May 2024

Omolola Fashesin, Principal
Financial Reporting & Assurance Standards Canada, Canadian Sustainability Standards Board
277 Wellington Street
Toronto, ON M5V 3H2

Re. CSSB Exposure Draft - CSDS 1 & 2

Dear Ms Fashesin,

Thank you for the opportunity to comment on the Board's proposed Canadian Sustainability Disclosure Standards 1 & 2.

Morningstar Research, Inc. is a leading provider of independent investment research, and our mission is to create products that help investors reach their financial goals. Our mission includes supporting individual investors, professional financial advisors, and institutional clients to identify sustainability risks, impacts, and opportunities through Morningstar Sustainalytics. We offer insights in this comment letter from the perspective of an ESG data provider, and a research firm covering equities and investment funds.

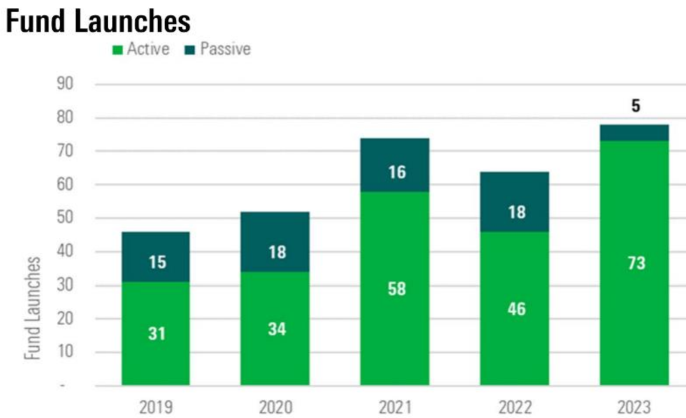
Executive Summary

Morningstar supports this proposal and believes it addresses a significant information gap investors face in assessing sustainability and climate related risks. Sustainability and climate risks have increasingly become material for many companies across different industries and, as such, disclosures in this area are financially material and a key aspect of investor decision-making. Our perspective is informed by data which shows:

- Interest in sustainable investing is strong in Canada.
- Greenwashing is a significant concern among Canadian investors.
- The majority of Canadian companies do not disclose scope 3 emissions or report on climate scenario analysis/resilience testing.
- Canadian companies are exposed to significant financial risks from physical climate change impacts, including extreme heat and flooding.

Sustainable Investing Landscape

Canadian institutional and retail investors continue to demonstrate interest in sustainable investing. Since 2019 the overall universe of funds with an explicit sustainability mandate has increased from 85 to 355, as of Q1 2024.



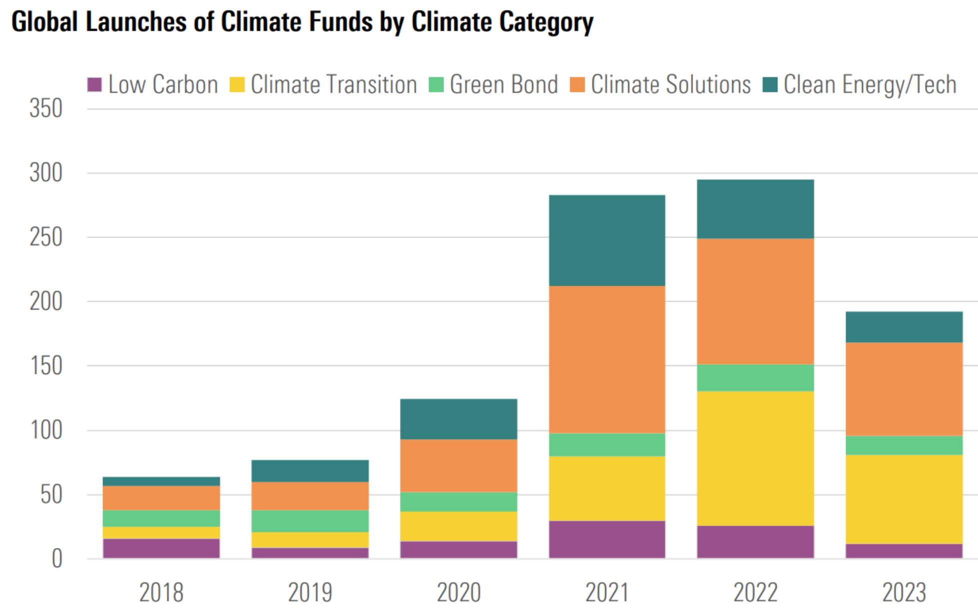
Source: Morningstar Data

The Responsible Investment Association's 2023 Investor Opinion Survey found a strong level of interest in sustainable investing among individual investors in Canada with 65% reporting being somewhat or very interested in sustainable investing. However, these investors also report a high degree of concern about whether sustainability commitments are being meaningfully executed, with 68% of respondents very or somewhat concerned about greenwashing[1]. The proposed CSDS 1 & 2 disclosure frameworks can help to address these concerns by enabling investors to make more informed investment decisions and to report on the attributes of sustainability funds with greater precision.

Climate Funds

Climate funds have grown significantly over the past several years, with 193 funds launched globally in 2023. Climate transition funds have been a particular driver of this growth, gaining 25% of assets in 2023. Climate transition strategies typically entail taking a best-in-class approach across sectors to identify companies that are best positioned to operate in a low-carbon economy. As such, these approaches are particularly reliant on comparable and decision-useful company disclosures to differentiate climate risk exposure and preparedness to manage climate risks.

[1] Responsible Investment Association, 2023 Investor Opinion Survey



Source: Morningstar data

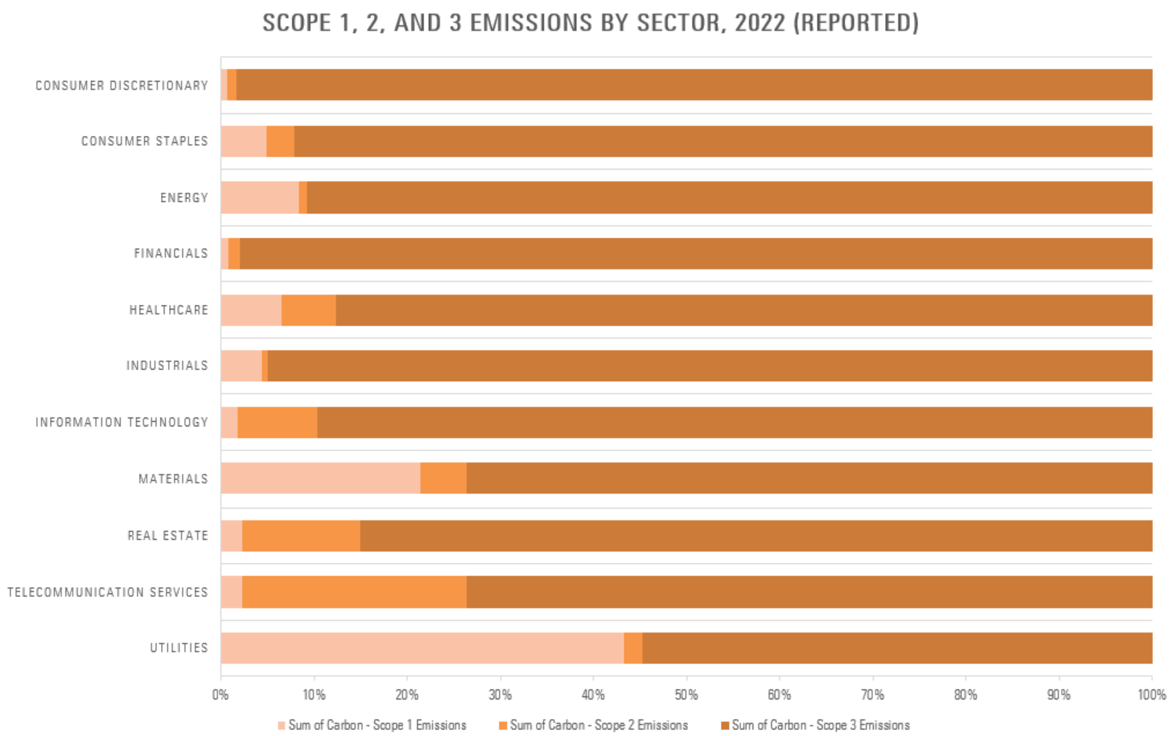
Across all investment funds, there is a strong need for fund disclosures to help investors understand what their sustainable fund does to manage carbon and climate risk. Advancing issuer-level disclosures will help asset managers improve related disclosures to individual investors and provide insights into the characteristics of sustainability and climate focused funds.

Our data shows important differences in how funds approach carbon and climate risk, and resulting fund exposure which should be considered by investors. For example, the majority (57%) of the Climate Solutions and close to half (47%) of the Clean Energy/Tech funds exhibit higher carbon intensity than the benchmark. This is driven by many of these portfolios holding utilities companies that run renewable energy operations, while also having legacy assets in fossil fuels. (For more information on this data, please reference the Morningstar report "Investing in Times of Climate Change: 2023 in Review").

Scope 3 Emissions

Morningstar supports mandating climate-related disclosures when they are financially material to the company, inclusive of Scope 1, 2 and 3 GHG emissions. Scope 3 emissions are particularly important to understanding a company's overall emissions profile given they account for greater than 70% of emissions on average[2]. In Canada, Scope 3 emissions comprise a larger proportion of total emissions relative to other regions. This is driven from the prevalence of sectors such as Financials and Oil and Gas in the Canadian market, which have above average scope 3 emissions as percentage of total emissions.

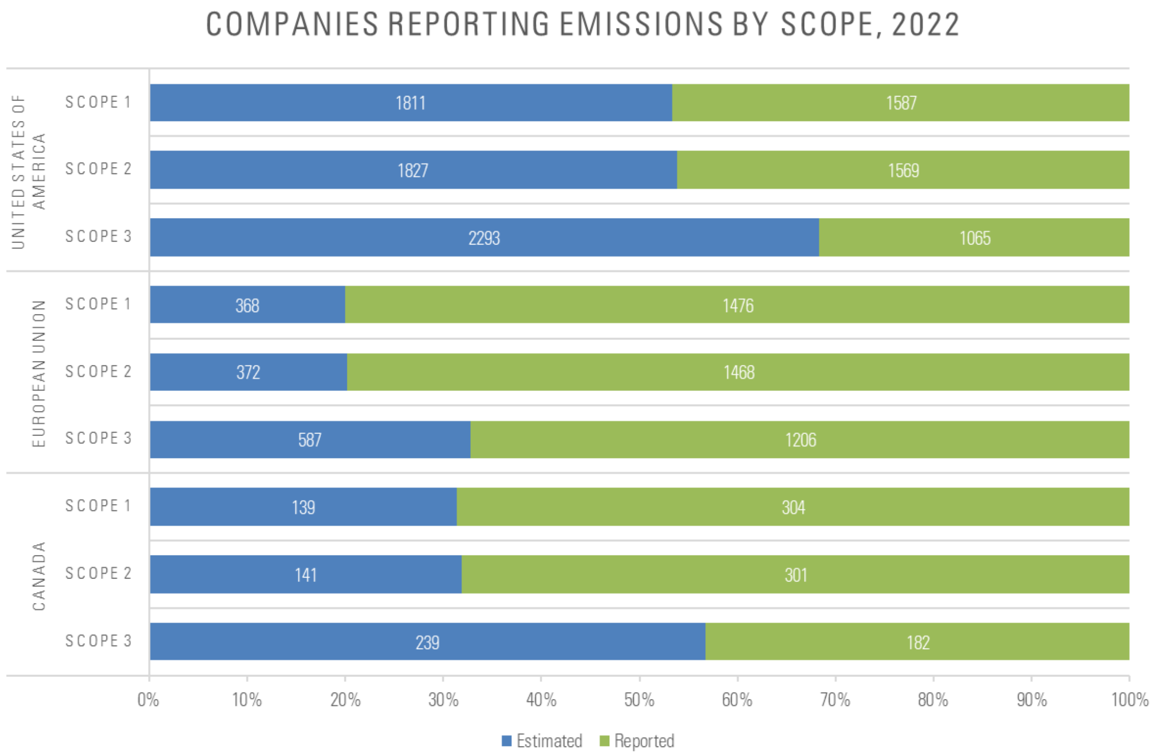
[2] UN Global Compact, https://www.unglobalcompact.org.uk/scope-3-emissions/.



Source: Morningstar Data

Morningstar recognizes that Scope 3 disclosure and accountability are becoming an investor expectation vis-à-vis the largest and leading companies globally. Transparency with respect to Scope 3 reporting can aid companies in reducing emissions across their value chain and help investors in understanding a company's progress, while allowing for more effective resilience and planning tied to physical risk.

Despite a growing number of companies reporting GHG emissions, a minority (43%) of companies covered by Morningstar Sustainalytics in Canada currently disclose some level of scope 3 emissions. In contrast, 67% of covered EU domiciled companies report scope 3 emissions, indicating that such disclosures are broadly feasible and improved disclosures from Canadian companies will foster stronger international comparability of carbon risk and performance.



Source: Morningstar Data

Scenario Analysis

Climate resiliency testing and scenario analysis add much-needed context to the degree of climate-related related risks that Canadian companies are faced with given the heavy concentration of issuers tied to the energy and materials sectors. Although leading companies are already reporting results of their climate scenario analysis, this is constrained to approximately 5% of Canadian public companies.

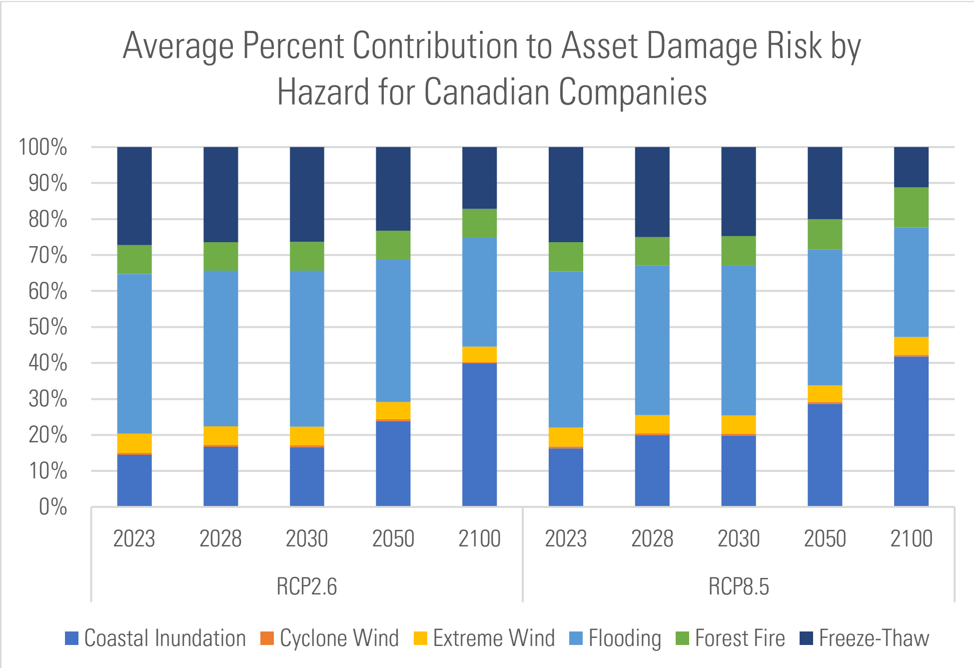
Improving standard disclosures in this area will better enable investors to better account for business model impacts under different scenarios of climate warming. Such analysis can help investors assess the value at risk in an organization if, for example, regulators introduced a carbon tax, new technology allowed other firms to produce similar products with fewer emissions, or a changing climate increased the price of supply chain inputs. Simply put, these analyses show investors under what circumstances value is at risk, and how a company's strategy will move them forward toward long-term profitability.

Physical Climate Risk

Canadian companies are increasingly exposed to material business impacts from climate-related damage to physical assets and critical local infrastructure, with over 3.1 billion in insured damages from weather events and natural catastrophes realized in 2023[3]. Specifically, our data covering 15 million properties in Canada shows significant risk of asset damage and productive capacity loss from hazards including:

[3] Insurance Bureau of Canada, https://www.ibc.ca/news-insights/news/severe-weather-in-2023-caused-over-3-1-billion-in-insured-damage

flooding, extreme heat and changing freeze-thaw cycles. Scenario analysis can be a valuable tool to understand business impacts driven from both transition and physical risks, and their interaction.



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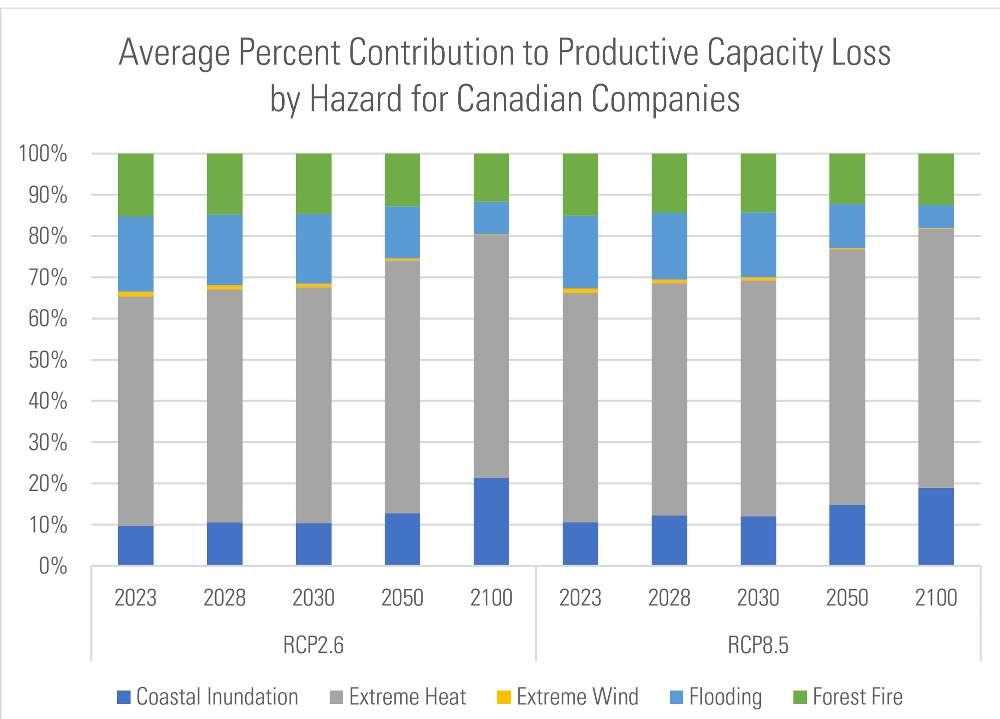

Source: Morningstar Data

Summary

To conclude, we are pleased the Board has proposed high-quality, internationally recognized sustainability disclosure standards for Canadian companies. We feel that improving the comparability and decision-usefulness of sustainability disclosures will support investors to make better informed decisions and report on fund characteristics with greater transparency. Thank you for the opportunity to comment.

Aron Szapiro
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