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INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

LETTER FROM THE PRESIDENT

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Innovative schemes can improve access to private investment capital to help meet our carbon emissions goals

HIGHLIGHTS:

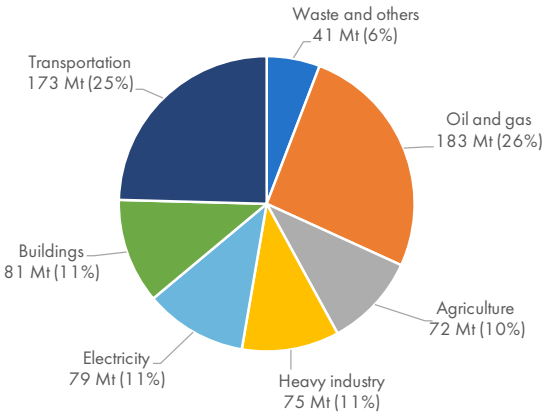
Meeting Canada's Paris Agreement commitments requires that all infrastructure development align with our transition towards a sustainable economy. Yet, infrastructure spending requirements have surprising variance, ranging from $50 billion to over $500 billion.

Private capital markets will be key to mobilizing sufficient funding for infrastructure spending. The financing models will include joint private-public funds, and green bonds issued by governments and corporations.

Consistent, transparent and practical definitions of what constitutes a green bond are critical to a well functioning green bond market. Issuers should adopt the ICMA *Green Bond Principles* that provide guidance on the use of proceeds; process for project evaluation and selection; management of proceeds; and reporting.

On June 13, the House of Commons Standing Committee on Finance put out its annual call for input on the upcoming federal budget. This year it requested submissions on the theme *Climate Emergency: The Required Transition to a Low Carbon Economy*. Under the Paris Agreement, Canada, along with 197 nations and territories, committed to a 30 percent reduction in emissions by 2030 and an overall 80 percent reduction by 2050. It's a daunting task to coordinate government action, provide the right incentives to drive change in consumer behaviour, and mobilize sufficient capital to fund large-scale capital investments in major sectors of the economy (infrastructure, electricity generation and transmission, oil and gas, building retrofits, and clean technology).

Greenhouse Gas Emissions by Canadian Economic Sector (Mt C02e)



Source: Environment and Climate Change Canada, 2016

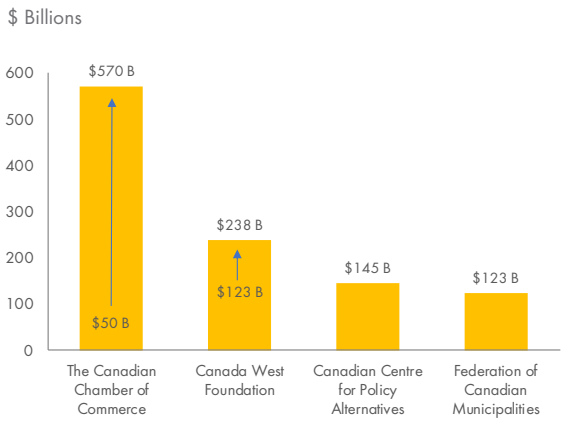
HOW DO WE GET FROM HERE TO THERE?

In our pre-budget submission to the Finance Committee, we made the following recommendations:

First, in order to meet Canada's climate objectives, governments at all levels and the private sector need to map out the magnitude, scope and horizon of the investment opportunity, financing requirements, sources of financing (private-public), and financing mechanisms. Currently, there are limited data available at the national level on the state of public infrastructure assets in Canada. Some data is available at the local level, but generally lacks details to support infrastructure planning. Estimates of the infrastructure gap range from $50 billion to $570 billion. Meeting our Paris Agreements commitments requires that all infrastructure development align with our transition towards a sustainable economy.

Second, the policy focus should be on improving the effectiveness of private market financing of infrastructure. Bridging the national infrastructure gap through public finances alone would place an unsustainable burden on government finances and taxpayers. For instance, financing large infrastructure projects will require considerable amounts of private and institutional capital (for example, modernizing Canada's electricity systems would require close to $1.7 trillion over the next 30 years, according to the Canadian Electricity Association). There are also many small and mid-sized infrastructure projects desperate for capital at the local and regional level (for example, building retrofits and telecommunications structures for smart technology).

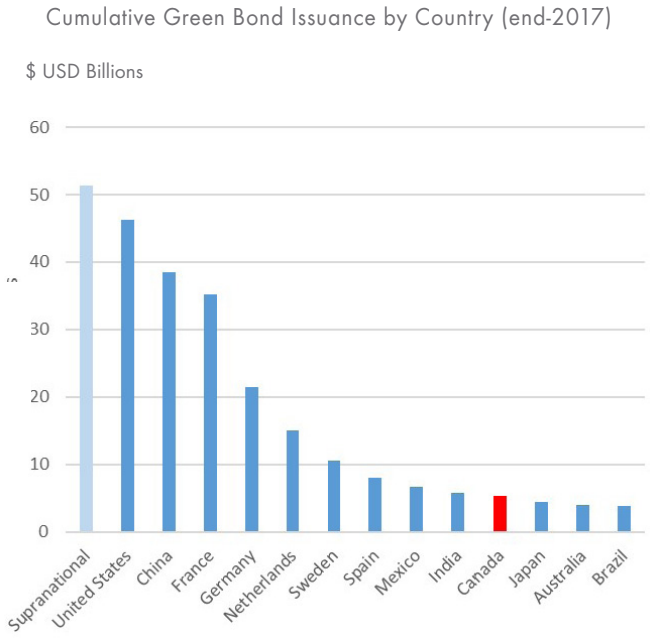
Estimates of Canada's Infrastructure Deficit



Source: The Canadian Chamber of Commerce; Canada West Foundation; Canadian Centre for Policy Alternatives; Federation of Canadian Municipalities

One solution could be joint private-public sector financing structures that enable public capital to participate alongside private capital in designated infrastructure projects, either single one-off small projects or a package of multiple projects that contribute to a low-emissions, climate resilient and energy efficient economy. The federal government would take a minority position in these infrastructure funds, conditional on the type of infrastructure project, and with the stipulation public funds are only forthcoming once the private tranche is fully subscribed and in place, ensuring private investors have full confidence in the project's viability. The contribution of public funds would increase the availability of invested capital, improve financing economics (narrower spread and better returns for investors and lower financing costs for issuers), help attract international investors, and bring a private sector discipline and accountability to the build-out and operation of projects.

Another solution is to improve the efficiency and functioning of Canada's green bond market through common standards for issuance and disclosure, and targeted tax incentives. Canada is a relatively small player when it comes to green bond issuance, but both supply and demand are growing. Market participants have pointed to number of challenges, including limited liquidity in secondary markets (often investors buy-and-hold), high set-up costs, and nascent definitions (i.e. taxonomies).



Source: Climate Bonds Initiative and Smart Prosperity Institute

The Investment Industry Association of Canada has been working with its Debt Markets Committee and Debt Syndicate Working Group, as well as buy-side institutions (the Canadian Bond Investors' Association) to help build a more liquid domestic market for green bonds. We have made several recommendations in this regard in our position paper, Opportunities in the Canadian Green Bond Market.

A consistent, transparent and practical definition of what qualifies as a green bond will accelerate uptake. In this regard, robust third-party accreditation standards and eligibility criteria (i.e. credible, science-based, widely supported guidelines about what should and should not be considered a qualifying investment) are critical to promoting product integrity and investor receptivity. Initial program eligibility should include green bonds that meet the Green Bond Principles (GBP) developed by our colleagues at the International Capital Markets Association (ICMA). These principles have four main components: use of proceeds; process for project evaluation and selection; management of proceeds; and reporting. The GBP are intended for broad use by the market: they provide issuers with guidance on the key components involved in launching a credible Green Bond; they aid investors by promoting availability of information necessary to evaluate the environmental impact of their Green Bond investments; and they assist underwriters by moving the market towards expected disclosures that will facilitate transactions. ICMA recommends that in connection with the issuance of a green bond, issuers appoint an external review provider to confirm the alignment of their bond with the four core components of the GBP.

Several interesting ideas were put forward in the Final Report of the Expert Panel on Sustainable Finance to incentivize both the supply of, and demand for accredited green bonds. The Expert Panel recommended time-limited fiscal incentives, including reimbursing first-time issuers for a portion of the set-up cost for issuing green bonds, and providing issuers a cash rebate to subsidize net interest payments. To stimulate demand and retail investment, the Panel recommended that the government increase the contribution room in registered savings or defined contribution pension plans and provide a 'super tax deduction' for contributions to registered retail savings plans earmarked for accredited climate-conscious products, such as green bonds.

Third, environmentally related taxes, such as a carbon tax, which attach an explicit cost to emitting pollutants or to undertaking activities with adverse environmental impacts, have an important role to play in helping Canada transition to a low carbon economy. By putting a direct price on carbon emissions, carbon taxes provide strong incentives for households and individuals to adjust their behaviour—reduce demand for carbon-emitting fossil fuels and adopt more energy efficient technologies.

Revenue generated from a carbon tax should be returned to taxpayers through reductions in personal and business income tax rates (i.e. the carbon tax is revenue neutral). Thus, we would shift away from penalizing work, saving and investment toward penalizing environmentally harmful activities. It would encourage businesses to invest in innovation and technologies to reduce their carbon emissions and energy costs. Giving lump-sum rebates to households does not generate these economic gains.

Lastly, market-based mechanisms, such as carbon pricing, should replace the regulatory approach to achieving environmental objectives. Layering carbon pricing on top of regulation raises costs, while reducing the freedom of businesses to respond to the carbon tax in a way that makes sense for their business.

Yours sincerely,

Ian C. W. Russell, FCSI
President & CEO, IIAC
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