Joint Submission to the Standing Committee on Environment and Sustainable Development (ENVI)

The Environment and Climate Impacts Related to the Canadian Financial System

November 2024

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Background and Summary

This brief recommends that the Government of Canada reforms financial policy to align with climate action. This is necessary both in pursuit of Canada's legally binding net-zero goals, and to ensure that Canada remains a competitive financial center and continues to attract international investment.

Major financial centers around the world are taking decisive steps to comprehensively align their financial sectors with climate action, but Canada is lagging behind trading partners. The European Union's 'Sustainable Finance Action Plan' encompasses a suite of policy mechanisms that work together to align finance with climate action, including: the EU taxonomy regulation, Corporate Sustainability Reporting Directive (CSRD), and the Directive on Corporate Sustainability Due Diligence (CSDD). In the US, the Department of the Treasury issued principles for net-zero financing and investment, the Securities and Exchange Commission proposed climate disclosure rules, and financial regulators issued interagency principles for climate-related financial risk management for large financial institutions. The United Kingdom is making a number of commitments to achieve a net-zero financial system, including: a manifesto commitment from the currently governing Labour party to require "UK-regulated financial institutions… and FTSE 100 companies to develop and implement credible transition plans[1] , and a mandate for the Financial Consumer Authority to implement transition plan requirements for listed companies.[2]

First and foremost, we would urge ENVI to make a final report on this study. Substantial time and resources have been put into this study by the Committee, its members, witnesses and other organizations over many months. These efforts should be thoroughly recorded and recommendations placed before the House to help support a whole of society movement to address the climate and environmental crises.

This brief makes three policy recommendations for the Committee to include in its report:

1. Climate-aligned financial reform;
2. Mandatory climate transition plans regulated across the economy; and
3. Governance principles to ensure that a taxonomy of sustainable finance is credibly aligned with 1.5°C pathways.

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[1] The Labour Party. "Labour's Manifesto: My Plan for Change," 2024. https://labour.org.uk/change/my-plan-for-change/.
[2] Financial Consumer Authority. "Primary Market Bulletin 45." *FCA*, August 2023. https://www.fca.org.uk/publications/newsletters/primary-market-bulletin-45.

Recommendation 1: Climate-Aligned Finance Reform

Recommendation:

The final report of the Committee should:

1. Suggest legislation that supports adopting policies and measures that will ensure Canada meets its international and domestic climate commitments.
2. Note that alignment from financial institutions is essential for Canada to deliver on its climate commitment, and that regulating federal financial institutions and aligning them with Canada's international and domestic commitments is important for consistency.
3. Such suggestions should include, in relation to strengthening existing disclosure requirements, the following:
   - **3.1.** Require federally-regulated public pension managers, in particular the Canada Pension Plan Investment Board and Public Sector Pension Investment Board, to fully disclose their commitments to private equity funds on a quarterly basis, as well as all private equity relationships, to ENVI and FINA, going back ten years to 2014.
   - **3.2.** Require these disclosures to include information on how relationships with private equity firms and financial commitments to private equity funds were subsequently disbursed, including dollar amounts, companies, projects and other information that could improve plan members' understanding of the impacts and risks of private equity investments.
   - **3.3.** Require these disclosures to ENVI and FINA on an annual basis going forward

Rationale for Action:

- **Climate-aligned financial regulation has unprecedented cross-party support.** In 2023, Motion 84 was introduced in the government, which has received the maximum support of 20 MPs from four political parties. This motion calls on the government to "use all legislative and regulatory tools at its disposal to align Canada's financial system with the Paris Agreement".[3]
- **Climate-aligned financial regulation helps address the root cause of the affordability crisis.** Climate-related damages already increase the average Canadian's household's cost of living by $700 each year and it will only get worse without swift action.[4] In 2022, 40% of all higher prices ended up as corporate profit in just three industries including oil & gas, and finance & insurance.[5] This underscores the urgent need to ensure that capital flows are directed towards mitigating the climate and affordability crises rather than exacerbating them.

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[3] Turnbull, Ryan. "M-84 Alignment with the Paris Agreement 44th Parliament, 1st Session," May 2023. https://www.ourcommons.ca/members/en/105480/motions/12396258.

[4] Ness, Ryan. "Climate Damages Are Inflating the Costs of Living for Every Canadian." Canadian Climate Institute, May 2023.
https://climateinstitute.ca/climate-damages-inflating-costs-of-living-for-every-canadian/.

[5] Macdonald, David. "Where Are Your Inflation Dollars Going?" The Monitor, January 17, 2023. https://monitormag.ca/reports/where-are-your-inflation-dollars-going/.

- **Canada's largest financial institutions fund the main source of climate disruption.** In 2022, the largest Toronto-based financial institutions collectively funneled over $1.43 trillion CAD ($1.1 trillion USD) in financing towards fossil fuel companies via loans, bonds, and equity, resulting in up to 1.44 billion tCO2e of financed emissions in 2022.[6]
- **Canada's competitive position is at risk**. In the words of Mark Carney, former Governor of the Bank of Canada and UN Special Envoy on Climate Action and Finance, *"Canada is jeopardizing its competitive position by dragging its feet on major climate-related financial policies as allies quickly adopt global standards and green investing rule books"*.[7] The Office of the Superintendent of Financial Institutions has said that: "delaying climate policy action increases the overall economic impacts and risks to financial stability".[8]
- **Regulation creates opportunities and benefits to future-proof the economy.** Well-designed policies can drive down the costs of reducing emissions, generate finance for truly clean technologies, contribute to broader sustainable development efforts, and carry co-benefits for other social and governance goals, such as increased job creation and savings on energy bills.[9] Comprehensive policy reform would ensure that the whole economy is pulling in the same direction toward climate action, thereby creating both consistency and efficiency.

Relevant Legislation – Bill S-243: Bill S-243 (CAFA or the Climate-Aligned Finance Act) was introduced in the Senate in March 2022 by independent Senator Rosa Galvez. CAFA is currently being studied by the Senate Standing Committee on Banking, Commerce and the Economy. CAFA's main goal is to align the activities of federal financial institutions and other federally regulated entities with Canada's international and domestic climate commitments through a comprehensive package of reforms. CAFA's adoption would increase the security of all Canadians by asking financial institutions to make timely and meaningful progress towards safeguarding the stability of both the financial and climate systems.

Specifically, CAFA:

- Establishes a duty for directors, officers and administrators to align the activities of financial institutions with Canada's climate commitments

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[6] Oshinowo, T, Allegra Nesbitt-Jerman, and Robert Soden. "Bay Street Climate Report." Toronto: Toronto Climate Observatory, 2024. http://climateobservatory.ca/baystreetclimatemonitor.

[7] Jones, Jeff. "Canadian Climate Finance Is 'Patchwork, Delivered Late, Falling Short,' Carney Says." *The Globe and Mail*, May 8, 2024. https://www.theglobeandmail.com/business/article-canadian-climate-finance-is-patchwork-delivered-late-falling-short/.

[8] Office of the Superintendent of Financial Institutions. "OSFI Response to Draft Guideline B-15 Consultation Feedback," October 16, 2023. https://www.osfi-bsif.gc.ca/en/consultations/consultation-summaries/osfi-response-draft-guideline-b-15-consultation-feedback.

[9] Clean Energy Canada. "A Pivotal Moment." *Clean Energy Canada*, March 2024. https://cleanenergycanada.org/report/a-pivotal-moment/.

- Requires financial institutions to develop credible Climate Transition Plans consistent with Canada's climate commitments, and to report on their progress on an annual basis
- Ensures climate expertise of the boards of directors of financial institutions and introduces measures to counter conflicts of interest on boards of directors
- Makes capital adequacy requirements proportional to microprudential and macroprudential climate risks generated by financial institutions

Additional Context: Without financial institutions playing their part, Canada will not be able to deliver on its climate commitments. Regulating federal financial institutions and aligning them with Canada's international and domestic commitments is a question of consistency. Comprehensive financial alignment with climate action is a key way to ensure the stability of both the climate and financial systems.

This briefing note brings elements of Bill S-243 *Climate-Aligned Finance Act* (CAFA) to the attention of members of the Standing Committee on Environment and Sustainable Development (ENVI). These elements are extremely relevant to ENVI's work on the Environment and Climate Impacts Related to the Canadian Financial System.

Positive Reception and Endorsements: CAFA is supported by more than 120 organizations across Canada and globally.[10] It is the subject of 5 petitions tabled in the House of Commons and enjoys the support of members from four of the five parties represented in the House of Commons.[11] It also enjoys the support of the United Nations Environment Programme - Finance Initiative (UNEP-FI). In his brief to the Standing Senate Committee on Banking, Commerce and the Economy, Eric Usher, head of the UN Environment Programme Finance Initiative supported CAFA by concluding his submission as follows: "*We therefore highly welcome that CAFA draws on international best-practice and recommendations to support global alignment of sustainable finance frameworks*." [12] In October, Financial Times correspondent Simon Mundy referred to CAFA as "one of the most exciting pieces of climate legislation currently in development worldwide."[13]

Recommendation 2: Transition Plans Across the Economy

Recommendation:

The final report of the Committee should:

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[10] Office of Senator Rosa Galvez. "Climate-Aligned Finance Act Quotes and Endorsements." Accessed November 8, 2024. https://rosagalvez.ca/en/initiatives/climate-aligned-finance/quotes-and-endorsements/.
[11] House of Commons. "Petition 441-01351 - Petitions." Accessed November 8, 2024. https://www.ourcommons.ca/petitions/en/Petition/Details?Petition=441-01351.
[12] Usher, Eric. "Witness Brief to the Standing Senate Committee on Banking, Commerce and the Economy Topic: Bill S-243 on 'Enacting Climate Commitments Act.'" Switzerland, December 4, 2023. https://sencanada.ca/en/committees/banc/briefs/44-1#?sessionFilter=44-1&OrderOfReferenceID=611937.
[13]Segal, Julie. "LinkedIn Post," October 2024. https://www.linkedin.com/posts/julie-segal_priinperson-decarbonization-sustainablefinance-activity-7249796697755701249-2H7q?utm_source=share&utm_medium=member_desktop.

1. Recommend the regulation of mandatory credible Climate Transition Plans to be pursued as a natural progression from the governments' existing commitments for climate-related disclosure under the 2023 Fall Economic Statement.
   1.1. Recommend that all federally-regulated financial institutions and large federally-regulated corporations are required to develop and implement Climate Transition Plans that align with the 1.5°C goal of the Paris Agreement through the adoption of CAFA or similar legislation.
   1.2. Recommend the inclusion of the following language in an upcoming budget statement: "The government acknowledges the progress made by other jurisdictions in implementing transition plans across various sectors of the economy. It commits to exploring the integration of climate-related transition plans, in alignment with the Paris Agreement, throughout the Canadian economy. This effort is part of its ongoing work to build a sustainable financial system and succeed on legislated climate commitments."
2. Endorse the United Nations' High Level Expert Groups' guidance on Net-Zero Emissions Commitments of Non-State Entities[14] as a minimum benchmark for credibility of a Climate Transition Plan.
3. Recommend OSFI consider its mandate with regards to its emerging roles and responsibilities under the *Federal Sustainable Development Act* as recommended by the CESD[15] and issue detailed guidance on the content of transition plans under B-15. The committee should consider sending a letter to OSFI in that regard.
4. Acknowledge global progress from Canadian economic partners to advance mandatory Climate Transition Plans that align with limiting global warming to 1.5°C, notably by the United Kingdom and European Union.

Rationale for Action:

- **Transition plans are a key policy to remain globally competitive in developing green economic sectors, and to ensure Canada does not fall further behind.** Canadian investors and corporations would benefit from new policy to ensure they align with global progress on transition plan requirements. Canada lags behind large trading partners: other jurisdictions are advancing to require 1.5°C-aligned transition plans across the private sector.
    - The **European Union** adopted a Corporate Sustainability Due Diligence Directive (CSDDD), which requires large companies to adopt and put into

[14]United Nations. "Integrity Matters: Net-Zero Emissions Commitments of Non-State Entities." United Nations. United Nations, November 2022. https://www.un.org/en/climatechange/high-level-expert-group.
[15]Office of the Auditor General of Canada. "Report 4: Supervision of Climate-Related Financial Risks—Office of the Superintendent of Financial Report 4 Institutions Canada," 2023. https://www.oag-bvg.gc.ca/internet/English/parl_cesd_202304_04_e_44242.html.

effect a transition plan for climate change mitigation aligned with the Paris Agreement, and with European Climate Law.[16]
    - The **United Kingdom** government committed to require credible transition plans that align with the 1.5°C goal of the Paris Agreement to be developed and implemented by financial institutions (including banks, asset managers, pension funds, and insurers) and FTSE 100 companies.
    - The **United States**' Department of the Treasury issued principles for net-zero financing and investment, the Securities and Exchange Commission adopted climate-related disclosure rules, and financial regulators issued interagency principles for climate-related financial risk management for large financial institutions.
- **Consistency within Government:** The mandate letters of the Ministry of Finance and the Ministry of Environment and Climate Change Canada both highlight to "work with provinces and territories to move toward mandatory climate-related financial disclosures" and "require federally regulated institutions, including financial institutions, pension funds and government agencies, to issue climate-related financial disclosures and net-zero plans."[17] A climate-aligned financial system is key for Canada to succeed on its legislated climate commitments.
- **Consistency within the market:** Most Canadian financial institutions - insurance companies, pension funds, and banks - have committed to reach net-zero emissions by 2050 throughout their business strategies. Yet most have not established a transition plan to accomplish the targets. Consistent requirements for mandatory Climate Transition Plans across the economy would support market clarity, and advance data quality and harmonization.

Relevant Regulation and Legislation:

- In March 2023, the Office of the Superintendent of Financial Institutions (OSFI) published Guideline B-15, which addresses climate risk management and includes the following requirement for Climate Transition Plans: "The FRFI [federally regulated financial institution] should develop and implement a Climate Transition Plan (Plan), in line with its business plan and strategy, that guides the FRFI's actions to manage increasing physical risks from climate change, and the risks associated with the transition towards a low-GHG economy."[18] OSFI is not establishing minimum criteria for Climate Transition Plans. Progress from within the federal government would help create direction and clarity for requirements of Transition Plans.

[16] European Commission. "Corporate Sustainability Due Diligence," July 2024. https://commission.europa.eu/business-economy-euro/doing-business-eu/sustainability-due-diligence-responsible-business/corporate-sustainability-due-diligence_en.
[17] Rt. Hon. Justin Trudeau, P.C., M.P. "Deputy Prime Minister and Minister of Finance Mandate Letter." Prime Minister of Canada, December 14, 2021. https://www.pm.gc.ca/en/mandate-letters/2021/12/16/deputy-prime-minister-and-minister-finance-mandate-letter.
[18] Office of the Superintendent of Financial Institutions. "Guideline B-15," March 2023. https://www.osfi-bsif.gc.ca/sites/default/files/import-media/guidance/guideline/2023-04/en/b15-dft.pdf.

- Mandatory Climate Transition Plans for large federally incorporated businesses could be implemented via amendments to the Canada Business Corporations Act, and work collaboratively with provinces to advance. The Government recently proposed to make such amendments to require "mandatory climate-related financial disclosures for large, federally incorporated private companies",[19] and it could advance such amendments to also require mandatory Climate Transition Plans.
- The proposed Climate Aligned Finance Act, if passed, would provide a detailed legislative definition of Climate Transition Plans.
- Strong guidance from the Competition Bureau on greenwashing could include requiring Climate Transition Plans from businesses making green claims.

Positive Reception and Endorsements: In a recent report on mitigating climate greenwashing in Canada, the Centre Québécois du Droit de L'Environnement (CDQE) makes several recommendations that pertain to improving transition plan guidance in Canada.[20]

Recommendation 3: The taxonomy must be credibly aligned with 1.5°C pathways

Recommendation:

1. ENVI should recommend that the taxonomy of sustainable finance is developed with parameters and governance structures in place which ensure it aligns with the overarching goals of the Paris Agreement, and credible 1.5°C with low or no overshoot decarbonisation pathways ("1.5°-aligned").
    - **1.1.** The taxonomy should be developed primarily by climate experts, not based on institutional affiliation.
    - **1.2.** The governance bodies should have a mandate to ensure that the taxonomy is developed according to internationally recognised 1.5°C decarbonisation pathways.
    - **1.3.** The taxonomy should be developed openly and transparently, according to open government principles.
    - **1.4.** The voting members on the taxonomy council should be appointed as independent experts, not representatives of a company or industry.
2. The taxonomy should be developed as part of a comprehensive regulatory framework that ensures taxonomy projects are part of a credible net-zero transition.

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[19] Department of Finance Canada. "Government Advances Made-in-Canada Sustainable Investment Guidelines and Mandatory Climate Disclosures to Accelerate Progress to Net-Zero Emissions by 2050," October 9, 2024. https://www.canada.ca/en/department-finance/news/2024/10/government-advances-made-in-canada-sustainable-investment-guidelines-and-mandatory-climate-disclosures-to-accelerate-progress-to-net-zero-emissions.html.
[20] Beaulieu, Julien O. "Climate-Washing in Quebec and Canada: How to Turn the Tide." Montreal: Centre québécois du droit, 2022. https://cqde.org/wp-content/uploads/2022/10/Ecoblanchiment_Rapport_Anglais.pdf.

Rationale for Action:

A taxonomy that is not aligned with what is scientifically required to limit global warming to 1.5°C would be more harmful to Canada than no taxonomy at all.

- **Scientific alignment with the 1.5°C goal:** The Canadian financial sector remains over invested in fossil fuels and underinvested in clean energy, which harms the country's ability to build climate resilience. Canada's banks are financing fossil fuels and clean energy at a ratio of 3.9:1.[21] The International Energy Agency has shown that this ratio must be flipped so that the ratio of clean energy to fossil fuel investment is 4:1 by 2030 in order to reach net-zero.[22] Clean energy and climate-aligned projects must be clearly labeled in order to support progress towards these financing ratios.
- **Scientific consensus:** There are many internationally recognised pathways that provide scientific guidance on what is needed for the net-zero energy transition. For example, in scenarios to limit warming below 1.5°C, "there are no new oil and gas fields approved for development".
- **Global credibility**: A sustainability labeling system must create confidence in the credibility and rigour of green investments; decision makers have to ensure the label scientifically aligns with limiting warming below 1.5°C. The European Union Technical Advisory Group (TEG) on the taxonomy warned "market understanding of goals that are not aligned with the Paris Agreement and other internationally agreed environmental objectives is likely to become confused".[23] As Canada trades with other jurisdictions, it is vital that Canada's taxonomy is Paris aligned and internationally credible.
- **Stranded assets and economic risk**: Canada faces over $100-billion of climate-related stranded asset risks (which occur when a project or investment loses its value earlier than expected). The Minister of Energy and Natural Resources, Jonathan Wilkinson, recently conceded that, for 'natural' gas, "the risk of stranded assets is a real one" in Canada. "Natural gas is a fossil fuel with a significantly underestimated climate impact that hinders decarbonization through carbon lock-in and stranded assets."[24] Not only should Canada's taxonomy be science aligned, but also protect Canada's financial system against stranded asset risk. This issue has also been globally recognized by the Network for Greening the Financial System, a network of central banks and financial supervisors.[25]

[21]InfluenceMap. "Canada's Big Five Banks: Heading to Net Zero?," March 2024. https://influencemap.org/report/Canada-s-Big-Five-Banks-26501.
[22]International Energy Agency. "Net Zero Roadmap: A Global Pathway to Keep the 1.5 °C Goal in Reach." IEA, September 26, 2023. https://www.iea.org/reports/net-zero-roadmap-a-global-pathway-to-keep-the-15-0c-goal-in-reach.
[23] Technical Expert Group on Sustainable Finance. "Taxonomy: Final Report of the Technical Expert Group on Sustainable Finance." EU Technical Expert Group on Sustainable Finance, March 2020. https://finance.ec.europa.eu/system/files/2020-03/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf. page 53
[24] Kemfert, C., Präger, F., Braunger, I. et al. The expansion of natural gas infrastructure puts energy transitions at risk. Nat Energy 7, 582–587 (2022). https://doi.org/10.1038/s41560-022-01060-3
[25] Network for Greening the Financial System. "A Call for Action: Climate Change as a Source of Financial Risk."April 2019. https://www.ngfs.net/sites/default/files/medias/documents/ngfs_first_comprehensive_report_-_17042019_0.pdf.

Relevant Regulation and Legislation: A taxonomy is only useful if legally enshrined in regulation and linked to other policies. The taxonomy should be implemented through regulation, which could be accomplished as new regulation under the *Competition Act* or the proposed *Climate Aligned Finance Act*. Linking the taxonomy to disclosure requirements for corporations, crown corporations, financial institutions and pension plans (through regulations under the Canada Business Corporations Act, the Financial Administration Act, the Pension Benefits Standards Act and guidelines set by OSFI respectively) is critical to ensure that guidance from the Taxonomy can be enforced and is effective at mitigating greenwashing. The taxonomy should also be linked to advertising laws under the Competition Act.

Positive Reception and Endorsements: 70 climate organizations from across Canada wrote to the government expressing that any taxonomy of sustainable finance should be 1.5°C aligned, and exclude all fossil fuels.[26] Three months later, over 100 individual climate experts and activists wrote to the government reiterating that a taxonomy must be 1.5°C aligned.[27]

Concluding thoughts

This brief has advocated that the Standing Committee on Environment and Sustainable Development produces a report on this study to the Government.

This brief recommends that the Committee includes the following recommendations in its report to the Government:

1. Climate-aligned financial reform;
2. Mandatory climate transition plans are regulated across the economy; and
3. Governance principles to ensure that a taxonomy of sustainable finance is credibly aligned with 1.5°C pathways.

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[26] Environmental Defence. “70 Climate Organizations Call on the Canadian Government for a Science Aligned Taxonomy.” Environmental Defence (blog), April 2024. https://environmentaldefence.ca/report/70-climate-orgs-call-government-for-science-aligned-taxonomy/.
[27] Alex Walker [@alex4lker]. “Why Did Ministers Wake up with an Email Inbox Looking Something like This Today? Https://T.Co/Z5DWcQ3cLy.” Tweet. Twitter, July 18, 2024. https://x.com/alex4lker/status/1813941755966062849.