GOVERNMENTS GOVERNMENTS GOVERNMENTS

Marla Orenstein & Brendan Cooke | June 2022

ESG | Why should governments care and what can governments do?

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Proactive means competitive

Environmental, social and governance (ESG) investing has seen a rapid rise both in Canada and internationally. ESG's relevance for business and investors is well understood. However, governments haven't caught up. Federal, provincial/territorial and municipal governments in Canada need to understand why ESG is relevant to them and how they should respond.

Ignoring these questions is not an option. Increasingly, ESG is a point of differentiation that affects competitiveness both for jurisdictions and the companies that operate within them. Sustainability performance has become "table stakes," and governments that don't explicitly grapple with these issues risk having others dictate how their performance will be assessed.

A real opportunity exists for governments in Canada at the municipal, provincial and federal levels to support strong and consistent ESG reporting, raise the bar for performance, communicate success to different stakeholder audiences, and provide clarity for investors. These actions will help companies operating in the jurisdiction; they also help the government by building its brand and its investment attractiveness. But there are many possible routes forward, and it can be easy for governments to get lost along the way or invest time in ineffective endeavors.

Why should governments care?

THERE ARE THREE MAIN REASONS WHY GOVERNMENTS NEED TO PAY ATTENTION TO ESG:

01

Because it intersects with protection of people, society and the environment
ESG intersects with government's mandate to protect people, social and institutional structures, and the environment. As governments enact or change legislation, regulations and policies that govern emissions, water use, waste management, health and safety, gender equity or corporate governance (as a few examples), there are knock-on effects for companies' ESG performance, and for the ESG "story" for the jurisdiction itself.

02

Because it influences business and investment attraction
A large and growing portion of global investors use ESG factors to direct where they place their money. To the extent that governments support clear ESG disclosure and strong ESG performance, it boosts investment competitiveness —and procurement competitiveness—among businesses in that jurisdiction. It also helps investment attraction agencies tell a better story when they attempt to draw foreign direct investment (FDI) to the jurisdiction.

03

Because it affects the government's credit rating and borrowing costs
It isn't just companies on the receiving end of ESG ratings; increasingly, it is jurisdictions as well. Over the last few years, major credit rating and investment research agencies such as Moody's, S&P, Fitch and MCSI have begun to apply ESG factors in their risk assessments of governments at municipal, regional and national levels. Their ESG ratings directly affect the government's credit rating, ability to secure financing and borrowing costs.

What actions can governments take?

THERE ARE FOUR CATEGORIES OF ACTIONS THAT GOVERNMENTS CAN TAKE TO MAXIMIZE THE BENEFITS THAT COME WITH ROBUST ESG PERFORMANCE:

Support strong and consistent ESG reporting

There is a role for government in building strong and consistent ESG reporting within the jurisdiction—across companies, sectors, industries and government departments, as well as across multiple levels of government. This provides all parties with a shared language and framework, so that they can more easily talk with one another and tell a common story as they compete globally.

Raise the bar for ESG performance

Both companies and jurisdictions are judged on their ESG performance—and the two are closely linked. Raising the bar involves using data and policy to incentivize high performance, make conditions more appealing to investors and stakeholders, and send strong signals about continuous improvement.

Communicate your ESG story

For strong performance to translate into benefits, government needs to ensure that data and information relevant to ESG is accessible to interested audiences, both in terms of being easy to find and being easy to use.

Provide clarity for investors

ESG is a tool to help investors evaluate financial investment risk and opportunity. Government agencies have a role in providing clarity and setting rules—with ESG just as with other financial claims. This clarity in turn increases investor confidence and attracts further investment.

Table ES-1 presents 18 specific actions that can be taken under these four categories. **It is critical to note that not all actions described are recommended.** While some actions are clearly marked as “not recommended,” even those marked as “potentially useful” may not be appropriate for some governments, or at certain times.

The right-most column of the table highlights what we consider to be priority areas for *new or additional* government action. These priority areas: a) have the potential to generate large improvements around ESG within the jurisdiction, b) have relatively low effort being put towards them currently, and/or c) can be most effectively carried out by government as opposed to other entities.

Table ES-1

Summary of Potential Actions and Priority Areas

			Potentially useful?	Extent of current efforts	Priority area for new government action
Support strong and consistent ESG reporting	01	Mandate climate disclosure reporting	Yes	High	
	02	Recommend or require that public companies provide full ESG disclosure	Yes	Medium	
	03	Create your own ESG standard/framework for companies in your jurisdiction	No		
	04	Endorse specific ESG frameworks	Yes	Medium	
	05	Consider guidance for locally relevant topics	Yes	Low	
	06	Align performance/compliance data with ESG reporting frameworks	Yes	Low	Yes
Raise the bar for ESG performance	07	Benchmark and improve the jurisdiction's own ESG performance	Yes	Low	Yes
	08	Build a solid foundation of environmental, social and governance policy and regulations	Yes	High	Yes
	09	Set targets, benchmarks or thresholds for ESG performance by companies	Yes	Low	
	10	Use ESG as an input into decision-making around permitting or oversight	No		
	11	Manage government investments using ESG criteria	Yes	Low	
	12	Manage public procurement using sustainability criteria	Yes	Low	
Communicate the ESG story	13	Better organize data for ESG-interested audiences	Yes	Low	Yes
	14	Broadcast your data and performance	Yes	Low	Yes
	15	Certify product origin	Yes	Low	
Provide definitions and clarity around ESG investment	16	Define what can be called "ESG investing"	Yes	High	
	17	Define "green" and "transition" finance instruments	Yes	High	
	18	Provide guidance to investors	Yes	Medium	

Introduction

Growing interest but currently little understanding

Over the past five years, Environmental, Social and Governance (ESG) reporting has skyrocketed—both across the Canadian economy and globally. Mostly, ESG has been framed as an issue that is relevant for businesses (which disclose their ESG performance) and for investors (who use the information to decide where to put their money). But governments in Canada—both national and subnational—face questions about how they should respond. They need to understand:

What governments in Canada need to understand about ESG

- How ESG aligns or intersects with government efforts and obligations to protect people and the environment
- Whether the government should take a role in regulating ESG disclosure, performance or ratings
- How governments can capitalize on investors' interest in ESG to attract capital to their region
- How ESG ratings affect a government's credit rating and ability to secure financing
- What actions are possible, which are recommended, and which are fraught with problems

While a profusion of guidance about ESG is produced every day in the form of reports, webinars and briefings, almost none of it focuses on what governments can or should be doing.

What is ESG?

ESG refers to the environmental, social and governance performance of organizations.

Environment

Captures information on topics such as greenhouse gas (GHG) emissions and carbon footprint, biodiversity impacts, water use, waste management, air pollution, land use and deforestation.

Social

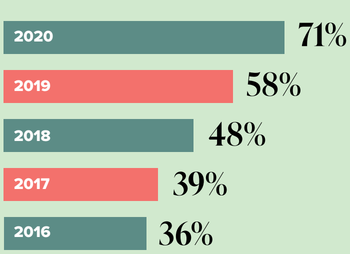
Describes the company's relationship with people, including its employees, customers, suppliers, host communities and host governments. Social metrics may include human rights, health and safety, gender equity, diversity, relationships with Indigenous groups, supply chain management and labour practices.

Governance

Describes features such as executive pay, Board diversity, political lobbying and oversight and compliance policies.

Figure 1

Canadian companies listed on the S&P/TSX Composite Index that released an ESG report (%)



Source: Millani, 2021. *Millani's 5th Annual ESG Disclosure Study: A Canadian Perspective.*

ALTHOUGH THE CONCEPTS considered under ESG are not new, ESG is rapidly gaining momentum on the world stage. Over the past five years, there has been a meteoric rise in ESG uptake:

- In 2020, 71% of companies listed on Canada's S&P/TSX Composite Index released an ESG report—almost double the rate from four years earlier (see Figure 1).
- Globally, figures are similarly high. A survey conducted in 2020 of the top 100 companies in each of 52 countries found that 80% report on their ESG performance—and this figure rose to 96% among the world's 250 largest companies.[1]
- Within Canada, the energy sector is also taking ESG reporting seriously, as documented in the Canada West Foundation's 2021 report *ESG and the Canadian Energy Sector*.

Primary Audience:

Financial investors

The primary audience for ESG reporting information is financial investors who want to better understand the risks of investing in particular companies. Studies[2] have shown that companies which focus on ESG are more likely to be better managed, leading to lower costs, improved community relations and fewer litigations, while also being more resilient to external risks – all outcomes that appeal to investors. And the amount of money invested using ESG considerations is enormous.

- Globally, asset funds applying ESG criteria to investment decisions have almost doubled over four years, and more than tripled over eight years, reaching a value of $40.5 trillion in 2020 and a projected $50 trillion by 2025.[3,4]
- In Canada, such funds grew to $3.2 trillion in 2019, representing 61.8% of Canada's assets under management.[5]

Stakeholders who value sustainability

But the growth in ESG has also been driven by the demands of other stakeholders—including governments, consumers, employees, NGOs and the general public—who want to understand the extent to which companies are acting in ways that align with stakeholder values.

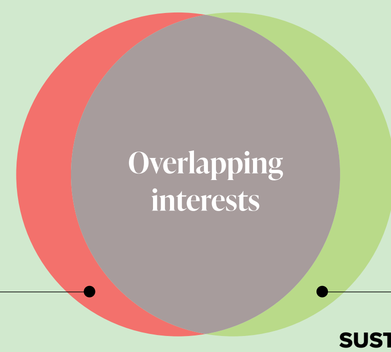
ESG & Sustainability:

Closely related but *not* identical

Both 'ESG' and 'sustainability' are terms often used when talking about environment, social and governance topics. While the two are closely related concepts, they are not identical. ESG is a set of metrics primarily of interest to financial investors evaluating risk (not always direct financial risk—for example, poor occupational health and safety performance comprises an indirect financial risk). Sustainability is somewhat broader and of interest to a wider range of audiences who want to gauge values alignment. This distinction—and the overlap—is shown in Figure 2. However, the terms are often blurred in the popular media and even among companies producing reports (some of which call it an "ESG report" and some a "sustainability report", even though the content may be near-identical).

Figure 2

ESG & sustainability reporting: closely related, but not identical



It is also critical to remember that ESG is not interchangeable with greenhouse gas (GHG) emissions or performance on climate change. While emissions and climate change are important components of ESG—and often draw the most attention—many other topics, both environmental and non-environmental, are included in the ESG landscape.

Part 1

Why should governments care about ESG?

Increasingly, ESG is a point of differentiation that affects competitiveness both for jurisdictions and the companies that operate from within them. Sustainability performance has become "table stakes." And governments that don't explicitly grapple with these issues risk having others dictate their story. But more explicitly, there are three good arguments for why governments—whether municipal, provincial/territorial or federal—need to sit up and pay attention to ESG.

01

Because ESG intersects with protection of people, society and the environment

The first reason for government to care about ESG is that it intersects with government's mandate to protect people, social and institutional structures and the environment, as well as to fulfill its democratic obligations.

All governments use legislation and regulations to control what actions may or must be taken with respect to water, air, land, plants, wildlife and other environmental topics/media. Many of these topics are also considered under the banner of ESG. This means that as governments enact or change legislation or regulations that govern these areas, there will be knock-on effects in terms of companies' ESG performance.

Governments also establish conditions that protect human health and safety, and individual and community well-being. Here too, ESG marches down the same road—although governments have a far broader focus than typical of ESG measures.

Governments also protect investors by setting rules around financial claims. As ESG is fundamentally a type of financial claim and rests on the pillar of corporate governance, governments are once again drawn into the conversation.

In all these areas, government actions intersect with ESG by providing stringent protections that enhance transparency and build public trust.

02

Because ESG influences business and investment attraction

A second reason for governments to care about ESG is because it influences business and investment attraction. This manifests in several ways.

Attracting direct investment

A large and increasing number of global investment funds use ESG factors to direct where they place their money. Companies with stronger ESG performance are more likely to be able to access those ESG-directed funds or to have lower borrowing costs.[6] To the extent that governments support clear ESG disclosure and strong ESG performance, it boosts the investment competitiveness of the businesses in that jurisdiction.

It also helps investment attraction agencies tell a better story when they attempt to draw foreign direct investment (FDI) to the jurisdiction. Global FDI flows have been decreasing over the last few decades, from $22 trillion in 2006 to $11 trillion in 2018, with the greatest declines seen among the richest countries.[7] This means the same number of jurisdictions are fighting over an increasingly small pie and ESG can (at least in theory) provide a leg up. This issue is particularly relevant in light of Russia's recent invasion of Ukraine, with many investors re-thinking asset investment strategies to align with global security concerns.

Attracting customers

ESG investors don't just look at a company's own performance, but increasingly, that of its entire supply chain.[8] As a result, many companies look to procure goods and services only from suppliers that can themselves demonstrate strong ESG performance. To the extent that governments support clear ESG disclosure and strong ESG performance in their jurisdiction, it increases the desirability of local companies as suppliers.

Attracting new businesses

For companies looking to relocate, a jurisdiction with strong ESG performance may be attractive because it lends credibility to the ESG claims of the companies that are based there. (Although strong ESG performance may increase the desirability of some jurisdictions, it is critical to note that it is seldom sufficient it itself; political risk and ease of doing business are other factors that remain important in this equation.)

03
Because ESG affects government's credit rating and borrowing costs

Finally, ESG ratings have started to affect jurisdictions' credit ratings, borrowing costs and ability to secure financing.

It isn't just companies that are on the receiving end of ESG ratings – increasingly, it is jurisdictions as well. Over the last few years, major credit rating and investment research agencies such as Moody's, S&P, Fitch and MCSI have begun to apply ESG factors in their borrowing risk assessments of governments at municipal, regional and national levels. Their assessments are based on the jurisdiction's exposure to and management of ESG risk factors, and how these factors might impact long-term economic performance. Table 1 shows how two different agencies—Moody's and Fitch Ratings—apply ESG factors when considering sovereign credit ratings.

Increasingly, those ESG ratings affect the government's ability to secure financing, obtain lower borrowing costs[9,10] and attain lower sovereign bond yield spreads. The equation is simple: better ESG performance by the jurisdiction equals a higher credit rating and a lower cost of borrowing. How much of a difference does it make? Quite a bit, even among developed countries. A study of 20 OECD countries found that a 10 per cent higher country ESG score reduced the sovereign bond spread by almost 11 per cent in the short term, and over 16 per cent in the long term.[11]

In addition, some jurisdictions have begun to issue sovereign green bonds—bonds issued by government explicitly to fund environmentally positive projects. Sovereign green bonds or other sustainability-linked bonds had been issued by 22 nations as of 2021, with 13 more signaling intent to issue. These bonds may have lower rates because of the secondary perceived benefit of helping the planet—but this only works if the jurisdiction has credibility that the environmental goals will be achieved.

In short, many of the factors that are considered by credit rating agencies under the rubric of ESG are ones that have influenced a jurisdiction's creditworthiness for a long time. Countries with traditionally poor governance practices have long been seen as a risk, for example. But credit rating agencies and lenders are increasingly explicit in considering the full suite of ESG factors when making decisions about governments and financing – and governments need to get out in front.

Table 1

How credit rating agencies consider ESG in assigning government credit ratings

EXAMPLE 1 | FITCH RATINGS

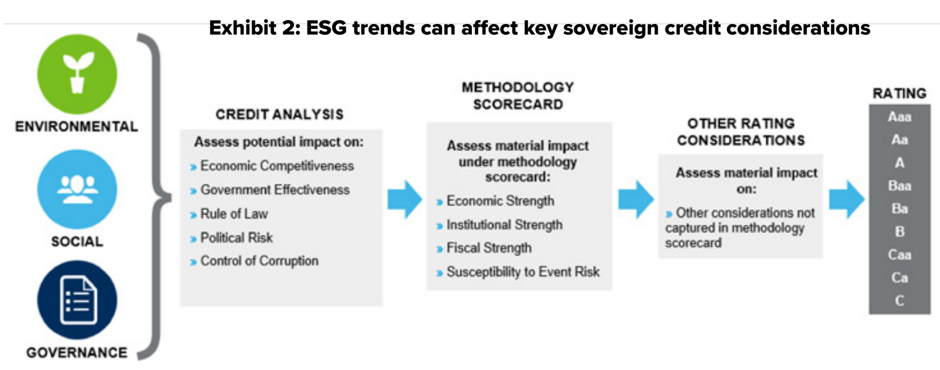
Fitch Ratings has developed a suite of ESG factors that they evaluate for relevance for each jurisdiction when developing their credit ratings. The table below shows their Sector-Specific ESG Factors for Local and Regional Governments.

Environmental Factors	**GHG Emissions and Air Quality**	Emissions and air pollution as constraints on the economy and revenue growth; enforcement/compliance with governmental/regulatory standards.
	Energy Management	Impact of energy resources management on the economy and governmental operations, including enforcement/compliance with governmental/regulatory standards.
	Water Resources Management	Water resource availability impacts on the economy and governmental operations, including enforcement of governmental/regulatory standards.
	Biodiversity and Natural Resource Management	Impact of natural resources management on the economy and governmental operations.
	Natural Disasters and Climate Change	Impact of extreme weather events and climate change on the economy, governmental operations and policy related to natural disasters treatment.
Social Factors	**Human Rights and Political Freedoms**	Policy framework on social stability and human rights protection.
	Human Development, Health and Education	Impact of health and education on economic resources and governmental operations.
	Labor Relations and Practices	Impact of labor negotiations and employee (dis)satisfaction.
	Public Safety and Security	Impact of public safety and security (including cybersecurity) on business environment and/or economic performance.
	Population Demographics	Impact on economic strength and stability (labor force supply, household income, population and aging, etc.).
Governance Factors	**Political Stability and Rights**	Impact of political pressure or instability on operations; tendency toward unpredictable policy shifts.
	Rule of Law, Institutional and Regulatory Quality, Control of Corruption	Government effectiveness; control of corruption; regulatory quality; management practices and their effectiveness; respect for property rights.
	International Relations and Trade	Trade agreements and impact on economy and revenue growth.
	Creditor Rights	Willingness to service and repay debt; exposure to outstanding or pending litigation.
	Data Quality and Transparency	Limitations on the quality and timeliness of financial data, including transparency of public debt and contingent liabilities.

Source: Fitch Ratings. *Where ESG Matters for International Public Finance.* November 17, 2021

EXAMPLE 2 | MOODY'S

Moody's takes a different tack, stating that the agency assesses how individual environmental, social and governance factors impact economic competitiveness, government effectiveness, rule of law, political risk and control of corruption and ultimately lead to assignment of a graded credit rating to the jurisdiction.



Source: Moody's Investor Service. *Moody's approach to assessing ESG in credit analysis*. 2017.

Part 2

How can governments respond?

The gory details

The previous section presented three compelling reasons for governments to care about ESG. The obvious next question is: how can governments respond?

This section presents 18 actions that governments can consider, drawing on examples of what has been done previously in Canada and internationally. **It is critical to note that not all actions described are recommended.** Some are clearly marked as "not recommended." However, even those marked as "potentially useful" may not be appropriate for some governments, or at certain times. Our intention was to compile a complete list of actions that have been considered or attempted, to help inform governments that are currently grappling with questions about the value of different approaches. The 18 actions are grouped into four complementary categories or themes:

- **Support strong and consistent ESG reporting**
- **Communicate your ESG story**
- **Raise the bar for ESG performance**
- **Provide clarity for investors**

Each action also describes the relevant government entities that could be involved. Responsibility for specific actions is delegated differently across different jurisdictions, and when it comes to ESG, almost every jurisdiction examined for this report has taken a different approach. Depending on the location, the activities described below have involved elected policy-makers; officials across numerous ministries and departments; financial regulators; central banks; stock exchanges; national standard setting organizations; investment attraction agencies; energy regulators; environmental regulators; and numerous others. Ultimately, the government in each jurisdiction must decide for itself where efforts are best housed.

Support strong and consistent ESG reporting

For companies, the landscape of ESG reporting can be difficult to navigate, with no single arbiter of what ESG reporting is or should be. For investors looking to understand ESG performance there is also confusion, as differing approaches to disclosure can make it tough to compare apples to apples.

The role for government lies in building strong and consistent ESG reporting within the jurisdiction—across companies, sectors, industries and government departments, as well as across multiple levels of government. Consistency helps all parties to have a shared language and framework so that they can more easily talk with one another and tell a common story as they compete globally.

01

Mandate climate change disclosure reporting

Climate-related disclosures are just one part of ESG, but—for obvious reasons—a very important part. As a result, there has been an outsized focus on climate within the ESG space. And recently, there have been some profound developments in this area.

Mandatory climate change disclosure is on the rise—in some cases for financial institutions and in other cases for large public companies, with the U.K., France, Switzerland and New Zealand among the countries that have recently implemented such legislation. In the U.S., the Securities and Exchange Commission (SEC) published draft rules in March 2022 that require public companies to disclose climate-related information in their SEC filings.[12] Information to be disclosed includes:

- The company's GHG emissions (Scope 1, Scope 2 and in some cases Scope 3 emissions)
- Climate-related risks that may have a material impact on the company's business, operations, or finances
- Climate-related financial metrics, including the costs of moving away from fossil fuels

And mandatory climate disclosure is also coming to Canada. The federal government's budget of April 7, 2022, outlined a plan to require federally-regulated financial institutions to begin reporting on climate-related financial risks—with efforts to be headed by the Office of the Superintendent of Financial Institutions (OSFI). While this rule only applies to federal financial institutions, the government noted that it expects there will be impacts for all types of Canadian businesses as requirements trickle down to the businesses that financial institutions work with. In addition, in October of 2021, the Canadian Securities Administrators (CSA) published proposed climate-related disclosure requirements that would apply to public companies.[13] The new requirements extend the CSA's existing requirements for reporting climate change-related risks. Most large emitters in Canada are public companies subject to these rules.

In most jurisdictions—including Canada, the U.S. and the U.K.—the entities behind these efforts have chosen to align their reporting requirements with the Task Force on Climate-Related Financial Disclosures (TCFD) framework, which represents the current global standard for how climate change risk is disclosed. This is a good move, as the use of a common reporting standard increases clarity and reduces reporting burden.

Given these efforts, do additional government agencies—particularly at a provincial level—need to get in on the act of requiring climate change disclosure? Possibly, but there are two key issues. The first is jurisdiction; within Canada, who has the right to compel companies to disclose their climate actions and risk? The second is the question of where the benefit outweighs the burden. As noted above, public companies, heavy emitters, and many large private companies fall under the existing or proposed rules. For many or most small- and medium-sized privately held companies, the burden of mandatory climate change reporting likely outweighs the potential benefit of producing this information. This leaves Crown Corporations and other government-owned enterprises, which are often entities with large footprints, under a great deal of scrutiny. There is an appropriate role for governments to require climate change reporting from Crown Corporations, to align with what is expected from other sectors and organization types.

Recommendation

- As mandatory climate change reporting becomes increasingly universal in coming years, government's role is to ensure that reporting requirements for external companies and organizations are effective, harmonized and provide information of value.
- Different levels of government (federal, provincial, municipal) can also play a role in mandating climate change disclosure from government-owned enterprises.

Entity

- At the federal level within Canada, efforts around mandatory climate change disclosure reporting are being led by the Canadian Securities Administrators and the Office of the Superintendent of Financial Institutions. Provincial governments may have an additional role with respect to Crown Corporations.

02

Recommend or require that public companies provide full ESG disclosure

Beyond the disclosure of climate-related topics, there arises the question of whether government agencies should require—or even just recommend—that companies produce ESG reports that cover the full suite of material environmental, social and governance issues.

To date, there are no examples of governments mandating full ESG reporting by companies. While regulators and other government agencies commonly require companies to provide data that falls under the ESG umbrella (whether on water use or gender diversity on Boards), none require companies to produce a comprehensive ESG report. The closest example of mandatory disclosure is the European Union's Non-Financial Reporting Directive (NFRD) and its proposed Corporate Sustainability Reporting Directive (CSRD).[14] Under the NFRD, large public interest companies—such as publicly traded corporations and banks—are required to provide information on their policies and performance regarding environmental and social matters, human rights, and anticorruption. However, the requirements are vague and do not constitute comprehensive ESG reporting. However, this may change under the proposed CSRD, which will expand the scope of companies impacted and will require alignment to E.U. sustainability reporting standards—and it can be assumed that these standards will be based on one of the globally recognized ESG frameworks.

This is an area where stock exchanges have begun to fill the void. Globally, a number of stock exchanges—sometimes working with securities market regulators and central banks—have begun to either recommend that listed companies produce ESG reports, or require that they do so as a condition of remaining listed on the stock exchange. As of March 2022, 27 exchanges worldwide (of 114 in total) had mandatory ESG disclosure, requiring companies to provide public ESG information in order to be listed on the exchange.[15] Of these, four have a market cap over USD$1 trillion (Euronext, the Hong Kong Exchanges, the National Stock Exchange of India, and the Johannesburg Stock Exchange). No North American exchanges currently have mandatory ESG disclosure. In addition, 43 stock exchanges provided voluntary ESG disclosure guidance for listed companies – including both major exchanges such as NASDAQ and the New York Stock Exchange, as well as Canada's TMX Group (Toronto Stock Exchange).

This is an emerging area and one that governments should pay close attention to moving forward. It is common for governments to require some environmental, social and governance information to be disclosed by companies, but it is not yet the case that governments require—or even recommend—that companies provide ESG information on all material issues. Led by developments in Europe, this may well change in coming years. As it does, there will be a role for government in proactively setting standards and being involved in the development of tools and reporting frameworks, including involvement with the international committees that set those standards—in much the same way that governments have done with electrical standards, for example.

Recommendation

- Not yet recommended. Requiring or recommending full ESG disclosure and reporting is not a common government practice, although many stock exchanges are leading the way for listed companies. However, government should keep a close eye on this area in order to remain in front of rapidly evolving norms and expectations.

Entity

- Globally, this action has been led by stock exchanges and security commissions. In Canada, the Canadian Securities Administrators would likely be in a good position to lead any developing efforts.

03

Create your own ESG standard/framework for companies in your jurisdiction

Some governments have considered the idea of developing a jurisdictional standard for ESG reporting—in other words, a template or framework that tells companies based in the jurisdiction exactly what topics to report on, and what metrics to use or how to approach the reporting. This idea is appealing because it could theoretically provide a context-specific set of material issues that are more locally relevant than those in global frameworks; and would provide consistent guidance for companies operating in the jurisdiction.

In practice, however, this idea has several critical problems baked into it.

First, it would only add to, and not replace, the international standards that the global financial community expects to see in a company's ESG report. This means that rather than streamlining the reporting process for companies, it would instead add complexity and burden. It also leaves an enormous grey area around companies that operate in and from multiple jurisdictions. Finally, it is unlikely to influence the rating of companies by ESG rating agencies, which are unlikely to care about the existence of a provincial or national ESG framework as they evaluate company performance.

Recommendation

- Not recommended

04

Endorse specific ESG frameworks

However, even without creating its own framework or standard, there are ways that a government can encourage companies to develop robust and (appropriate) reporting.

A strong option would be for a government to endorse a specific framework as a preferred way for companies in its jurisdiction to report their ESG disclosures. An endorsement would not have the weight of a requirement or regulation, but would promote good practice and may improve disclosure standardization for companies in the jurisdiction.

A number of frameworks or standards for ESG reporting have been developed by multinational organizations and have gained international traction. These include (but are not limited to):

- Global Reporting Initiative (GRI)
- Sustainability Accounting Standards Board (SASB)
- Task Force on Climate-related Financial Disclosures (TFCD)
- International Integrated Reporting Council (IIRC)
- Climate Disclosure Standards Board (CDSB)
- CDP (formerly the Carbon Disclosure Project)

However, there has recently been some movement towards *consolidation and harmonization* across a number of these global frameworks to reduce "confusion and cost for both producers and users of sustainability information."[11] Two proposed consolidated frameworks (the ISSB and the ESRS) are summarized on page 20 and comprise the leading contenders for government endorsement (at least as of the time of publication of this report; this field is changing very rapidly).

For governments looking to endorse a framework that only pertains to climate change and GHG emissions, the TCFD has been rising to the top as the instrument of choice. Unlike the ISSB, ESRS, SASB or GRI which cover a broad range of E, S, and G topics, the TCFD applies only to a company's disclosures with respect to climate change.

Recommendation

- Potentially useful. This action can help create consistency within a jurisdiction; but even without government endorsement, certain ESG standards and frameworks are becoming the norm based on the recommendations of agencies such as the Canadian Coalition for Good Governance; major Canadian and international investment management firms; and stock exchanges.

Entity

- This endorsement could come from any or all of: elected leadership; ministries or departments; financial regulators; or non-financial regulators (e.g., energy regulators).

05

Consider guidance for locally-relevant topics

One problem with global standards is that they often lack adequate guidance on specific issues that are important but relevant only in some jurisdictions. Indigenous rights and relationships is a prime example. Most global frameworks provide no direction on disclosure, and those that do (SASB and GRI) address it only at a very high level or in a very limited fashion. Indigenous groups do not appear to have been consulted as to what topics or indicators they would like to see included. Nonetheless, Indigenous rights, reconciliation and relationships are of critical importance to most companies, and certainly to all governments within Canada.

Because of these deficiencies, some efforts have been made to develop supplemental materials that can provide guidance on locally-relevant topics that are poorly served by global approaches. For example, the Independent Review Committee on Standard Setting in Canada is conducting a review of whether a Canadian version of or supplement to the ISSB standards would be useful. And the First Nations Major Projects Coalition (FNMPC) has been publishing materials exploring the intersection of ESG and the rights and interests of Indigenous groups in Canada.

Either preparing such supplementary guidance, or endorsing a supplementary framework created by other groups, could be a useful jurisdictional action that would provide both clarity and consistency to reporting organizations.

Recommendation

- Medium priority. As in the action item above, this action can improve clarity and consistency for reporting companies. Some progress is occurring—led mainly by non-governmental organizations—but some government involvement or endorsement of these external efforts could be useful.

Entity

- Preparing supplementary guidance could involve ministries or departments that are responsible either for the types of companies preparing disclosures (e.g., energy); or for the topics being addressed in the supplement (e.g., Indigenous rights). It may also involve financial regulators. Government agencies should make efforts to coordinate closely with other Canadian jurisdictions or external organizations that may be undertaking similar work.

Leading Contenders for Consolidated Reporting Standards

The International Sustainability Standards Board (ISSB)

On November 3, 2021, the International Financial Reporting Standards (IFRS) Foundation announced the formation of the International Sustainability Standards Board (ISSB).[16] The ISSB will establish one globally recognized set of ESG disclosure standards that will replace multiple standards that are in use today. It brings together many of the current major ESG reporting standards, including the Climate Disclosure Standards Board (CDSB, an initiative of CDP) and the Value Reporting Foundation, which houses the Integrated Reporting Framework and the SASB Standards; and also draws on the work of the Task Force on Climate-related Financial Disclosures.

The IFRS is the body responsible for setting international accounting standards and they have indicated that the new ISSB standards are likely to have strong accountability procedures, and integrate with verification processes already used by financial verifiers.

The organization has also confirmed that the focus for the new standards will continue to be investors and other users of financial information (as opposed to other stakeholders interested in sustainability more broadly).

Overall, the ISSB is a gamechanger for ESG reporting. Greater standardization globally had been called for by preparers and users of ESG information, and this new approach provides exactly that. It will facilitate wider adoption of ESG reporting as the standards are easier to use, facilitate auditing of the information, make it easier to analyse and compare ESG performance, and provide a clear front-runner. The ISSB is expected to be up and running by June 2022, and will establish its head office in Frankfurt and a secondary hub in Montreal.

These attributes make the ISSB a clear front-runner by government agencies looking to endorse a particular standard.

European Sustainability Reporting Standards (ESRS) and Global Reporting Initiative (GRI)

The ISSB is focused on ESG reporting that satisfies the needs of financial investors. For stakeholder audiences interested in sustainability more broadly, a different approach may be of more interest.

The European Sustainability Reporting Standards (ESRS) are currently under development, led by the European Financial Reporting Advisory Group (EFRAG), working in partnership with the Global Reporting Initiative (GRI)—an international sustainability standards-setting organization established in 1997 by the United Nations' Environment Programme. All companies that are required to report under Europe's Corporate Sustainable Reporting Directive will be required to comply with these sustainability reporting standards.

The ESRS is still under development, but will represent a complement to the ISSB, with the ISSB focused more narrowly on reporting for investor audiences, and the ESRS presenting information that is of interest to a wider group of stakeholders.

06

Align performance/compliance data with ESG reporting frameworks

Assembling ESG data can be extremely time-consuming and expensive for companies. The cost of climate disclosure alone has been estimated to be around USD$420,000 per year for a small publicly listed company, and $530,000 per year for a larger company.[17]

Companies in certain sectors—such as energy—also need to report performance data to different levels and agencies of government, including (but not limited to) energy regulators. Governments can help companies be efficient by ensuring that the data does not need to be assembled and reported in multiple formats. This applies both to ESG reporting frameworks and to reporting across multiple layers of government.

If government aligns its own reporting requirements with the way data needs to be provided under ESG reporting frameworks—for example, by using the same metrics and indicators to represent specific topics—this will help companies to assemble relevant data only once, but use it for multiple purposes. While this may not be possible for all data, the review of reporting requirements to increase efficiency for the reporting entities is good practice.

Recommendation

- High priority. Making the process integrated rather than additive helps reduce red tape for companies.

Entity

- Ministries and regulators that require private-sector companies to report data.

Raise the bar for ESG performance

Both companies and jurisdictions are judged on their ESG performance—and the two are closely linked. Raising the bar involves using data and policy to incentivize high performance, make conditions more appealing to investors and stakeholders, and send strong signals about continuous improvement. At the same time, this must be done in a way that takes into consideration the capacity of different companies and organizations to adapt, and ensures that the government doesn't inadvertently decrease competitiveness—the opposite of what is intended.

07

Benchmark and improve the jurisdiction's own ESG performance

The actions described above are intended to bring improvement and consistency to the ESG disclosures of companies operating in a jurisdiction. But as described in Part 1 of this report, governments themselves are also being graded on their ESG performance, with implications for their credit ratings and borrowing costs. This means that it is critical for governments to do some strong self-reflection in order to understand, benchmark and improve their own ESG performance, and to do this both honestly and transparently, and in a way that makes it clear that the jurisdiction is serious about improvement. In addition to improving the jurisdiction's own credit rating, this will boost the ESG credibility claims of the companies operating in the jurisdiction—a win all around.

There is no established path for governments that want to go down this road, and few governments worldwide have developed any public-facing materials that describe the approaches they are taking. However, the Government of Alberta recently went through an ESG soul-searching process—described in the box on page 24—that provides a concrete example of how this task can be robustly approached.

The Alberta government gave the initial task of reviewing needs and options to an ESG Secretariat that reported to the Premier's office. After extensive consultation, the Secretariat chose to develop a jurisdictional ESG framework that would act as "the connective tissue that ties together the work in each ministry to a common vision and set of outcomes"—in other words, a whole-of-government approach in which all departments were talking the same language and working to the same end. The process is still underway, making it too early to evaluate the extent to which it has helped the Alberta government reach its goals. But there are three elements of Alberta's approach that have broad application for any government:

a) Identify and benchmark current ESG performance

b) Improve ESG performance over time

c) Communicate the jurisdiction's ESG performance and future plans for improvement to interested audiences

Recommendation

- High priority. This action feeds directly into the government's credit rating and borrowing costs, and the ability of investment attraction to tell a compelling story. It is also something that will take a long time to develop and implement, so getting sufficient lead time is critical.

Entity

- This is likely to work best if led by elected leadership (Premier's office, City Council, etc.) but conducted using a whole-of-government approach.

Case Study

Alberta's Jurisdictional ESG Strategy

In March 2021, the Government of Alberta established an ESG Secretariat, the first of its kind by any province, to serve as a strategic coordinating body for all ESG-related activities across government. The ESG Secretariat was given responsibility for threading together Alberta's broad policy environment into a unified narrative that communicates Alberta's commitment to strong ESG performance, as well as to provide a clearinghouse for factual ESG data and performance metrics across industry sectors.

After spending most of the year consulting with a broad range of stakeholders, the Secretariat decided to pursue an innovative "Jurisdictional ESG framework" approach. Rather than focusing on the performance of individual corporations, or of the government as a business entity, the jurisdictional approach looks at the performance of the province as a whole.

Using the UN's Sustainable Development Goals as a starting point, the Secretariat conducted a review for relevance—ultimately settling on 16 key factors (Table 2) that will be used to measure the province's performance both now and into the future. Moving into 2022 and beyond, a major part of the Secretariat's work will be to garner intragovernmental support for the jurisdictional framework. This will include mapping policies, performance to date, strategic investments, and investments from industry to measure ESG performance.

Table 2

Jurisdictional ESG Framework for Alberta (draft)

Environment	**Social**	**Governance**
• Fresh water availability, conservation and renewal • Emissions, effluents, decarbonization and renewability • Natural capital, biodiversity, remediation and reclamation • Waste reduction, recycling and redirection • Physical climate and weather risk	• Demographics, immigration, inclusion, diversity and social mobility • Indigenous partnerships, participation and reconciliation • Wellness and wellbeing, safety and security • Education, skill development, income growth and affordability • Citizenship, community engagement and civil society	• Compliance, transparency and public disclosure • Human rights and production responsibility • Institutional governance, credibility and independence • R&D, innovation and technology adoption • Job creation, exports and economic growth • Financial stewardship and future capacity

Ultimately, the goal of the Secretariat is to advance the province's ESG performance – and then to use that positive performance to showcase Alberta as a confident and respected global brand. The jurisdictional framework will be useful both as an internal tool to ensure all parts of government are speaking the same language, and as an external stakeholder tool to help communicate the jurisdiction's ESG performance to others.

08

Build a solid and coherent foundation of environmental, social and governance policy and regulations

One of the fundamental roles of government is to enact policy, legislation and regulations that protect the safety and wellbeing of people and the environment—whether it pertains to emissions, water, waste, gender equity, or governance transparency and accountability. In many cases, this role is aligned with the overall purpose and approach of ESG. As governments enact new policies and regulations, improve existing ones, and improve monitoring, oversight and enforcement, the ESG performance of companies in the jurisdiction may improve by providing a "floor." (The *may* relates to the fact that the design and implementation of a regulation greatly affects the extent to which it achieves its objectives.) It may also help the government produce a credible ESG improvement story that affects its own credit ratings—as described earlier.

It is also helpful for a government to consider the coherence of its policies—and climate change policies in particular—as both the jurisdiction itself and the companies operating within it are judged on this. A coherent set of policies ensures both that there are no gaps and that the full suite of policies is aligned with net zero targets and agreements.

An additional action that government can consider is to empower government agencies (such as regulators) to consider sustainability as part of decision-making. Because many government agencies work under enabling legislation that does not explicitly mention sustainability or ESG considerations, they are unable to incorporate these factors when making decisions—and many find it frustrating and limiting in terms of serving government's overall sustainability objectives.

Recommendation

- This action is a high priority, as it strongly influences the way that the jurisdiction is viewed by investors and ESG / credit rating agencies.

Entity

- All policy-making functions (elected leadership, ministries and departments and regulators).

09

Set targets, benchmarks or thresholds for ESG performance by companies

In some cases, it can be useful to establish specific benchmarks, thresholds or targets that can be used to objectively gauge company performance and to identify what constitutes adequate, good or exceptional performance in specific E, S or G areas.

Not all ESG topics are amenable to setting benchmarks or targets—but many are. And setting binding thresholds and targets is an activity that has been taken on both by government and by industry organizations.

Governments in Canada have set thresholds or performance targets for methane emissions; vehicle performance; fuel composition; occupational health and safety performance; and employment conditions, for example. In addition, a number of Canadian industry sectors —including forestry, mining, beef, chemistry and electricity—have established performance management programs* that set binding targets or thresholds for company performance for all companies that are members of the industry association.

*See the Canada West Foundation's report *Performance Management and the Oil Sands* for a review of the performance management programs across these five sectors.

In setting targets or thresholds, governments can support beneficial outcomes that are important for people or the environment; enhance performance of individual companies and the jurisdiction itself; and provide a point of differentiation that can be used in soliciting ESG investment or attracting Foreign Direct Investment. Extreme care must be taken, however, to ensure that targets and thresholds are realistic and achievable, and do not inadvertently reduce the competitiveness of companies operating in the jurisdiction.

If targets or thresholds are established, this raises the question of how to verify or validate performance claims. In the example of the industry performance management programs above, external third-party validators are used. For the emerging ISSB standards, auditing will also be conducted by external qualified parties. Validation and auditing is not an area that government should be directly involved in unless the target/threshold measures are tied into a regulatory compliance obligation, in which case the applicable regulator would have a structure and mechanism set up to verify compliance.

Recommendation

- Potentially useful for some ESG topics, but targets and thresholds must be crafted carefully to ensure they are achievable and don't squelch competitiveness.

Entity

- The establishment of targets and thresholds is typically done by elected leadership with support from ministries or the applicable regulators.

10

Use ESG as an input into decision-making around permitting or oversight

Of all entities within government, regulators—and in particular energy and environmental regulators—have a distinct and particularly large overlap with ESG.

Energy and environment regulators are charged with ensuring that regulated entities (which are usually private sector companies) perform responsibly with respect to people and environment. The topics that they review to determine a company's compliance include water, waste, emissions, land use, health and safety, and other environmental and social (and sometimes governance) elements. Furthermore, regulators are charged with conveying this compliance information to a broad range of stakeholder audiences. In this way, the mandates of regulators have a strong alignment with the purpose and approaches used in ESG disclosure.

Because of this overlap, some regulators have raised the question of whether a company's ESG disclosures could be used to streamline, speed up or strengthen a company's application during the permitting process. However, there are several key differences between ESG and regulatory approaches that severely limit the utility of this.

The first difference is the granularity, or level, of observation. Regulatory permitting decisions are made about a *specific project* in a specific location. Information is required about the potential effects of the project on its local environment. ESG information, in contrast, is reported at the level of the *parent company*, using a single metric to represent all of its operations across all projects, subsidiaries, provinces and countries.

As an example, the Impact Assessment Agency of Canada may be asked to make a determination about issuing a permit to Shell for an exploratory drilling project off the coast of Nova Scotia. While Shell engages in extensive ESG reporting, it does not break out its Canadian operations separately from its global operations, let alone at a project level. This means that the specificity of information provided in ESG reports is insufficient for the regulator to use in assessing the past or likely future performance of the drilling project.

The second difference is rigour of the data. Regulators evaluate company compliance and performance with reference to standardized and published information on metrics definition, data collection methodology and thresholds or benchmarks for performance indicators. They do this because the data they collect, use and publish must have legal validity. ESG data, by contrast, rarely includes any information about methodology, and does not make reference to standardized thresholds, benchmarks or performance standards that can be used to gauge the adequacy of a company's efforts. (The one exception is for GHG reporting, for which there is starting to be consensus around how to measure and how to report and—to some degree—what constitutes good performance.)

Finally, the topics addressed in a company's ESG reports are those that have been identified as relevant primarily to investors, rather than adhering to regulatory terms of reference.

As a result of this mismatch, it is not appropriate to use ESG data to make decisions about regulatory permitting or oversight.

Recommendation

- Not recommended

11

Manage government investments using ESG criteria

Governments at the federal, provincial and municipal levels hold substantial financial assets—such as public pension funds and sovereign wealth funds—that are invested in income-generating instruments. Although these funds have a primary fiduciary duty to maximize returns, analysis has expanded to include ESG consideration. According to DBRS Morningstar, "Pension Funds believe that neglecting ESG analysis would be a failure of fiduciary duty as it may lead to the mispricing of risk and poor asset allocation decisions."[18] They cite CPP Investments, with approximately $500 billion in assets, which stated "We believe that companies that effectively manage Environmental, Social, and Governance factors are more likely to create financial value over the long term, improving investment performance by the Fund." The policy uses broad ESG criteria and does not screen for particular sectors like oil and gas or alcohol.

A different approach that governments can take is to use policy to direct investments to support specific environmental, social or governance outcomes, where maximizing financial returns is not the prime directive. For example, the Caisse de depot et placement du Quebec (CDPQ) has earmarked a $250 million investment fund to be deployed over four years to increase diversity and inclusion in companies within Québec and Canada. And in British Columbia, a new Crown corporation, InBC, will handle a $500 million strategic fund that will invest in companies that meet the government's social, economic and environmental policy objectives. Such investments can be used to incentivize improvement from companies in the jurisdiction that receives funding.

There are several benefits that stem from managing government investments with an eye towards sustainability, ESG, or preferred environmental, social or governance outcomes. First, it may generate better returns. Second, it is a way to demonstrate that the government manages its money based on its values—which comes back to successfully telling the ESG story of the jurisdiction.

Recommendation

- Potentially useful. This action can help demonstrate a government's alignment with ESG principles and can help create ESG high performers in the jurisdiction. However, this recommendation may not be as immediately critical as others in this report.

Entity

- Investment funds across government.

12

Manage public procurement using sustainability criteria

Some governments—particularly at a national level—have stated that they are interested in advancing sustainable public procurement in line with the UN's Sustainable Development Goal target 12.7. As described by *Canadian Business for Social Responsibility (CBSR)*, sustainable public procurement directs the purchasing of goods, services, works and utilities based on criteria that include the overall benefit to society and the environment as well as the economy.

To date, however, efforts have been patchy, and no government seems to be doing this particularly well. For the most part, the language of sustainability has been used broadly, but the actual scope of issues has been quite narrow: primarily GHG emissions and supply chain issues related to human rights and modern slavery, on top of criteria that have been in use for much longer, such as preferring local or minority-owned businesses.

There are substantial implementation challenges for governments that want to engage in sustainable procurement, or procurement that considers particular environmental, social or governance factors. One challenge relates to international trade agreements. The World Trade Organization (WTO) Government Procurement Agreement governs procurement spending across 48 members, including Canada. While the agreement was revised in 2012 to permit environmental considerations, it has yet to explicitly address the social aspects of sustainability.[19] Other implementation challenges include the development of appropriate performance indicators; sufficient guidance for government departments and agencies; and cross-governmental collaboration. Germany has attempted to meet these challenges by developing a Centre of Excellence for Sustainable Procurement that works with public contracting bodies at the federal, state and local levels.

Recommendation

- This area is still relatively undeveloped. However, it is an area to watch as it is likely to evolve as governments grapple with how to align their actions with broader commitments (such as "building back better") and objectives (such as the UN Sustainable Development Goals).

Entity

- All parts of government would be involved, as virtually all engage in some public procurement. However, direction-setting needs to come from the top.

Communicate your ESG story

Good performance doesn't matter if people don't know about it. Governments need to engage with a broad range of ESG-interested audiences—investors, consumers, data analysts, industry organizations, NGOs, ESG raters and the general public—to ensure that they have the information they need to understand and substantiate claims of ESG performance. This requires making data accessible, usable and meaningful. And it means building trust that the government is truly committed to improvement and not just spinning a good story.

13

Better organize data for ESG-interested audiences

The government can support companies by providing credible and objective data that support ESG performance claims.

Many government agencies produce information that is of interest to audiences who want to better understand the ESG performance of a region, a company or a specific project. While much of this data is on environmental indicators, governments maintain useful sources of social and governance data as well. Some examples of ESG-relevant material include:

- The Canadian Energy Regulator's (CER) *Canada's Energy Future* reports; safety performance dashboard; and provincial energy profiles
- Statistics Canada's numerous provincial and sector level data tables on environmental metrics, and diversity and inclusion
- The B.C. government's geospatial data available through iMapBC
- The Alberta Utilities Commission and Alberta Electric System Operator's data on provincial power capacity and generation profiles
- The Saskatchewan government's Business and Economy dashboard

However, this data is not always packaged in a way that makes it easy to find or easy to use. Government can take action to organize or package this information in a way that highlights its ESG relevance and increases ease of use for audiences that are interested in using data for this purpose. This includes not only those audiences who review ESG reports, but also individual companies that want to use the data as part of their disclosure efforts.

This action will require outreach to identify what information is relevant to these groups, and may include adjusting what metrics are used, how data is presented, or simply highlighting the relevance of the information for ESG purposes.

Recommendation

- High priority, with a lot of bang for the buck. It fills a need that can't be addressed by markets alone and is highly appropriate for governments to step in and provide information.

Entity

- All parts of government that produce and publish data relevant to ESG: ministries and departments, regulators, data agencies and others.

14

Broadcast your data and performance

The action items above suggest a variety of ways that governments can improve ESG reporting consistency and clarity, and induce improvements in performance across both the private sector and government itself. But there is no point in doing any of that if nobody knows about it.

For agencies that create ESG-relevant data and information, this means doing the work to ensure that interested audiences are aware that the data exist and can easily find it. Part of this may be as simple as making this information highly visible on the agency website; another part may involve outreach to ESG-interested organizations or groups.

But investment attraction agencies—at the municipal, regional or national level—can also use the ESG "story" to promote companies as investable and to better advocate for the jurisdiction.

Alberta's jurisdictional ESG framework (described on page 24) represents one approach that its investment attraction agency, Invest Alberta, will be able to use to demonstrate credible ESG performance in the province. Another emerging example comes from B.C., where the B.C. Government is developing an ESG Centre of Excellence. While details have not yet been released, the government states that the Centre is intended to "facilitate ESG investments in B.C., attract socially and environmentally conscious investors, and diversify markets for B.C.'s world-class goods and services under a respected and trustworthy ESG brand." Both these efforts represent a coordinated and highly visible effort across the provincial government to promote ESG performance to external investors as a way of differentiating companies and the jurisdiction as a whole.

Recommendation

- High priority; this action can help bridge the gap between ESG perception and on-the-ground performance reality.

Entity

- All parts of government that produce and publish data relevant to ESG (ministries and departments, regulators, data agencies) as well as investment attraction agencies.

15

Certify product origin

Once a jurisdiction's ESG brand has been built, governments can leverage the benefit by helping companies authenticate that their products actually come from that region—particularly for products such as commodities where it may be important but difficult for purchasers to verify the origin.

While the private sector offers several solutions to assist in the verification and certification of goods and services, there has to date been very little activity in this area by governments. However, the British Columbia government's Ministry of Energy, Mines and Low Carbon Innovation is a front runner in this area. The Ministry has partnered with IBM to pilot a "digital trust ecosystem" that uses blockchain technology to confirm the B.C. origin of mining products.[20] The ecosystem will connect producers with purchasers and provide verified and secure ESG data, as well as confirm the source location of raw materials. It will make use of government-held data on the emissions profile of the producer's operations. While the pilot focuses only on the mining sector and GHG emissions data, once it is proven it could be applied across multiple industries with an expanded offering of additional ESG metrics.

While demand for certified-origin oil and gas products is not yet strong, this may change with sanctions on products of Russian origin.

Certification-of-origin systems can provide multiple benefits to the organizations and jurisdictions that implement them. It provides easy access to existing ESG data by producers, consumers and investors; but also uses this data to elevate a trustworthy ESG narrative for the entire region.

Recommendation

- Potentially useful, under the right circumstances. Although this action has precedent and may bring benefit, creating such a system is difficult and expensive; and in order to derive benefit a jurisdiction has to be well informed about whether a particular market cares about a commodity's origin and must be careful not to inadvertently give competitors an easy way to block Canadian exports.

Entity

- This activity would need to be led by the relevant government ministry or department, working with the relevant regulator (for example, an energy regulator) where applicable.

Provide clarity around ESG spending and investment

At its core, ESG is a tool designed to help investors evaluate investment risk and opportunity, an area regulated directly and indirectly by government. However, there is no single template for how government needs to be involved because different jurisdictions have very different models of how they oversee and regulate investments. Depending on the jurisdiction, the financial agencies charged with protecting and informing investors—including financial regulators, central banks, stock exchanges and standards associations—may be positioned within government, outside government or at an arm's length. Which agency has oversight over securities markets, pensions, insurance, collective investment schemes, etc. also differs across jurisdictions.

Despite the many forms that financial regulation and oversight may take, government in all cases maintains a strong role in ensuring that financial actors and markets operate in a fair, transparent and stable manner for ESG claims as well as more traditional financial representations.

16

Define what can be called "ESG investing"

ESG funds are investment tools that curate a portfolio based on the environmental, social and governance performance of the equities, bonds or other instruments within the fund. As noted earlier in this report, ESG investing* has grown exponentially in recent years. With this growth has come an increasingly stringent view on what qualifies as an ESG fund. This has been largely due to concerns about "greenwashing," or misrepresentation of how the fund actually uses ESG information to select its investments.

In response, many financial regulators across the globe have implemented—or are in the process of implementing—regulations and guidance to clarify what can be claimed to be an ESG investment. This frequently takes the form of mandatory or voluntary disclosure standards regarding the focus of the fund; what ESG metrics are considered; the degree to which ESG is used in decision making; and the policies and procedures used to curate the portfolio. Table 3 provides a sample of the regulations and guidance documents that exist today. Almost all such disclosure standards have been produced at the national level, although the *Ontario Pension Benefits Act* represents an example of sub-national guidance.

To put some "teeth" behind the guidance and regulations, securities regulators in both Canada and the U.S. have conducted reviews of ESG investment products, with penalties including regulatory enforcement and potential liability misrepresentation.[21] Similarly, Morningstar—a global investment data provider—cut 1,200 funds worth $1.4 trillion in assets from its sustainable investment list in February 2022, after determining that their claims for ESG investing were not sufficiently substantiated according to the EU's Sustainable Finance Disclosure Regulation.[22]

* ESG investing, ethical investing, sustainability investing, impact investing – all these have slightly different meanings and objectives, but all invest in companies based on factors beyond just financial performance.

Table 3

Sample of regulations and guidance on what constitutes an ESG investment fund

Country	Document	Year	Publisher
Canada	*Ontario Pension Benefits Act*	2016	Financial Services Commission of Ontario
Canada	*CSA Staff Notice 81-334 – ESG-Related Investment Fund Disclosure*	2022	Canadian Securities Administrators
European Union	*Sustainable Finance Disclosure Regulation*	2021	European Parliament
Israel	Amendment of the Provisions of the Consolidated Circular – Chapter 4 of Title 5 (Management of Investment Assets): Investment related to environmental, social and corporate governance, cyber and technology risks	2021	Capital Markets Authority
Malaysia	*Guidelines on Sustainable and Responsible Investment Funds*	2017	Securities Commission Malaysia
Switzerland	*Guidance 05/2021: Preventing and combating greenwashing*	2021	Swiss Financial Market Supervisory Authority
United Kingdom	*The Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019*	2019	UK Pensions Regulator
United States	*Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices*	2022	Securities Exchange Commission

Recommendation

- Useful, but within Canada action has already been taken. In January 2022, the Canadian Securities Administrators issued guidance to investment funds on ESG fund disclosure practices.[23] For the time being, it is unlikely further action will be required.

Entity

- In Canada, issues pertaining to the validity of claims made by investment funds—including ESG funds—are regulated by the provincial securities regulators under the umbrella of the Canadian Securities Administrators.

17

Define "green" and "transition" finance instruments

Increasingly, companies and jurisdictions are able to leverage strong ESG performance to raise capital. One mechanism to do this is through issuing bonds that raise funds for sustainability-related initiatives. Financial markets classify these bonds in several ways. "Green bonds" are used to finance projects that have a positive environmental impact. "Transition bonds" are used by heavy emitters to aid their transition to lower emissions. (A related financing approach, sustainability-linked loans, have interest rates tied to a company's ability to meet certain ESG performance standards. When objectives are not met, the preferential lending rates associated with the sustainability goals are removed, resulting in a higher rate of borrowing.) Defining green and transition finance instruments has quite large financial repercussions. Since 2014, the annual "sustainable debt issuance" has grown from $43 billion to over $780 billion.[24]

The rapid rise in the use of green bonds and transition financing has led to many questions from investors. Mainly: how do we know that we are getting what we paid for—a project that is truly green or facilitates a transition to lower emissions?

This is where financial agencies have stepped in. Currently, there is no global standard, but there have been numerous jurisdictional efforts to define what projects and economic activities should be classified as green or sustainable. The most prominent is the EU's Taxonomy for Sustainable Activities,[25] which was introduced in 2020. In Canada, a parallel taxonomy is under development, with efforts being led by the Canadian Standards Association.[26] The CSA's final taxonomy document was intended to be released in June 2021; however, as of May 2022, the report has not been issued and an updated release date has not been provided.

The heavy lifting on this action has already been done by the Canadian Standards Association with their development of national definitions. Sub-national definitions for green or transition instruments are not recommended and would likely be ignored by the financial sector. However, there is a potential role for both national and sub-national governments in supporting and promoting the standards once they have been published.

Recommendation

- Useful, and the Canadian Standards Association is in the process of developing national definitions for green and transition finance instruments via a Canadian "taxonomy." Jurisdictional governments can support and promote the taxonomy after it has been published.

Entity

- Supporting and promoting the taxonomy would fall under the purview of financial regulators, and particularly securities regulators, which are responsible for dictating how financial information is reported and for ensuring investment claims are accurate.

18

Provide guidance to investors

While the majority of ESG guidance in the financial sphere has been developed for companies and fund managers, some agencies such as the TMX Group[27] and the U.S. Securities Exchange Commission[28] have also begun providing guidance to individual investors. Such guidance helps individuals to understand ESG investing and evaluate ESG-related financial product offerings.

Recommendation

- Low priority. Investors are more likely to turn to banks and investment advisors for this information than to government bulletins. Government efforts—through financial arms—can ensure that these institutions are providing transparent and accurate information to their clients.

Entity

- Securities commissions and stock exchanges.

Summary of potential actions and priority areas

Table 3 summarizes the potential actions described above and highlights those that comprise a priority area for *new or additional* government action. These priority areas have the potential to generate large improvements around ESG within the jurisdiction, have relatively low effort being put towards them currently, and/or are most effectively carried out by government.

Table 4

Summary of Potential Actions and Priority Areas

			Potentially useful?	Extent of current efforts	Priority area for new government action
Support strong and consistent ESG reporting	01	Mandate climate disclosure reporting	Yes	High	
	02	Recommend or require that public companies provide full ESG disclosure	Yes	Medium	
	03	Create your own ESG standard/framework for companies in your jurisdiction	No		
	04	Endorse specific ESG frameworks	Yes	Medium	
	05	Consider guidance for locally relevant topics	Yes	Low	
	06	Align performance/compliance data with ESG reporting frameworks	Yes	Low	Yes
Raise the bar for ESG performance	07	Benchmark and improve the jurisdiction's own ESG performance	Yes	Low	Yes
	08	Build a solid foundation of environmental, social and governance policy and regulations	Yes	High	Yes
	09	Set targets, benchmarks or thresholds for ESG performance by companies	Yes	Low	
	10	Use ESG as an input into decision-making around permitting or oversight	No		
	11	Manage government investments using ESG criteria	Yes	Low	
	12	Manage public procurement using sustainability criteria	Yes	Low	
Communicate the ESG story	13	Better organize data for ESG-interested audiences	Yes	Low	Yes
	14	Broadcast your data and performance	Yes	Low	Yes
	15	Certify product origin	Yes	Low	
Provide definitions and clarity around ESG investment	16	Define what can be called "ESG investing"	Yes	High	
	17	Define "green" and "transition" finance instruments	Yes	High	
	18	Provide guidance to investors	Yes	Medium	

Conclusion

Rapid evolution & real opportunity

The world of ESG is growing and evolving rapidly, and shows no signs of slowing down in the short- to medium-term. Across the globe, agencies inside and outside government have been working to improve consistency, provide clarity and ensure the validity of ESG disclosure and performance. Nonetheless, it is still a very messy playing field.

A real opportunity exists for governments in Canada at the municipal, provincial and federal levels to support strong and consistent ESG reporting, raise the bar for performance, communicate success to different stakeholder audiences, and provide clarity for investors. These actions will help companies operating in the jurisdiction; they will also help the government by building its brand *and* its investment attractiveness. But there are many possible routes forward and it can be easy for governments to get lost or invest time in ineffective endeavors.

For this reason, the final action that governments should consider—although it may seem obvious—is to keep a close eye on the rapid changes in the ESG landscape so that they can identify and act on areas of opportunity as they arise.

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