

INVESTOR BRIEF: TSX, NYSE: RY

RBC MUST MORE PRUDENTLY MANAGE ITS "SUSTAINABLE FINANCE" PORTFOLIO TO REDUCE COMPLIANCE AND REPUTATIONAL RISKS

ABOUT SHAREHOLDERS FOR PARIS COMPLIANCE

Investors for Paris Compliance (I4PC) is a shareholder advocacy organization that works with investors to hold publicly traded Canadian companies accountable to their net zero commitments.

In December 2021 I4PC released a best practices report on Canadian banks and net zero that can be found [here](#).

VOTE FOR THE I4PC SHAREHOLDER PROPOSAL AT THE ROYAL BANK OF CANADA AGM

Meeting date: **April 7, 2022**

Proxy cut-off date: **1pm EST, April 5, 2022**

Voting Information: [here](#)

NOTE: This is not a solicitation of authority to vote your proxy. Please DO NOT send us your proxy card; I4PC is not able to vote your proxies, nor does this communication contemplate such an event. I4PC urges shareholders to vote FOR its shareholder proposal at RBC following the instructions provided on management's proxy mailing.

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THE SHAREHOLDER PROPOSAL

In November 2021 I4PC filed a shareholder proposal with the Royal Bank of Canada (RBC) regarding its definition of "sustainable finance." The resolved clause of the resolution is as follows:

Resolved: In order to ensure RBC meets its net zero emissions reduction targets and protects against reputational risk, shareholders request that the Royal Bank of Canada ("RBC" or the "Bank") updates its criteria for "sustainable finance" to preclude fossil fuel activity and projects facing significant opposition from Indigenous Peoples.

The full proposal together with the supporting statement can be found in the Appendix. The proposal was prompted in part by a controversy that revealed larger systemic risks at RBC that the bank has thus far failed to acknowledge and remedy.

In early 2021 RBC co-structured and financed a sustainability linked loan (SLL) at pipeline company Enbridge. RBC then served as a joint lead manager of a sustainability linked bond (SLB) issuance with Enbridge later in the year. These transactions occurred during the height of **conflict** regarding Enbridge's expansion of the Line 3 oil sands pipeline, adamantly opposed by Indigenous peoples in Minnesota fearful of despoiling of their lands and waters, including court cases and hundreds of arrests. Enbridge **paid** local police forces for enforcement activities. The expansion created the **equivalent** of 50 new coal-fired power plants of emissions.

Sustainability linked instruments are structured with key performance indicators (KPIs) negotiated by the financier(s) and recipient that trigger a higher or lower cost of capital depending on whether they are met. They are not use-of-proceeds instruments, and for the bond issuance, Enbridge **stated** that it "does not intend to allocate the net proceeds specifically to projects or business activities meeting environmental or sustainability criteria." It also **stated** that "no assurance is or can be given to investors by [Enbridge], the agents, any second party opinion providers or any External Verifier that the Notes will meet any or all investor expectations regarding the Notes or [Enbridge's] targets and goals qualifying as "sustainable"."

The Line 3 controversy was high profile across North America, which meant that RBC's "sustainability" financing at the time was also controversial, landing in Canada's highest circulation newspaper, the **Toronto Star**, with an allegation of "greenwashing." Enbridge's SLL attracted negative **attention** as far away as Europe. This occurred during a heightened awareness of RBC's role as the fifth largest funder of fossil fuels in the world, with the bank also participating in other financing of projects facing significant opposition by Indigenous peoples.

The Enbridge example uncovered larger systemic risks. RBC has pledged C\$500 billion to "sustainable finance" by 2025 with no clear definition of what that means, and critically, no commitment that activities it labels "sustainable" aren't actually *increasing* emissions, as in the case in the Enbridge example. This was also not an isolated example, as we see with the case of Tamarack Valley Energy, described below.

BACKGROUND

"The area of sustainable investing has been damaged by the vast amount of greenwashing that has gone on." - John Browne, the former chief executive of BP Plc

- Sustainable finance is exploding in popularity. In 2021 over US\$1.6 trillion in sustainable debt instruments were issued globally, a major increase over the US\$763 billion issued in 2020.
- Financial institutions follow only voluntary principles for sustainability linked bonds, sustainability linked loans, green loans, social bonds and green bonds overseen by the [Loan Syndications and Trading Association \(LSTA\)](#) and the [International Capital Markets Association \(ICMA\)](#).
- These voluntary principles make no effort to be Paris aligned nor to preclude projects or recipients that are increasing overall emissions. They also provide no guidance regarding human rights or Free, Prior, and Informed Consent (FPIC) by Indigenous peoples.
- Use of proceeds instruments like green bonds are slightly more stringent in outlining qualifying categories of activities, but include pollution abatement, which could in theory apply to projects in the zone of 'getting worse more slowly' (such as putting a scrubber on a new smokestack). The sustainability linked instruments are looser and tied to KPIs negotiated between the financier and recipient, with the financing not earmarked specifically for activities related to those KPIs.



RBC acted as joint bookrunner and structuring advisor to a sustainability linked bond, proceeds of which Tamarack Energy used to expand fossil fuel production by buying another oil and gas company.

- These lax principles coupled with growing pressure for banks to meet revenue targets in the fast-growing sustainable finance segment have led to world-wide allegations of "greenwashing," such as with the [example](#) of a green bond issuance by the Hong Kong airport during its expansion—with resulting emissions increases.
- Because of its size, RBC is a market leader both within Canada and internationally. It set a commitment to providing C\$500 billion in "sustainable" finance by 2025 and [published](#) a vague one page framework "aligned with" the voluntary principles mentioned above that is silent on Paris alignment or regarding RBC's own commitments under the Net Zero Banking Alliance (see below). Unlike other banks' frameworks, there is nothing regarding eligibility of clients or exclusions on any grounds. There is little sense of how RBC will manage risk.

- RBC's sustainable finance framework is similarly silent on human rights or FPIC. The bank is a signatory to the [Equator Principles](#) which supposedly commits members to uphold FPIC in financing projects on territories subject to traditional ownership or use, or that have significant impact on cultural heritage. These standards should apply to all of RBC's financing, sustainable or otherwise.
- In RBC's framework, the bank does acknowledge: "The sustainable finance market is evolving rapidly, with additional criteria being developed and new products and services becoming available. We recognize this complexity and are committed to working across industry sectors, with government, other financial institutions and third parties, to promote consistency and comparability, and to evolve our methodology as needed to reflect the changing landscape."
- Increases in absolute emissions by oil and gas companies are often masked by the exclusion of reporting on Scope 3 emissions (from the value chain) and use of "intensity-based" emission reductions targets (per unit of output) rather than absolute reductions targets. Enbridge, for example, despite claiming it has a [net zero by 2050 commitment](#), does not measure or report on its overall Scope 3 emissions and has set only intensity-based targets for its Scope 1 and 2 emissions. This allows it to *add* massive amounts of Scope 3 emissions through projects like its Line 3 oil sands pipeline expansion while claiming to be following its own targets.
- In addition to the Enbridge example outlined above, in February 2022 RBC [acted](#) as joint bookrunner and structuring advisor for a sustainability linked bond issuance by the oil and gas drilling company Tamarack Valley Energy, with a portion of the proceeds earmarked for Tamarack's purchase of another oil and gas drilling company Crestwynd Exploration Ltd. This deal was [hailed](#) as the "first North American oil firm with [a] sustainable bond."
- Similar to the Enbridge example, Tamarack does not report on its Scope 3 emissions and has only [set](#) intensity-based targets for its Scope 1 and 2 emissions. Its latest [annual information form](#) shows the company investing in expanding oil and gas production, thereby *increasing* its Scope 3 emissions. The company has no plans to diversify into nonpolluting forms of energy.
- Contrary to such examples of increasing fossil fuel production, analyses such as the International Energy Agency's [Net Zero pathway](#) conclude that "Net zero means huge declines in the use of coal, oil and gas." Banks' labelling of fossil fuel activity as "sustainable" in any way runs counter to climate science and to their own pledges to reach net zero.
- In sum, with its scant and vague sustainable financing framework, RBC has set no guardrails around ensuring that its "sustainable" financing doesn't amount to greenwashing and has applied this label to deals where the client, far from acting consistently with the net zero transition, is demonstrably *increasing* overall emissions during the climate crisis. In the case of Enbridge and Line 3, it has also applied the "sustainability" label to a client that failed to secure FPIC to the point where Enbridge flowed money through to local police for enforcement actions against Indigenous peoples.



RBC participated in both a sustainability linked loan and bond for Enbridge while it was expanding the oil sands pipeline Line 3 while failing to secure the consent of impacted Indigenous peoples.

REASONS FOR SUPPORT OF THE PROPOSAL

1. Supporting the resolution will help RBC reduce compliance risk

In October 2021 RBC **joined** the Net Zero Banking Alliance (NZBA) along with many of its peers. Among other things, the NZBA **commits** its members to:

- For financed emissions, including and managing Scope 3 emissions "where significant," as they are in the oil and gas sector.
- Setting targets to reduce absolute financed emissions to net zero by 2050, with NZBA co-founder Mark Carney **encouraging** participants to set 2030 targets that assume their fair share of halving emissions by that date.

While the NZBA is voluntary, Canada's national government and bank regulator are starting to move to regulate climate-related risk. For example:

- The most recent **mandate letter** for Canada's Minister of Finance directs her to: "require federally regulated institutions, including financial institutions, pension funds and government agencies, to issue climate-related financial disclosures and net-zero plans."
- The Superintendent of Financial Institutions Peter Routledge recently **indicated** that the Canadian bank regulator is looking at increasing the amount of reserve capital that banks need to hold against climate risk.
- A recent **stress test pilot project** that included the Bank of Canada, the bank regulator, and RBC examined climate transition risk and concluded that there is a marked increase in the probability of credit default in the oil and gas sector in a variety of scenarios.

These initiatives indicate that should Canada's banks fail to voluntarily change their practices regarding climate risk, that they will be required to.

Here is the key point: **If RBC is increasing its financed and facilitated emissions in some of the products it deems "sustainable," what chance does it have of meeting its NZBA commitments across all of its products and demonstrating to the authorities that it is adequately managing climate risk?**

"Sustainable" products are supposed to confer a performance premium over "regular" products, but if the former take RBC further away from its climate targets rather than closer to them, then this is an indicator of compliance risk in the whole system.

Introducing safeguards to preclude fossil fuels in its sustainable finance would position the bank on a better pathway to manage climate risk and comply with its commitments and with the emerging regulatory environment.

2. Supporting the resolution will help RBC reduce reputational risk

As the climate crisis has become more severe, over the past few years, banks around the world have come under greater scrutiny for their role in facilitating emissions. Canada has also started to face up to its colonial history, with Reconciliation becoming a mainstream concept in society and in corporate Canada, and with governments—including the Canadian government—**formally recognizing** the UN Declaration on the Rights of Indigenous Peoples that recognizes FPIC.

As the largest bank in Canada and as the **5th largest** lender to fossil fuels in the world, RBC has emerged as a primary target of activist campaigns in Canada, with prominent national NGOs ranging from Greenpeace to Stand.earth to Leadnow.ca identifying the bank for **attention** and **action**.

As noted above, RBC caused controversy in Indigenous communities by putting a "sustainability" label on its financing with Enbridge just as the company was flowing through money to Minnesota police for enforcement operations targeting Indigenous protestors. RBC is also facing **sustained protests** at dozens of its bank branches by people upset with its financing of the Coastal GasLink pipeline, opposed by the hereditary houses of the Wet'suwet'en people and once again leading to multiple arrests. A 2019 BankTrack report on human rights and banking included FPIC, with RBC **scoring** almost the lowest in the world for its policy and disclosure, marginally ahead of three Chinese banks.

Given the mounting attention on RBC, courting allegations of "greenwashing" via its sustainable finance activities increases the bank's reputational risk, particularly with clients or projects in conflict with Indigenous peoples. Supporting the proposal would at least begin to remedy this particular aspect of reputational risk, even though the bank has further to go with regards to controversy regarding its other financing.

RBC is the fifth largest funder of fossil fuels in the world

Cumulative fossil fuel loans 2016-20 (\$bn USD)



Source: Banking on Climate Change

RBC RESPONSE, WITH REBUTTALS

RBC responded to the I4PC shareholder proposal on p. 96 of its **proxy circular**. Here are its responses, which have already been dealt with in this memo:

- RBC has a guiding document, "**Commitment to Sustainable Finance**," with investment categories and verification information. But as stated above, this is a vague one-page document that fails to tell investors how this program aligns with net zero, if at all, or manages risk of various kinds. RBC's peers have more robust frameworks—see below.

- RBC works with clients on "robust" sustainability strategies and meets the criteria set out by ICMA and LSTA. Again, as stated above, ICMA and LSTA are voluntary initiatives that make no attempt to align with net zero and leave it to banks to self-define what "robust" means, including in RBC's case allowing clients to increase Scope 3 emissions and still receive sustainable finance.
- RBC highly values the relationships it has with Indigenous Peoples and is a signatory to the Equator Principles. Again, as stated above, the Equator Principles commit signatories to respecting FPIC, but RBC has repeatedly financed projects—including via "sustainability linked" debt—that fail to secure FPIC, putting RBC in violation of the Principles.

The one positive note in RBC's response is that it reiterates that the sustainable finance market is evolving and that it is open to reviewing and updating its criteria. A "yes" vote on the shareholder proposal would send a clear signal to management that now is the time to do that.

PEERS

Because of its size, RBC is a global bank and should be compared to other global banks, many of which have far more detailed internal policies governing their use of sustainable finance. Here are some examples:

- Barclays Sustainable Finance [framework](#) has fossil fuel exclusions under its use of proceeds financing and eligibility criteria for its general purpose financing.
- BNP Paribas' Green Bonds [framework](#) contains exclusions for unconventional oil and coal, and flags human rights as a risk consideration.
- In its sustainable finance [framework](#), Deutsche Bank references alignment with the EU sustainable finance taxonomy and possible reference to its reputational risk committee.
- Other banks such as [Credit Agricole](#) have broader exclusion policies for some oil and gas that apply to all of their financing, superseding their "sustainable" finance criteria.

These examples are not meant to imply that these peer banks can't also improve their frameworks, but it does demonstrate a heightened level of risk management that is lacking at RBC.

ENGAGEMENT

Investors for Paris Compliance conducted engagements with all five major Canadian banks this season. Our experience with RBC stood out for its brevity. We had one meeting with RBC and were promised follow-up materials that never came. Unlike other banks, there was no further effort on the part of RBC to continue the dialogue, to the point of our emails going unanswered. We can only surmise that RBC opposes our proposal because the bank didn't even take the necessary time to say so. We are also aware of other RBC shareholders who attempted to file or engage with RBC this season who were stymied in their efforts, pointing to a pattern.

APPENDIX—THE FULL PROPOSAL AS SUBMITTED

Resolved: *In order to ensure RBC meets its net zero emissions reduction targets and protects against reputational risk, shareholders request that the Royal Bank of Canada ("RBC" or the "Bank") updates its criteria for "sustainable finance" to preclude fossil fuel activity and projects facing significant opposition from Indigenous Peoples.*

Supporting statement: RBC has set a target of providing \$500 billion in "sustainable finance" by 2025.¹ To guide this, RBC follows voluntary initiatives like the Green Bond Principles, the Social Bond Principles, and the Sustainability Linked Loan Principles. The Bank is also a signatory to the Equator Principles, which contains provisions to respect Free, Prior and Informed Consent (FPIC) by Indigenous Peoples in major projects that affect them.

While taxonomies and regulations are emerging, what ultimately qualifies as "sustainable finance" is currently decided by RBC. Reputational risk is possible when the public's expectations do not align with the company's definitions.

On September 27, 2021 a Toronto Star article referenced RBC as a bank involved in \$1.5 billion financing to pipeline company Enbridge, \$1.1 billion of which was "sustainability linked." Critics alleged "greenwashing."²

Regarding the "sustainability-linked" financing, Enbridge stated that it "does not intend to allocate the net proceeds specifically to projects or business activities meeting environmental or sustainability criteria."³

The investor-led Climate Action 100+, of which RBC Global Asset Management is a signatory, found that Enbridge "does not meet any criteria" in aligning its capital allocations with the Net-Zero Company Benchmark.⁴

At the time of the financing, Enbridge was completing the Line 3 oil pipeline expansion, a project with the equivalent emissions impact of 50 new coal-fired power plants.⁵ The Line 3 expansion also failed to secure the Free, Prior and Informed Consent (FPIC) of affected Indigenous Peoples, resulting in court cases, hundreds of arrests, and significant media attention.⁶

None of the guidelines or frameworks RBC is party to require the Bank's "sustainable financing" be numerically consistent with its net zero emissions reductions targets, nor do they preclude financing of fossil fuel activity.

The EU Taxonomy for Sustainable Activities recognizes the risk of carbon lock-in from financing fossil fuel activity, even for pollution abatement, and therefore precludes it.⁷ Transition finance is reserved for activities for which there are no low-carbon alternatives.

In addition to Line 3, RBC has been involved with financing other major fossil fuel projects that failed to secure FPIC.⁸ There have been dozens of demonstrations outside RBC branches accusing the bank of failure to respect Indigenous Rights in its financing.⁹ While RBC should consider strengthening its policy regarding FPIC across all its financing activities, failure to respect Indigenous Rights in financing branded "sustainable" heightens the prospect of reputational risk.

We urge shareholders to vote FOR this proposal.

APPENDIX—ENDNOTES

- 1 http://www.rbc.com/community-sustainability/_assets-custom/pdf/OurCommitment_EN.PDF
- 2 <https://www.thestar.com/news/canada/2021/09/27/canadian-banks-are-loaning-enbridge-over-1b-with-questionable-sustainability-requirements.html>
- 3 <https://www.thestar.com/news/canada/2021/09/27/canadian-banks-are-loaning-enbridge-over-1b-with-questionable-sustainability-requirements.html>
- 4 <https://www.climateaction100.org/company/enbridge-inc/>
- 5 <http://priceofoil.org/content/uploads/2020/01/Giant-Step-Backward-report-01-29-19-FINAL-online-version.pdf>
- 6 <https://www.theguardian.com/environment/2021/aug/10/protesters-line-3-minnesota-oil-gas-pipeline>
- 7 https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-taxonomy-faq_en.pdf
- 8 These include the Trans Mountain pipeline, Coastal Gas Link, and the Dakota Access Pipeline.
- 9 <https://www.newswire.ca/news-releases/on-the-eve-of-cop26-stand-earth-joins-people-across-the-country-that-are-unhappy-with-canada-s-largest-bank-rbc-for-its-refusal-to-stop-financing-new-fossil-fuel-projects-800456703.html>

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