DUE DILIGENCE FRAMEWORK: CLIMATE CHANGE

Canada

EDC

TAKE ON THE WORLD

FRAMEWORK CONTROL SHEET

CONTROL SHEET

Framework Name:	Climate Change Due Diligence Framework
Framework Owner:	Director, Environmental and Social Risk Management
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Endorsed by (if applicable):	N/A
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APPROVAL, REVIEW AND REVISION HISTORY

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1.1	Approved by Director, Environmental and Social Risk Management	April 2020	Minor revisions
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1.3	Approved by Director, Environmental and Social Risk Management	February 2021	Minor revisions

1. INTRODUCTION, PURPOSE AND SCOPE

1.1. INTRODUCTION

As Canada's export credit agency, EDC's mandate is to support and develop Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities.

As elaborated in EDC's Climate Change Policy, EDC's large and diverse portfolio includes companies operating in carbon intensive sectors that are important to the Canadian economy, as well as businesses at the leading edge of the clean technology sector. EDC believes that companies across this spectrum can play a role in the transition to a low carbon and climate-resilient economy. EDC also believes that the most important contribution it can make is through continuing to provide its products and services in support of customers' innovation and transition, as the organization builds the portfolio of the future.

This framework articulates EDC's efforts to date to identify and assess climate-related risk as part of its environmental and social due diligence process. The steps outlined here are a starting point. EDC anticipates its climate change-related due diligence approach will evolve over time, as the organization's understanding of this complex issue, as well as its implications for business and that of their customers, continues to mature.

1.2. PURPOSE

This framework elaborates on EDC's efforts to identify and assess climate-related risk as part of EDC's environmental and social risk assessment processes. The content of this framework supports EDC's Climate Change Policy, including EDC's commitments to:

- Be more transparent about EDC's approach to carbon intensive sectors, starting with a strengthened thermal coal position,
- Integrate climate-related risks and opportunities, such as carbon intensity, into EDC's risk assessment processes, alongside other credit and non-credit considerations, to inform decision-making for both project and non-project transactions and
- Work toward implementing the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD).

1.3. SCOPE

This framework applies to EDC's customer relationships, as well as project-related and non-project transactions that are reviewed by EDC's Environmental and Social Risk Management team. A project is defined in paragraph 5 of EDC's Environmental and Social Review Directive (ESRD). Non-project transactions refer to those transactions undertaken by EDC that fall into various EDC product categories, such as general corporate purpose financing (where the majority of funds are not directed at financing a project), as well as diverse insurance and guarantee products.

2. FRAMEWORK

2.1. EDC'S THERMAL COAL POSITION

EDC has established clear parameters for when it will or will not consider transactions involving thermal coal power, mining or dedicated thermal coal-related infrastructure. These parameters are articulated in EDC's Thermal Coal Position, found in Appendix A of EDC's Climate Change Policy:

EDC shall no longer provide new:

- financing for the development, construction or expansion of coal-fired power plants (CFPPs), regardless of geographic location, unless equipped with carbon capture and storage or equivalent emissions-reduction technology satisfactory to EDC*;
- financing for the development, construction or expansion of thermal coal mines or other projects solely focused on supplying CFPPs (e.g., thermal coal terminal, rail links);
- financing to companies for which thermal coal power generation and/or thermal coal mining account for more than 40% of their revenue**, as determined by EDC;
- financing for an existing CFPP unless the financing will be used to equip that facility with carbon capture and storage or equivalent emissions-reduction technology satisfactory to EDC.

EDC has begun to transition out of its current credit insurance relationships with Canadian customers whose business is primarily focused on the thermal coal power generation and/or thermal coal mining sectors.

Notes:
******This position applies to financing for new industrial projects, if powered by CFPPs, even if the financing is not specifically earmarked for the captive plant.*
****** *However, if the company has between 40-60% of revenue derived from thermal coal-related business, EDC will consider support provided that the company can demonstrate that it is implementing a credible and public low-carbon transition plan within the next five years. EDC would also consider support for such companies if the financing is specifically in support of a renewable energy project that meets EDC's corporate sustainability and responsibility requirements.*

2.2. APPROACH TO OTHER CARBON-INTENSIVE SECTORS

Section 2.1 specifically addresses EDC's position with respect to transactions involving thermal coal. EDC has also developed a due diligence approach for transactions involving carbon intensive sectors other than thermal coal. The approach depends on whether the use of funds for the transaction are in relation to a project or not. As required, EDC will continue to review other carbon-related sectors to make determinations about whether they will be subject to the due diligence approach.

2.2.1. Non-project transactions

EDC considers climate change transition risk as part of the environmental and social due diligence for non-project transactions. This due diligence is known as an Environmental and Social Risk Review and is administered by EDC's Environmental and Social Risk Management (ESRM) team. At this time, EDC's evaluation of climate change transition risk is linked to whether customers operate in carbon intensive sectors and, in EDC's determination, are therefore more susceptible to higher risks related to a transition to a low-carbon economy. In alignment with EDC's Environmental and Social Risk Management Policy and the due diligence process outlined in its supporting guideline, EDC transactions above USD 5M[1] are subject to greater scrutiny from a climate change perspective. EDC uses this financial threshold as an indicator of potential climate-related risk. For transactions beyond this threshold, where the company under review operates in one or more carbon intensive sectors, the relevant counterparties are subject to targeted, climate change-related due diligence.

EDC has identified sectors to be carbon intensive if the average emissions of the sector in Canada emit over an average of 500,000 tonnes of carbon dioxide equivalent (tCO_2e) per year[2]. This includes:

- Airlines
- Cement Manufacturing
- Metals Smelting and Processing (includes aluminum, steel and other metal smelting, does not include mining of various metals)
- Petrochemical and Chemicals Manufacturing (includes fertilizer production)
- Thermal Power Generation
- Upstream Oil and Gas Operations

If not already publicly available, EDC will request the following information from the company under review that operates in one or more carbon intensive sectors[3]:

- Planned or actual climate change-related disclosure in line with recognized international frameworks (TCFD or CDP);
- Annual greenhouse gas (GHG) emissions (Scope 1 and Scope 2) for the last three years; and
- Details regarding the company's strategies, plans or targets to reduce absolute GHG emissions.

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[1] When EDC's support is above USD 5 million and the use of proceeds for the transaction does not meet the thresholds identified by the ESRD for a project-related review, EDC's Environmental and Social Risk Management team undertakes a corporate Environmental and Social Risk Review (ESRR). Transactions are assessed using a systematic and consistent approach, based on recognized methodologies and standards, to provide an opinion on the degree of associated environmental and social risk.

[2] Based on sectors reporting to Environment and Climate Change Canada's Greenhouse Gas Reporting Program, as well as data collected on annual average airline emissions.

[3] Certain types of transactions within these sectors are excluded from EDC's climate change due diligence, as a result of low annual Scope 1 and 2 GHGs, such as transactions involving EDC support for oil and gas drilling equipment, retailers or operators, leasing companies, natural gas distributors and metal recyclers and retailers.

Where relevant and appropriate, EDC will also leverage third party references and tools, such as the CDP[4], to help identify and assess climate-related risk.

The information above contributes to ESRM's opinion on the degree of climate change-related risk (as a component of broader environmental and social risk) associated with a customer or transaction. In the absence of such information and depending on the nature of the customer or transaction, EDC may work with its customer to develop management systems that allow it to more effectively address and disclose climate change transition risk.

For certain EDC products types, EDC requires customers in the upstream oil and gas, as well as the petrochemicals/refining sectors to disclose corporate climate-related information aligned with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). EDC recognizes that achieving alignment with the TCFD recommendations will be a journey and EDC is committed to working with such customers to improve the quality of these disclosures over time.

At present, EDC does not consider climate change physical risk in its due diligence approach for non-project transactions, given the complex geographic and sectoral diversity of some of the companies within EDC's portfolio. EDC will continue to explore how such considerations can be integrated into EDC's risk assessment processes in a meaningful and reproducible way.

2.2.2. Project-related transactions

Project reviews are done in accordance with EDC's Environmental and Social Review Directive (ESRD), which aligns with the Equator Principles (EP) and Organization for Economic Co-operation and Development (OECD) Common Approaches on Environmental and Social Due Diligence, both of which rely on the International Finance Corporation's (IFC) Environmental and Social Performance Standards as the international benchmark standards. EDC considers climate change in the context of a project-related transaction according to requirements set out in the EP 4 and OECD risk management frameworks.

For projects that are expected to or currently produce more than 25,000 tCO_2e (Scope 1 and Scope 2) annually, EDC:

- obtains an estimate of annual GHG emissions from the project sponsor;
- verifies the reasonableness of the estimated emissions using an internationally recognized methodology and good practice; and
- reports the estimated annual emissions of the project to the OECD, as part of EDC's OECD project reporting commitments.

4 CDP, formerly known as the Carbon Disclosure Project, is a not-for-profit charity that runs a global disclosure system for investors, companies, cities, states and regions to manage their environmental impacts. Additional information about CDP can be found at www.cdp.net.

Further to the requirements outlined in EP4 and elaborated on in the associated guidance note, for projects under consideration by EDC that are expected to or currently produce more than 100,000 tCO_2e (Scope 1 and Scope 2) annually, EDC expects:

- project sponsors to complete an alternatives analysis to evaluate lower GHG-intensive alternatives;
- the project sponsor to report publicly on an annual basis, combined Scope 1 and 2 GHG emissions, during the operational phase of the project (for Category A, and, as appropriate, Category B projects) as well as, if appropriate, the greenhouse gas emissions efficiency ratio associated with the project;
- Environmental and Social Impact Assessments (ESIAs) or other Environmental and Social Assessment documentation for all Category A, and, as appropriate, Category B projects to include a Climate Change Risk Assessment which considers relevant transition risks, as defined by the TCFD (definitions also included in section 6 of this Due Diligence Framework).

Additionally, for Category A, and, as appropriate, Category B projects, EDC expects Environmental and Social Impact Assessments (ESIAs) or other Environmental and Social Assessment documentation to include consideration of relevant climate change physical risks.

Adherence to the above will influence ESRM's evaluation of the overall environmental and social risk associated with a project-related transaction and will inform EDC's decision-making.

3. ROLES AND RESPONSIBILITIES

This Climate Change Due Diligence Framework is administered by EDC's Environmental and Social Risk Management team.

4. REVIEWS AND REVISIONS

This Climate Change Due Diligence Framework will be reviewed or revised at least as frequently as EDC's Climate Change Policy.

5. OTHER RELATED DOCUMENTS

The following documents relate to the Climate Change Due Diligence Framework:

- EDC Climate Change Policy
- EDC Environmental and Social Risk Management Policy
- EDC Environmental and Social Review Directive
- EDC Transparency and Disclosure Policy
- Equator Principles (Version 4; July 2020)

- International Finance Corporation Performance Standards (January 2012)
- Organization for Economic Co-operation and Development Common Approaches (April 2016)

6. KEY TERMS

Term	Definition
Alternatives analysis	An evaluation of technically and financially feasible and cost-effective options available to reduce project-related GHG emissions during the design, construction and operation of a project.
Carbon dioxide equivalent (CO_2e)	The universal unit of measurement to indicate the global warming potential (GWP) of each of the six greenhouse gases, expressed in terms of the GWP of one unit of carbon dioxide. It is used to evaluate different greenhouse gases against a common basis.
Carbon intensive sector	Sector identified by EDC as having, on average, high annual greenhouse gas emissions. EDC's determination of carbon intensive sectors is based on average annual Scope 1 and Scope 2 greenhouse gas (GHG) emissions of sectors in Canada above 500,000 tCO2e/year.
Category A project	A project that is likely to have significant adverse environmental and social effects that are sensitive, diverse, or unprecedented. These effects may affect an area broader than the sites or facilities subject to the physical works, and may be irreversible.
Category B project	A project that is likely to have less adverse potential environmental and social effects than those of Category A projects. Environmental and social effects associated with Category B projects are usually site-specific; few if any are irreversible; and in most cases mitigation measures can be designed more readily than for Category A projects.
Climate Change Risk Assessment	An assessment to define the potential climate change-related risk (transition risk, physical risk) of a project. Usually includes an alternatives analysis (see above).
Climate change transition risk	Transitioning to a lower-carbon economy may entail extensive policy, legal, technology, and market changes to address mitigation and adaptation requirements related to climate change. Depending on the nature, speed, and focus of these changes, transition risks may pose varying levels of financial and reputational risk to organizations.
Climate change physical risk	Physical risks refer to those climate change-related risks linked to event-driven (acute) or longer-term shifts (chronic) in climate patterns. Acute physical risks include increased severity of extreme weather events such as cyclones, hurricanes, or floods. Chronic physical risks refer to longer-term shifts in climate patterns (e.g., sustained higher temperatures) that may cause sea level rise or chronic heat waves.
Environmental and Social Impact Assessment (ESIA)	The process of assessing the environmental and social effects of a project in order to evaluate their significance, and may include identifying measures to prevent,

Term	Definition
	minimize, mitigate or compensate for adverse environmental and social effects. Environmental and social assessment is the responsibility of the project sponsor.
Environmental and Social Risk Management team	EDC's team of environmental, social, and human rights subject matter experts that monitors the implementation of and provides advice to the organization on EDC's Environmental and Social Risk Management Policy Framework.
Equator Principles	A risk management framework, adopted by financial institutions, for determining, assessing and managing environmental and social risk in project finance. It is primarily intended to provide a minimum standard for due diligence to support responsible risk decision-making.
Greenhouse gas emissions efficiency ratio	A metric that calculates greenhouse gas emissions per unit of activity. For example, emissions per unit of economic output (e.g., unit of production, number of employees, or value-added) is widely used.
IFC Environmental and Social Performance Standards	An international benchmark for identifying and managing environmental and social risk that many organizations have adopted as a key component of their environmental and social risk management.
OECD Common Approaches on Environmental and Social Due Diligence	Agreement among OECD Members relating to measures that Members should take in order to address the potential environmental and social impacts of projects for which official export credit support is requested.
Scope 1 emissions	Direct greenhouse gas emissions that occur from sources that are owned or controlled by a company. (Source: GHG Protocol)
Scope 2 emissions	Indirect greenhouse gas emissions from the generation of acquired and consumed electricity, steam, heat, or cooling (collectively referred to as "electricity"). (Source: GHG Protocol)
Task Force on Climate-Related Financial Disclosures (TCFD)	Appointed by the Financial Stability Board, the TCFD developed voluntary recommendations for climate-related financial disclosures that aim to provide consistent, reliable, clear, and decision-useful climate change information to lenders, insurers, and investors.