Responsible Investing includes Canadian oil

By: Jackie Au, Lindsay Puls

Wealth Management
Dominion Securities

Responsible Investing has gained significant interest as one way for investors to address climate change concerns. When it comes to energy companies, one approach is to exclude or divest of energy companies (i.e. negative screening) from a particular portfolio or fund. However, we believe this approach does not solve the core issue of lowering global emissions. We advocate ESG Integration, which is the practice of incorporating material ESG factors (including carbon emissions) into investment decision making to identify risks and improve long-term returns. A more holistic analysis of oil & gas companies considers how they are reducing emissions and transitioning operations over the coming decade.

Divestment is NOT the solution

We are often asked, “Why don’t we remove oil & gas companies from our portfolios?” While that seems an easy way to disassociate from carbon, it doesn’t solve the longer-term issue of lowering global emissions or global reliance on fossil fuels. Divestment from all products with fossil fuels would be impractical to achieve given how pervasive fossil fuels are in everyday products. Further, a sudden removal of oil and gas could lead to substituting lower quality energy sources. During the global energy crisis in 2022, countries reverted to coal in record amounts, setting back years of progress on reduction. A sound transition plan requires consideration of energy security as well.

Energy transitions take time. The infrastructure required to support renewable energy is not yet fully developed. It will take time to phase out the internal combustion engine, transform gas furnaces, and find alternatives for jet fuel. Oil & gas companies can play a role in this transition by decarbonizing traditional energy sources so that countries can continue to access the energy they need to fuel their economic development. Shunning the sector would hamper their technological edge on developments such as green hydrogen and carbon capture, which are likely to be opportunities going forward.

Reaching net zero

A better way to integrate environmental goals with investing is to understand how companies are reducing greenhouse gas emissions. The oilsands extraction and production industry contributes 12% of Canada’s total CO_2 emissions – more than any other activity.[1] But it is also a major producer and a primary economic driver for our country. Therefore, the sector’s ability to decarbonize will heavily influence Canada’s ability to meet its Paris Agreement goal of no more than 1.5°C of global warming.

The leading oilsands producers in Canada, who collectively account for nearly all of the country’s production, formed the Pathways Alliance with a joint goal of net-zero emissions from operations by 2050,[2] meaning completely offsetting all greenhouse gases emitted. This ambitious goal demonstrates a strong industry commitment to addressing climate change, as no other jurisdiction has seen such cross-collaboration among major oil producers. One of their key strategies is Carbon Capture, Utilization, & Storage, which involves capturing 60% of emissions to be reused or stored underground, with the remainder reduced using projects such as enhanced recovery techniques, fuel switching, and steam reduction.[3]

If Pathways is successful in reaching net-zero emissions, they will have **removed or offset roughly 68 million tons of GHG emissions per year from current levels** (Figure 1). The plan would also significantly reduce methane emissions which have more warming power than CO_2 emissions. However, achieving these ambitious targets still requires relatively new technology reaching commercial scale quickly, and a more robust carbon credit system to be implemented in Canada. Addressing these challenges will be key to achieving large-scale emissions reductions.

Focused on improvement

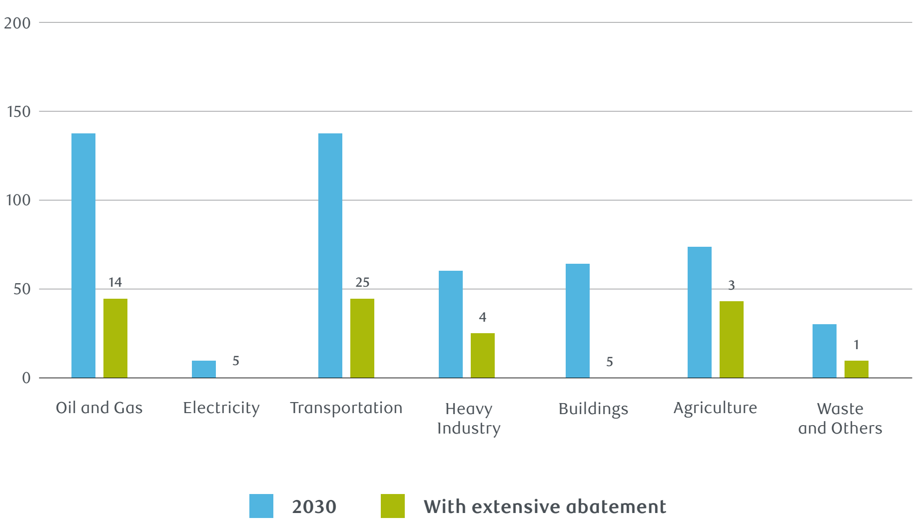
Canada's oilsands have made meaningful progress lowering emission intensity through innovation (Figure 2). However, intensity is still high when compared to other oil exporting countries, which means there is an opportunity to reduce emissions further to match that of global peers. And despite declining intensity, total emissions have continued to rise due to growing output. As abatement is implemented, we should see absolute emissions taper and eventually decline as well.

Technological progress in the oilsands gave rise to efficient extraction techniques, such as steam-assisted gravity drainage (SAGD) and directional drilling, which have a reduced environmental impact compared to traditional methods. Canadian oil & gas invests over $1.1B annually in clean tech, surpassing other industries and even global peers.[4] Further developments are under way, putting Canadian companies at the forefront of innovation. Technological improvements that drive down intensity are often applicable in other industries, and thus have far-reaching impacts on the fight against climate change.

Gas flaring is the process of burning off natural gas that is released as a byproduct of oil production. This wasteful practice releases

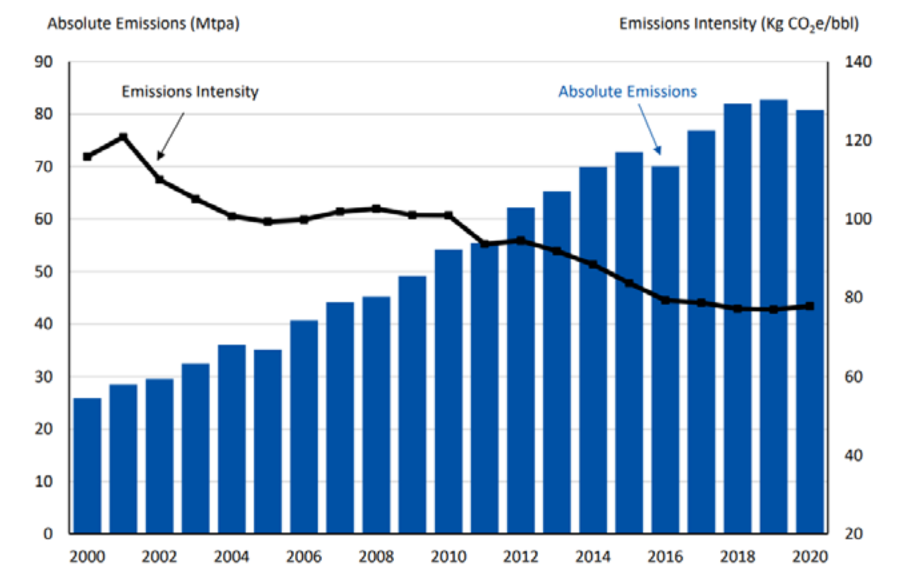
Figure 1 | Net Zero is already feasible in some sectors

Emissions by sector, millions of metric tonnes of CO_2 equivalent



Source: Environment and Climate Change Canada, Natural Resources Canada, RBC Economics, October 20, 2021
* Labels indicate annual abatement cost ($Bn)

Figure 2 | Oilsands Emissions, 2000-2020

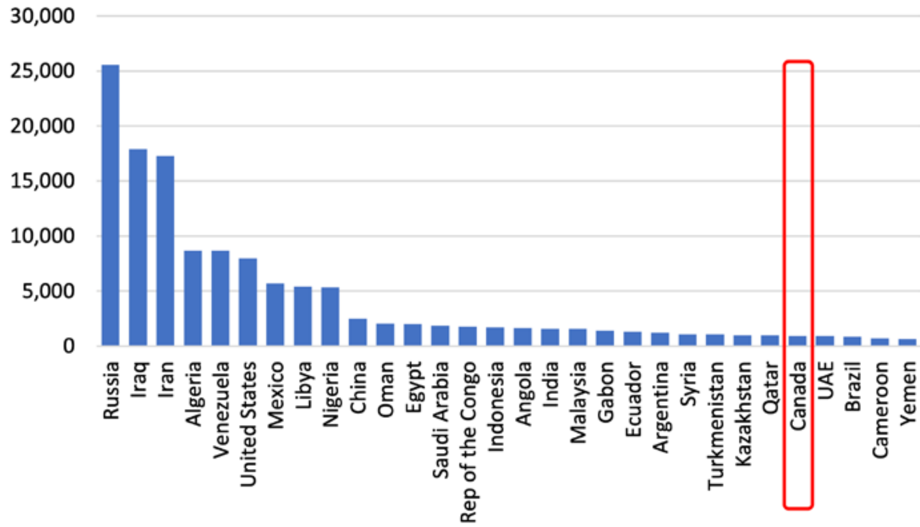


Note: Oil sands emissions intensity calculated as annual absolute emissions/total annual oil sands production.
Source: Greenhouse Gas Emissions Report (Environment and Climate Change Canada), CER, February 7, 2023

significant GHGs and air pollutants into the atmosphere. Of the major oil-producing regions in the world, Canada has some of the lowest flare volumes (in absolute and per-barrel terms) due to heavy regulation and technology investment (Figure 3). Alberta has contributed to the World Bank's Global Flaring Reduction Partnership and other regions seeking to establish their own flaring reduction measures.

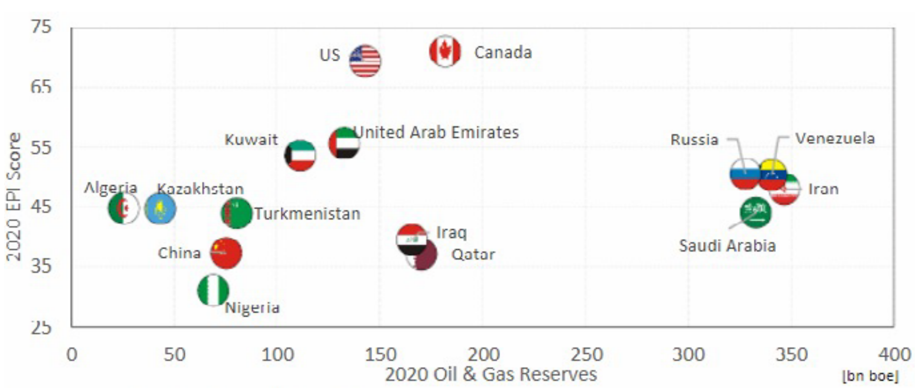
Canada is well positioned to be a leading global supplier for ethically sourced, clean carbon fuels. Of the top oil-producing nations, Canada is one of the highest on Yale's Environmental Performance Index, which measures a country's comprehensive environmental performance (Figure 4). As the path to net-zero continues to drive reliance on less carbon-intensive hydrocarbons, our energy companies will continue to play a role in meeting the world's energy needs.

Figure 3: Top 30 Countries' Flare Volume (bcm)



Source: World Bank, Global Gas Flaring Tracker Report, March 2023. data as of end of 2022

Figure 4: Top Oil & Gas Reserves by Country and EPI Score



Source: Yale Environmental Performance Index, BP's Statistical Review of World Energy

Don't forget social and governance

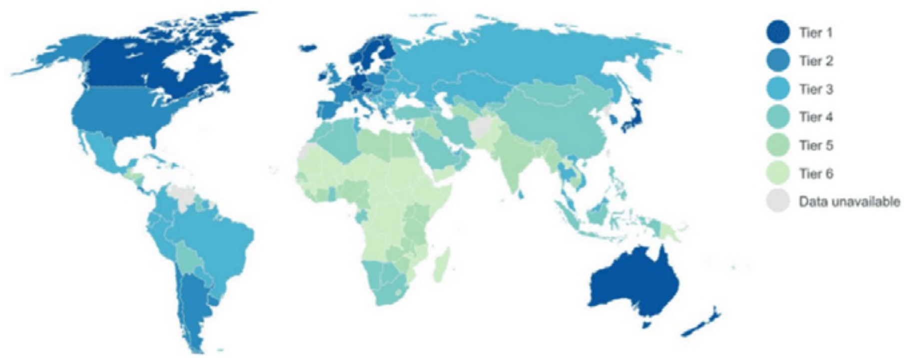
In addition to environmental considerations, social and governance factors play an essential role in evaluating the performance of oil & gas companies. This is particularly evident in the wake of the Russia-Ukraine War as countries desire to source critically important energy from socially responsible countries like Canada. Canada has a strong social and governance record, ranking high in the Social Progress Index and the World Bank's Worldwide Governance indicators. Individual companies also demonstrate responsible business practices compared to their global peers.

RBC's Climate Strategy

As a bank in a major energy producing economy, RBC recognizes the importance of supporting clients in the energy sector to achieve their energy transition objectives. Energy companies play a crucial role in building the low-carbon energy system of the future while also addressing emissions from conventional sources of energy today. By providing financial support and expertise to these companies, RBC aims to help them navigate the transition to a low-carbon economy and maintain energy security for the world.

RBC's approach under its climate strategy has been to start with the highest-emitting sectors where the bank can have the greatest impact in helping clients reduce emissions. Engaging with clients to understand their transition plans enables RBC to deepen its support, including allocating capital and providing financial advice. RBC assists energy companies in developing and implementing robust transition plans that align with the Paris Agreement. This not only helps clients reduce their emissions and transition to cleaner energy sources but also positions them for potential long-term success in a changing business landscape.

Figure 5 | Social Progress Index



Source: Social Progress Imperative, 2021

RBC's climate strategy, **Climate Blueprint**, articulates a commitment to align the bank's lending activities with net-zero by 2050. In addition, the bank set 2030 interim targets for three high-emitting sectors: Oil & Gas, Power Generation, and Automotive. Need for robust transition is clearest in these sectors. By supporting them, RBC can have a significant impact on reducing emission and accelerating the shift to a low-carbon economy, thereby contributing to the global fight against climate change.

The path forward

The coming energy transition requires a comprehensive and balanced approach. While divestment may seem like a straightforward solution, it does not address the complex challenges of reducing global emissions or our reliance on fossil fuels. The Canadian oilsands industry plays a crucial role in the transition. By investing in emissions reduction technologies and adopting responsible business practices, the industry can contribute to environmental goals while ensuring economic development and energy security.

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[1] https://www.canadianenergycentre.ca/canadian-oil-and-gas-continues-world-leading-spend-on-cleantech-rd/

[2] https://pathwaysalliance.ca/

[3] https://natural-resources.canada.ca/climate-change/canadas-green-future/capturing-the-opportunity-carbon-management-strategy-for-canada/canadas-carbon-management-strategy/25337

[4] https://www.canada.ca/en/environment-climate-change/services/environmental-indicators/greenhouse-gas-emissions.html