Institute of Corporate Directors

Podcast Transcript: Be it resolved that Canada needs to set its own path for sustainability standards.

Rahul Bhardwaj (00:03): Welcome to Be It Resolved, the podcast where bold ideas meet courageous leadership. I'm Rahul Bhardwaj, President and CEO of the Institute of Corporate Directors in Canada. In each episode, I speak with experts to delve into pressing issues, impacting directors and decision-making in the boardroom.

My guest today is Sarah Keyes, a partner in PWC Canada's sustainability strategy and transformation practice. Sarah helps boards connect sustainability and climate change to performance and long-term value creation. Sarah will help us better understand the evolving, regulatory and corporate landscape for ESG oversight, board strategy, and long-term planning, both in Canada and some insights about what's happening globally.

Now, today's resolution is: Be it resolved, Canada needs to set its own path for sustainability standards. To our listeners, which way would you vote?

Sarah, welcome, today. I'm gonna ask you which way you'd vote, but that'll come a little later. Thanks for joining us.

Sarah Keyes (01:08): Thanks for having me.

Rahul Bhardwaj (01:10): Great. So let's start at the beginning. What are sustainability standards?

Sarah Keyes (01:15): So before we get into what the standards are, let's define the topic itself, which has been a bit of a lightning rod for controversy as of late. So terms like sustainability, ESG, and CSR are the ones that come to mind. So let me briefly define those before we jump into what the standards are for them.

So first and foremost, CSR longstanding- corporate social responsibility - been around since the 1980s, all about the impact of the company on environment and society, think corporate giving, employee volunteering, et cetera.

Rahul Bhardwaj (01:46): And a lot of philanthropy there.

Sarah Keyes (01:48): A lot of philanthropy there and a lot of great work that's been done. However, of course, in the face of unchecked environmental and social issues, we've started to see them rear their ugly head impacting the financial and operating performance of companies and their access to and cost of capital. That's where ESG came from. Environmental, social, and governance defined by the institutional investor community in the early 2000s. The concept of sustainability captures both sides of that coin, the impact of the company on environment and society, and the impact of environmental and societal issues on the company's performance.

Rahul Bhardwaj (02:22): So when we're talking about sustainability, we're talking about both sustainability of the company and the planet.

Sarah Keyes (02:28): Yeah, it's essentially contextualizing that companies today have to operate in an environment and society that's thriving so that they can create long-term value themselves.

Rahul Bhardwaj (02:38): Now, if it was only that simple. So this is a lot of different interpretations around the world, it'd be great to get your sense of what is going on in Europe and in Asia, of course in the US. And I also wanna come back to there's some shareholders and stakeholders who really get behind sustainability and there are others though, that are detractors.

Sarah Keyes (02:56): So you've highlighted a critical point. So when we think about what the standards actually are about, I think we need to take a step back and ask who we're trying to communicate to as a company. So let's take the institutional investors who care about the financial performance of the firm.

They ultimately are the ones who've been driving a lot of the push for mandatory standards from companies so that they have the information they need to make investment decisions.

Now in Canada, we haven't seen as much of a regulatory push as we have in Europe or in Asia. So in the past several years, we've seen Europeans lead the way on mandatory sustainability reporting. And to your point, it considers those two away risks, the CSR aspects as well as the ESG aspects. And that's a lot of information for companies to gather and report on. And so they're communicating to a wide range of stakeholders.

If you look here in North America, the focus has largely been on financial materiality and communicating to institutional investors and the capital markets at large. In other words, those who provide capital to the company, whether debt or equity. Now those investors have really wanted this information so that they can get it from companies. And in the absence of it, they've ultimately had to turn to voluntary reporting, which has grown in volume over the past several decades.

Rahul Bhardwaj (04:14): So let's unpack that a little bit. Is there a tension between short-term investors and long-term investors when it comes to the very concept of sustainability?

Sarah Keyes (04:25): Undoubtedly, I think it's important to contextualize this in reality. So those who have a shorter holding period are less likely to focus on sustainability issues in their investment decision-making. However, we are starting to see interesting examples of this in the private equity world, which typically does have a shorter holding period in the grand scheme of things. They're really investing in this because they think that the companies that do well on ESG will have a premium on exit. So when they sell the company, they're looking to get that extra value out of it because of its ESG performance.

Rahul Bhardwaj (04:59): So why such a big push back on it? There seems to be a sense that a focus on sustainability standards and disclosure is a burden, a distraction, takes away management's focus on competitiveness, am I right?

Sarah Keyes (05:14): I think it's a fair statement. A large number of companies are responding to the increased reporting burden placed on them as a result of gathering a lot of net new information. But not all of it is net new. And that's an interesting piece of this puzzle. A large number of natural resource-based firms would tell you they've been gathering and reporting on environmental and social issues and data for many decades. Why? Not because they had to, but because it was meaningful to their business, their access to capital, their social license to operate, their ability to get projects through the regulatory permitting process around the world.

And so what's kind of interesting here is if you step back, there's a bit of a bifurcation in the market, some of those who really don't want to report any of this information and some who see a tremendous amount of value in doing so.

Rahul Bhardwaj (06:03): So right sizing, we've heard that phrase used in the ESG world, that there's too much of a burden, too much regulation, and there are others who are saying, no, actually, you gotta say something though, we do need to know; particularly if you wanna manage risk, and we wanna be able to evaluate the efficacy of a strategy over the long term. So what does right sizing need to focus on?

Sarah Keyes (06:27): Well, let me put it in the context of our resolution that we're talking about today. So when we think about Canada as a nation, we have some unique aspects that make it quite challenging from a regulatory reporting burden standpoint to adhere to these global standards.

Number one, we have a heavy natural resource-based economy. It's been the backbone of how we've grown as a society and it's essential for jobs and value creation and our GDP.

And as I mentioned, many of those companies in the natural resource space, mining, utilities, oil and gas, forestry, et cetera, have been gathering this information, not for regulatory reporting, but for improved performance. Now, the challenge we have is the number of small, medium-sized enterprises that also fit in our economy. We're 99%, in Canada, small medium enterprise. So when we think about global standards, the reporting burden may be disproportionate on smaller medium enterprise who tend to be focused on keeping the lights on and focusing on that year to year value creation as opposed to having the benefit to look in the long-term as some of the larger corporations do.

Rahul Bhardwaj (07:34): Right. And the question posed often is, is anybody actually reading this disclosure?

Sarah Keyes (07:40): You know, it's interesting. I think it depends on who you're trying to communicate to and understanding that audience and where they get the information and also how they digest it. An interesting fact around the use of regulatory filings by institutional investors, they're not reading it themselves. They're actually using AI tools now to scan through these filings and pull out keywords and information that is meaningful to their investment decision.

The same thing is starting to happen with sustainability reports. Increasing use of AI and generative AI tools to scrape through the vast amounts of information. Because if you really step back, I don't believe any institutional investor has the time to read a two to 300-page sustainability report. And if you think about those European standards that I mentioned earlier, I'll give you an example of what happens when we go a little too far and too fast. So we saw Europe go ahead with that double materiality approach, capturing over 120 different data points for each and every company that is reporting.

Rahul Bhardwaj (08:40): Can you just explain the double materiality?

Sarah Keyes (08:43): So the double materiality is those two-way risks, the CSR and the ESG impact of the company on people and planet and impact of those issues on the company's performance. So it's really expanding the scope. And what they did with the corporate sustainability reporting directive is they captured over 50,000 companies globally with this regulation when it first came out.

A couple of years later- and we've seen the first wave of reporting - we've also seen the omnibus regulation scaling back significantly, both the scope of companies covered as well as providing voluntary reporting standards that are rightsized for small medium enterprise. So even jurisdictions that have the political will and the support to go far and fast on sustainability have found themselves needing to come back to a place of pragmatism, helping small medium enterprise actually adopt standards that are right sized for their business.

Rahul Bhardwaj (09:37): Which brings us to today. We're seeing the CSA Canada's dialed back the disclosure a little bit, there's more to it, more of a focus on perhaps competitiveness. What are your thoughts on that, especially around materiality?

Sarah Keyes (09:51): So like anything, sustainability is only one factor that companies and corporate directors are thinking about today. And I don't know about you, but it's been a dizzying news year so far in terms of trying to keep up with geopolitical trends, policies, and impacts to our economy, both directly and indirectly through our supply chains.

And why is this important? The push-back against sustainability is coming at a time at which companies are feeling incredibly overwhelmed. It's a volatile market. And so when we think about this entire push-back, it actually makes sense as we mature sustainability as a discipline.

So let's come back to materiality. What I've seen over the past several years of advising companies is sustainability still being treated in a silo as something separate from corporate strategy and enterprise risk management; almost treated like a reporting and compliance exercise driven by the flurry of new standards and regulations we've seen over the past five years.

As we have this moment of pause and relief from some of these regulatory burdens, this is where companies should double-down and focus on the issues that are most material to their business and linking it in to strategy and risk management.

And that's what's interesting about how the CSA position, their decision to pause, introducing new rules on climate and diversity disclosure for Canadian public companies. They reiterated climate risks are indeed a mainstream business issue. And security legislation already requires issuers to disclose material climate risks affecting their business.

Rahul Bhardwaj (11:23): So we've got the regulators speaking, we've got boards that are concerned about compliance burden, distraction for management, but there's also a sense of we do need to know what the impacts of organizations are, and organizations, particularly in the resource sector saying, give us an even playing field. Which brings us to the question, does Canada need an even playing field better than we have right now?

Sarah Keyes (11:51): It's an important question, and I'm gonna take a step back and look at a really important inflection point we found ourselves at when we were establishing the global accounting standards.

So back in 2010, Canada was one of the many countries around the world that adopted the International Financial Reporting Standards. And that's the same organization that is developing the international sustainability reporting standards.

And why do I bring this up? Simply because prior to that, each country had their own generally accepted accounting principles. And it was hard for investors who invest globally to actually evaluate a company in Canada versus a company in another part of the world. And we made a decision that departed from our neighbors to the south and the United States, we chose to go to global accounting standards.

Why? To facilitate competitiveness and access to global pools of capital. Canada's economy is relatively small in the world. And so those opportunities to access that capital have been more important than ever to help our small and medium enterprises grow.

Rahul Bhardwaj (12:54): So we're not Europe, we're not Asia, we're not the US. Why do we need unique standards for Canada?

Sarah Keyes (13:02): So I think one of the reasons we hear is that natural resource economy coupled with small medium enterprises as the backbone of our economy. And then I'll throw in an additional piece - that's the physical risks of climate change.

The extreme weather events have been impacting our country drastically, and we've seen the costs associated with these events on the rise. Look no further than the Insurance Bureau of Canada who will show you all of the statistics around insured losses in this country and it is truly your Canadian hockey stick diagram.

So the reason it's important is we are uniquely susceptible and takers of global climate policy. So one of the reasons I think Canadian organizations have largely focused on not only measuring their emissions because of global investor scrutiny on that particular metric, but also starting to measure and report on their physical risks less because they've been pressured to do so and more because it's having real impacts in the short term. And that's where, as we spoke about earlier, small medium enterprises need to keep the lights on. So a huge weather event that knocks out operations will have a disproportionate impact on their ability to survive.

Rahul Bhardwaj (14:15): So what do we say to folks who say, that's great, and here comes the big but and not wrong, in some respects. We're in a world where the global trade order is being upset that productivity is lagging, that our competitiveness is struggling in this country, and we have assets everywhere that are very difficult to unlock. And if we were to unlock that, that would not really positively impact the issues around sustainability. And it seems to be a unique problem for Canada, at least in the context of our conversation. What would you say to people in that context?

Sarah Keyes (14:51): Yeah, so a couple of things. I think we're having this conversation amidst a trade war with our biggest trading partner. And I think that conversation has really opened up Canadians' minds, the idea of diversification of our economy, increasing our number of trade partners and thinking about how others are viewing sustainability and how we need to do business with those economies as well as inter-provincial trade.

So we're having a number of bigger picture conversations that will impact sustainability issues in this country. The diversification of our trade partners is a huge one because when we look overseas and contrary to popular belief, China is moving ahead with a number of climate-related initiatives, and we see them as one of our largest trading partners today. In addition, we know that we're looking more to European markets to see how we can do business overseas. These are also going to be critical sustainability issues to them.

So taking a bit of a global perspective means not just living in our bubble of Canada and thinking about what Canada needs, but what the world expects of us. And that comes back to our resources and unlocking those resources.

Canada is home to the largest number of publicly traded mining companies in the world, and our minds span globally. Canadian companies are impacting sustainability issues abroad and their ability to get projects built, community support, a strong workforce, and access to capital to do so is also impacted by it. So to get our minerals unlocked, to get our natural resources to these new markets, we have to think about our customer's perceptions of sustainability issues as well.

Rahul Bhardwaj (16:30): So you might not be seeing the tension quite as much as others. You can see these reconcilable then.

Sarah Keyes (16:36): Yeah, I think they are reconcilable, but I think it's gonna be bumpy in the short term. Some hard choices are gonna have to be made, and some trade-offs are gonna be realities.

In 2020 through 2022, we saw companies making massive commitments; writing pretty big checks that they likely couldn't cash and didn't have a plan to achieve. Now we're seeing a bit of a right-sizing - smaller, more focused, scalable initiatives that need to demonstrate an ROI before further investment is made. And so I think it'll be a little bit of two steps forward and one back as we progress through the short term toward that long-term sustainability

Rahul Bhardwaj (17:12): Sounds like a very typical Canadian solution, doesn't it? But you did say hard decisions and trade-offs, which is pretty common in boardrooms. You're gonna have to make some choices based on obviously some really good supporting data and the sort. But let's talk a little bit more about what boards and what the role of boards are in the construct of sustainability materiality.

You're talking to boards, you're talking to directors, and it's not a one size fits all, we've established that. Different industries, different size organizations, the equity public [regulated unregulated], but if you had to pull a thread to say, this is what, let's say successful boards are doing to navigate materiality and sustainability and not overburden management, or actually hinder their strategy. I know that's a lot to get on the table, but what are the good ones doing?

Sarah Keyes (18:07): It's the question of the day, and it's an important one, so I'm glad you asked it. So one of the things I would say really effective organizations are doing is taking a very strong and frequent pulse of their key stakeholders that drive value. And I'm not just talking about the stakeholders internal to the organization, but they're important too.

Talking to management about how they see sustainability issues, helping or hindering the achievement of strategic priorities; talking to the workforce about what makes them engaged, productive, and happy to work for the organization. But going outside and getting those views to understand the perception of the company by those who either directly or indirectly are critical to its value creation.

And yes, we've talked lots about investors and providers of capital, but pulling on that thread of customers, whether you're a B2B or B2C organization, your customers drive your top line revenue - understanding their sentiment, but not just their sentiment, what actually changes a purchasing decision. That's how we get deeper and deeper through materiality conversations away from, do you care about this issue, yes or no, to how much do you care about it and what would drive a change in decision?

Now that's how we bring it back to meaningful impact to the business. That's how we tie it back to strategy and our risk appetite. How far, how fast do we wanna go? But also our strategic planning. What are our corporate priorities and how do these stakeholders perceptions about sustainability help or hinder the achievement of those?

Rahul Bhardwaj (19:38): Now, what do you say to directors who say, Sarah, that sounds really good, but the reality of the business and the work that we've gotta do as a board, the regulations are creating a lot of work for us on the compliance side. We've got geopolitical issues and uncertainty like we've never seen before. We were just getting used to the uncertainty of digital technology, and now we've got AI, and now you want us to be thinking about sustainability. How much more can a board really get its head around?

Sarah Keyes (20:09): It's an incredibly difficult time to be a corporate director. The complexity of the issues, the landscape and the volatility are all driving exactly those questions from all of the board members that I'm talking to right now. And that's where I come back to this idea of linking it up to the things that matter, the things that you're already spending time and energy on.

So it's kind of important to take a step back and think about the broader topic in response to all of those issues and that's business resilience. I would argue that sustainability issues are foundational to thinking about business resilience, not only in the long-term, but in the short-term. And I'll use the example of extreme weather.

Building resilience to extreme weather to avoid an impact or downtime to assets and facilities is going to save you money in the long run. And we know for certain that extreme weather events are on the rise. So we see companies getting paybacks right off the bat thinking about this as a resilience and competitiveness issue, exactly as you said.

Rahul Bhardwaj (21:09): So Sarah, this has been a really interesting conversation that we've really covered a lot of territory. Thank you for that.

And we've got a resolution on the table: Be it resolved Canada needs to set its own path for sustainability standards. Which way would you vote?

Sarah Keyes (21:24): Such a nuanced issue. And I'm gonna vote against the resolution, and here's why. At this time of incredible tumultuous change and the impact of the policy shift south of the border with our largest trading partner, I think it's more important than ever for Canada's competitiveness to think bigger, to think global, and to start to expand our horizons, follow the same path that we did with the reporting standards for accounting.

It was a bumpy ride for the first couple of years. Let's find ways to make that smoother for our small, medium enterprises, and let's find ways to celebrate the great work that our natural resource sectors are doing.

Rahul Bhardwaj (22:00): Well now, if I was chair of the board, I thank you for a very thoughtful opposition to that resolution. We're gonna have to come back and unpack what's going on globally at another time. Sarah, thanks so much for joining us today. Really, really thought-provoking discussion.

And to our listeners, I hope you enjoyed today's episode of Be a Resolved, that you've deepened your boardroom insights to stay ahead of emerging trends. Now if you enjoyed this episode, please do subscribe, rate and leave a review on your favorite streaming platform. From the Institute of Corporate Directors in Canada, I'm Raul Bhardwaj. Until next time.