Sustainable Investing and Canada

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Evolutions in Sustainable Investing

Cary Krosinsky, Nick Robins, Stephen Viederman Eds.

Dana Krechowicz and Alex Wood

SP Sustainable Prosperity

Canada's investment and business landscape, like its geography, is one of variety and of extremes. It is a country that prides itself on the beauty and richness of its land, with a progressive, environmentally conscious population. Statistics Canada valued its natural resource wealth at CA 3 trillion in 2011.[1] *And yet Canada has achieved no real progress toward reducing the carbon and resource intensity of its economy. Canadians seem to take their environmental riches for granted, and their sheer abundance may be a contributor to the country's lackluster productivity and innovation records.*

At the same time, the Canadian economy is one of the most diversified and stable in the world. Its economic institutions and management are considered paragons of strength in the global economy.

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[1] Statistics Canada, "Human Activity and the Environment: Economy and the environment," 2011. http://www.statcan.gc.ca/pub/16-201-x/2011000/aftertoc-aprestdm1-eng.htm.

The Basics

The Canadian investment scene is dominated by large national banks, credit unions, mutual funds, and private and public pension plans. Although Canada has 22 domestic banks, the banking sector is dominated by the big five national banks: Bank of Montreal, Canadian Imperial Bank of Commerce, Scotiabank, Royal Bank of Canada, and TD Bank. These five collectively account for almost 92% of Canada's banking sector assets.

The banking sector in Canada is highly regulated, which helps explain why Canadian banks fared better than their U.S. and other international counterparts during the global financial crisis. The big-five banks have integrated environmental, social, and governance (ESG) concerns into their core banking activities to varying degrees. Some have started to explore environmental products and services in their lending and commercial banking businesses, but there is little integration of sustainability into investment banking or research.

Canada also has a thriving credit union sector; about a third of the country's population are members of one of the country's 877 credit unions, which have a collective asset base of US $256 billion.[2] Major credit unions include Vancity (British Columbia)[3] and Desjardins Group (Quebec), the latter being among Canada's largest financial institutions with CA $172 billion in total assets.[4] The core values of credit unions have a strong alignment with sustainable investing, and as such some of Canada's foremost sustainable mutual fund companies (such as NEI Investments, profiled in more detail in Chapter 11) arose out of the credit union sector.

On the product side, Canadian retail investors have a relatively large selection of sustainability-themed funds to choose from at various major financial institutions; in Quebec alone, there are over 70 such funds.[5]

Employer-sponsored pension plans, with assets of approximately CA $1.1 trillion, represent 58% of Canada's total pension assets.[6] Canada's public pension funds, mainly the Canada Pension Plan and Quebec Pension Plan, have a smaller pool of capital (7.1% of total pension assets) but affect the lives of more Canadians.[7] Most of Canada's largest public pension plans have sustainable

[2] World Council of Credit Unions, "National Credit Union Data: Canada," 2010. http://www.woccu.org/memberserv/intlcusystem/icus_country?region=NA&c=CA.
[3] Credit Union Central of Canada, "Largest 100 Credit Unions (outside of Quebec): Second Quarter 2010. www.cucentral.ca/Top100_2010Q2.
[4] "Desjardins: The Largest Cooperative Financial Group in Canada," December 31, 2010. www.desjardins.com/en/accueil/groupe-financier-cooperatif/.
[5] "Dossier: Les fonds éthiques," Protégez-vous, February 2011. www.protegez-vous.ca/affaires-et-societe/fonds-ethiques.html.
[6] Statistics Canada, "Income, pensions, spending and wealth" 2010. http://www.statcan.gc.ca/pub/11-402-x/2010000/chap/pensions/pensions-eng.htm.
[7] Ibid.

investing policies and approaches in place, though they vary in terms of sophistication, depth, and implementation.

Venture capital investments in 2010 totaled just over CA $1 billion, with the majority concentrated in the information technology sector.[8] The "clean-tech" investment category is booming: It grew 47% during the recession of 2008–2009, and is projected to increase 117% between 2010 and 2012.[9]

Growth of Canada's Sustainable Investment Industry

Sustainable investment has grown substantially in Canada in recent years. As of June 30, 2010, CA $530.9 billion was invested according to socially responsible guidelines, representing almost 19.1% of total assets under management.[10] At the same time, Canada remains a small player internationally. As of late 2010, Canada had 34 (out of 833 global) signatories to the United Nations Principles for Responsible Investment, consisting of 10 asset owners, 16 investment managers, and 8 professional services partners. Of the 534 global signatories to the Carbon Disclosure Project (CDP), only 49 are Canadian.

Although Canadian investors may be slowly catching up with the global leaders in terms of integrating ESG criteria into their investment decision-making process, Canadian companies are generally lagging when it comes to corporate disclosure of ESG information. For example, less than half the Canadian companies surveyed responded to the 2010 CDP information request (92 out of 201).[11] Overall, the CDP ranked Canadian companies in the middle of the pack globally when it comes to disclosure of climate risks and found them to be particularly lagging in their adoption of emissions reduction plans and external verification of emissions.[12]

At the same time, Canadians have played a role in the development of the sustainable investment research field. Two pioneering companies in the domain, Innovest (now part of MSCI) and Jantzi-Sustainalytics, have Canadian roots, although competitive necessity and consolidation in the industry has taken these companies international.

[8] Canada's Venture Capital and Private Equity Association via Thomson Reuters, "Total VC Investment Activity by Sector (2010)," 2011. www.cvca.ca/files/Downloads/2009_VC_Investment_Activity_by_Sector.pdf.
[9] Russell Mitchell Group and Sustainable Development Technology Canada, "The 2010 SDTC Cleantech Growth and Go-to-Market Report," 2010. http://www.sdtc.ca/uploads/documents/en/CLEANTECH%20REPORT.pdf.
[10] Social Investment Organization, "Canadian Socially Responsible Investment Review 2010," 2011, p. 5. http://www.socialinvestment.ca/documents/CanadianSociallyResponsibleInvestmentReview2010_English_final.pdf.
[11] Carbon Disclosure Project, "Carbon Disclosure Project Report 2010: Canada 200," 2010, p. 10. https://www.cdproject.net/CDPResults/CDP-2010-Canada-Report-english.pdf.
[12] Ibid.

Context and Trends

Two factors define the Canadian economic landscape. The first is the rich endowment of natural resources that have defined the country's economic development throughout its 400-year history. The second important economic factor is proximity and access to the American marketplace.

Natural Resources

The sheer quantity of Canada's natural resources also means that they have been and will likely continue to be underpriced. The availability of cheap and plentiful energy, water, and natural resources has underwritten much of Canada's economic prosperity. Although Canada has evolved into a large and complex modern economy, the infamous description of Canadians as "hewers of wood and drawers of water" still has some salience. This has a direct impact on Canadian capital markets, whose default business is still the natural resource sector. In fact, the Toronto Stock Exchange is the third most carbon-intensive exchange in the world (the first two being from emerging economies), at least in part due to the oil and gas sector.[13]

Little wonder that the biggest Canadian business story of 2010 was the attempted takeover of Saskatchewan's Potash Inc. (a miner of the eponymous substance so critical to global fertilizer demand) by Australia's BHP Mining, which was vetoed by the federal government. The centrality of the natural resource sector to Canada's economic self-definition is further underlined by statements made by the Canadian prime minister during visits to Asia, declaring that Canada could be counted on to deliver the raw materials necessary to Asia's economic growth. This story continues into 2012, with the ongoing consultations and controversy about the Northern Gateway pipeline, which would link Canadian crude oil exports to Asian markets, though it carries considerable environmental risks. Canada is a net energy exporter, with huge reserves of natural gas and (mostly unconventional) oil. Whether these natural resources are developed in a responsible manner is a key concern for investors, as much of Canada's untapped resources are located in northern, underpopulated areas, giving rise to social concerns with regards to local Native populations and their rights.

[13] Trucost and Mercer, "Carbon Counts: Assessing the Carbon Exposure of Canadian Institution Investment Portfolios," September 2010. http://assets.wwf.ca/downloads/wwf_canada_report_final.pdf.

Proximity and Access to the U.S.

Hitching its economic wagon to the largest and most dynamic economy in the world—even if by the accident of geography—has been a winning proposition for Canada. The Free Trade Agreement negotiated with the United States in the early 1990s (and extended to include Mexico) concretized that dependency and has yielded some real benefits for Canada. According to the Organization for Economic Cooperation and Development, Canada has enjoyed the highest and most stable rate of growth of any of the Group of Eight (G8) economies over the past 20 years (recession included).

More generally, the dependency on the trade relationship with the United States reflects a larger truth: Canada's domestic market is small and fragmented. As a result, of all the G8 countries, Canada is the most dependent on foreign trade and foreign markets for its prosperity, now and in the future. As demand in those foreign markets starts to shift toward lower carbon- and resource-intensive products, Canadian companies will have to respond. That, more than domestic demand, may end up being the most important driver of change in the national market in the long term.

Summary

For sustainable investors, the Canadian economy presents certain challenges and opportunities, mainly around the key themes of natural resources, energy, and emerging environmental risks.

Canada has warmed more than the global average so far (with the largest increases in the North). Given its varied geography and Arctic region, the country will face major, but uneven, climate change impacts—impacts the government currently is not prepared to manage. Given the country's economic dependence on natural resources, any increased unpredictability in their availability (e.g., changes to agricultural growing seasons) will greatly impact those sectors.

Moreover, Canada currently is not well positioned for a low-carbon future. Its economic dependence on carbon-intensive fossil fuels (i.e., the oil sands), lack of national policy framework or meaningful action to reduce emissions, and lack of innovation and research and development all provide large challenges for competing in the global low-carbon economy.

Canadians are awakening to the need to be better stewards of the country's natural resources. Water is heavily embedded in the Canadian economy in sectors from forestry to energy, though water's historic abundance has given rise to waste and mismanagement. Some regions of Canada, such as the prairies, are subject to water scarcity, which has implications for the agricultural sector, and water quality is a concern in urban areas across the country.

On the opportunity side, several Canadian provinces have introduced policies encouraging the development of local renewable energy sectors. For example, the local content rules of Ontario's Feed-In-Tariff have already spurred millions in local investments.

The Canadian economy and lifestyle are very energy, carbon, and resource intensive. As many have noted, the Canadian economy will need to become much more resource efficient to remain competitive. That represents a daunting challenge for Canadian business but presents enormous opportunities for companies and their investors to play a role in transforming the economy.