TORYS LLP

Climate disclosure on the rise

2024 Climate Disclosure Report

Introduction

Last year, 97 of the world's 100 largest public companies made disclosures regarding climate change impacts on their business or indicated that they planned to do so.[1] Nearly 99% of S&P 500 companies, representing approximately 80% of U.S. large cap public companies, are currently publishing sustainability reports.[2] Tens of thousands more companies globally are making environmental or climate-related disclosures, including to benchmark progress, uncover opportunities and risks, better position themselves in the market, or comply with (or get ahead of) regulation.[3]

Similar trends are taking place in Canada, with many companies filing sustainability, environmental, social and governance (ESG) or climate action reports. The disclosure is being driven by many factors: pressure from institutional investors and other stakeholders for decision-useful information about companies' carbon footprints and climate transition plans; alignment with international reporting frameworks and the disclosure practices of peers; and, in some cases, compliance with European reporting rules that have leapt ahead of North America.

At the same time, companies must carefully navigate a rising wave of anti-ESG sentiment, including anti-ESG laws spreading across the United States, and manage potential liability for "greenwashing". In Canada, amendments to the *Competition Act* aimed at addressing greenwashing led to widespread confusion across the country, calls for regulatory clarity and, in some cases, the removal of public sustainability disclosures. Some warn that continuing political pressure and concerns regarding potential liability will either create a chilling effect, where companies reasonably determine that the risks of disclosure outweigh its benefits, or contribute to "greenhushing", where companies underreport their environmental efforts.

Amidst all the noise and after several years of regulatory limbo, Canadian climate reporting rules are in sight. Starting in 2025, Canadian banks, insurers and other federally-regulated financial institutions will be required to publicly report on climate-related matters.[4] The Canadian Sustainability Standards Board (CSSB) plans to publish its final standards in December 2024, a key benchmark based on the International Sustainability Standards Board (ISSB) standards and expected to guide mandatory Canadian climate reporting rules. Once the CSSB standards are finalized, the Canadian Securities Administrators (CSA) are expected to release revised climate-related disclosure rules that will apply to public companies.

For the private sector, the Canadian federal government recently announced its intention to amend the *Canada Business Corporations Act* to require climate reporting by "large" (yet to be defined) federally incorporated private corporations, with reporting requirements to be harmonized with securities laws. At the same time, Canada announced it will be moving forward with the development of a sustainable investment taxonomy for green and transition labelled economic activities—an important first step in building standardized terminology and, ultimately, the market's confidence in sustainability disclosures. All of these developments point to a general consensus among regulators and lawmakers on the adoption of climate reporting rules in Canada, although the 2025 federal election may impact this outcome.

Against this backdrop, climate policy in the United States is expected to take a sharp turn under the Trump administration, with potential knock-on impacts in Canada. Given the President-elect has succeeded on a platform to significantly slash regulation, combined with speculation that the U.S. may once again withdraw from the Paris Agreement, climate disclosure rules proposed by the Securities Exchange Commission—which were already stayed pending a number of court challenges—are not expected to survive. A number of U.S. states, however, continue to drive ahead with the development and enforcement of climate reporting rules, and many U.S. institutional investors continue to incorporate sustainability metrics into investment decisions.

Given the interconnectedness of the Canadian and U.S. markets, Canada will undoubtedly be monitoring developments in the United States. However, it appears that Canada, consistent with other significant markets around the globe, is moving in the direction of mandatory reporting.

In the context of ever-evolving trends and developments in Canada and worldwide, we decided it was an opportune time to survey the climate disclosure practices of 220 of Canada's largest public companies. We hope the results of our report are informative as companies and other market participants continue to advance their sustainability strategies and anticipate what comes next.

December 2024

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Report highlights

To provide a snapshot of current disclosure practices in Canada, we surveyed the disclosures of 220 companies included on the S&P/TSX Composite Index[5] as of May 31, 2024, representing approximately 70% of total market capitalization of the TSX. For more details regarding the surveyed companies and our approach, see "Scope and methodology".

The results were revealing—here are some key takeaways:

- 45% of companies have publicly set a target to achieve net-zero greenhouse gas (GHG) emissions, with the substantial majority (74%) targeting net-zero by 2050
- 95% of companies are publishing a sustainability, ESG, climate action/transition or similar report
  - 69% of those state they are reporting in accordance with the Taskforce on Climate-related Financial Disclosures (TCFD), the international framework on which Canadian rules are expected to be based
- 78% of companies identify climate, environmental, ESG or sustainability skills in their board skills matrix
- 88% of companies are disclosing Scope 1 and 2 GHG emissions, with over 50% of those disclosing at least some Scope 3 GHG emissions, although approaches to Scope 3 GHG emissions reporting vary considerably
- 59% of companies indicate that executive compensation is linked to climate-related goals or metrics

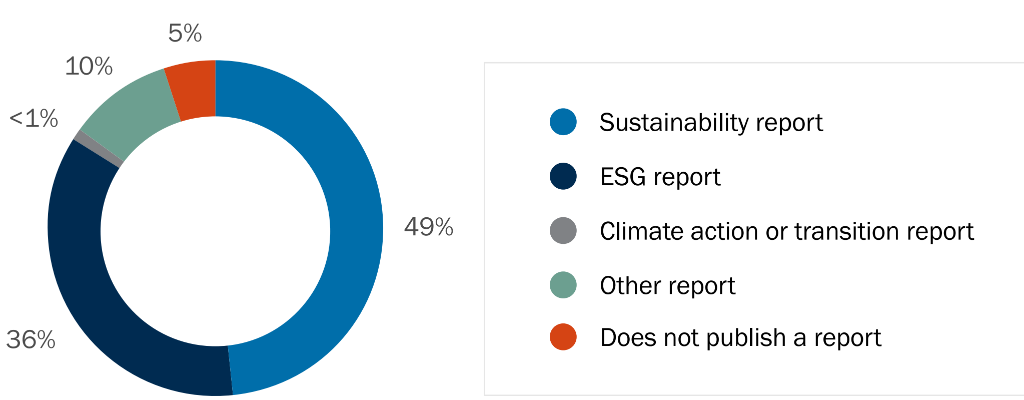
This rise in climate disclosure practices comes at a time of economic turbulence, climate policy shifts and political uncertainty. In the absence of clear, broadly applicable disclosure rules, market practice remains mixed and forward-looking trends are uncertain. Only time will tell whether the advent of Canadian climate disclosure rules will lead to standardized reporting and increased transparency, or if countervailing political pressures or concerns about greenwashing liability will continue to muddy the waters.

General disclosure practices

Almost a decade has passed since the Financial Stability Board established the TCFD. Just two years later, the TCFD released what is now known as the leading framework for climate-related financial disclosure along with its first recommendations. In recent years, advancements have been made to memorialize and build upon the TCFD's work, including the publication of the International Financial Reporting Standard on Climate-related Disclosures (IFRS S2) by the ISSB and the draft Canadian Sustainability Disclosure Standard on Climate-related Disclosures (CSDS 2) by the CSSB, which is expected to be finalized by the end of the year. Although the TCFD disbanded in October 2023, having fulfilled its remit, its recommendations remain influential. The four pillars of the TCFD framework—governance, strategy, risk management, and metrics and targets—have become so ubiquitous that we have relied on them to structure our findings in this report.

95% of surveyed companies prepare an annual sustainability or similar report, with most now using the term "sustainability" to describe it rather than "ESG"

Terminology used to describe reports



Does the company disclose that it is reporting in accordance with the TCFD?

69%	31%
Yes	No

Does the company disclose that it is reporting in accordance with IFRS S2?

4%	96%
Yes	No

69% of surveyed companies disclose reporting in accordance with the TCFD, while only 4% disclose reporting in accordance with IFRS S2. Our study did not reveal any meaningful differentiation in this data by sector or market capitalization.

In addition, it appears that a minority of companies are currently using a "double materiality" standard for reporting purposes. Under Canadian securities laws, materiality assessments typically focus on whether information may be market-moving or important to a reasonable investor when trading in the securities of a company. The concept of double materiality, originating from sustainability reporting rules in Europe, requires a company to assess both how sustainability-related risks and opportunities may impact the company's financial performance, as well as how a company's actions impact people and the environment.

Antitrust and competition legislation muddy the waters

Antitrust and competition legislation are quickly becoming another layer of complexity that companies must navigate when considering sustainability-related practices and disclosures.

In the U.S., antitrust legislation has recently been used to challenge ESG-related investment policies and practices of asset managers. In June 2024, House Judiciary Committee Republicans released a report accusing environmental activists and major financial institutions, among others, and including asset managers BlackRock, State Street and Vanguard, of being part of a “climate cartel” and colluding to impose radical ESG goals on American companies. The report alleges that this climate cartel “forces companies to disclose their carbon emissions, reduce their carbon emissions, and enforce their disclosure and reduction commitments by handcuffing and restricting company management”.

The House Judiciary Committee also sent letters to 130 participants in Climate Action 100+ (a global initiative aimed at urging companies to increase their ambition in climate action and greenhouse gas emissions reduction), accusing them of colluding with climate activists to adopt left-wing ESG goals. While a number of major asset managers, including Invesco, JP Morgan, Goldman Sachs, Pimco and State Street, have withdrawn from Climate Action 100+, numerous other significant U.S. investors remain on the Climate Action 100+ list.

In Canada, anti-greenwashing amendments were made to the *Competition Act* in June 2024 regarding certain unsupported representations to the public about the environmental or climate-related benefits of a company’s products or business. The amendments to the Act require that such product representations be supported by adequate and proper testing, and that such business or business activity representations be substantiated in accordance with an internationally recognized methodology. The amendments also place a reverse onus on the company making the representation to demonstrate compliance.

The amendments received criticism across the country given the ambiguity of the new provisions, which were brought into force without any significant public consultation or guidance from the Competition Bureau, and which have proven to be impractical or impossible to comply with in many circumstances. In late September 2024, several months after the amendments came into force, the Competition Bureau concluded a public consultation on the new provisions and is now working on interpretive guidance. In the meantime, the ambiguity of the amendments has had an unintended chilling effect on voluntary environmental and climate-related disclosures, leading some businesses to determine that it is preferable to cease making voluntary disclosures that could constitute environmental representations rather than risk sanction.

A rise of anti-ESG sentiment in the United States

Anti-ESG sentiment and political pressure continue to spread across the U.S., with 198 anti-ESG bills introduced and 23 enacted in 2023.[6] That trend continued through mid-June 2024, with 95 anti-ESG bills introduced and 4 enacted.[7] Certain states have passed laws prohibiting fund managers from considering ESG factors in their investments and restricting state entities from investing with asset managers deemed to be discriminating against, or boycotting, the fossil fuel industry. Shareholder proposals from anti-ESG groups are also putting pressure on the governance and sustainability policies of U.S. companies, with over 100 proposals from anti-ESG proponents submitted through the first half of 2024—representing 17% of all sustainability-related proposals made in 2024—and approximately 80% of those proposals having gone to a vote.[8] Notwithstanding the rise of anti-ESG shareholder proposals in the U.S., shareholder support levels remain quite low, averaging only 2.4% in 2023 and less than 2% in 2024.

This increasing politicization has resulted in a shift away from the use of the term “ESG”, with Larry Fink, Chairman and CEO of BlackRock, noting that the term has been “weaponized”. Our study found that 49% of companies in the S&P/TSX Composite Index now use the term “sustainability” to describe their disclosure in this space, with only 36% using the term “ESG”. This shift in terminology, however, does not appear to have lessened the scrutiny of companies’ climate reporting and strategy setting.

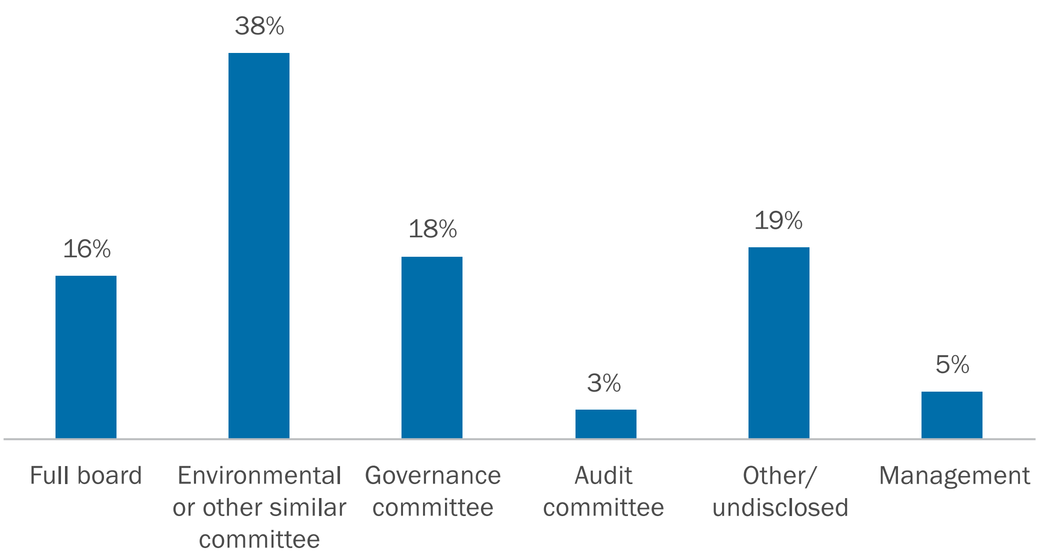
In Canada, while anti-ESG sentiment has not, to date, taken hold in the same manner as in the U.S., Canadian public companies are not immune to its effects. While few in number and each receiving less than 1.5% of shareholder support, 2024 saw a greater number of anti-ESG shareholder proposals in Canada. Five of the largest financial institutions each received a proposal to quantify (1) the impacts of divestment from the Canadian oil and gas sector on shareholder value and (2) the effect of continuing on the path toward net-zero objectives, and others received proposals to end net-zero pledges altogether. Canadian companies doing business in the U.S. have also been caught in the crosshairs of anti-ESG movements, particularly in light of state laws designed to pressure companies to avoid any action that might be characterized as boycotting local fossil fuel industries.

Some observe that the absence of mandatory climate reporting rules, coupled with potential liability under competition/antitrust legislation for unsubstantiated environmental claims and increasingly negative public scrutiny from anti-ESG proponents, are likely to lead to an increase in “greenhushing”, where companies deliberately underreport their environmental efforts. For example, in its 2024 global climate analysis, South Pole, a climate consultancy and carbon offset developer, observed that 58% of the 1,400 companies surveyed across 14 countries and 12 sectors said communicating their climate actions was now more difficult, and that they planned to decrease their level of external communications.

Governance

Disclosure regarding an organization's governance and oversight of climate-related risks and opportunities is a central aspect of the TCFD framework. While general oversight responsibility rests with the board, companies take varied approaches when assessing and managing climate- and sustainability-related matters.

Where does primary oversight of climate-related risks and opportunities reside?[9]



> Nearly 65% of surveyed companies indicated that primary oversight of climate-related matters is delegated to either a Board committee, most commonly an environmental committee, or to management.

Expertise and knowledge in climate and sustainability is becoming an in-demand skill for directors, and is sometimes linked to executive compensation.

Expertise on boards

78% of surveyed companies identified climate, environmental, ESG or sustainability as a key skill in their board skills matrix[10]

69% of that group disclose that the majority of their directors possess such a skill

Does the company link executive compensation to climate-related goals or metrics?[11]

59%	41%
Yes	No

Executive compensation. 59% of surveyed companies indicate they link executive compensation to climate-related goals or metrics and 38% of that group disclose quantitative performance indicators connected to those goals or metrics as factors determining executive compensation.

A role for shareholders in climate-related governance?

Recent years have seen a rise in shareholder action aimed at changing corporate climate policy by influencing, or even attempting to take away, board discretion in establishing and monitoring those policies.

In both Canada and the U.S., environmental-related shareholder proposals continue to be on the rise, representing a significant portion of total shareholder proposals received. According to Sodali & Co's 2024 Canadian Proxy Season Review report, of the 156 proposals submitted by shareholders to Canadian companies in the 2024 proxy season, 74 were ESG-related (47%) with 27 being environmental specific (17%). The most prevalent environmental-related proposal was to request that companies conduct an annual say-on-climate vote, represented by 12 shareholder proposals. Currently, say-on-climate votes remain extremely rare in Canada; our study found that only two surveyed companies are currently conducting annual votes. In the U.S., according to Georgeson's 2024 AGM Season report, among the Russell 3000 companies, 998 ESG-related shareholder proposals were disclosed during the 2024 proxy season, with 170 of those being environmentally-focused. Notwithstanding their prevalence, however, shareholder support for such proposals remains low, with only one of the 2024 environmental-related proposals receiving majority support in the U.S. and none in Canada.

Two recent court cases in the United States and United Kingdom further illustrate the tension between board authority and shareholder dissatisfaction with climate-related policy.

ClientEarth v the directors of Shell plc

A proposed derivative action in the United Kingdom aimed at changing a corporation's climate transition plans raised questions about the effectiveness and the aptness of shareholder litigation as a mechanism to change corporate climate policy.

ClientEarth, an environmental activist with a nominal shareholding in Shell plc, initiated a derivative action in the United Kingdom against the directors of Shell, alleging that the directors breached their duties by failing to pursue more aggressive climate transition plans, a corporate risk that the board of Shell is responsible for managing. The litigation goal was not the recovery of damages already caused to Shell by the board's management of climate change risk, or the prevention of harm visible on the horizon, but rather forcing the board to adopt what ClientEarth believed were better climate transition plans.

ClientEarth's application for permission to pursue the proposed derivative claim was ultimately dismissed by the UK court because it failed to make a prima facie case. At its core, the reasons of the UK court expose a fundamental problem with the theory of the case and the roles for directors and shareholders posited by ClientEarth for corporate decision-making. The court held that under applicable corporate law norms, it is the responsibility of the board, not shareholders, to set corporate policy and its approach to managing climate-change related risk, a responsibility the board carries out in accordance with the directors' duties and the obligation to consider different stakeholder interests and act in the best interests of shareholders as a whole. Litigation by a shareholder is not an apt tool for questioning and forcing a change to that decision-making exercise.

Claims like the ClientEarth claim have not yet been pursued in Canada, and with corporate law norms similar to the UK's, it is hard to foresee that a derivative action in Canada, absent real harm or the risk of such harm to private corporate interests, would be an effective way for shareholders to move directors to adopt a more public-oriented approach to climate change.

ExxonMobil Corporation v. activist shareholders

In the U.S., the 2024 litigation commenced by ExxonMobil Corporation against two activists about the scope of shareholder proposals highlights important questions: (i) who, as between shareholders and the board, sets climate change strategy; and (ii) given the purpose of corporations, are there limits on the kinds of strategy a shareholder can validly propose?

Arjuna Capital (a U.S. investment adviser, acting on behalf of two clients) and Follow This (a Netherlands-based organization) submitted a climate-related shareholder proposal for Exxon's 2024 annual shareholder meeting that effectively would have required Exxon to accelerate its climate transition activities. Exxon opposed the inclusion of the proposal in its meeting disclosure, principally on "ordinary business operations" grounds—under Securities and Exchange Commission Rule 14a-8, a shareholder proposal needn't be included in a company's meeting disclosure if, among other things, "the proposal deals with a matter relating to the company's ordinary business operations". Typically, objections to the inclusion of shareholder proposals are dealt with by applying to the SEC for a "no action" letter. However, in this case Exxon instead sought a court declaration that it was not required to include the proposal in its meeting disclosure.

In the face of the litigation, the shareholders withdrew their proposal. However, Exxon persisted in its litigation, leading to two hearings and the eventual dismissal of the complaint in two orders: (i) the court found it lacked jurisdiction over Follow This; and (ii) after Arjuna undertook not to re-submit similar proposals in the future, the court found that the case against it was moot.

Exxon's strategy for dealing with the activists attracted support and criticism, with a focus on the proper role and subject matter of shareholder proposals in corporate decision-making. Exxon's argument was that the proposal offended corporate law norms in two respects. First, it reflected a view of the purpose of the corporation inconsistent with the principle that the corporation operates to create value for shareholders. Second, the proposal assumed for shareholders the role of decision-maker with respect to climate change policy. Because of the dismissal of the action, these arguments have not been tested but they reflect a position that shareholder proposals should have a circumscribed role in the corporate governance of climate change.

In Canada, the validity of shareholder proposals and the decision to include or exclude them is a matter of corporate law. In view of the model of corporate law in Canada following the BCE decision, and the duty of directors to act in the best interests of the corporation considering all stakeholders (not solely based on maximizing shareholder value), it is difficult to see a corporation being successful in excluding a shareholder proposal of the kind at issue in the Exxon proceedings.

Increasing focus on "E" for ESG metrics in compensation programs

For a number of years, companies have focused on how to appropriately incorporate ESG metrics into their compensation programs. These initiatives attempt to motivate the executive team to pursue, and create greater accountability for advancing, the overall ESG strategy of the organization.

While historically ESG targets in incentive programs were predominantly focused on social and governance matters, boards are now facing increased scrutiny from investors and governance bodies on prioritizing climate matters. As a result, climate-related goals and metrics are being included in executive compensation arrangements—our study found that 59% of surveyed companies currently do so.

Companies need to consider which environmental strategies are appropriate to include in incentive plans, whether the goals will be included in short-term plans or long-term plans and to what extent the targets are qualitative versus quantitative. In selecting these goals, companies will need to be comfortable disclosing the metrics, explaining their success in achieving the metrics and choosing metrics that are challenging yet capable of being met.

Companies should also be mindful of how the selected climate metrics complement the creation of shareholder value. To ensure climate goals are not being pursued to the detriment of the company's other financial and strategic priorities, companies may wish to include climate goals as one factor within a broader group of financial, operational and strategic priorities, or as a modifier for incentive payouts.

Of the companies surveyed that currently link executive compensation to climate-related goals, our study found that 38% now include some form of quantitative metrics. Carbon footprint, emissions and waste reduction are some of the areas in which quantitative metrics are being incorporated.

As companies develop more sophisticated climate change management systems and public reporting, we anticipate seeing more nuanced climate change targets in executive compensation programs over time.

Strategy

The TCFD and ISSB recommend that companies disclose, where material, certain information about their strategy for managing climate-related risks and opportunities. Companies are also advised to describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios—including a 2°C or lower scenario.

Does the company use the word "sustainability", "resilience" or a similar term when it describes its mission or purpose?

40%
Yes

60%
No

Does the company disclose information about its *strategy* to use emissions credits to meet its emissions reduction commitments?[12]

32%
Yes

68%
No

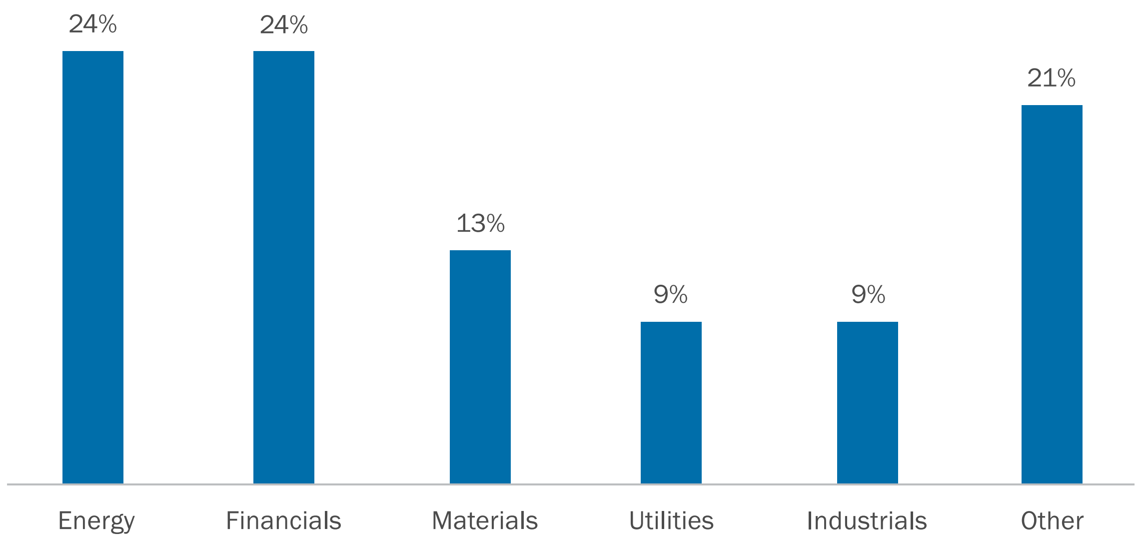
Strategy and use of emissions credits. Our study found that 32% of surveyed companies disclose information about their strategy to use emissions credits to achieve their emissions reduction commitments. Even fewer—25%—disclose that they use emissions credits to meet those commitments.

Does the company disclose that it *uses* emissions credits or offsets to support its emissions reduction commitments (including any net zero or interim emissions reduction targets)?

25% Yes

75% No

Sector breakdown: Companies who disclose they *use* emissions credits to support emissions reduction commitments



Developments in voluntary and compliance carbon markets. Public companies disclosing GHG emissions reduction targets are increasingly disclosing whether they intend to purchase carbon credits as part of their emissions reduction strategy. Some businesses are subject to mandatory carbon reduction schemes, which allow them to purchase carbon credits to meet their compliance obligation. Additionally, there is a growing voluntary market for carbon credits in which corporate buyers can buy carbon credits to help offset their Scope 1, 2 and 3 emissions.

Canada's sustainability taxonomy

Many financial market participants in Canada—including banks, insurers, pension funds, asset managers and investors—have expressed the need for clarity around what economic activities can be characterized as sustainable and aligned with the transition to net zero.

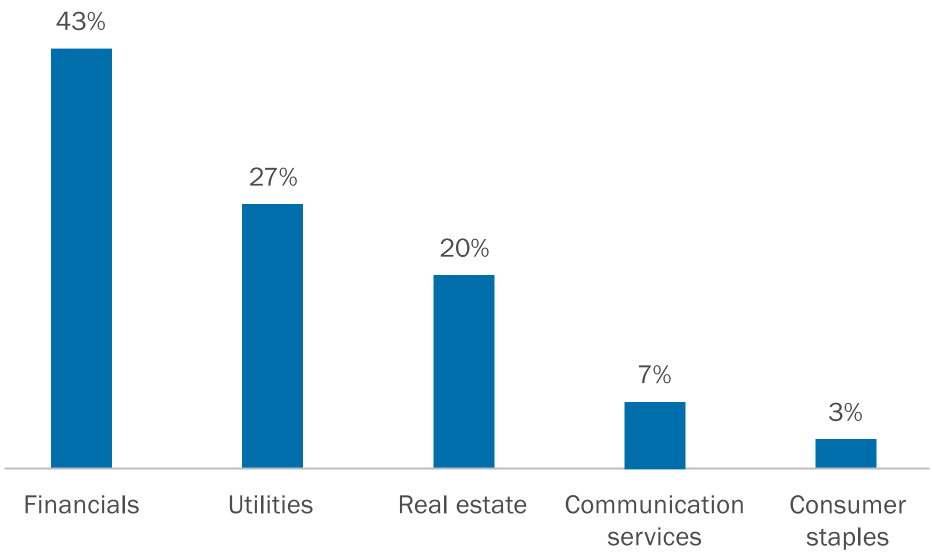
Our study found that 14% of surveyed companies disclosed that they issue green, social or sustainability bonds. Yet to date, Canada has not adopted a sustainable finance taxonomy. In contrast, over 40 jurisdictions worldwide are developing or have implemented taxonomies for sustainable investment, which generally are calibrated to a particular country's domestic economy and priorities.

The Government of Canada-appointed Sustainable Finance Action Council (SFAC) delivered its *Taxonomy Roadmap Report* in 2022, which supports the development of a Canadian taxonomy and makes detailed recommendations regarding governance, design and implementation, including advice regarding climate disclosure as an eligibility requirement.

The Government of Canada is now establishing an external expert organization to develop made-in-Canada sustainable investment guidelines, which will initially focus on certain priority sectors and may include company-level requirements that include climate disclosure. The first set of guidelines is expected to be released within 12 months of the external expert organization beginning its work.

Some market participants have expressed concerns that the delay in the adoption of the SFAC's recommendations is a threat to Canada's competitiveness in the race for climate-focused capital, with other jurisdictions moving to implement green taxonomies more efficiently and, in some cases, based on the preliminary work of the SFAC. For example, the Australian government announced the approval and funding of its sustainable finance taxonomy in 2023 with reference to the roadmap prepared by the SFAC.

Sector breakdown: Green/social/sustainability bond issuance[13]



Green/social/sustainability bonds. 14% of surveyed companies disclose having issued green/social/sustainability bonds. Our study found that the issuance of such bonds is concentrated in the financials, utilities and real estate sectors. Those three sectors accounted for 90% of the companies disclosing the issuance of such bonds despite those sectors comprising only 27% of the overall index.

Canada’s role in developing nuclear and other low-carbon energy sources

Canada’s commitment to achieve net-zero emissions by 2050, codified in the *Canadian Net-Zero Emissions Accountability Act*, requires a whole-of-economy approach. To help incentivize the move to decarbonize, the government has set in motion a series of energy transition strategies, including $60 billion in investments to cut pollution, support clean technology innovation and grow the economy.[14]

Most recently, the Government of Canada released several measures in succession to help meet Canada’s rapidly approaching 2030 benchmark to reach 40-45% emissions reductions below 2005 levels. Notably among these measures, the 2024 federal budget included a suite of clean energy and clean technology investment tax credits to attract private capital and investors to help build the next generation of clean energy projects.

Of particular importance to Canada’s clean energy future is having reliable, clean and affordable electricity that will keep pace with the energy demand that is forecasted to rise substantially. The makeup of Canada’s energy supply mix may change significantly in response to both increased demand and the government’s directive to move towards low emissions sources, leading to more efficient ways of using fossil fuels or introducing entirely new options, such as advanced biofuels.

Nuclear energy, particularly, poses significant opportunities for energy generation. Currently, four nuclear-generating stations in Canada provide about 15% of the country’s total electricity generation[15], and Ontario recently announced its vision to use nuclear facilities, both new and refurbished, to meet its growing energy needs in the “largest expansion of nuclear energy on the continent”.[16]

As one of the largest producers of uranium, Canada’s nuclear energy industry remains firmly in the mix of energy supply options in a low-carbon economy. In addition to the previously discussed investment tax credits, provincial and federal governments are mobilizing nuclear energy development for traditional nuclear facilities as well as newer small modular reactors (SMRs) that have the potential to deliver a cost-effective, non-carbon-emitting energy source. Further, SMRs can help emissions-intensive industries—for example, SMRs could play a pivotal role in the mining industry by reducing electricity costs, providing reliable power to assist with energy-demanding activities like on-site milling and producing hydrogen fuel for mining vehicles.[17]

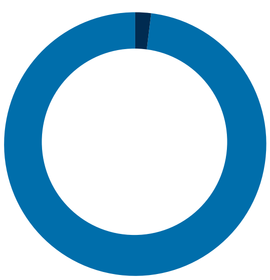
Other industries may also benefit from SMRs’ lower emissions, including oilsands operators and industry associations who are looking into whether oilsands’ high-emission steam generators could potentially be replaced with the heat from SMRs.[18] Additionally, data centre operators are looking to SMRs to help meet their energy needs and net-zero commitments, with several tech giants, including Google, having recently announced deals to purchase energy from SMRs.

Risk management

Identifying, monitoring and developing mitigation strategies to address climate-related risks are becoming central components in corporate climate change strategies. While identifying and describing material risks of any kind is a familiar exercise for many companies, quantifying the impact of those risks on financial performance is a much more complex exercise. Nevertheless, international rules and standards, including IFRS S2, require companies to provide quantitative information to help investors understand the magnitude and potential impact of climate-related risks.

Does the company disclose the impacts of climate change on its historical or future financial performance?

Historical



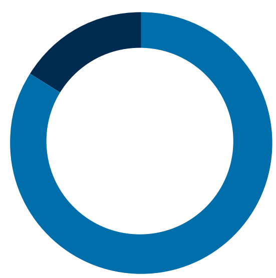
98%

No

2%

Yes

Future



84%

No

16%

Yes

> IFRS S2 recommends that companies disclose quantitative information about how climate-related risks and opportunities have affected financial performance for the reporting period and are expected to impact future financial performance. If made mandatory, it appears that most companies would not currently meet this requirement, as only 16% of surveyed companies currently disclose the potential impact of climate change on future financial performance and even fewer disclose the impacts of climate change on current or historical financial performance—in each case with a varied approach to quantifying that impact.

Does the company disclose that it is undertaking climate scenario analysis?[19]

While 53% of surveyed companies disclose that they undertake climate scenario analysis, only 50% of those currently disclose that they are currently using standardized scenarios published by a governmental agency.

The use of scenario analysis

Scenario analysis is an approach that can be used to consider, analyze and communicate the hypothetical risks and opportunities of one or more climate change scenarios. Although it is not yet mandatory, our study found that 53% of surveyed companies are currently disclosing that they undertake some form of scenario analysis.

Companies can choose to adopt climate-related scenarios developed by external organizations to analyze business implications or develop their own internal scenarios uniquely tailored to certain sectors, locations or operations. For example, many climate-related scenarios compare the implications of a future where government policies remain status quo to a future where governments follow through on climate commitments, whereas other climate-related scenarios consider the implications of various degrees of global warming at a future date. Importantly, scenarios are not intended to predict the future but instead enhance strategic thinking about the implications of one or more paths to one or more possible outcomes.

Certain climate-related standards are beginning to recommend or require adopters to incorporate climate scenario analysis into their climate-related disclosures. For example, the TCFD recommends that disclosure of climate-related business strategies “take into consideration different climate-related scenarios, including a 2°C or lower scenario and, where relevant to the organization, scenarios consistent with increased physical climate-related risks”. Both the ISSB and CSSB also recommend the use of scenario analysis.

In recent years, certain Canadian regulators have developed their own climate scenarios for voluntary use in particular sectors:

- **Financial sector**. In 2022, the Office of the Superintendent of Financial Institutions (OSFI) and the Bank of Canada, in collaboration with six Canadian federally regulated financial institutions, completed a climate scenario analysis pilot that considered four climate scenarios: (1) a baseline based on 2019 policies, (2) an immediate action scenario to limit average global warming to below 2°C, (3) a delayed action scenario to limit average global warming to below 2°C, and (4) a more ambitious action scenario to limit average global warming to below 1.5°C that includes net-zero commitments by some countries. In its Guideline B-15, OSFI has also indicated that federally regulated financial institutions will be required to complete standard climate scenario exercises and report their results to OSFI on a periodic basis.

- **Energy sector**. In 2023, the Canada Energy Regulator published scenarios to provide projections for all energy commodities across Canada, considering how varying levels of future climate action might affect Canada’s energy future. Three scenarios were developed: (1) a current measures scenario assuming limited future action in Canada and globally, (2) a scenario where Canada and many countries achieve their net-zero targets but action is insufficient to limit warming to 1.5°C, and (3) a more ambitious scenario where the world reduces emissions enough to limit global warming to 1.5°C.

Pension plan oversight of ESG

Pension plan regulators in Canada have recently been turning their attention to risk associated with climate change and other elements of ESG.

On September 9, 2024, the Canadian Association of Pension Supervisory Authorities (CAPSA) released its Guideline Number 10, *Guideline for Risk Management for Plan Administrators*, containing a section dedicated to managing ESG risks.

The CAPSA Guideline notes that it is consistent with fiduciary duties for a plan administrator to consider ESG factors when assessing investment risk and return, and not taking ESG into account when making investment decisions may be a breach of fiduciary duty.

Other pension regulators across Canada, including OSFI, have also released guidance on climate change risks and/or ESG risks. This guidance applies to all pension plans and not only the largest plans in Canada.

Employers administering smaller registered pension plans are also expected by pension regulators to turn their attention to ESG factors, which includes understanding how delegated investment managers use and incorporate ESG factors into their investment policies.

Businesses who administer pension plans also need to be mindful that their corporate ESG policies may not be directly applicable to their pension investment policies, which generally require that ESG be used to evaluate the financial characteristics of investments, not for social or moral purposes.

Businesses must be aware that when administering a pension plan, their fiduciary duties mandate a different standard of care than when operating their business. How the business chooses to approach ESG for business reasons is not necessarily the same as what is in the financial best interests of pension plan beneficiaries under a prudent investment policy.

ESG in the private funds context

Over the past several years, there has been increasing pressure on fund sponsors to consider and diligence ESG criteria when making portfolio company investment decisions. This increasing pressure has been predominantly driven by institutional investors, particularly pension plans and other sophisticated investors, many of whom are fiduciaries of capital themselves, with internal objectives, mandates and requirements to advance ESG policies and commitments.

These internal initiatives have also been informed by institutional investors' commitments to internationally recognized ESG initiatives, such as the United Nations Principles for Responsible Investing (UNPRI). Many institutional investors have become a signatory to the UNPRI, and they expect the same commitment and implementation of ESG-principles from fund sponsors.

A significant driver of the ESG movement in North America also comes on the heels of the Alternative Investment Fund Manager Directive (AIFMD) mandated disclosure in Europe, which requires fund managers and sponsors to provide regulators and investors (both prior to and after their initial investment) with increased disclosure, including with respect to ESG integration into investment decisions and sustainability risks, as well as global advancements to standardize sustainability-related disclosures, for example through finalization and adoption of the ISSB standards.

The increased spotlight on ESG has also led to scrutiny and either real or perceived operational, strategic and cost burdens associated with ESG-related policies and procedures on private fund investment returns.

To complicate matters, the recent politicization of ESG matters, particularly in the United States, has driven many fund sponsors and institutional investors to shift towards different terminology. Recently, this has been seen in historically "ESG"-termed departments and policies—at the organizations of both fund sponsors and institutional investors—being rebranded with such terms as "sustainable investing" or "responsible investing", which operate to minimize any ESG-related stigma from both a financial return and polarization of ESG vs. non-ESG investment dollars perspective.

Metrics and targets

Understanding a company's GHG emissions profile is a cornerstone of climate-related disclosure. While companies commonly report Scope 1 and 2 GHG emissions, disclosing Scope 3 GHG emissions continues to lag, in large part due to challenges with third-party data collection and integrity. In addition, our study found that less than half of surveyed companies have announced net-zero targets even though all of Canada's major financial institutions and a number of other companies have set net-zero targets.

Does the company disclose a net-zero target?[20]

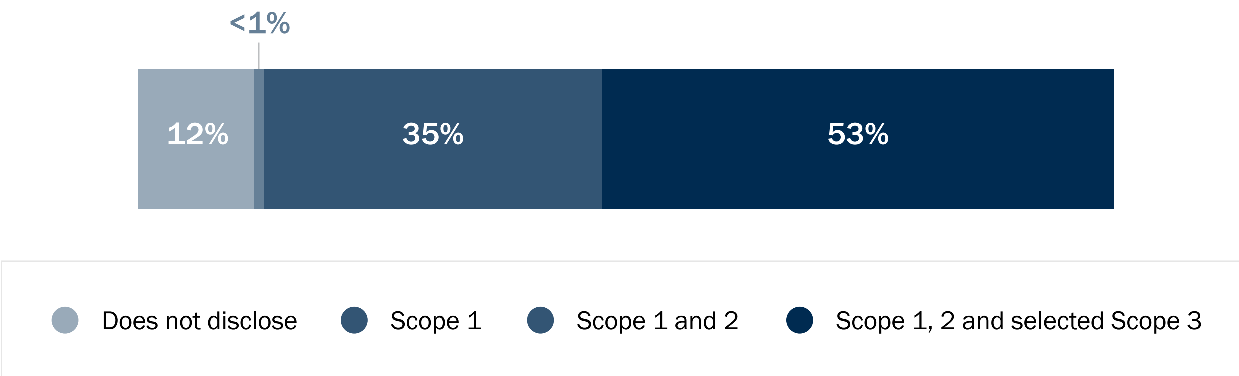
45%	55%
Yes	No

For companies that have set net-zero targets, what is the target year for achieving net zero?[21]

9%	3%	5%	2%	74%
2030	2035	2040	2045	2050

45% of surveyed companies have disclosed a target to achieve net-zero emissions. Of those companies that have publicly set a net-zero target, 74% are currently targeting 2050, with a few targeting as early as 2030 (9%). In addition, 85% of companies disclosing net zero targets have also disclosed interim GHG emissions reduction targets. However, only 27% of companies with interim GHG emissions reduction targets currently disclose that they have obtained or are in the process of obtaining third-party certification that such targets are on a scientifically credible path toward net zero.

Does the company disclose GHG emissions and if so, which of Scopes 1, 2 and 3 does it disclose?



The vast majority of companies disclose Scope 1 and 2 GHG emissions, with 53% of surveyed companies disclosing at least some Scope 3 emissions, with business travel (72%) being the most commonly disclosed Scope 3 category by far.

Does the company state that it discloses its GHG emissions in accordance with the GHG Protocol?

Over half of surveyed companies state that they disclose GHG emissions in accordance with the GHG Protocol, with the majority disclosing that they use the operational control approach. Under this approach, a company reports on the GHG emissions of all operations over which it has control; it does not report on GHG emissions from operations in which it owns an interest but over which it has no control.

A cornerstone of reporting: GHG emissions

Our study found that nearly 90% of surveyed companies are disclosing at least some of their GHG emissions. As defined in the Greenhouse Gas Protocol, the world's leading corporate GHG reporting framework, GHG emissions are divided into three categories:

- **Scope 1**: the direct emissions under the control of the company.
- **Scope 2**: the emissions caused by the consumption of purchased electricity.
- **Scope 3**: the indirect emissions in the value chain that are necessary for the activities of the company, including both the upstream emissions that occur during the production of goods and services used by the company and downstream emissions that occur during the use and disposal of their products and services.

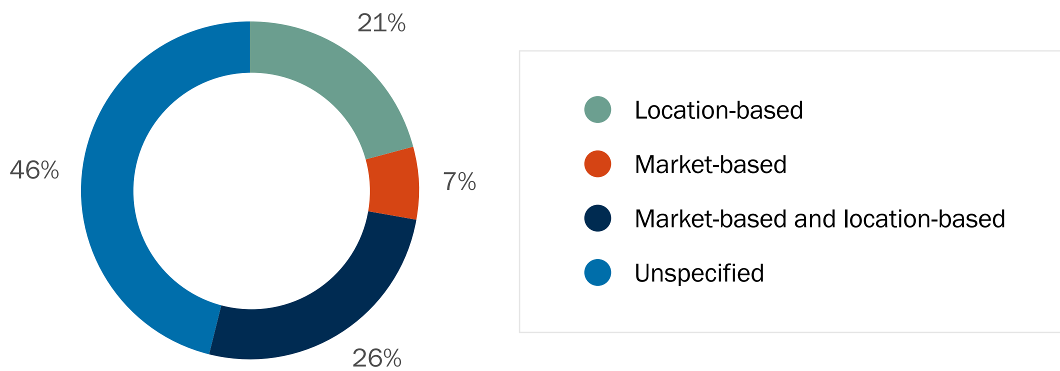
Our study found that 88% of surveyed companies are disclosing Scope 1 and 2 emissions. Collecting the data necessary to estimate Scope 3 emissions can be challenging; nonetheless, reporting on certain Scope 3 emissions would be mandatory under the standards developed by the ISSB.

In many industries, the amount of Scope 3 emissions dwarfs the company's Scope 1 and 2 emissions. Notwithstanding this complexity, perhaps surprisingly, our study found that 53% of surveyed companies voluntarily include at least some Scope 3 emissions in their reporting (with Scope 3 business travel emissions being the most reported on category).

Scope 3 emissions reporting is, however, the most challenging for companies because they must rely on data provided by third parties in their value chain. In many cases, this data is not readily available or, if available, the quality of the data may be poor or difficult for the company to independently validate. The introduction of mandatory climate reporting rules that require disclosure of Scope 1 and 2 GHG emissions might assist companies in their collection efforts and confidence in Scope 3 emissions data.

Third-party assurance for GHG emissions disclosure. Notwithstanding nearly 90% of surveyed companies reporting GHG emissions data, the majority of those (52%) do not currently disclose that they obtain third-party verification or assurance regarding that data. For those that do, most limit assurances to Scope 1 and 2.

If the company discloses Scope 2 emissions, does it use a market- or location-based approach?



Scope 2 emissions can be calculated using either a market-based or location-based approach. Of those companies that disclose their approach to Scope 2 reporting, the location-based approach, where emissions are calculated based on the average emissions intensity of the local power grid, is the most common. In contrast, the market-based approach, which allows location-based emissions to be offset by the purchase of renewable energy certificates and similar instruments, is less widely used.

Scope 3 GHG emissions categories. Of those Scope 3 categories specified by the GHG Protocol's reporting standards, each of the following had over 40% of surveyed companies reporting: business travel (72%), purchased goods and services (47%), waste generated in operations (44%), employee commuting (44%) and capital goods (41%). All other Scope 3 categories were reported on by less than 40% of surveyed companies, with many of the categories only being reported on by only a small percentage of companies.

Beyond climate—the rise of nature-related financial disclosures

As public companies increasingly make climate-related disclosures, the companion issue of nature and biodiversity loss has emerged as another potential financial risk for businesses to consider. Driven by human activities and climate change, natural ecosystems have declined 47% on average relative to their earliest estimated states, and approximately 25% of species are threatened with extinction, based on the 2019 IPBES Global Assessment Report.

Across a variety of sectors, businesses are considering how nature and biodiversity may impact their finances, operations, personnel, compliance obligations and overall strategy.

Launched in 2021, the Taskforce on Nature-Related Financial Disclosures (TNFD) is “a market-led, science-based initiative” and a “government-backed initiative” supported by financial institutions, corporates and market service providers with over US$20 trillion in assets.

Much like the TCFD, the TNFD provides organizations with practical guidance on disclosure and the tools to act on an evolving set of issues. The TNFD published its first draft recommendations in September 2023 and is now conducting tests on its prototype framework with businesses and financial institutions around the world.

The TNFD’s recommendations and guidance cover a range of topics, including governance, strategy, risk and impact management, and metrics and targets. While the TNFD’s recommendations and guidance are nascent and entirely voluntary, it is possible that over time they will emerge as market standards and set a new benchmark for how corporates should tackle nature-related disclosures.

A list of TNFD “adopters” is posted publicly, and includes Canadian businesses in the forestry, construction and agriculture sectors. Over time, substandard identification, analysis and disclosure of nature-related issues could expose businesses to investment risks or challenges complying with tightening environmental regulations.

Scope and methodology

This report's findings are based on a review of certain corporate disclosures of the constituents of the S&P/TSX Composite Index[22], as at the close of trading on May 31, 2024. As of that date, the S&P/TSX Composite Index was comprised of 220 companies listed on the TSX representing approximately 70% of the total market capitalization of the TSX.

The documents we reviewed consisted of (i) the most recent annual financial statements and related management's discussion and analysis and management information circular filed on SEDAR+ and (ii) any sustainability, ESG or similar report posted on the company's website, in each case made publicly available on or before May 31, 2024 and covering the most recent of the 2023 or 2022 fiscal years available as of that date.

The overall breakdown of the market capitalizations of the companies surveyed is as follows:

- **30%** Large cap - >C$10B
- **50%** Mid cap - C$2B-C$10B
- **20%** Small cap - <C$2B

The primary sector breakdown, as defined and categorized by S&P Capital and determined by the number of companies in each sector (not by market capitalization), of the companies surveyed is as follows:

23% Materials

18% Energy

12% Financials

12% Industrials

8% Real estate

7% Utilities

6% Consumer discretionary

5% Consumer staples

5% Information technology

2% Communication services

2% Health care

Endnotes

[1]Task Force on Climate-Related Financial Disclosures 2023 Status Report

[2]Governance and Accountability Inc. 2024 Sustainability Reporting in Focus

[3]CDP Disclosure Insight Action's 2023 Corporate Environmental Action Tracker

[4]Superintendent of Financial Institutions Guideline B-15 Climate Risk Management

[5]As of close of trading on May 31, 2024, prior to the anti-greenwashing amendments to the *Competition Act* contained in Bill C-59. See "Scope and methodology" for more details on our compilation of data for this report.

[6]Pleiades Strategy 2024, 2024 Statehouse Report: Anti-ESG State Legislation Tracker & Analysis

[7]Ibid.

[8]Sustainable Investments Institute 2024, Anti-ESG Proposals Surged in 2024 But Earned Less Support

[9]In circumstances where both the full board and a committee were disclosed as having a similar level of oversight over climate-related matters, the applicable committee was identified. Figures do not add up to 100% due to rounding.

[10]Given the breadth of the terms "sustainability" and "ESG", these figures may include directors who are identified as having non-climate related sustainability or ESG skills (e.g., expertise in a different environmental, social or governance matter).

[11]Companies were required to disclose a clear and specific climate-related quantitative metric as a component used in determining executive compensation in order to be included in the "Yes" category. For example, a metric could include a percentage reduction in GHG emissions per year.

[12]In order to be included in the "Yes" category, companies were required to disclose a specific strategy as to how emissions credits are or will be used to meet their targets. Companies that made general statements about purchasing (or intending to purchase) credits or offsets without describing a specific strategy were included in the "No" category.

[13]Given the breadth of the term "sustainability", these figures may include companies that disclosed issuing bonds or entering into sustainability-linked loans that serve a non-climate related sustainability or ESG purpose (i.e., social purposes).

[14]Government of Canada 2019, Clean Canada: protecting the environment and growing our economy

[15]Canada Energy Regulator 2022, Market Snapshot: The Potential Role of Nuclear in Canada's Energy Future

[16]Ministry of Energy and Electrification 2024, Ontario's Affordable Energy Future: The Pressing Case for More Power

[17]Government of Canada 2021, Small Modular Reactors (SMRs) for Mining

[18]CBC 2023, Alberta investing $4M into Cenovus Energy study on small modular reactors

[19]The "Yes" category includes all companies that disclosed undertaking scenario analysis, regardless of whether such companies also disclosed the results of such scenario analysis.

[20]7% of the companies that set net zero targets set a target earlier than 2030, set multiple targets for subcategories of emissions or had already met their target.

[21]The IPCC defined net-zero emission as when, over a specified time period, human-caused GHG emissions to the atmosphere are balanced by equivalent GHG emissions withdrawals from the atmosphere resulting from deliberate human activity.

[22]For a description of the S&P/TSX Composite Index, please see the S&P Global website.

About our sustainability practice

Torys is a full-service business law firm with offices in Toronto, New York, Calgary and Montréal. Our multidisciplinary strength across regions and practices allows us to provide organizations with tailored counsel as the legal, regulatory and business landscape continues to evolve. We support clients as they integrate sustainability into their strategy and operations, and work closely with boards and management on corporate governance, disclosure, liability and transactional considerations—always with a view to the latest industry practices, standards and legal requirements.

We help businesses define and advance their sustainability goals with sophisticated interdisciplinary counsel that draws on our leadership in corporate governance, capital markets, environmental and climate change law, Indigenous matters, energy project development, financial services, fund formation and investment, lending and project finance, pensions and employment, and litigation and disputes.

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Acknowledgment

We would like to thank Claire Seaborn, Adam Ibrahim, Max Ledger and Caroline Marful, as well as the Torys summer student class of 2024, for their significant contributions to this report.

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