2023 Update to White Paper

ALIGNING CANADIAN FINANCE WITH CLIMATE COMMITMENTS:
Recent developments in Sustainable Finance
Financial institutions are awakening to the fact that they are on the front lines of climate risk (see box 2 and 5) and that the cost of inaction can no longer be ignored.

Around the world, advanced economies are implementing initiatives arising from central banks, financial regulators and private actors.

In the last 18 months since releasing our initial White Paper on Aligning Canadian Finance with Climate Commitments, the pace of global developments has only accelerated. In addition to bold action in Europe and the U.S. (see box 3), the International Sustainability Standards Board (ISSB) released its first two standards, including one specifically for climate-related disclosures.

In June 2023, ten Multilateral Development Banks announced common methodological principles of how they will ensure alignment of their new operations with the mitigation and adaptation goals of the Paris Agreement. Canada must follow suit and move faster if it wants to be part of the emerging low-carbon knowledge economy (see box 4 and 6).
The global banking and financial services industry saw a **70% increase in the number of climate-related greenwashing** incidents in the last year, with more than half involving fossil fuels or linking a financial institution to an oil and gas company.

The Global trends in **climate change litigation report shows an explosion of ‘climate-washing’ court cases** over the last few years, with 53 cases filed in 2021 and 2022 including in the financial sector.

To reduce greenwashing risk, asset managers **voluntarily downgraded** reported ESG investments, resulting in a $8.7 trillion restatement of U.S. sustainable investment Assets Under Management in 2022 compared to 2020.

At least **three climate-related greenwashing complaints** have been filed with the Competition Bureau in Canada, including against oil sands producers’ Pathways Alliance and RBC.

According to the UN High-Level Expert Group on the Net-Zero Emissions Commitments of Non-State Entities, **regulated requirements are necessary to tackle greenwashing.**

In contrast, Canada has at best adopted a wait and see approach. The Canadian Securities Administrators (CSA) will eventually consult on adopting disclosure standards based on ISSB standards (single materiality). Where 40 countries and regions have adopted or developed taxonomies, the federal government has still not responded to the Sustainable Finance Action Council’s taxonomy report, more than a year after receiving it.

**Box 2: Mounting reputational and litigation risk of greenwashing in the absence of strong regulation**

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**Box 3: Recent developments on climate & finance nexus from Canada’s major trading partners**

**United States of America**
- Passed Inflation Reduction Act
- Passed Infrastructure Investment and Jobs Act
- U.S. Securities and Exchange Commission proposed climate disclosure rule
- U.S. financial regulators issued interagency principles for climate-related financial risk management for large financial institutions
- U.S. Department of the Treasury issued principles for net-zero financing & investment
- California passed SB 253 - Climate Corporate Data Accountability Act and SB 261 - Climate-Related Financial Risk Act

**European Union**
- Adopted Corporate Sustainability Reporting Directive (CSRD) and accompanying European Sustainability Reporting Standards (ESRD) (double materiality)
- Taxonomy for Sustainable Activities in force with technical screening criteria defined through democratic, open and transparent process
- All legislation proposals under European Climate Law’s ‘Fit for 55’ package adopted, including a revised Emissions Trading System Directive, a Carbon Border Adjustment Mechanism, and a Social Climate Fund
- European Banking Authority issued world’s first ESG add-on to capital requirement rules, including climate
Months after the Basel Committee on Banking Supervision (BCBS) released principles for the management and supervision of climate-related financial risks, Canada’s Office of the Superintendent of Financial Institutions (OSFI) published Guideline B-15: Climate Risk Management, a subject of criticism by the Commissioner of the Environment and Sustainable Development with respect to timing and ambition relative to international peers. We are lagging more than ever, while the need for climate-aligned finance has never been more urgent.

Hidden risks within the financial system can rattle the global economy and threaten livelihoods and investments. It is imperative that Canada’s financial system confront and better manage its exposure to climate risks, especially with regard to how the financial system itself contributes to amplifying the climate risks it should instead mitigate by aligning with climate commitments. The best way to minimize the risks that climate change poses to the financial system is to limit the risks that financial institutions pose to the climate system.

**Box 4: Independent assessments of Canada’s recent actions: lagging behind**

“OSFI’s strategy to tackle climate-related financial risks aims to improve the resilience of federally regulated financial institutions but will remain short of incentivizing the transition to a net-zero emissions economy.”

- Commissioner of the Environment and Sustainable Development Report on OSFI’s supervision of climate-related financial risks

“… a lack of legal clarity about investors’ duties and insufficient action by policy makers to encourage and enable responsible investment, rendering Canada a low-regulation jurisdiction by international standards”.

- Principles for Responsible Investment (PRI) report on Canada’s legal framework for impact

**Box 5: Canadian financial institutions overexposed to fossil fuel risks**

- A February 2023 report from BloombergNEF on financing the transition tracking 100 banks financing more than $1 billion in energy supply found that Canadian banks are lagging international peers in the bottom third and therefore leading the race on risky investments.

- RBC, a Canadian bank, was the world’s #1 financier of fossil fuels in 2022.

- Recent findings peg stranded assets in the oil and gas sector globally at more than US$1 trillion, including around US$100 billion in stranded assets in Canadian oil and gas fields.

- California joined over two dozen U.S. local governments suing fossil fuel companies for the cost of climate change as a result of decades of misinformation.
Ambitious and coherent legislation requiring that finance proactively aligns with achieving global climate commitments would create enormous clean sustainable investment opportunities and spur a new era of prosperity (see box 6).

We propose a set of recommendations that define what leapfrogging from laggard to leader would look like for Canada in terms of ensuring a climate-aligned stable low-carbon financial system.

Box 6: The Advantages of Future-Proofing the Economy Through Rigorous Decarbonization

- 2.2 million jobs created in the Canadian clean energy sector by 2050.
- The inflation-adjusted GDP of the clean energy sector would increase to become six times larger in a net-zero 2050 compared to 2025.
- A united, systemic net-zero transition could boost global GDP by US$43 trillion over the next 50 years.

As a first step towards true climate action in Canada’s financial industry, the Honourable Senator Rosa Galvez introduced Bill S-243, Climate-Aligned Finance Act (CAFA) on March 24, 2022. This legislation would guide Canada’s financial sector through an orderly transition to a low-carbon economy while safeguarding the financial system from the systemic risks posed by climate change by increasing coherence, transparency, and accountability. There have since been five petitions calling for CAFA’s adoption introduced in the House of Commons. In May 2023, motion 84 was introduced by (now) Parliamentary Secretary Ryan Turnbull in the House of Commons calling for the government to use “all legislative and regulatory tools at its disposal to align Canada’s financial system with the Paris Agreement”, an initiative which has received “groundbreaking” cross-party support.
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<th>Recommendation</th>
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<td>1</td>
<td>All entities, including financial institutions, must be aligned with climate commitments.</td>
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<td>2</td>
<td>Avoidance of carbon lock-in, the entrenchment of our dependence on fossil fuels, must be a consideration in all financial decisions.</td>
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<td>3</td>
<td>Require responsible target-setting and planning, including compliance with a global carbon budget consistent with the Paris Agreement 1.5°C temperature goal and mandatory consideration of all life cycle emissions.</td>
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<td>4</td>
<td>Capital requirements must account for systemic climate risks generated by the activities of financial institutions.</td>
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<td>5</td>
<td>Recognize climate change as a superseding interest relevant to all directors’ duties.</td>
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<td>6</td>
<td>Avoid conflicts of interest and leverage climate expertise, experience and knowledge.</td>
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<td>7</td>
<td>Respect the rights of Indigenous Peoples as well as environmental and social goals.</td>
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<td>8</td>
<td>Develop a comprehensive action plan to align all financial products with climate commitments.</td>
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