“What We Heard”
Aligning Canadian Finance with Climate Commitments

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Consultation convened by the **Concordia Sustainability Institute**

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Introduction

Most financial reform proposals in recent years have centered on disclosure schemes that aim to identify and quantify the financial risks of climate change for businesses, in the hope that market participants and capital flows evolve accordingly. So far, this has not happened. It is unlikely that we will see significant movement until Canada's financial regulations and commercial incentives not only require climate risk disclosure but also genuine alignment with climate commitments. For too long, well-meaning market-driven initiatives have mostly sought to shield finance from climate risks; now is the time to urgently address the risks that finance poses to the climate.

To address these shortcomings, independent Senator Rosa Galvez introduced Bill S-243, the *Climate-Aligned Finance Act*, in the Senate of Canada in March 2022 to align the activities of federal financial institutions and other federally regulated entities with the superseding public interest matter of achieving climate commitments. The bill aims to safeguard the stability of both the financial system and climate system by recognizing the systemic risks posed by not aligning financial flows to all sectors of the economy with climate commitments.

To ensure the bill would be the gold standard of innovative approaches, Senator Galvez and her team, the Trottier Family Foundation, and the Sustainability Ecosystem at Concordia University co-hosted a series of consultations, including a convening that brought together a select group of high-level national and international experts to provide commentary on the legislative proposal. With their expertise in climate, finance, and related fields, the consultations solicited useful feedback on the content of the bill. Participants helped the team source critical data and frameworks, identified international best practices, and provided feedback on how to maximize the uptake and impact of the bill.

Specifically, consulted experts were asked to provide feedback on the scope of the proposal, key definitions including "alignment to climate commitments", provisions of conflicts of interest, climate expertise requirements on corporate boards, disclosures and reporting, and climate-related financial risk considerations. Experts also gave their insight on particular questions of interest such as the use of carbon offsets and negative emissions technologies, the concept of fair share, and other hot-topic issues. This discussion paper gives a brief overview of the experts' feedback on these important themes.

We would like to thank the more than 40 participants that generously donated their time and efforts in helping draft the *Climate-Aligned Finance Act*.

The views expressed in this document do not necessarily reflect the views or positions of the organisations with which the experts are affiliated.

Alignment & The Role of the Government

The focus of the *Climate-Aligned Finance Act* is the alignment of financial flows with our climate commitments. Although they recognize the importance of the concept of alignment, some experts argued that could be difficult to define. The different perspectives on the concept of alignment and the desired goals add another layer of complexity. For example, the 1.5 degrees target within the Paris Agreement is clear and specific. However, to achieve that goal, the legislation should explicitly mention what each actor must do and exactly how their performance will be measured. Legislation should be clear, precise, and explicit on the definition of both climate commitments and alignment.

Furthermore, it would be difficult to ask banks not to invest in emissions-intensive activities if the government is still investing in fossil fuels and its actions are not aligned with the best available climate science. If the expectation is for financial institutions to align with climate commitments, the government should be held accountable as well. Additionally, financial institutions may be unable to do this without government support and investments. Incentivizing the movement of capital towards transition and clean growth would make such a proposal much more appealing.

"The federal government has invested in pipelines and is still investing in fossil fuel subsidies. How can we ask banks not to do this while the government itself is engaging in these activities?"

Dr. Olaf Weber, Professor & University Research Chair, School of Environment, Enterprise and Development, University of Waterloo

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Fair Share

In defining "alignment with climate commitments", experts were asked to give their insight on the concept of "fair share", which recognizes *common but differentiated obligations* as specified in the Paris Agreement and UNFCCC. The initial legislative proposal included an explicit reference to the concept of "fair share", but this proved to be a point of contention during the discussions and many potential issues were brought up. The concerns stemmed from the belief that attempting to define and assess what "fair share" means would be difficult. From having to figure out what that would entail on a multinational level down to a company level, many were skeptical that this would work.

Since individual companies would probably have difficulty identifying their own fair share, some experts suggested the concept of fair share should be part of an overarching policy where an organization assigns a fair share to each entity and identifies sectoral pathways to decarbonization.

One expert referred to the work being done by the Science Based Targets initiative (SBTi) and the Climate Action 100+ initiative on fair share and alignment. Since "fair share" will be difficult to determine and politically unpopular, the concept of alignment would be a better approach.

"Several NGO's have done great work to evaluate what is Canada's fair share. In the context of this legislative proposal, it would be important to clarify if it references Canada's fair share, or rather a sectorial or company specific fair share."
Julie Segal, Senior Program Manager, Climate Finance, Environmental Defence

Disclosure

Climate-related risk disclosure is perhaps the most prominent sustainable finance proposal on the world stage and many governments and organizations are well underway in establishing guidelines and standards. During the consultation, there was a general agreement among experts that climate-related risk disclosure is indispensable, but it is not sufficient. It is a necessary step for financial institutions to be able to properly assess their risks; however, one expert expressed that there is little evidence that disclosure has any positive impact on climate outcomes. Also, putting a heavy emphasis on disclosure rather than tangible action can have potentially negative effects. Striking the perfect balance is tricky.

Some comments addressed the need to cast a wide net to ensure that public companies are not the only entities subject to disclosure requirements. Experts also pointed out that Canada should take inspiration from the incredible work being done on disclosure in the European Union.

"There are a lot of good things happening in the EU on disclosure, but there is an unfounded belief that once the enormous work on disclosure is done then the world will be saved. Disclosure is indispensable, but it is not sufficient"
Thierry Philipponnat, Chief Economist, Finance Watch

Net-Zero, Offsets, and Clear Reporting Timelines

Given the recent trend of net-zero commitments, the legislative proposal aimed to help guide entities in achieving these goals. Although a net-zero plan should be part of the legislation, clear reporting timelines with tangible goals based on the best available science need to be included. If a company reports that it will be net-zero by 2050, this can result in delayed rather than immediate action.

Concern were raised on gaps around reporting for private entities. These entities, both privately held emissions-intensive companies and private equity funds, should not be exempt from alignment with climate commitments and reporting. Although the legislative proposal would cover all federally regulated financial institutions, including pension funds, it would not cover separate private equity funds.

When establishing targets and plans, the overreliance on carbon offsets and negative emissions technology from emissions-intensive entities is a question of much debate. The inclusion of carbon offsets limitations was a point of contention during the consultations: a few experts favoured a strict prohibition of offsets and negative emissions technology as the lack of clarity and transparency surrounding their use does not yet make for credible plans. The general consensus was that net-zero plans should only include carbon credits and offsets for activities that cannot be abated. Suggestions also included having a maximum relative use for offsets; for example, the SBTi Net-Zero Standard framework allows for a maximum of 10% of emissions to be compensated via offsets.

"The term 'carbon offsets' is largely misleading. Even setting aside the major issue of the quality and permanence of offsets, offsetting does not trap past emissions but only enables current and future emissions, therefore only displacing – and not reducing – emissions. By providing a seemingly easy and low-commitment solution, offsets can delay climate action by replacing emission reductions. To limit this negative effect, it is essential to indicate carbon offsets should only be used, once all emissions reduction options have been pursued, to compensate so-called 'residual emissions'."

Paul Schreiber, Campaigner, Regulation of Financial Institutions, Reclaim Finance

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Fiduciary Duty

A key feature of the legislative proposal is the superseding public interest matter of alignment with climate commitments and the new fiduciary duty for directors to act in their official capacities to enable an entity to be in alignment. In order to be successful, the legislation should very clearly define fiduciary duty when it comes to financial institutions. For many consulted experts, the inclusion of a new fiduciary duty is an elegant approach to put climate at the forefront of financial decision-making thinking.

In fact, the private sector tends to lead the public sector on this matter according to one expert. According to an in-depth legal analysis of directors' duties regarding climate change risk published by Carol Hansell, Founder of Hansell LLP and internationally-recognized expert in governance, "[d]irectors should recognize that the courts, regulators and investors accept that climate change poses real risks"[1] and they expect directors to consider these risks as part of their duties.

One expert, however, raised concerns surrounding pension fund fiduciaries. The *Income Tax Act* regulations state that the primary purpose of pension funds must be financial to provide lifetime

[1] Hansell LLP (2020) "Putting Climate Change Risk on the Boardroom Table", p.24 https://law-ccli-2019.sites.olt.ubc.ca/files/2020/06/Hansell-Climate-Change-Opinion-1.pdf

retirement income for employment services rendered. Additionally, there exists a "duty of loyalty" which requires pension funds fiduciaries to act in the best interest of beneficiaries. Consequently, any superseding duty that puts impacts ahead of financial considerations could clash with existing duties. It was recommended to explore amendments to the Schedule III of the *Pension Benefits Standards Act*, which establishes the list of permitted investments, by narrowing it to only allow investments that would be aligned with Canada's climate commitments.

"Pension organization should already be doing this by fiduciary duty standards; the Climate-Aligned Finance Act *reinforces and codifies the things they should be doing anyway. The clearer these responsibilities, the better."*
Keith Ambachtsheer, Director Emeritus, International Centre for Pension Management, Rotman School of Management, University of Toronto & Senior Fellow, National Institute on Aging, Ryerson University

Board Expertise and Conflicts of Interest

Recognizing the lack of climate expertise at the financial decision-making tables across the country, the legislative proposal included a requirement for climate expertise on the boards of certain Crown corporations as well as more broadly applied conflict of interest provisions to reduce barriers to alignment.

Requiring the appointment of climate experts to boards was heavily supported among the experts. Some comments focused on the need to ensure broad climate expertise criteria provide for a diverse range of backgrounds and opinions. As for the provisions and definition of conflict of interest, the consulted experts were divided with some indicating that such measures could be too strict. For example, excluding people associated with fossil fuels in general could attract criticism. In the absence of existing statutory rules on conflicts of interest pertaining to emissions-intensive industry representation on boards of directors, there was no consensus among experts on prohibition. Concerns were also raised on potential complications associated with barring someone who may otherwise have had a positive influence in terms of advocating for climate-friendly policies on the board.

"Climate expertise needs to be defined more objectively, using a predetermined set of criteria, to ensure that boards appoint real climate experts rather than making this just a box ticking exercise."
David Uzsoki, Senior Advisor & Lead, Sustainable Finance, International Institute for Sustainable Development

Capital Adequacy and Surcharge Requirements

In order to ensure financial institutions consider the systemic climate risks that their financial activities generate, the legislative proposal required the Office of the Superintendent of Financial Institutions (OSFI) to develop more stringent guidelines for capital adequacy. Participants noted the importance of concentrating on the impact of these institutions on the worsening of climate change rather than just the risk to the institutions, as this would not capture the systemic risk. On the suggestion that OSFI produces capital adequacy guidelines for financial institutions in relation to climate commitments to safeguard against systemic risk, one expert specified that capital requirement should be applied to exposure rather than commitments and recommended that OSFI should propose the appropriate capital charges be applied for investments in fossil fuels. That same expert goes on to say that the capital adequacy requirements are essential because the proven reserves for oil and gas are already six-fold what is allowed under the remaining carbon budget resulting in, by definition, the loss of any future investment. This is also in line with the findings of the International Energy Agency's 2021 report, *Net Zero by 2050: A Roadmap for the Global Energy Sector*, which concluded that "no new oil and natural gas fields are required beyond those that have already been approved for development"[2] because they will not be needed.

Another expert elaborated with their concern about capital requirements on exposure: despite Canada being one of the largest direct fossil fuel funders, they represent less than 2% of a bank's investments. That exposure wouldn't provoke the collapse of an individual bank but rather cause a ripple of instability throughout the entire financial system because of stranded assets and stranded workers.

Additionally, experts suggested looking deeply at the lending activities of the banks and investment activities of pension funds. Many studies show that Canada will not fare well in an unconstrained supply scenario.

"It is important to concentrate on the impact that these institutions have on the continued worsening of climate change and the lock-in of stranded assets and stranded workers, rather than attempting to account for the risk to individual banks; the latter won't capture the actual risk to the Canadian economy, which is more systemic."

Dr. Ellen Quigley, Senior Research Associate (Climate Risk & Sustainable Finance), University of Cambridge

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[2] IEA (2021) "Net Zero by 2050: A Roadmap for the Global Energy Sector", p.99. https://iea.blob.core.windows.net/assets/deebef5d-0c34-4539-9d0c-10b13d840027/NetZeroby2050-ARoadmapfortheGlobalEnergySector_CORR.pdf

Transition

One of the main objectives of the legislative proposal is to provide the tools for the financial sector to facilitate the transition to a net-zero economy. It was clear for many experts that a transition must be well defined and create sectoral pathways to achieve our climate targets. It must be guided by science as opposed to politics – 1.5 degrees is not a political debate; it is a fact. For one expert, it is in the best interest of the country to initiate a transition guided first by science, followed by economic benefits. Allocation of capital and subsidies should also follow these considerations.

Experts recognized the intent and the need to stop the financing of emissions, but some worried about the slow release of capital for the transition. Legislative solutions should focus on incentivizing desirable investment and behaviour. As one expert posited, we need to give companies the mechanisms to transition and avoid penalizing those that wish to transition.

“Prioritizing early and ambitious action and direct emissions reductions within the value chain are crucial to the transition and capital allocation strategies form an important component of any robust decarbonization action plan.”
Mike Toulch, Engagement Research Specialist, Shareholder Association for Research & Education

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Conclusions

The expert consultation played an essential role in helping to shape the *Climate-Aligned Finance Act*, as many of their suggestions have been incorporated into its final version. In general, the experts wanted to emphasize the idea that measures must be comprehensive to avoid a financial crisis on top of the looming climate crisis. The finance sector is critical to bringing about systemic change and helping mobilize and shift capital to fully decarbonize the economy. Although the finance sector is increasingly concerned about climate change and some are taking the lead despite being in an uncertain policy environment, Canada must do better in guiding its actions. The sector has come a long way; however, much work remains to be done, both by the industry and by governments. Partnerships between governments and the financial sector are critical in areas where there are capital flow barriers; governments must incentivize financial flows toward activities that support a low-carbon, climate-resilient economy. Given the complexities of climate change and how financial institutions operate, creating a bill with clear guidelines include climate change as part of their fiduciary duty will result in the greatest success.

Consultation Participants

This paper documents the collective feedback from over 40 individual experts, including the following consultation participants:

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