Sustainable Finance in Canada: time for authentic leadership

Discussion Note No.1

Executive Summary

The recently announced Expert Panel on Sustainable Finance sets the stage for Canada to become a leader in the global transition of capital markets towards a prosperous zero emissions global economy. While it is certain that the impacts of climate change and the transition away from fossil fuels on the economy will be transformational – the UN Secretary General recently described the threat as "existential"[1] – the response of the Canadian financial sector has been muted. The Expert Panel has an opportunity to engage with the largest investors and capital market players in the country, retail investors, and regulators on how to adapt and respond to these risks and opportunities. This Discussion Note draws on consultations with Canadian financial sector stakeholders in Canada and internationally. It seeks to raise expectations that the Expert Panel will produce an ambitious plan for action across the financial system.

The paper builds on Preventable Surprises' 2015 report, 'Canada: an opportunity for investor leadership on climate change.'[2] The analysis here goes beyond climate change to include sustainable finance themes and considers key institutional investors and capital markets stakeholders within the Canadian financial system. The common thread that weaves through both papers is the pressing need for more robust investor stewardship, particularly on the part of Canada's 'Big 8' public sector pension funds in the transition towards a more sustainable financial system and robust climate action. The paper engages with current debates over how to reform capital markets and the architecture of the financial system to better support sustainable development goals and long-term prosperity for all citizens. It seeks to show how new conversations between Canadian stakeholders could trigger more consistent leadership by the Canadian financial system as part of a global shift towards more sustainable capitalism.

All comments are welcome and will inform a new Discussion Note to be published in Q1/2019. Where readers disagree with aspects of the analysis, it would be helpful to know if this because you consider the identified problems to be marginal issues, or because you think change is unnecessary, or any other reasons.

Please send comments to hamish@susfin.com

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[1] ''Direct existential threat' of climate change nears point of no return, warns UN chief' (10.09.2018): https://news.un.org/en/story/2018/09/1018852

[2] 'Canada: an opportunity for investor leadership on climate change:' https://preventablesurprises.com/wp-content/uploads/2015/10/Canada-chapter_October2015.pdf

The Expert Panel on Sustainable Finance sets the stage for Canadian leadership

The recently announced Expert Panel on Sustainable Finance sets the stage for Canadian leadership in a global transition of capital markets towards a prosperous zero emissions global economy.[3] With a strong mandate from the Ministry of Finance and the Ministry of Environment, the Expert Panel has an opportunity to facilitate agreement on core principles required for a re-engineering of the Canadian financial system into an engine of economically, socially and environmentally sustainable growth, aligned with existing national legislative frameworks and commitments under international law.[4] While the Expert Panel's initial mandate is narrowly focused on climate risk disclosure,[5] there are strong arguments for growing the scope of work to be in line with international action to align capital markets with sustainability goals, including but not limited to climate change.

Increasing both the scope of work and the level of ambition for strategic global leadership may seem counter-intuitive – "let's just focus on the easy things" has obvious appeal. We are well aware that previous recommendations to embrace sustainability have been largely ignored.[6] Nonetheless, our argument is that a comprehensive approach is needed if Canada is to reap the benefits of sustainable finance.[7] Put simply, a little bit of extra climate risk disclosure will do little to help Canada play the role it should be taking in managing the existential risk of climate change. A focus solely on disclosure also has

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[3] Government of Canada 'Expert panel on sustainable finance:' 'https://www.canada.ca/en/environment-climate-change/services/climate-change/expert-panel-sustainable-finance.html

[4] In September 2015, the Government of Canada and 192 other United Nations members states adopted the 2030 Agenda for Sustainable Development. The 2030 Agenda is a global framework of action for people, planet, prosperity, peace, and partnership, that commits Canada "to end poverty and inequality, and build peaceful societies and a healthy planet." See Government of Canada 'The 2030 Agenda for Sustainable Development:' http://international.gc.ca/world-monde/issues_development-enjeux_developpement/priorities-priorites/agenda-programme.aspx?lang=eng; Canada's adoption of the Paris Agreement in 2015 and the United Nations Declaration on the Rights of Indigenous Peoples (UNDRIP) in 2016 both set related international and domestic legal obligations. See UNFCCC (2017) 'Indigenous Empowerment Is Vital for Climate Action': https://unfccc.int/news/indigenous-empowerment-is-vital-for-climate-action; practical implementation and action on both international law instruments has been mixed.

[5] The core role of the Expert Panel is to "[w]ork with the private sector and the federal government, in collaboration with securities commissions, to promote awareness among Canadian financial market participants of climate-related risks and to advance the recommendations of the TCFD." Online: https://www.canada.ca/en/environment-climate-change/services/climate-change/expert-panel-sustainable-finance.html

[6] See, for example, Bak (2017) 'Conference report - The Pathway to a Green Finance Road Map: Disclosure, Risk and Opportunities to Scale Up Green Finance in Canada:' https://www.cigionline.org/publications/pathway-green-finance-road-map-disclosure-risk-and-opportunities-scale-green-finance.

[7] The case for moving away from siloed ESG thinking to a more integrated sustainable finance approach has been made by many commentators: https://www.ipe.com/analysis/long-term-matters/long-term-matters-what-world-are-we-creating-by-saving-the-world/10026416.article; and Robins et al (2018) 'Investing in a just transition - Why investors need to integrate a social dimension into their climate strategies and how they could take action:' https://www.cccep.ac.uk/wp-content/uploads/2018/06/Robins-et-al_Investing-in-a-Just-Transition.pdf

marginal value with a financial system that is essentially focused on the same goals, and operates within the same cultural norms, as it always has. Increased gender diversity in Canadian boardrooms[8] and action on executive pay are two closely related sustainability imperatives.

Our assumption is that the Expert Panel will want to ensure that the Canadian investment system does not lose out to peers in Europe and East Asia.[9] Forward-looking work on the sustainable finance agenda would help to build a more resilient and competitive financial sector at home and internationally. The Expert Panel should draw on international experience and expand their work to include core sustainable finance themes and the development of strategic leadership capacity at investee companies, asset owners, and asset managers.

Canada is still catching up on sustainable finance

Sustainable finance refers to the realignment of financial investment and savings across the economy to support long-term growth and investments which incorporate environmental, social and governance considerations. It also means that investment decision-making should extend its time horizon to consider longer-term risks and opportunities for value creation and sustainable prosperity.[10] Proponents of sustainable finance as a key theme in Canadian and international capital markets architecture suggest that its origins lay in the Global Financial Crisis and the Paris Agreement.[11]

These two events - the narrowly averted collapse of the global financial system and a legally binding agreement to phase out fossil fuels and address the potential collapse of Earth's climate system - triggered policymakers, institutional investors, and pension savers to re-examine the purpose of finance

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[8] Canadian boardrooms are notoriously "pale, male, and stale" – 39% of TSX-listed companies have no women on their boards and only 14% of all board seats at TSX-listed companies are held by women and often this is a lone female director which has proven to be ineffective in changing culture. See 'More work must be done to boost gender diversity in Canada's boardrooms' (18.02.2018): https://www.theglobeandmail.com/report-on-business/rob-commentary/more-work-must-be-done-to-boost-gender-diversity-in-canadas-boardrooms/article38017420/

[9] On the European Commission's work, see 'Sustainable finance: Commission's Action Plan for a greener and cleaner economy:' https://ec.europa.eu/clima/news/sustainable-finance-commissions-action-plan-greener-and-cleaner-economy_en.

[10] Bank of England 'Breaking the tragedy of the horizon - climate change and financial stability - speech by Mark Carney' (29.05.2015): https://www.bankofengland.co.uk/speech/2015/breaking-the-tragedy-of-the-horizon-climate-change-and-financial-stability. According to Carney, "..Climate change is the Tragedy of the Horizon... the horizon for monetary policy extends out to two to three years. For financial stability it is typically a bit longer, but typically only to the outer boundaries of the credit cycle - about a decade. In other words, once climate change becomes a defining issue for financial stability, it may already be too late."

[11] The Paris Agreement is an agreement within the United Nations Framework Convention on Climate Change (UNFCC), dealing with greenhouse-gas-emissions mitigation, adaptation, and climate finance. See UNFCCC 'The Paris Agreement:' https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement. Although it preceded the Global Financial Crisis, the establishment of the UN Principles for Responsible Investment in 2006 was another significant event in the reassessment of capital markets and investment as potential drivers of sustainable development: https://www.unpri.org/pri/about-the-pri

and its role in society. As a result of the financial crisis, the failure of the financial sector to address climate change, and growing inequality and ballooning household debt in advanced economies, thought-leaders globally are calling for a fundamental shift in investment thinking.[12] Both asset owners and the investment management industry need new business models to realign financial flows with long-term sustainability targets and a more equal society.[13] Only if we have a massive shift in capital will we experience the more equitable, low-carbon, and climate-resilient economy that is possible.[14]

With financial sector policymakers in China and Europe prioritising sustainable finance and the transition away from fossil fuels, Canada must not be left behind. In responding to the sustainable finance challenge, members of Canada's Expert Panel can draw on the experience of established initiatives in number of different countries, and at the international level via the G7[15], the G20[16], including at the Financial Stability Board, and the prudential regulator's Network for Greening the Financial System.[17]

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[12] World Economic Forum (2013) 'The Role of Financial Services in Society A Multistakeholder Compact:' http://www3.weforum.org/docs/WEF_FS_RoleFinancialServicesSociety_Compact_Report_2013.pdf; Pension Insurance Corporation (2017) 'The Purpose of Finance - Why Finance Matters: Building an industry that serves its customers and society:' https://www.pensioncorporation.com/media/100020/the-purpose-of-finance-report-2017.pdf; Kay (2015) 'Other People's Money: Masters of the Universe or Servants of the People?';E3G (2017) 'G20: Shifting the Trillions investment, finance, infrastructure and g20 negotiations face climate risk:' https://www.e3g.org/showcase/g20-shifting-the-trillions/; Barron's (2018) 'Economist Mariana Mazzucato on the Downside of Shareholder Value:' https://www-barrons-com.cdn.ampproject.org/c/s/www.barrons.com/amp/articles/the-downside-of-shareholder-value-1535571901

[13] Canada and more than 150 other countries have all adopted the 2030 Agenda for Sustainable Development, which includes the Sustainable Development Goals (SDGs): http://www.undp.org/content/undp/en/home/presscenter/pressreleases/2015/09/24/undp-welcomes-adoption-of-sustainable-development-goals-by-world-leaders.html

[14] UNEP-FI 'The financial system we need: from momentum to transformation:' http://unepinquiry.org/wp-content/uploads/2016/09/The_Financial_System_We_Need_From_Momentum_to_Transformation_Summary_EN.pdf; http://www.paulsoninstitute.org/green-finance/; the Dutch central bank has worked with the country's largest pension funds and asset managers to create a methodology for assessing investment alignment with the Sustainable Development Goals: :https://www.dnb.nl/en/binaries/SDG%20Impact%20Measurement%20FINAL%20DRAFT_tcm47-363128.PDF?2018020717. The project was an output of the Sustainable Finance Platform, a collaboration between the central bank (DNB), the Dutch Banking Association, the Dutch Association of Insurers, the Federation of the Dutch Pension Funds, the Dutch Fund and Asset Management Association, the Netherlands Authority for the Financial Markets, the Ministry of Finance, the Ministry of Infrastructure and the Environment, and the Sustainable Finance Lab. Set up by DNB in 2016, its goal is to promote and encourage a dialogue on sustainable finance in the financial sector: https://www.dnb.nl/en/about-dnb/co-operation/platform-voor-duurzame-financiering/index.jsp

[15] At the conclusion of the G7 Ministerial Meeting on Environment in Bologna, Italy, in June 2017, the G7 released a communiqué acknowledging "that scaling up sustainable finance is fundamental to achieve sustainability and climate goals"; https://www.newswire.ca/news-releases/leading-canadian-and-g7-investors-come-together-in-support-of-global-development-initiatives-684685981.html

[16] http://unepinquiry.org/publication/green-finance-progress-report/

[17] https://www.fsb-tcfd.org/; The Network for Greening the Financial System includes 13 Members and 2 Observers: Banco de España, Banco de México, Bank Al Maghrib, Bank of England, Banque de France / Autorité de contrôle prudentiel et de résolution (ACPR), Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), De Nederlandsche Bank, Deutsche Bundesbank, European Central Bank, Finansinspektionen (Swedish FSA), Monetary Authority of Singapore, Oesterreichische National Bank, and the People's Bank of China. The Bank for

The reality is that the policy context is not as supportive as it needs to and could be. Canada's commitment to phase out the production and use of fossil fuels in line with its international legal commitments, has stalled.[18] Continued government support for an increasingly uneconomic sector will create challenges for investors seeking to accurately price market risks and opportunities as the energy transition gathers pace. Canadian capital markets regulators could be more proactive in assessing how financing of fossil fuels will be wound down in a transparent manner. This would have implications for all participants in the institutional investment chain, from retail pension savers and pension managers,[19] through to banking sector lenders, underwriters, and auditors[20] of the largest oil, gas, and coal projects in North America.[21] International accounting standards bodies, actuaries,[22] prudential regulators are already assessing these risks in the pension, banking, and insurance sectors.

The Economist Intelligence Unit summarised the need for proactive regulatory intervention to correct market failures relating to climate change, noting that "any institution with a remit to promote financial stability or financial reporting standards or to address systemic financial risk has the responsibility… to address climate-related financial risk."[23] The Expert Panel should engage systemically with the financial regulatory community in Canada to ensure that regulatory approaches are consistent with international best practice in order to safeguard investors and the competitiveness of the Canadian economy.[24]

International Settlement and the OECD are official observers. The Bank of Canada is not currently a member. See Banque de France (29.05.2018) 'Publication of the mandates of the NGFS technical workstreams and expansion of the NGFS membership:' https://www.banque-france.fr/en/communique-de-presse/publication-mandates-ngfs-technical-workstreams-and-expansion-ngfs-membership

[18] 'G7 leaders agree to phase out fossil fuels' (08.06.2016): https://www.ft.com/content/ec2c365a-0ddf-11e5-aa7b-00144feabdc0

[19] CCPA (2018) 'Canada's Fossil-Fuelled Pensions: the case of the British Columbia Investment Management Corporation:' https://www.policyalternatives.ca/fossil-fuelled-pensions

[20] 'Stranded: Accounting for unused assets' (26 01 2018): https://blogs.thomsonreuters.com/answerson/stranded-accounting-for-unused-assets/; ACCA (2016) 'Filling the information black hole: How are fossil fuel companies reporting on the stranded asset risk?' https://www.accaglobal.com/content/dam/ACCA_Global/Technical/oil-gas/ea-stranded-assets.pdf.

[21] RAN (2018) 'Banking on Climate Change:' https://www.ran.org/bankingonclimatechange2018

[22] IoFA (2017) 'IFoA warns on climate change financial risks:' https://www.actuaries.org.uk/news-and-insights/media-centre/media-releases-and-statements/ifoa-warns-climate-change-financial-risks

[23] The Economist Intelligence Unit (2017) 'The Road to Action: Financial Regulation Addressing Climate Change:' https://eiuperspectives.com/financial-services/road-action-financial-regulation-addressing-climate-change, at 26.

[24] Given the rapid development in financial regulatory approaches to climate change and other sustainability risks in jurisdictions like Europe and California, commentators have noted that further inaction in Canada could create compatibility challenges in key capital markets sectors including in the marketing and sale of retail and institutional investment products across asset classes.

Global leadership on the low carbon transition starts at home

As Canada intensifies its efforts to shift from a fossil fuel-based energy system to a greener, wealthier, and more sustainable one, the current structure of the financial sector will have to change.[25] Assets will need to shift away from the fossil fuel sector and associated infrastructure into other, more economically productive sectors of the economy.[26] Achieving this shift without negatively impacting growth and job creation is frequently described as a key public policy aim for federal and provincial politicians and business leaders. Yet action to date has been limited, with a strong focus on preserving the status quo. The federal Minister of Finance and the directors of Canada's largest commercial banks all remain staunchly supportive of a business as usual approach to fossil fuel extraction and energy investment. This may be a partial reflection of federal government policy capture by the fossil fuel sector.[27] [28] The federal government's recent decision to use public funds for the acquisition of Kinder Morgan Inc.'s Canadian pipeline assets is the latest example of such policy capture. This suggests that the path to sustainable finance leadership and more robust climate action could be long and arduous.[29] The Expert Panel has a key role to play in accelerating orderly progress along that path. The Panel members should be clear with key capital market actors on the need for swift action in support of the transition to a more sustainable financial system in Canada, and to maintain a genuinely competitive financial sector.[30]

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[25] Pension Insurance Corporation 'Purpose of Finance Project:' 'https://www.pensioncorporation.com/thought-leadership/the-purpose-of-finance/

[26] Robins and Brunsting (2018) 'Investing in a just transition Why investors need to integrate a social dimension into their climate strategies and how they could take action:' https://www.unpri.org/download?ac=4718

[27] 'How the oil industry created a 'deep state' in Canada' (06.10.2017): http://www.macleans.ca/opinion/is-there-a-deep-state-in-albertas-oil-industry/; 'NEB panel members step down after flurry of criticism' (09.09.2016): https://www.cbc.ca/news/canada/montreal/neb-panel-steps-down-1.3755872; most recently evidenced in the decision to acquire Kinder Morgan Canada's pipeline asset using public funds, and Finance Minister's dogged support for the project. 'Federal court quashes Trans Mountain approval in setback for Trudeau' (31.08.2018): https://www.bnnbloomberg.ca/federal-court-rules-ottawa-must-resubmit-trans-mountain-project-for-review-1.1131017

[28] 'Royal Bank of Canada CEO touts pipelines as key to transitioning to a greener economy' (26.09.2016): https://business.financialpost.com/commodities/energy/royal-bank-of-canada-ceo-dave-mckay-touts-pipelines-as-necessary-to-creating-a-greener-economy; Scotiabank (2018) 'Pipeline Approval Delays: the Costs of Inaction:' https://www.gbm.scotiabank.com/scpt/gbm/scotiaeconomics63/pipeline_approval_delays_2018-02-20.pd; the Expert Panel could also address persistent conflicts of interest in the investment banking sector, where banks who are providing lending and underwriting services to fossil fuel energy and infrastructure also publish sell-side research which does not provide realistic risk appraisals of the same projects, as has been suggested with Kinder Morgan; 'Robyn Allan: Scotiabank's oil report a work of fiction' (04.03.2018): https://vancouversun.com/opinion/op-ed/robyn-allan-scotiabanks-oil-report-a-work-of-fiction

[29] Department of Finance Canada (2018) 'Backgrounder: Details of Agreement for the Completion of the Trans Mountain Expansion Project:' https://www.fin.gc.ca/n18/data/18-038_1-eng.asp. The downside risk of inaction is significant. Most recently explained in GMO (2018) 'The Race of Our Lives Revisited:' https://www.gmo.com/docs/default-source/research-and-commentary/strategies/asset-allocation/the-race-of-our-lives-revisited.pdf

[30] Bak (2017) 'Can Canada Step into the Breach? Addressing Climate-related Financial Risk and Growing Green Finance?' https://www.cigionline.org/sites/default/files/documents/PB%20no110web_1.pdf.

Recommendations for consideration by the Expert Panel

The G7, the G20, and the Financial Stability Board have all made clear their commitment to scaling-up and enhancing climate and sustainability risk integration in the global financial system and the Trump Administration – which will face new elections in 2018 and 2020 – has not been able to disrupt this. Canada now has an opportunity to learn from the experience of its global peers and make sustainable finance a focus for the remainder of its G7 Presidency in 2018. Alongside its identified focus on climate-related financial disclosures,[31] the Expert Panel should consider additional key themes that are already well-established components of the global sustainable finance agenda. Aligning its work programme with issues raised in the European Commission's Sustainable Finance Action Plan and at the G20 Sustainable Finance Study Group,[32] for example, would help ensure that the Canadian financial sector remains globally competitive while also adapting to better serve the long-term interests of all Canadians.

To support more robust government and industry action on the sustainable finance agenda the Expert Panel should consider action to:

1. Develop tools and metrics to shift capital away from fossil fuels.

There is an opportunity for the Canadian government and investors to support economic growth and increased productivity through investment in low carbon technologies that is more sustainable from a macroeconomic and environmental perspective.[33] The Expert Panel should analyse needs and

[31] The Expert Panel's Terms of Reference asks the four appointed members to:
[a] work with the private sector and the federal government, in collaboration with securities commissions, to promote awareness among Canadian financial market participants of climate-related risks and to advance the recommendations of the TCFD;
[b] Where feasible, engage industry participants to dialogue on private sector-led approaches and collaboration or through private-public leadership; and
[c] Draft a report to Ministers outlining: global trends in sustainable finance, including climate-related risk disclosure roles and responsibilities for sustainable finance in Canada; opportunities and challenges relating to sustainable finance and climate-related risk disclosure in Canada; recommendations of potential next steps the Government of Canada may wish to consider within its area of jurisdiction:" https://www.canada.ca/en/environment-climate-change/services/climate-change/expert-panel-sustainable-finance.html. The 2018 Climate Economy Report from the high-level Global Commission on the Economy and Climate, led by former President of Mexico Calderon and composed of Lord Stern, heads of the OECD, World Bank, ADB, EBRD has already provided clear recommendations that: "companies and investors should be required, as a matter of good corporate practice, to disclose their climate-related financial risks and how their business strategy is compatible with the Paris Agreement, following the TCFD recommendations:" http://newclimateeconomy.report/2018

[32] 'G20 Green Finance Repository:' http://unepinquiry.org/g20greenfinancerepositoryeng/

[33] On the risks associated with overreliance on consumption-led and household debt-based economic growth cycles to support economic growth see IMF (2018) 'Understanding the Macro-Financial Effects of Household Debt: A Global Perspective:'
https://www.imf.org/~/media/Files/Publications/WP/2018/wp1876.ashx

opportunities for innovation to increase productivity through a shift of capital away from fossil fuels to more sustainable clean energy and zero emissions transport. Currently, direct and indirect subsidies to the fossil fuel sector consume billions in public funds,[34] and there are also significant off-balance sheet costs for reclamation and remediation costs in the oil sands sector that will be a significant burden on public finances in coming decades.[35] The Expert Panel should assess how the removal of fossil fuel subsidies can boost productivity and free up government funds for investment into more economically and socially useful infrastructure - clean energy, public transport, schools, etc. This would include analysis on the implications of fossil fuel subsidy reform on the banking sector, and consider options for raising capital requirements for all commercial and government lending to high-carbon infrastructure and energy projects.

2. Improve transparency in reporting and financial product labelling.

Greater transparency in the reporting of sustainability and climate-related financial risks by Canadian companies could support more resilient business models and improve long-term performance, both in financial and non-financial terms.[36] Over time, more comprehensive risk management and reporting would support robust growth and employment as well as increased trust among stakeholders, including investors and consumers of financial services.

More uniform and transparent labelling of sustainable investment products and 'green finance' instruments would enable investors across Canada to better align capital allocation and investment decisions with sustainable development and climate-related goals. For example, no banks currently identify the environmental attributes of their loans and underlying asset collateral, with most loans provided for general business purposes. Clearer, more systematic loan labelling would support the scaling up of sustainable finance in large fixed income and structured finance markets. Given the work

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[34] Estimated at an annual average subsidy of around $3 billion by the ODI: 'G20 subsidies to oil, gas and coal production: Canada:' https://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/9988.pdf. Given the complexity of tracking subsidies and differing methodological approaches, estimates can vary.
[35] 'Albertans may face $8B bill for orphan wells unless rules change, lawyer says' (27.10.2017): https://www.cbc.ca/news/canada/calgary/orphan-wells-alberta-energy-minister-redwater-1.4420929; Influence Map (2016) 'Fossil Fuel Subsidies in the G7 and EU:' https://influencemap.org/site/data/000/234/Fossil_Fuel_Subsidies_Country_Report_Nov_16.pdf; 'Without Big Ideas, Canada's Growth Rate Could Be Cut in Half in the Coming Decades' (13.12.2017): https://www.bcg.com/d/press/13december2017-canada-prosperity-delivering-big-ideas-for-growth-179332 ; on the global scale, Canadian investors and global businesses would benefit from the boost to growth from the global transition to clean energy. See IRENA (2016) 'Increasing World's Share of Renewable Energy Would Boost Global GDP up to $1.3 Trillion:' http://www.irena.org/newsroom/pressreleases/2016/Jan/Increasing-Worlds-Share-of-Renewable-Energy-Would-Boost-Global-GDP-up-to-13-Trillion
[36] The Canadian Securities Administrators (CSA) 'Climate Change Disclosure Review Project' is one example of efforts to harmonise corporate climate risk reporting in line with recommendations from the Financial Stability Board's Task Force on Climate-related Financial Disclosures: https://www.securities-administrators.ca/aboutcsa.aspx?id=1567

on sustainable finance product labelling that is already underway in Europe and Asia,[37] the Canadian financial sector's ability to compete in new global debt markets must not be undermined by timidity of ambition.[38]

3. Clarify ESG integration and stewardship as part of fiduciary duty.

Canadian pension savers should be confident that pension fund trustees and external fund managers appointed to manage these funds are systematically considering financially material sustainability risks. Under Canadian law, fiduciary duties to beneficiaries are twofold: a duty to act prudently and a duty of loyalty.[39] A variety of other duties emanate from these two principal duties that all suggest Canadian investment fiduciaries should be taking sustainability and climate-related risks into consideration.[40] The Expert Panel should recommend that other financial institutions, not just pension fund trustees, also be subject to fiduciary/trust law standards of prudence with reference to sustainability risks, including insurance companies, investment companies, banks and philanthropic endowments. The Expert Panel has an opportunity to signal that the fiduciary duties of institutional investors, asset managers, and investment advisors in Canada should include the integration of material sustainability considerations into the investment process and asset stewardship and corporate governance activities.

What happens today, however, is that the majority of Canadian institutional investors and asset managers interpret fiduciary duty as prioritising a focus on maximising short-term financial returns and

[37] Norton Rose (2018) 'Sustainable finance: regulatory intervention on the horizon:' http://www.nortonrosefulbright.com/knowledge/publications/166610/sustainable-finance-regulatory-intervention-on-the-horizon

[38] The outstanding balance of the Canadian securitization market was approximately $92bn as at December 2017. The largest asset classes continue to be credit cards, autos and mortgages, with mortgages making up; RBC (2018) 'Canadian Securitization Market Update: 2017 Year-in-Review and 2018 Outlook:' https://www.rbccm.com/assets/rbccm/docs/uploads/2017/CDN_Securitization_Update_Investors_Final_March_2018.pdf. The international market is significantly larger, and the portion of this which is "green" is set to grow: Michael Sheren (2017) 'A Powerful New Engine For Green Finance:' https://blogs.thomsonreuters.com/sustainability/2017/12/06/executive-perspective-powerful-engine-green-finance/

[39] Hodgkinson v Simms, [1994] 3 SCR 377 [Simms] at 419: https://scc-csc.lexum.com/scc-csc/scc-csc/en/item/1181/index.do. These common law duties have been incorporated into provincial and federal statute.

[40] Blueberry River Indian Band v. Canada (Department of Indian Affairs and Northern Development), [1995] 4 SCR 344: https://scc-csc.lexum.com/scc-csc/scc-csc/en/item/1322/index.do. The duty of loyalty requires fiduciaries to act in good faith in the interests of their beneficiaries, impartially balance the conflicting interests of different beneficiaries, avoid conflicts of interest, and includes a duty to not act for the benefit of themselves or a third party. The prudential obligation requires fiduciaries to act with the care, diligence and skill in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person. For a detailed discussion on the interaction of common law fiduciary duties and the statutory duty of care under Canadian law see: Sarra and Williams (2018) 'Directors' Liability and Climate Risk: Canada - Country Paper:' https://www.smithschool.ox.ac.uk/research/sustainable-finance/publications/CCLI-Canada-Paper-Final.pdf, 6-7.

disregarding long-term effects on performance due to sustainability factors and risks.[41] The result is that ESG risks such as climate change are integrated into investment decision-making processes and reported to pension savers in an inconsistent manner.[42] The Expert Panel should discuss more uniform ESG risk reporting principles from a fiduciary duty perspective, and reinforce the view that investment fiduciaries must consider these themes.[43]

Critically important vis a vis sustainability disclosure, Canadian pension funds should disclose their voting practices and those of their managers and provide rationales for the votes cast to their beneficiaries in a manner which enables easy comparison.[44] As pension savers increasingly expect stewardship activities and proxy voting to align with long-term prosperity and to address systemic risks like climate change, their pensions need to be taking stewardship on these themes much more seriously than they have, and this includes the actions of delegated managers.

In particular, the alignment of investor corporate governance, proxy voting, say on pay voting policies and processes, performance metrics, long-term incentive design and strategic leadership development are all required to drive the transition to a low carbon economy.[45] Creating an approach to investment, corporate governance and asset stewardship that is truly integrated will foster innovation and investment and the development of strategic leadership capacities that are able to envision and lead the required business model and industry structure changes to a low carbon economy.

With this in mind, the Expert Panel should recommend better disclosures related to strategic leadership development as well as executive compensation in order to foster future leaders in finance and the investment industry in particular, who are ready to implement new business models aligned with the low-carbon transition.[46] This type of leadership will be necessary to achieve acceptable portfolio returns

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[41] The Canadian UN-PRI signatory group has flagged these concerns in UN-PRI (2017) 'Fiduciary duty in the 21st century: Canada roadmap:' https://www.unpri.org/fiduciary-duty/fiduciary-duty-in-the-21st-century-canada-roadmap/260.article

[42] Sarra & Williams (2018) 'Directors' Liability and Climate Risk: Canada - Country Paper:' http://www.smithschool.ox.ac.uk/research/sustainable-finance/publications/CCLI-Canada-Paper-Final.pdf, at 21; In Ontario, the Pension Benefits Act now requires pension funds to disclose information about whether ESG factors are incorporated into a plan's investment policies and procedures and, if so, how those factors are incorporated. This unique piece of provincial legislation takes a "disclose and explain" approach, and pension funds do not necessarily need to consider these ESG factors, which would include climate change financial risk, but they do need to disclose whether they consider ESG factors, and if so how. See O Reg 235/14, s. 8. Pension Benefits Act, RRO 1990, Reg 909: https://www.ontario.ca/laws/regulation/900909?search=e+laws

[43] Recent reports on climate risk and fiduciary duty in the pension investment context have yet to be acted on by Canadian regulators, unlike in a number of their G7 peer jurisdictions. See Koskie Minsky (2015) 'Climate Change and the Fiduciary Duties of Pension Fund Trustees in Canada:' https://kmlaw.ca/climate-change-and-the-fiduciary-duties-of-pension-fund-trustees-in-canada/

[44] This would supplement existing regulations applicable to fund managers, outlined in National Instrument 81-106, 'Continuous Disclosure Regime for Investment Funds. NI 81-106 requires disclosure of policies, procedures and proxy voting record annually: http://www.osc.gov.on.ca/en/6449.htm

[45] See IRRCi (2015) 'The Alignment Gap Between Creating Value, Performance Measurement, and Long-Term Incentive Design:' https://irrcinstitute.org/wp-content/uploads/2015/09/alignment-gap-study1.pdf

[46]The Caisse de dépôt et placement du Québec (CDPQ) stands out from its peers at the Canada Pension Plan Investment Board and the Ontario Teachers Pension Plan in incorporating climate change and transition to a low

while at the same time achieving broader societal, and environmental benefits, alongside sustainable economic development.

4. Scale up public and private financing for sustainable infrastructure.

To support the transition to more sustainable infrastructure, the Expert Panel should recommend the application of robust climate metrics to government energy and infrastructure financing through all channels.[47] Globally, a large volume of infrastructure investment is required over the next 15 years: around US$90 trillion, representing an unparalleled opportunity for investment in Canadian communities and globally.[48] As part of its infrastructure investment plan, the federal government recently created a Canada Infrastructure Bank, and it has pursued blended finance options to support international climate finance.[49] The infrastructure bank is authorized to invest $35 billion in green infrastructure across the country. In order to achieve Canada's ambitious SDG and climate-related commitments, significantly more investment will be required in clean energy and transport infrastructure both at home and abroad. This will most likely have to come from the private sector and through blended finance mechanisms. A genuine focus on sustainable infrastructure would also meaning winding down of financing for fossil fuel infrastructure, in line with Canada's international commitments.[50]

5. Identify the financial infrastructure required to channel capital away from fossil fuels.

In order for capital to be channeled away from high-polluting sectors into more productive activities, new investment benchmarks are required. The Expert Panel should initiate research on the creation of a new national investment benchmark methodology for low carbon benchmark indexes that would guide

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carbon economy as part of the CEO performance review. See CDPQ (2017) 'Annual Report:' https://www.cdpq.com/en/performance/annual-reports/2017, at 95.

[47] This would align with similar work by the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority to introduce a monitoring system to assess environmental, social and governance (ESG) risks, a future-oriented climate scenario analysis. See: 'Frequently asked questions: Commission proposals on financing sustainable growth:' http://europa.eu/rapid/press-release_MEMO-18-3730_en.htm. This work could build on existing Canadian corporate reporting on forward looking risk.

[48] Global Commission on the Economy and Climate (2016) 'The Sustainable Infrastructure Imperative: financing for better growth and development:' http://newclimateeconomy.report/2016/wp-content/uploads/sites/4/2014/08/NCE_2016Report.pdf

[49] 'Canada-IFC Blended Climate Finance Program for private investments in climate solutions:' https://www.devdiscourse.com/Article/46059-canada-ifc-blended-climate-finance-program-for-private-investments-in-climate-solutions. Blended finance is the strategic use of development finance for the mobilisation of additional finance from impact investors, pension funds and others to support financing for the sustainable development goals and other projects in developing countries.

[50] With this goal in mind, a number of approaches to restricting fossil fuel extraction are under consideration at the international level. See Green & Denniss (2018) 'Cutting with both arms of the scissors: the economic and political case for restrictive supply-side climate policies:' https://link.springer.com/article/10.1007%2Fs10584-018-2162-x; and Green (2018) 'The Logic of Fossil Fuel Bans:' https://www.nature.com/articles/s41558-018-0172-3

retail and institutional capital into more sustainable investments. A number of investable low carbon indexes exist in Canada, but methodologies remain inconsistent. For all index tracking capital to transition out of high-carbon sectors, these benchmarks must change.[51] The Expert Panel could spearhead new research on sound and transparent methodologies for assessing different types of low-carbon strategies and identifying tools to measure the performance of investment funds against a national low-carbon transition benchmark.[52] Sustainability metrics should be addressed in the way that the reporting of financial performance has been standardised and made more comprehensible for savers. This would help to align Canadian standards with evolving international best practice and make financial sector companies more globally competitive.[53]

6. Empower Canadian savers to invest in change.

Some may be tempted to follow the US Department of Labour's backwards steps on ESG integration[54] but this would be a serious error, not least because forthcoming US elections could make this change temporary. In contrast, Canada should show global leadership on the integration of ESG preferences in the provision of financial advice by regulated financial advisors and given the importance of the Canadian asset owner community, global service providers – US headquartered ones too – would need to adapt. Thus Canadian investors would be influencing US market norms in a way which is both legitimate and urgently needed.

This would mean that when providing investment advice, investment firms would be required to ask clients' ESG preferences and act upon it. In order to inform this work, investment intermediaries will require more consistent and comparable information from reporting companies. This could be achieved by amending the Canadian Corporations Act to require ESG risk reporting, among other targeted policy

[51] 2 Degrees Investing Initiative (2015) 'Assessing the alignment of portfolios with climate goals: climate scenarios translated into a 2d benchmark:' http://2degrees-investing.org/wp-content/uploads/2018/02/2dportfolio_v0_small.pdf. In Canada, the TSX60 Index, for example, is made up of three sectors with significant direct and indirect exposure to fossil fuels, with allocations to financial services at 40%, energy at 20%, and materials at 10%, accounting together for 70% of the investment universe. This is significant as, according to a 2012 survey by the international Monetary Fund, Canadian investors hold about 59% of their equity in domestic stocks: https://www.penderfund.com/blog/active-management-demystifying-the-canadian-stock-market/

[52] Similar to the regulatory process now underway in Europe to create "a new category of benchmarks, comprising the low-carbon benchmark or "decarbonised" version of standard indices and the positive-carbon impact benchmarks." See 'Sustainable finance: Making the financial sector a powerful actor in fighting climate change' (24.05.2018): http://europa.eu/rapid/press-release_IP-18-3729_en.htm

[53] 'Report on investment performance:' 'https://www.getsmarteraboutmoney.ca/protect-your-money/investor-protection/regulation-in-canada/report-on-investment-performance/; In France, Institutional investors are mandated to "disclose in their annual report, and make available to their beneficiaries… their exposure to climate-related risks, including the GHG emissions associated with assets owned, their contribution to the international climate targets and the energy and ecological transition. That contribution will be assessed with regards to indicative targets taking into account the nature of their activities… set by the implementation decree."

[54] Silk & Niles (2018) 'Department of Labor Cautionary Tone on ESG-Related Activities:' https://corpgov.law.harvard.edu/2018/05/02/department-of-labor-cautionary-tone-on-esg-related-activities/

interventions. Supporting a more consistent national taxonomy to define and report on investment strategy alignment with the energy transition would be an important first step.

7. Align corporate accounting frameworks to support long-term prosperity

The Expert Panel should examine existing legal frameworks that could help companies and investors incorporate the critical importance of environmental sustainability and, at least until targets are met, put these concerns ahead of the interests of financial creditors.[55] This would help to redress the financial sector's bias towards short-termism at the expense of environmental health and social welfare. Such an approach could accelerate the shift in lending and investing practices in the financial sector by raising the repayment risk in the event of bankruptcy, and encourage more robust investment decision-making processes. Currently, federal bankruptcy laws and government-backed insurance protect creditors whereas obligations for pollution and remediation lay with the taxpayer.[56] For example, if banks are owed money and a major oil sands player goes bankrupt and defaults, the rules surrounding receivership means the banks will be in line to be repaid, but the obligations for tailings maintenance and/or remediation will not be recognized in the same manner, with the same rights of recovery. This means that asset retirement and remediation costs often fall to the public, increasing taxpayer burdens and re-directing substantial funds into clean-up activities. In order to begin to remedy this situation and to facilitate the managed wind-down of the fossil fuel sector,[57] the Expert Panel could simply recommended the proactive enforcement of the Polluter Pays Principle that already exists in Canadian law. This would help to channel investment flows towards higher quality projects, reduce emissions and enable Canada to move more quickly towards achieving agreed upon sustainability and climate change targets.[58]

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[55] For a detailed summary of existing ese Sarra and Williams (2017) 'Canada: country summary on climate change financial risk:' :https://hennickcentre.ca/wp-content/uploads/2017/11/CCLI-country-summary-Sarra-Williams-for-conferences.pdf

[56] NRDC (2017) 'Tar Sands Tailings: Alberta's Growing Toxic Legacy:' https://www.nrdc.org/experts/tar-sands-tailings-albertas-growing-toxic-legacy. As a result of the significant business risks posed by more transparent and accurate reporting on liabilities, the simple transition to IFRS accounting measures in the oil and gas sector was bitterly opposed by the industry incumbents: https://www.cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/international-financial-reporting-standards-ifrs/publications/decommissioning-liabilities-in-a-business-combination; For a discussion of historical case studies see Pembina Institute (2010) 'Toxic Liability: how Albertans could end up paying for oil sands mine reclamation:' https://www.pembina.org/reports/toxic-liability-report.pdf

[57] Oil Change International (2016) 'The Sky's Limit; why the Paris climate goals require a managed decline of fossil fuel production:' http://priceofoil.org/content/uploads/2016/09/OCI_the_skys_limit_2016_FINAL_2.pdf

[58] The preamble to the federal *Canadian Environmental Protection Act* expressly endorses this principle: "Whereas the Government of Canada recognizes the responsibility of users and producers in relation to toxic substances and pollutants and wastes, and has adopted the "polluter pays" principle." https://www.ec.gc.ca/lcpe-cepa/default.asp?lang=En&n=EE479482-1&wsdoc=08911AB8-D8D7-B548-3C28-9A134BD20ED1

The structure of the Canadian financial system: ready for the future?

Canada's financial system is large and stable, with assets totaling about 5 times GDP.[59] It is dominated by the government and a small handful of players in most commercial sectors.[60] The financial system is supported by three key pillars: pension funds, the insurance sector, and commercial banks. Alongside this group of core actors, key intermediaries include pension investment consultants, asset managers, actuaries, accountants and auditors, credit rating agencies, and citizen investors. In addition to the largest financial sector actors, non-financial sector companies control large pools of capital that are not currently supporting enhanced economic productivity or innovation.[61] The government of Canada is a large financial player, with key roles facilitating access to capital and debt markets for governments and businesses around the world. Government policy and legislation play a fundamental role in directing private capital flows across the economy. The cooperative banking sector is one of the most well developed in the world, but total assets are modest with just over $200 billion.[62]

Canada's eight largest public pension funds, referred to as the "Big Eight" by the Bank of Canada, are major investors across the economy, with gross assets under management of more than $1.5 trillion.[63] In total, the public pension fund sector holds about 15 percent of the total assets in the Canadian financial system. The pension system is a model for other countries – which is another reason why Canada should not be "middle of the road" in its sustainability goals,[64] and the largest public sector

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[59] IMF (2014) 'Canada Financial Sector Stability Assessment.' Online: https://www.imf.org/external/pubs/ft/scr/2014/cr1429.pdf, at para.2. This compares with a ratio of over 10:1 in the United Kingdom, 8.8 in the Netherlands, 5.6 in Switzerland, 6.4 in Japan, and 3.9 in the US: https://www.imf.org/external/pubs/ft/scr/2016/cr16167.pdf

[60] In the context of Canada's oligopolistic financial sector, many consider the Competition Bureau and the Office of the Superintendent of Financial Institutions as incapable of proactively regulating the largest capital markets players, or to bring meaningful enforcement actions in response to cartel-like behaviour an associated abuses. This poses further challenges for advancing the sustainable finance agenda. For an international perspective see Linklaters (2018) 'Pressure Points: Global cartel enforcement in 2018:' https://lpscdn.linklaters.com/-/media/files/insights/2018/april/linklaters_global_enforcement_index_2018.ashx?rev=afb13921-0a32-4007-ba94-bbb33db9ea12

[61] IMF (2015) 'The Corporate Saving Glut in the Aftermath of the Global Financial Crisis.' Online: https://www.imf.org/external/np/seminars/eng/2015/secularstag/pdf/Gruber.pdf. The 'Corporate savings glut' represents the excess of corporate cash holdings (saving) over their investment back into business growth, human capital, and innovation.

[62] Canadian Credit Union Association (2017) 'National Sector Results Fourth Quarter 2017': https://www.ccua.com/~/media/CCUA/About/facts_and_figures/documents/Quarterly%20National%20System%20Results/4Q17SystemResults_14-Mar-18.pdf

[63] Bank of Canada (2016) 'Financial System Review.' Online: http://www.bankofcanada.ca/wp-content/uploads/2016/06/fsr-june2016.pdf, at 33.

[64] World Bank (2017) 'Building a world-class pension organization - Lessons from Canada:' http://documents.worldbank.org/curated/en/780721510639698502/pdf/121375-WP-PUBLIC-TheEvolutionoftheCanadianPensionModelAllPagesFinalLowRes.pdf; 'World Bank highlights Canadian pension model as ideal system for emerging countries to follow' (22.11.2017): http://www.pionline.com/article/20171122/ONLINE/171129941/world-bank-highlights-canadian-pension-model-as-ideal-system-for-emerging-countries-to-follow; 'Canada's giant pension funds are the new masters of the universe' (21.06.2015): https://www.telegraph.co.uk/finance/comment/11690310/Canadas-giant-pension-funds-are-the-new-masters-of-the-universe.html

funds are world-renowned direct investors in the fossil fuel sector, real estate and infrastructure.[65] The approach taken by pension funds is quite uneven. While it would be impractical to amend the Canada Pension Plan's governing legislation to incorporate sustainability rewards and risks, the Canada Pension Plan Investment Board (CPPIB) Board of Directors could exercise considerable discretion and do more within the current legal regime. Genuine leadership from the Canada Pension Plan Investment Board to incorporate sustainability considerations across asset classes (equities, fixed-income, real estate, private equity, infrastructure, and hedge funds) would send a signal to other investors. Indeed, this is what the Caisse de dépôt et placement du Québec (CDPQ) has sought to do with its announcement of a 2-degree aligned investment policy.[66] If Canada's largest pension investors correctly reflected climate risks in their asset valuations, one would expect them to apply higher discount rates for carbon-intensive assets since they are exposed to higher transition and liability risks,[67] but this has not happened, and ought to be further investigated by the Expert Panel.

Canadian life and health insurers hold over $1.6 trillion in assets,[68] and the property and casualty industry over $160 billion.[69] Three quarters of life and health insurance assets are held by just three firms - Manulife, Great West, and Sun Life.[70] The impact on the insurance industry of costs related to climate change is material as recent ongoing forest fires and flooding have shown, but leadership from the three dominant players is largely absent.[71] These companies are doubly exposed to risks via their underwriting of property and mortgage insurance, and their heavy investment in the fossil fuel sector through public equity markets. While individuals within the sector will privately express concern and recognize the need for the financial sector to adjust, clear top down institutional leadership is missing. This should be an area of concern to the Expert Panel as a functioning insurance sector is critical to the continuation of our modern economy.

The Big Six banks - the Royal Bank of Canada, the Bank of Montreal, TD Canada Trust, the Bank of Nova Scotia (Scotiabank), the Canadian Imperial Bank of Commerce (CIBC), and the National Bank of Canada - account for nearly 95 per cent of the banking industry assets and control approximately $6 trillion in

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[65] World Bank (2017) 'The evolution of the Canadian pension model : practical lessons for building world-class pension organizations:' http://documents.worldbank.org/curated/en/780721510639698502/The-evolution-of-the-Canadian-pension-model-practical-lessons-for-building-world-class-pension-organizations

[66] CDPQ (2017) 'CDPQ announces investment strategy to address climate change:' https://www.cdpq.com/en/news/pressreleases/cdpq-announces-investment-strategy-to-address-climate-change

[67] For a detailed discussion see Litterman et al. (2015) 'Applying Asset Pricing Theory to Calibrate the Price of Climate Risk:' https://www0.gsb.columbia.edu/mygsb/faculty/research/pubfiles/11566/DLW_climate-20150201.pdf

[68] Canadian Life and Health Insurance Association (2016) 'Canadian Life and Health Insurance Facts.' Online: https://www.clhia.ca/domino/html/clhia/CLHIA_LP4W_LND_Webstation.nsf/resources/Factbook_2/$file/2016+CLHIA+Factbook+ENG.pdf, at 2.

[69] Insurance Bureau of Canada (2016) 'Facts of the Property and Casualty Insurance Industry in Canada 2016.' Online: http://assets.ibc.ca/Documents/Facts%20Book/Facts_Book/2016/Facts-Book-2016.pdf, at 6.

[70] IMF (2014) 'Canada Financial Sector Stability Assessment.' Online: https://www.imf.org/external/pubs/ft/scr/2014/cr1429.pdf, at para. 2.

[71] Manulife, Great West, and Sun Life all sit near the bottom of the Asset Owners Disclosure Project ranking of global insurance companies' climate risk awareness. See AODP (2018) 'Got it covered? Insurance in a changing climate:' https://aodproject.net/wp-content/uploads/2018/05/AODP-Got-It-Covered-Insurance-Report-2018.pdf.

assets – 4 times what is held by pension funds. Whilst they are respected internationally as stable and well-governed financial institutions, this should not be taken for granted. In late May of 2017, Moody's downgraded the credit ratings of the Big Six, citing increased private sector debt and elevated house prices.[72] After this downgrade, the credit ratings of the Big Six remain equal to or higher than those of most global banks, including those in the United States, the Euro area and Australia. The Big Six are key players in the transition to sustainable finance but currently approach these themes as a marketing challenge rather than as integral component of their investment decision-making and underwriting processes. Alongside the large commercial banks, there is a significant cooperative banking sector, and a hedge fund sector with $1.8 trillion in assets under management.[73]

The credit ratings sector in Canada is similarly concentrated, with DBRS, Fitch Ratings, Moody's and Standard & Poor's (S&P) dominating the market. Of the four international credit rating agencies, S&P and Moody's have been the most proactive in communicating their efforts to integrate sustainability and environmental-related risks in their rating processes.[74] Fitch and DBRS lag notability on the communication of climate risk integration in their ratings process.[75] As a result of concerns over the concentration of the global credit ratings sector and market abuse by the oligopoly of ratings providers,[76] the Bank of Canada and Ministry of Finance have joined their G20 peers in seeking to build internal ratings capacity, but the market in Canada remains an oligopoly susceptible to conflicts of interest identified during the financial crisis.[77] Until Canadian credit rating agencies integrate climate and sustainability risk into their credit assessment, in a transparent and systematic manner, we can expect debt capital markets in Canada to continue to ignore the market risks linked to climate change and the

[72] 'Rating Action: Moody's downgrades Canadian Banks.' Online: https://www.moodys.com/research/Moodys-downgrades-Canadian-Banks--PR_366355
[73] https://www.aima.org/about/aima-annual-reports-and-reviews.html
[74] S&P Global (2017) 'How The Recommendations Of The Task Force On Climate-Related Financial Disclosures May Figure Into Our Ratings.' Online: https://www.capitaliq.com/CIQDotNet/CreditResearch/RenderArticle.aspx?articleId=1901283
[75] The limitations of credit rating agencies' methodologies in integrating climate risks have led some financial institutions (e.g., Nordea) to develop their own in-house climate risk assessments. For a detailed discussion see Mathiesen (2018) 'Rating climate risks to credit worthiness' Nature Climate Change, 8, 454-456: https://www.researchgate.net/publication/325452184_Rating_climate_risks_to_credit_worthiness
[76] US SEC (2014) 'Public statement by Commissioner Luis A. Aguilar - Restoring Integrity to the Credit Rating Process:' https://www.sec.gov/news/public-statement/2014-08-27-open-meeting-statement-nrsro-laa
[77] In response to these concerns, the Bank of Canada is participating in Financial Stability Board work to diversify sources of credit ratings information to include more public data sets. See FSB (2010) Principles for Reducing Reliance on CRA Ratings.' Online: http://www.fsb.org/wp-content/uploads/r_101027.pdf; and Bank of Canada (2017) 'Methodology for Assigning Credit Ratings to Sovereigns.' Online: http://www.bankofcanada.ca/wp-content/uploads/2017/05/sdp2017-7.pdf. The BoC project seeks to "support efforts by reserve managers and other investors to go beyond mechanistic reliance on credit rating agency ratings and instead establish or strengthen internal credit assessment practices." Coffee explains a "rating agency receives one fee to consult with a client, explain its model, and indicate the likely outcome of the rating process; then, it receives a second fee to actually deliver the rating (if the client wishes to go forward once it has learned the likely outcome). The result is that the client can decide not to seek the rating if it learns that it would be less favorable than it desires". Coffee (2008) Testimony before the U.S. Senate Committee on Banking, Housing and Urban Affairs: https://www.banking.senate.gov/hearings/turmoil-in-us-credit-markets-the-role-of-the-credit-rating-agencies

energy transition.[78] The silence of Canadian institutional clients on significant blind spots in the commercial credit ratings agency ratings suggests an opportunity for positive engagement to update their business practices. The Panel should recommend more systematic and transparent integration of sustainability and environmental risk factors in commercial credit rating agency ratings methodologies, and could encourage investors to demand this. Updating government credit ratings methodologies within institutions like Export Development Canada is another key opportunity area. Regulatory intervention will also be required to update market practices and improve transparency – relying on voluntary actions alone has failed and will not work going forward.

The regulatory landscape

Canadian policy-makers and capital market regulators have a key role to play in providing a supportive framework for capital to flow into economically productive investments with positive social and environmental outcomes that support long-term growth. The use of blended public/private finance for development policy objectives is one well-established option to achieve these goals. Key stakeholders like Export Development Canada (EDC) are already showing leadership on green bonds,[79] but their primary focus remains on promoting the fossil fuel sector investments within Canada and globally.[80] Other federal capital market regulators implicated in G7 sustainable finance goals include the Office for the Superintendent of Financial Institutions (OSFI), the Bank of Canada, and the federal Canadian Securities Administrators (CSA). The Canadian regulatory community should consider lessons from its peers to guide development of a more coordinated approach to incorporating sustainable finance and climate change concerns into their capital markets oversight.[81]

[78] 'A Transition in Thinking and Action: remarks given by Mark Carney, Governor of the Bank of England International Climate Risk Conference for Supervisors' (18.04.2018): https://www.bankofengland.co.uk/-/media/boe/files/speech/2018/a-transition-in-thinking-and-action-speech-by-mark-carney.pdf; UNEP-FI (2018) 'Outputs of a working group of 16 banks piloting the TCFD Recommendations Part I: Transition-related risks and opportunities:' http://www.unepfi.org/publications/banking-publications/extending-our-horizons/

[79] 'Export Development Canada prices its first Green Bond in Canadian Dollars responding to rising global interest in climate financing' (30.08.2017). Online: https://www.edc.ca/EN/About-Us/News-Room/Pages/CAD-Green-Bond.aspx

[80] EDC provided more than $10 billion in financing solutions to oil and gas companies last year, and close to $12 billion in 2016: https://www.edc.ca/EN/About-Us/Disclosure/Reporting-on-Transactions/Pages/industry-sub-sector-2017.aspx

[81] For example, in the UK, the Financial Conduct Authority, along with the Bank of England, the Financial Reporting Council, and the Pensions Regulator, all participate in the 'UK Regulators Climate Forum' to ensure a harmonised approach across the UK regulatory landscape. See: https://www.parliament.uk/documents/commons-committees/environmental-audit/correspondence/180706-FCA-Response-to-EAC-Greening-Finance.pdf; in the Netherlands, the Dutch central bank hosts a Sustainable Finance Platform with six working groups made up of pension, banks and other stakeholders: :https://www.dnb.nl/en/about-dnb/co-operation/platform-voor-duurzame-financiering/werkgroepen/index.jsp

Canadian Securities Administrators

As the central coordinator of Canadian securities markets, the CSA actively monitors the quality of issuers' climate change-related disclosures but has not issued strong guidance on the subject. Their recent report on best practices in this area and developments in reporting frameworks suggests some interest in international regulatory developments to address climate change in corporate reporting.[82] The CSA continue to assess whether investors require additional types of information, such as disclosure of certain categories of greenhouse gas emissions, to make investment and voting decisions.[83]

Ontario Securities Commission

As the transition away from fossil fuels gathers pace, stock exchanges with heavy listings of fossil fuels will have the most at stake in changes to disclosure obligations for those companies. A growing number of listed companies on the Toronto Stock Exchange will be impacted and the political and corporate lobbying pushback will be more significant.[84] A dysfunctional National Energy Board,[85] and Energy East and Kinder Morgan pipeline debates all illustrate the extent of corporate lobbying and political capture achieved by fossil fuel incumbents in Canada.[86] Independent capital market regulation will be key to ensuring efficient capital markets, so the OSC has a vital role to play in ensuring timely and accurate corporate climate risk and sustainability-related disclosures are made by the country's largest companies. In the meantime, Canadian investors who have a diversified portfolio and a long-term investment horizon should be encouraged to engage with their investee companies and the regulators/legislators on issues related to corporate capture. Lessons can be learnt from Australia where investors recently challenged two major mining companies on these issues with encouraging results.[87]

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[82] 'CSA Staff Notice 51-354 Report on Climate change-related Disclosure Project:' http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20180405_51-354_disclosure-project.htm

[83] 'Canadian securities regulators report on climate change-related disclosure project' (05.04.2018): https://www.securities-administrators.ca/aboutcsa.aspx?id=1677

[84] 'How is the S&P/TSX Composite Index Weighted?' (23.07.2018): https://investingnews.com/daily/resource-investing/how-is-the-sptsx-composite-index-weighted/

[85] 'Dismantle National Energy Board, panel advises Ottawa' (15.05.2017): :https://www.ctvnews.ca/politics/dismantle-national-energy-board-panel-advises-ottawa-1.3413634 https://www.canada.ca/en/natural-resources-canada/news/2017/05/national_.html

[86] 'How the oil industry created a 'deep state' in Canada' (06.10.2017): http://www.macleans.ca/opinion/is-there-a-deep-state-in-albertas-oil-industry/

[87] The Australian Centre for Corporate Responsibility (ACCR) brought the resolutions at BHP and Rio Tinto. See: 'Rio Tinto faces $84bn shareholder revolt over membership of Minerals Council' (02.03.2018): https://www.theguardian.com/business/2018/mar/02/rio-tinto-faces-84bn-shareholder-revolt-over-membership-of-minerals-council

The Bank of Canada and the Office of the Superintendent of Financial Institutions

The Bank of Canada's core statutory purpose is "to promote the economic and financial welfare of Canada" as defined in the Bank of Canada Act.[88] In pursuit of these goals, the Bank of Canada could work with the Office of the Superintendent of Financial Institutions (OSFI) to develop methodologies for assessing climate-related systemic risk and integrating environmental risk into its standards stress-testing of regulated entities; accounting for climate risk in the Bank of Canada's collateral frameworks;[89] and raising the capital risk weighting for bank lending to high-carbon projects, among other actions.[90] Canada's prudential regulators are already engaged with international networks like the Network for Greening the Financial System, but have not formally joined their international peers to work on these themes. More formal work on these issues could increase Canadians' confidence in the financial system and support the future-proofing of the Canadian economy.[91] The macroeconomic implications of climate risk have driven the creation of a global network of prudential financial regulators and central bankers. Canada is not yet a member of this group.

It is generally agreed that properly and proactively assessing financial system risks is a key requirement for monetary policy operations. Yet sustainability-related risks have yet to appear in the Bank of Canada's annual review of the Canadian financial system.[92] Yet the Bank identifies "the most important vulnerabilities for the Canadian financial system" as consumer debt and mortgages, both of which will be impacted by increased incidence of extreme weather, and the wind-down of Canada's fossil fuel sector as per Paris Agreement commitments. By omitting or underestimating one source of risk (such as climate risk) in its operations results in an overexposure to risks for the Canadian economy and does not meet the standards for sound policy implementation.[93] Regarding asset purchases, the Bank of Canada

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[88] Bank of Canada Act R.S.C., 1985, c. B-2: http://laws-lois.justice.gc.ca/eng/acts/B-2/page-1.html

[89] If the bonds issued by carbon-intensive companies are included in the Bank of Canada's list of eligible assets and those issued by low-carbon entities are not, for example, the collateral framework introduces more favorable funding conditions for the former.

[90] Kidney et al (2017) 'Recommendations for central banks on how to support the development of the green bond market,' paper presented at the CEP-DNB workshop on "Central Banking and Green Finance", November 28-29 2017, Amsterdam.

[91] Other prudential regulators are producing public research on these issues. See work by the Bank of Greece: https://www.bankofgreece.gr/BogEkdoseis/Paper2018247.pdf; the Bank of Spain: https://www.bde.es/f/webbde/GAP/Secciones/Publicaciones/InformesBoletinesRevistas/RevistaEstabilidadFinanciera/18/MAYO/Articulo_Marques__Romo-en.pdf; and the Bank of England: https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2018/climate-change-and-the-macro-economy-a-critical-review.pdf; Campiglio et al (2018) 'Climate change challenges for central banks and financial regulators:' https://www.nature.com/articles/s41558-018-0175-0.epdf

[92] Bank of Canada (2017) 'Financial System Review.' Online: http://www.bankofcanada.ca/wp-content/uploads/2017/06/fsr-june2017.pdf. The Bank identifies ƒ elevated household indebtedness and imbalances in the Canadian housing market as key interrelated risks: alongside two vulnerabilities related to the structure of the financial system: ƒ fragile fixed-income market liquidity and cyber threats.

[93] Monnin (2018) 'Central banks should reflect climate risks in monetary policy operations:' https://www.suerf.org/policynotes/3325/central-banks-should-reflect-climate-risks-in-monetary-policy-operations ; 'Climate change and finance: what role for central banks and financial regulators?:' https://bankunderground.co.uk/2018/08/30/climate-change-and-finance-what-role-for-central-banks-and-financial-regulators/

does not currently communicate the precise composition of the assets they purchase. They emphasize, however, that they aim at market neutrality and suggest that this goal is aligned with using a benchmark that reflects market capitalization, which in Canada is fossil-fuel heavy and therefore exposed to the transition risks described by Governor Carney and other central bankers.[94] As Canadian banks experiment with climate risk reporting through international pilot projects, the Bank of Canada and prudential regulators will have to act.[95] In the interest of investors and transparent capital markets, the Expert Panel should make it clear that regulators must not wait any longer to assess and publicly report on these risks.

The Chief Actuary of Canada

The Chief Actuary of Canada sits within OSFI and is responsible for providing appropriate checks and balances on the future costs of the different federally regulated public pension plans, including the Canada Pension Plan.[96] The Chief Actuary could lead the way on 2-degree stress testing at Canada's largest pension funds, banks, and insurance companies, in line with international best practice. Prudential regulators in the United Kingdom[97] and The Netherlands,[98] have already reviewed the climate risk profiles of the insurance and banking sectors in both countries. Two of Canada's six largest banks are already participating in international pilot programmes to report their exposure to climate-related financial risks and have partially assessed the credit risk implications of a secular decline on the fossil fuel sector. The Chief Actuary has a central role to play in ensuring common standards for climate risk scenario analysis and risk reporting at Canada's largest financial institutions and public sector pension funds. Ensuring that climate risks are reported on transparently and consistently is key to maintaining confidence in the capital markets.

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[94] Bank of Canada 'Framework for Market Operations and Liquidity Provision:' https://www.bankofcanada.ca/markets/market-operations-liquidity-provision/framework-market-operations-liquidity-provision/

[95] Oliver Wyman (2018) 'Assessing credit risk and opportunity in a changing climate: Outputs of a working group of 16 banks piloting the TCFD Recommendations:' http://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2018/april/EXTENDING-OUR-HORIZONS-AW.pdf; https://www.bis.org/review/r180904c.pdf

[96] http://www.osfi-bsif.gc.ca/eng/oca-bac/Pages/default.aspx

[97] In the UK, the Institute and Faculty of Actuaries, the global actuarial trade body, issued a climate risk alert for its members in 2017: 'IFoA warns on climate change financial risks:' 'https://www.actuaries.org.uk/news-and-insights/media-centre/media-releases-and-statements/ifoa-warns-climate-change-financial-risks; as well as producing formal guidance for members: 'Climate Risk: A Practical Guide for Actuaries working in Defined Contribution Pensions:' https://www.actuaries.org.uk/practice-areas/resource-and-environment/research-working-parties/relevance-resource-and-environment-issues-pension-actuaries. In contrast, the Canadian Institute of Actuaries has resisted undertaking substantive work on these themes.

[98] DNB (2017) 'Waterproof? An exploration of climate-related risks for the Dutch financial sector:' https://www.dnb.nl/en/news/news-and-archive/dnbulletin-2017/dnb363837.jsp

Conclusions - global leadership would need to start at home

The Canadian financial sector is respected around the world for its stability and leadership in responsible investment. The Expert Panel can build on this status and help to maintain a competitive financial sector at home and abroad while improving long-term outcomes for Canadian savers and retail investors. We suggest seven channels to accelerate leadership on sustainable finance by: developing tools and metrics to shift capital away from fossil fuels; improving transparency in reporting and financial product labelling; clarifying ESG integration and stewardship as part of fiduciary duty; scaling up public and private financing for sustainable infrastructure; identifying the financial infrastructure required to channel capital away from fossil fuels; empowering Canadian savers to invest in change; and aligning corporate accounting frameworks to support long-term prosperity.

Globally, Investment in low-carbon energy has slowed recently but capacity expansion has held up, partly the result of lower costs.[99] Yet the shift in financing away from fossil fuels needs to be dramatically accelerated. An essential step must be the removal of fossil fuel subsidies, which still massively outweigh support given to low-carbon alternatives. In particular, removing the largest subsidy of all by implementing the polluter pays principle and a realistic price on carbon to reflect the external costs of using fossil fuels, such as health and climate impact. As Alex Steffen, the futurist has noted, “incrementalism is the new denialism”, and the Expert Panel should take the necessary bold steps to catalyse meaningful change across the economy.

[99] IEA (2018) ‘World Energy Investment 2018:’ http://www.iea.org/wei2018/; ‘Renewables: power move’ (21.07.2018): https://www.ft.com/content/203eb6ba-8c0a-11e8-b18d-0181731a0340#myft:my-news:grid