



Canada ESG Financing A Maturing Market

Issuer & Investor Market Insights



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About the report

HSBC has worked with East & Partners (East) to continue its sustainable finance research programme into a third year. The main research objective is to further explore the underlying approach to the sustainable financing and ESG market across the investor and issuer base in each geography, the importance of disclosure to them, how that has changed, and what the future holds.

The first round of research in 2016 reported on sustainable financing with particular focus on environmental, which was expanded to cover social investing in the next round in 2017. Round III in 2018 has broadened this further to encompass all three ESG factors (environmental, social and governance) pivotal to sustainable and responsible investing.

The reporting is based on direct interviews conducted by East with 1,731 global entities including 863 issuers and 868 investors over a five week period ending 29 June 2018. Among corporate issuers, the average company size was USD\$23.8bn, with 54% of issuers with annual turnover under USD\$10bn and 46% with turnover in excess of USD\$10bn. Among investors, the average assets under management (AUM) were USD\$178.8bn, with 43% of investors with AUM under USD\$100bn and 57% with AUM in excess of USD\$100bn. Group Treasurers, CFOs, CIOs and Heads of Investments Strategy included in the sample frame were located across Europe, North America, Asia and the Middle East.

As briefed, East have produced global, regional and individual country reports. This edition is the Canada report issued on August 2018.

Exhibit 1

Geographical Distribution

N Count of Issuers & Investors

Market	Corporates/Issuers (N: 863)	Investors (N: 868)
China	126	125
Hong Kong	127	125
Singapore	51	50
UK	126	126
France	42	43
Germany	42	43
Saudi Arabia	50	50
UAE	50	51
United States	125	129
Canada	124	126

Key themes

Positive outlook among those engaged with ESG as both Issuers and Investors increases the value of their ESG commitments

Global forecasts point to continuing growth across the ESG market in 2018. Figures from industry participants such as S&P, Moody's, Fitch, Bloomberg and the Climate Bonds Initiative point to this and insight gained from this round of research into Issuer and Investor forecasts confirms this outlook.

Decisions increasingly financially driven, proving the market is sustainable

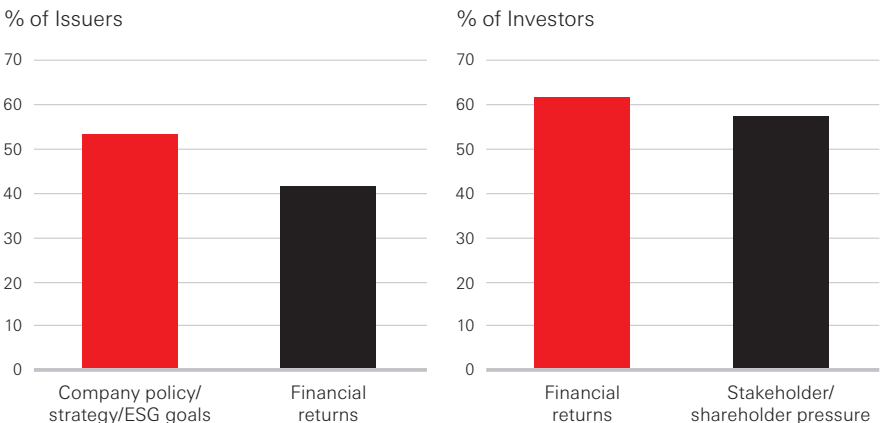
In Canada, company policy/strategy/ESG goals is the top driver of ESG decision making among Issuers, and financial returns among Investors. Financial returns for Issuers and stakeholder pressure among Investors are reported second.

Tax incentives follow these among Issuers, with over a third reporting this alongside a similar proportion of Investors.

In the context of increasing awareness and responsibility among shareholders and stakeholders it is important to note that pressure from these groups remains vitally important to the sustainability of the ESG market, although this has been tempered somewhat since the last round of research where they were the number one driver of increased ESG financing (comparison is indicative only due to the higher turnover bracket in the investor selection used in the 2018 survey).

Exhibit 2

Key Drivers of ESG Decision Making in Canada



www.climatebonds.net

www.youtube.com/watch?v=XkKF6lbwSj4

www.moody.com/sites/products/ProductAttachments/MIS_Green_Bonds_2018_key_trends.pdf

www.bloomberg.com/professional/blog/blossoming-green-bond-market-growing-toward-250-billion-year

Disclosure still has a long way to go

Disclosure of ESG strategy and policy is very much an ongoing ‘work in progress’ in Canada.

82 percent of Issuers and 83 percent of Investors have an ESG strategy, although less than 30 percent of those disclose it in the public space, lower than the global average.

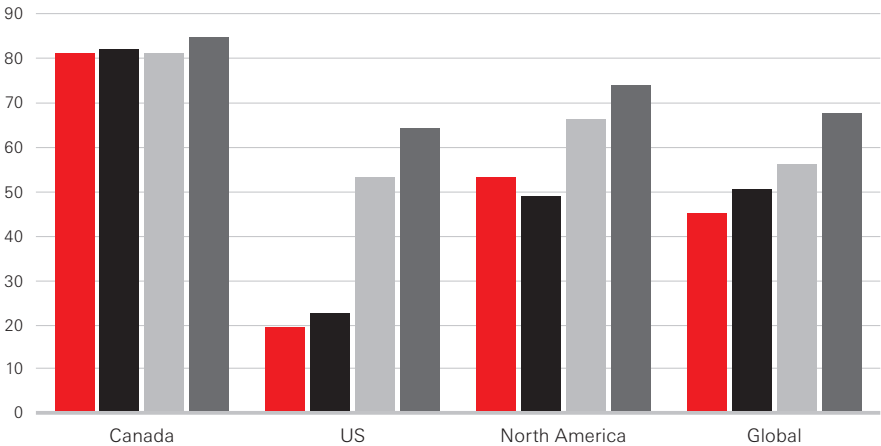
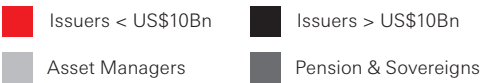
Increased disclosure, in part driven by avoiding the risk of negative publicity, is a little concerning for the industry but regulation, stakeholder pressure, enhanced risk management and financial returns will be key to ensuring the industry continues to work towards full disclosure and transparency.

In terms of ESG policy, we see a less transparent approach, with 77 percent of Issuers and 52 percent of Investors not disclosing their policies.

Exhibit 3

Do you have an ESG Strategy?

% of Issuers & Investors who have an ESG Strategy



Key Reporting Insights

Who's involved

The use of ESG financial instruments among the Canada's Issuers is 85 percent and 87 percent on the Investor side of the market.

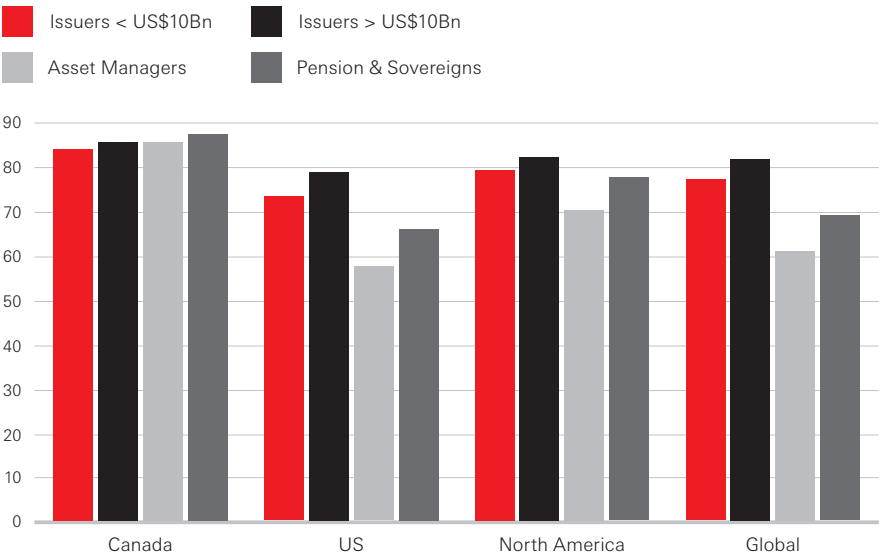
Second only to the UK and China among Issuers and the UK among Investors for penetration of both ESG financing and investing, Canada's ESG market is far more mature than its US counterpart. Whilst penetration among Issuers is only 10 percent greater than in the US, it is in the Investor market that we see a considerable intra-regional variance where a 40 percent higher usage is reported in Canada, increasing to 48 percent among Asset Managers.

A similar proportion are involved across Issuer revenue segments and Investor categories, presenting an equal approach by the market at large.

Exhibit 4

Penetration of ESG Financing / Investing in Canada

% of Issuers & Investors



ESG Decision drivers

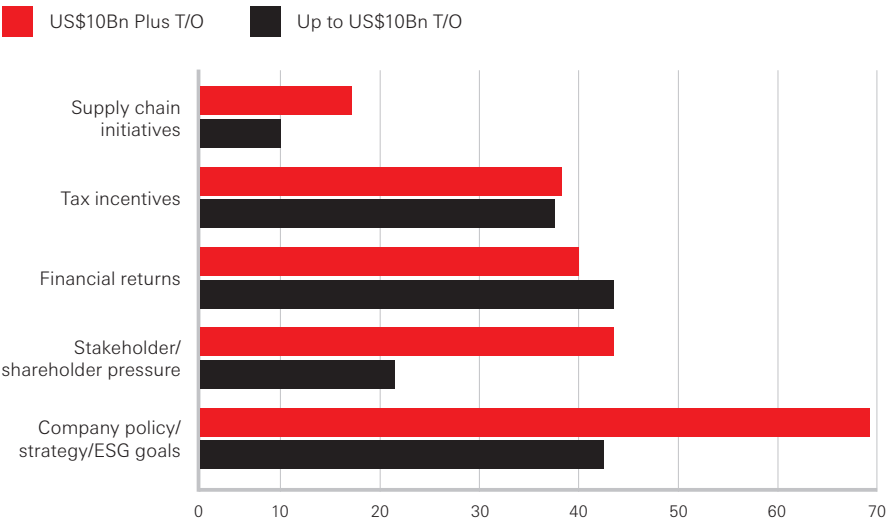
Issuers in Canada rate company policy / strategy / ESG goals and financial returns as the top two drivers of ESG decision making, with 54 and 42 percent of Issuers noting these respectively. These are followed closely however by stakeholder pressure, especially among Issuers with turnover exceeding US\$10 billion, and tax incentives.

Canada's Investors have a broader range of focus than their Issuer peers, led by financial returns and stakeholder / shareholder pressure, but also including company policy / strategy / ESG goals and regulation, each of which are reported by more than 50 percent of Investors with higher levels among Pension Funds and Sovereign Wealth Funds. Risk management and alignment of values with investment partners are also important to increasing their presence in the ESG space.

Exhibit 5

Drivers of ESG Decision Making in Canada – Issuers

% of Issuers Engaged with ESG Financing



An interesting line can be drawn between ‘leading’ Issuer markets, Canada, China and the UK, where the relative importance placed on company policy / strategy / ESG goals is higher than less mature markets. This is most apparent with those Issuers who have turnover greater than US\$10 billion where 69 percent state this as a driver, twice as much as in the US.

The standout difference among Canada’s Investors, alongside the UK, compared to other markets and regions is the range of factors being reported by more than a third of Investors across both Asset Managers and Pension Funds and Sovereign Wealth Funds. In the US, only three factors are reported by more than a third of Investors as driving their ESG decisions.

Exhibit 6

Drivers of ESG Decision Making in Canada – Investors

% of Investors Engaged with ESG Investing



Disclosure

In Canada, 82 percent of Issuers and 83 percent of Investors have an ESG strategy.

The level of attention being given to the ESG market in Canada is encouraging but the lack of subsequent disclosure of strategy and policy to the market places a question mark against any leadership towards ESG financing and investment, especially when considered against the higher levels seen in the UK.

When compared against the low levels of ESG in the US, almost four times the number of Issuers are likely to have an ESG strategy and 42 percent more Investors have one, although of those that do, it must be noted that a higher proportion, US Issuers disclose theirs to the market.

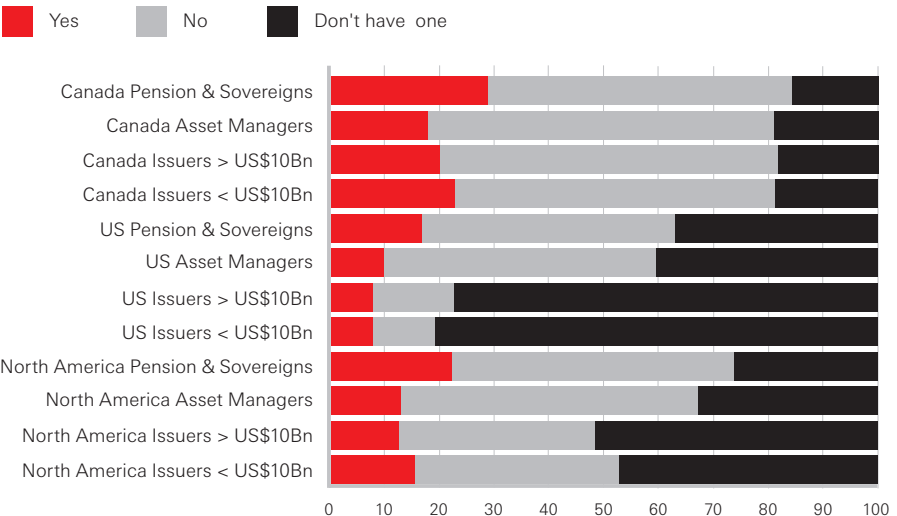
A slightly concerning issue is the prominence attributed to avoiding negative publicity, especially among Pension Funds and Sovereign Wealth Funds who, at 78 percent, report this as the number-one driver alongside regulation. However, financial returns and stakeholder pressure are also seen as important drivers towards increased disclosure and transparency. This highlights the positive approach evident in the Canadian market.

These factors are largely in line with Canada’s intra-regional peer, the US, although considerably less importance is placed on stakeholder pressure south of the border. This raises an interesting thought around how stakeholder engagement in Canada and its corporate culture can be used as an example for the US, or do the differing market dynamics between the two countries make this a redundant task.

Exhibit 7

Do you Disclose your ESG Strategy?

% of Issuers & Investors



Allocation of funds by Issuers

Issuers in Canada are consistent with their intra-regional peers with regard to the most popular asset classes, investing in ‘business projects which are green by definition’ along with environmental / green impact investing, both of which are most popular in total and by revenue segment.

However, Canada’s Issuers allocate funds to a wider range of investments than any other market or region globally. Highlighting this are those with turnover exceeding US\$10 billion who are the only Issuers globally of whom more than 50 percent allocate funds to three different types of investment including ‘ESG principled pension funds’.

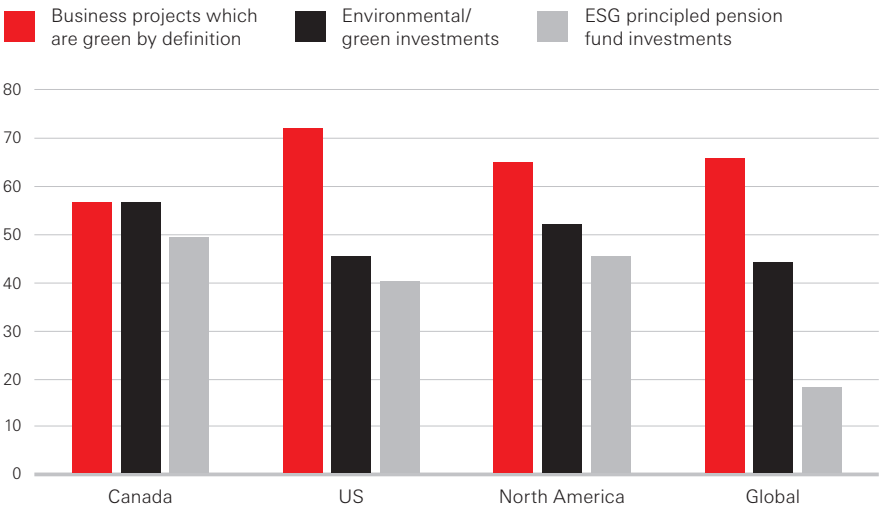
This is an important difference; not only do Canadian Issuers invest in more asset classes on average, but a higher proportion of Issuers compared to all other markets invest in ‘operational changes to improve ESG compliance’, Green M&A, and ‘sustainable investments through strategic asset allocation / fund management’.

This willingness and intent by Issuers to invest broadly provides an interesting parallel to the UK where a seemingly similarly mature ESG Issuer market is narrowly focused on its use of funds but is more transparent on ESG strategy and policy.

Exhibit 8

What Green financing is being used for

% of Issuers



Performance compared to traditional products

For both Issuers and Investors, performance of ESG financing / investments compared to traditional products is linked to reputation. Both sides of the fence rated their reputational performance relatively better as a result of their ESG commitments.

Based on a 1 to 5 scale where 1 is better and 5 is worse, Issuers rated their reputational performance at 1.90 and Investors at 1.92. This reputational performance is also seen in the ratings attributed to shareholder / investor engagement and uptake / demand of products on offer, with the implication that one leads the other.

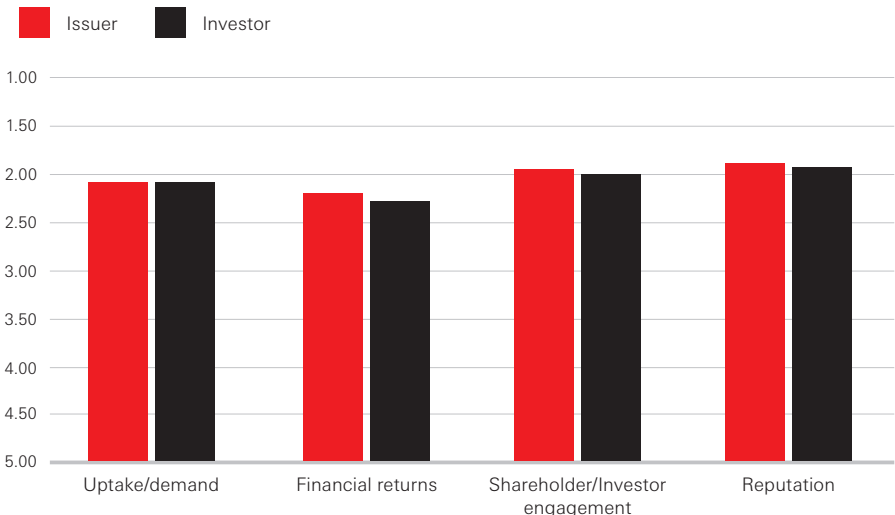
Although rated least favourably by both Issuers and Investors, the comparative performance given to financial returns has been rated higher than any market or region globally. This is especially pertinent to the ratings given by the US who reported among the lowest on this metric. When comparing all metrics intra-regionally, these ratings are considerably better than the US across all Issuer revenue segments and Investor categories.

The rating attributed to reputational performance also provides a key insight on how stakeholder pressure is actioned. Year on year changes to drivers of increased disclosure show that the relative importance of negative publicity to Issuers has substantially increased, meaning the resulting effort to avoid this risk is actively delivering improvements to reputation.

Exhibit 9

ESG Performance Compared to Traditional Products in Canada

1 = better | 5 = worse



Investment styles by Investors

The Global Sustainable Investment Alliance (GSIA) defines seven styles of investment and there are three clear styles being utilised by Investors in Canada:

- » Sustainability themed investing 63 percent
- » Integration of ESG factors 56 percent
- » Negative / exclusionary screening 45 percent

These are in line with the three most used styles globally, albeit in a different order of importance.

Compared to the US, Investors in Canada are more likely to use these investment styles, with just 10 percent stating they don't employ any in their decision making process, compared to 28 percent in the US. With 90 percent using GSIA investment styles, Canada has the highest global penetration, especially among Pension Funds and Sovereign Wealth Funds who, with just seven percent not using them, are far more likely to use these compared to the UK's 15 percent, who are the next most engaged.

Of those who do, the average number used per Investor is 2.7, split between Asset Managers, who average 2.6, and Pension Funds and Sovereign Wealth Funds, who average 2.8. With the exception of the US, these average figures are the lowest across all other markets, although overall usage among Investors must be taken into consideration when assessing this figure.

Exhibit 10

Average Number of Investment Styles

per Investor



Structure of ESG investments

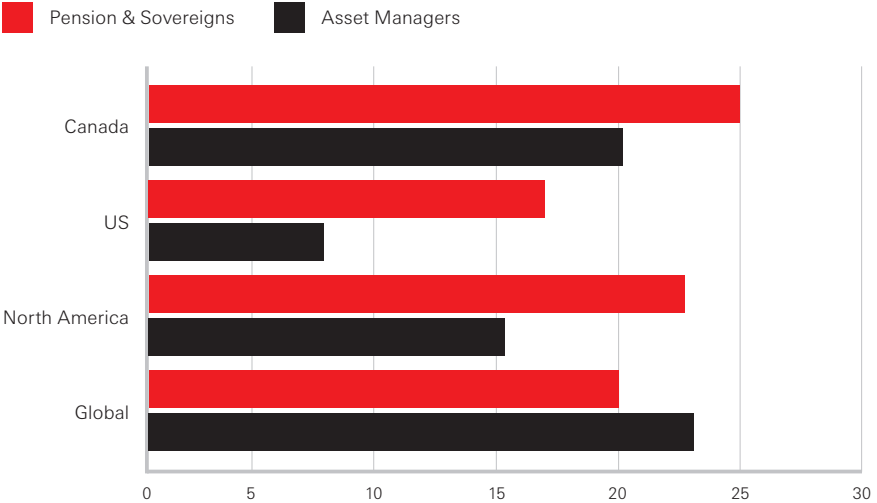
The proportion of ESG investments structured in a ringfenced / dedicated manner is low at 10 percent, with Asset Managers lagging slightly behind Pension Funds and Sovereign Wealth Funds. This is significantly higher than in the US which, again, highlights the differences in the North American market.

Encouragingly, and whilst from a low starting point, this is forecast to increase 23 percent in the coming year, almost double that in the US and increasing to over two and a half times among Asset Managers.

This increased transparency is crucial for an investor market that has experienced its share of cynicism. With 57 percent of Investors citing stakeholder pressure as a key driver of ESG decision making combined with 72 percent citing the avoidance of the risk of negative publicity as a driver to increase disclosure, it's not surprising that this trend towards dedicated funds is growing rapidly.

Exhibit 11

Growth of Ringfenced / Dedicated ESG Investment Structures % Growth



Barriers to financing / investing

Very few of Canada’s Issuers and Investors see barriers to increasing their ESG commitments, with 87 percent and 83 percent stating there are none, respectively.

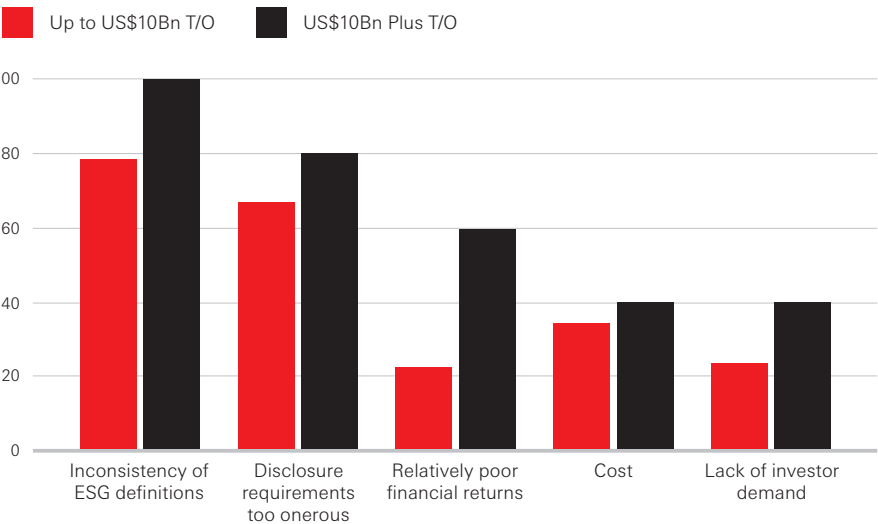
Among Issuers who see barriers, this is second only to the Asian markets, China and Hong Kong, and is the highest figure reported globally in the Investor market. This is considerably higher than the US, where Issuers are over five times more likely to see barriers and almost three and a half times more amongst Investors.

With such a low proportion of Canada’s Issuer and Investors stating there are barriers, it is difficult to take more than an indicative gauge on what needs to be improved.

Exhibit 12

Key Barriers to increasing ESG Financing in Canada – Issuers

% of Issuers



Barriers to financing / investing (cont.)

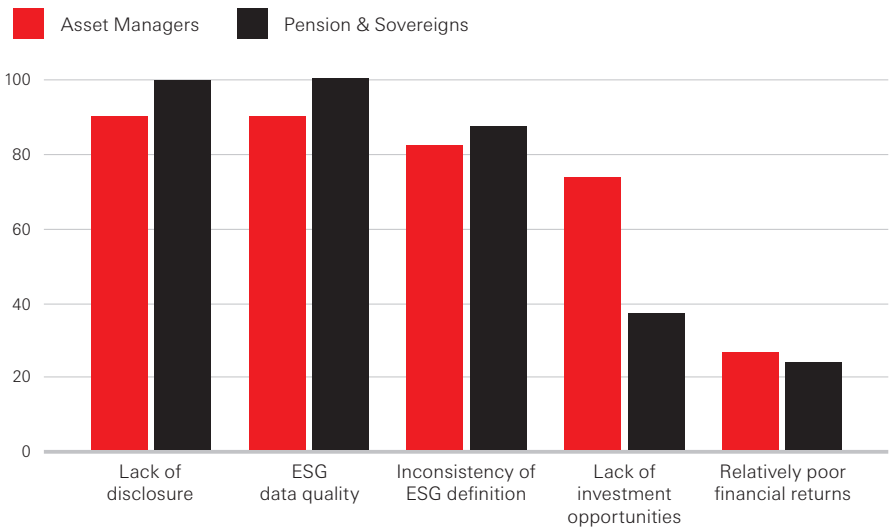
However, inconsistency of ESG definitions and disclosure issues are noted by over 70 percent of both, with ESG data quality also reported as an issue among Investors. Differences between Issuer revenue segments and Investor categories are seen especially between Issuer revenue segments regarding financial returns and between Investor categories for investment opportunities.

One difference to note intra-regionally is the weighting attributed to poor financial returns by both Issuers and Investors in the US. Across the market, this is reported by more than double that seen in Canada.

Exhibit 13

Key Barriers to increasing ESG Investment in Canada – Investors

% of Investors



Key Headlines in Canada

Who's involved

- » 85 percent of Issuers and 87 percent of Investors engaged with ESG financing and investing.

ESG Decision drivers

- » Company policy and the commercial reality of financial returns driving a majority of Issuers' ESG decision making.
- » More than 50 percent of Investors report company policy, regulation, financial return and stakeholder pressure.

Disclosure

- » Regulation, stakeholder pressure and the risk of negative publicity driving disclosure and transparency.

Allocation of funds by Issuers

- » Funds are allocated to the broadest range of investments globally.

Performance compared to traditional products

- » Improved reputation and the subsequent impact this has on shareholder / investor engagement highlights the importance of being involved in the ESG market.
- » Highest rating globally given to performance of financial returns.

Investment styles by Investors

- » Clear consistency with the main investment styles being used globally, although in a different order of importance.
- » Highest proportion using these investment styles globally.

Structure of ESG investments

- » Leads North America in proportion of funds in dedicated structure and also in their forecast growth.

Barriers to financing / investing

- » The majority of Issuers and Investors see no barriers to increasing their ESG commitments.
- » Among Investors this is the highest proportion globally.



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