UBS Global Asset Management (UK)	Tri-State Coalition for Responsible Investment
Universities Superannuation Scheme	Union Investment
Walden Asset Management	VicSuper Proprietary Limited
West AM	Wells Fargo & Co.

*Canadian signatories to the Carbon Disclosure Project as of May 2003.

APPENDIX 8:



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Corporate Profile

Established in 1989, the Social Investment Organization is a national non-profit organization dedicated to the advancement of socially responsible investment in Canada. It is funded primarily from membership dues and is accountable to its membership. The SIO has more than 400 members across Canada, representing the following:

- Socially- and environmentally-screened mutual funds and their staff
- Financial institutions providing socially responsible investment products or operating according to corporate social responsibility principles
- Investment advisors providing advice and assistance on socially responsible investment
- Investment managers managing socially responsible investment assets
- Institutions investing according to socially responsible investment guidelines
- Retail investors investing according to socially responsible investment guidelines
- Non-governmental organizations and other groups with an interest in responsible investment

Our members serve more than half a million depositors and investors in Canada.

The mandate of the SIO is to raise the public profile of socially responsible investment, to reach out to other groups interested in socially responsible investment, to provide information to our members and the public and to take a leadership role in coordinating the development of the socially responsible investment agenda in Canada.

Socially responsible investment is defined as the process of selecting or managing investments according to social or environmental criteria. We estimate there is more than \$51 billion in socially responsible investment assets in Canada.

Socially responsible investment includes three components:

1. Positive and negative screening. This is the application of social and environmental guidelines or “screens” to the investment process. Negative screens usually include issues such as tobacco and military production, companies operating with sweatshop or child labour, or the manufacture of alcohol or pornography. Examples of positive screens are companies making a contribution to social, economic or environmental sustainability or industries with exemplary employee practices.
2. Community Investment. This is the investment of money in community development or micro-enterprise initiatives that contribute to the growth and well-being of particular communities. The idea is to reverse the drain of capital and income that debilitate low-income communities.
3. Shareholder Advocacy. This is the process of using shareholder influence to help to bring about positive social and environmental change at corporations. This can include corporate engagement (communicating with management on particular issues), filing shareholder resolutions and using the threat of divestment to bring about positive change.

SIO members believe that socially responsible investment represents a catalyst for positive social change as well as a useful investment tool to enhance returns and reduce risk by incorporating social and environmental factors traditionally excluded from portfolio management.