Introduction on Climate Change Considerations

Investor Factsheet
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How can a community foundation take climate change considerations into account within its investment portfolios? This factsheet provides an introduction on the fundamentals to know before undertaking the process. First, it outlines important terminology and definitions related to climate change and investing; and second, it outlines some of the approaches you can use for your community foundation.

The climate crisis is complex and multi-faceted. No single institution or sector can solve climate change, but together we can help shape a positive outcome.

**Climate Terminology for Investors**

Climate-Related Risks and Opportunities - The global mitigation of and adaptation to climate change presents both risks and opportunities for businesses and investors.

- **Acute physical risks** result from the increasing frequency and severity of extreme climate or weather events (e.g. heat waves or floods), which, in addition to carrying a heavy social toll, can damage physical property and impact business operations.

- **Chronic physical risks** arise from long-term shifts in climate and weather patterns (e.g. rising average temperatures), which may negatively impact important resource availability, as well as human health and migration.

- **Transition risks/opportunities** are financial risks that result from moving to a low-carbon economy. They are driven by changes in policies, technology, market sentiment or customer behaviours.

- **GHG or Carbon Emissions** – Carbon emissions are typically referred to in terms of Scope 1, 2 and 3, and expressed in terms of tonnes of CO2 equivalent. Scope 1, 2 and 3 is a way of categorizing the different kinds of carbon emissions a company creates.
based on whether they occur in its own operations or its broader value chain. The term first appeared in the Green House Gas Protocol of 2001.

- **Scope 1 emissions** include GHG emissions a company makes directly (e.g. running its boilers and vehicles)
- **Scope 2 emissions** include GHG emissions a company makes indirectly (e.g. the electricity or energy it buys for heating and cooling buildings)
- **Scope 3 emissions** are more difficult to track. This category includes all the emissions associated, not with the company itself, but that the organisation is indirectly responsible for, up and down its value chain (e.g. from buying products from its suppliers to customers using its products). Scope 3 emissions are broken into 15 separate categories, and different categories will be material for different industries. For many sectors (e.g. automotive, food), Scope 3 is nearly always the largest emissions source. It is also the most difficult source to track accurately; it currently has the lowest quality data available for investor use and is subject double counting issues.

- **Financed Emissions** – refers to the Greenhouse Gas (GHG) emissions financed by investors through their investment portfolios. They are investors’ Scope 3 emissions and provide a measure of absolute portfolio contribution to climate change. It is calculated by taking the Scope 1 and 2 emissions of investee companies and dividing this by the full enterprise value of each company, and then apportioning those to each investor, based on the value of equities or bonds they hold in each company.

- **Net-Zero** - refers to a state in which the greenhouse gases going into the atmosphere are balanced by removal out of the atmosphere. The ‘net’ in net zero is important because it will be very difficult to reduce all emissions to zero on the timescale needed. Net zero by 2050 or sooner is the internationally agreed upon goal for mitigating global warming in the second half of the century (global warming should be well below 2°C, preferably no more than 1.5°C above pre-industrial levels by 2100).

- **Net-Zero Investor Commitments** - means taking action to align investment portfolios with the goal of limiting global warming to well below 2°C, preferably no more than 1.5°C above pre-industrial levels by 2100. Investors may approach net zero commitments through various means including:
  - **Net Zero Stewardship** – engaging with investee companies to encourage them to take action to align their businesses with a net zero pathway.

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1 In time, Financed Emissions are expected to expand to include scope 3 emissions of investee companies. However given the data quality issues, this will likely take some time.
**Portfolio Adjustments** – making changes to the composition of portfolio holdings to bring down financed emissions, in-line with net zero objectives (e.g. fair share of 50% reduction by 2030, and net zero by 2050).

**The Investor Toolkit**
Much like ESG investing, there is no one-size-fits-all approach to investing for climate change either. Rather, investors should think about climate changes and investing as a continuum, and their approach should be determined based on their objectives.

- **Low-Carbon** – low carbon investment strategies are designed to help decarbonize portfolios, and may reduce risk by lowering exposure to carbon-intensive businesses. They tend to be broadly diversified and can be used as a core portfolio allocation. Importantly, having a lower carbon footprint does not equal an investment in climate solutions.

- **Fossil Fuel Free** – In addition to targeting a lower carbon footprint for a portfolio, a significant number of investors have chosen to divest from entities that primarily produce, transport, or generate power from fossil fuels. This decision is typically driven by stakeholder concerns and will have varying impacts on the investable universe across asset classes.

- **Climate Solutions and Clean Tech** – strategies that seek to capture climate transition opportunities and/or investing in companies relatively more exposed to the transition to a lower carbon economy. These strategies tend to have a narrower market exposure, small/mid cap bias, and are most commonly added as part of satellite portfolio allocations. Interestingly, these strategies may sometimes have higher carbon intensities, if investing in companies that have both clean tech and fossil fuel exposure (e.g. a power company that has both renewables and legacy fossil fuel power generation).

- **Climate Conscious/Climate Focused** – climate-conscious or climate-focused investment strategies strike a balance between managing carbon risk and investing in climate solutions, as their selection criteria tends to go beyond carbon intensity to include overall business transition alignment and/or revenue opportunities. While possibly suitable as a core portfolio allocation, they also tend to be more constrained than low-carbon strategies.

- **Green Bonds** – Green bonds are fixed-income securities issued to finance environmentally friendly projects, such as renewable energy development, energy efficiency improvements, and sustainable transportation infrastructure. They provide investors with an opportunity to support sustainable initiatives while receiving regular interest payments and principal repayment at maturity. As the green bond market is still quite small in Canada (<4% of bond universe), green bonds are often used as a satellite allocation within portfolios.
• **Impact Investing**: Impact investing involves allocating capital to companies, projects, or initiatives with the explicit goal of generating a measurable, positive environmental or social impact alongside a financial return. Climate-friendly impact investments may target renewable energy projects, sustainable agriculture, or other initiatives that directly contribute to climate change mitigation.

**Final Thoughts**

There are a variety of ways that community foundations can incorporate climate change into their investments:

a) Investment Policy Statement – by updating your investment policy statement (IPS) to define values and objectives around climate, such as carbon footprint objectives, Net Zero alignment, targeted engagement, and/or exclusions.

b) Impact investing or granting – by allocating a portion to climate-related impact investing at the broader level. By financing climate-related projects at the community level.

c) Public commitment to system-level change with regard to climate – by making a public commitment and taking actions, such as the Canadian Philanthropy Commitment on Climate Change, by being part of the Climate Resilience Cohort (CFC), or by developing an internal Climate Action Plan (CAP).

In developing an informed approach, investors should start by answering the following question: “What is my climate objective?” Consistent with your organizational values, are you focused on reducing exposure to carbon intensive businesses? Decarbonizing the portfolios? Seeking increased exposure to climate solutions?Aligning with a “Net-Zero by 2050” objective? Investing in projects/companies with positive and measurable impact?

And finally, investors should consider engaging their investment manager to take stock of their current portfolio. Some questions to start with might be:

- What public commitments has my investment manager made to climate change?
- How are my managers integrating climate change analysis at the security level? At the portfolio level?
- What climate metrics (e.g. financed emissions, carbon intensity) are available for the portfolio?
- What is their approach to incorporating climate into stewardship practices, such as proxy voting and engagement?
## Appendix: Climate Disclosure Frameworks and Standards:

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<th>TCFD</th>
<th>CDP</th>
<th>SASB</th>
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<td><strong>What</strong></td>
<td>A voluntary reporting framework designed for institutions to publicly disclose their approach to climate change. TCFD-aligned disclosure is becoming mandatory in some regions.</td>
<td>Largest public database of GHG emissions. Companies voluntarily complete a questionnaire annually (GHG emissions data by Scope, emission reduction targets, source of GHG emissions, governance, strategy, etc.) and get scored on content.</td>
<td>The Sustainability Accounting Standard Board provides disclosure standards on material sustainability topics to better connect businesses and investors. Designed to be used by companies and investors. Focus on materiality.</td>
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<td><strong>Why</strong></td>
<td>Financial markets need better climate-related disclosure to get an understanding of climate-related risks and opportunities. TCFD provides a framework for this disclosure.</td>
<td>To get the data needed to better assess climate-related financial risks and opportunities.</td>
<td>Non-Financial value drivers have grown in importance but it remains difficult to capture their financial value. ESG disclosures lack comparability, reliability and usefulness for investor decision-making.</td>
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<td><strong>When</strong></td>
<td>Created by Mark Carney (and led by Mike Bloomberg) in 2015 after COP21. COP21 is famous because this is when the Paris Agreement* is created to limit global warming at well below 2°C, preferably to 1.5°C compare to pre-industrial levels.</td>
<td>Created in 2003. Includes specific module for some industries (ex: O&amp;G) and a new questionnaire for small/mid cap companies.</td>
<td>Created in 2011 in the US. In 2022, SASB merged into IFRS, creating the International Sustainability Standards Board (ISSB). On top of maintaining SASB standards, the ISSB has released two additional standards. IFRS S2 sets standards for the disclosure of climate-related risks and opportunities. The requirements are consistent with the TCFD framework.</td>
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<td><strong>How</strong></td>
<td>Participants disclose on 4 pillars: 1) Governance 2) Strategy (includes scenario analysis to test resilience) 3) Risk Management 4) Metrics and targets</td>
<td>Companies answer questions. The report is then made available for investors on cdp.net</td>
<td>Companies disclose on relevant sustainability topics following a set of standards designed by industry.</td>
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*Community Foundations of Canada is grateful for the collaboration of Jarislowsky Fraser Ltd. in creating this factsheet for community foundations.*

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**TCFD**

A framework

**CDP**

A climate questionnaire

**SASB**

Disclosure Standards
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