Canada’s Expert Panel on Sustainable Finance

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Kim Thomassin
Canada’s Expert Panel on Sustainable Finance

- Launched April 2018 by Minister McKenna and Minister Morneau
- Objective of providing recommendations to the federal government for consideration.
- Interim report published in October
- Final Report with recommendations – Spring 2019

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Call to Action:  
Canada’s Imperative

Near universal recognition that global climate is changing with dramatic implications for the economy
• need to invest in adaptation and transition

Canada, together with 197 jurisdictions, has signed the Paris agreement, with the goal of limiting global temperature increases below 2°C
Call to Action

Canada’s Economy is Carbon Intensive. We are exposed.

GHG Emissions per Capita in G7 Countries, 2015

- United State: 20.5
- Canada: 20
- Germany: 11.1
- Japan: 10.4
- United Kingdom: 7.9
- France: 7.2
- Italy: 7.0

We need to invest in transition
Pan-Canadian Framework is Canada’s Blueprint

![Greenhouse Gas Emissions by Canadian Economic Sector (Mt CO2e), 2016](chart.png)

**Greenhouse Gas Emissions by Canadian Economic Sector (Mt CO2e), 2016**

- **Oil and gas**: 183 Mt (26%)
- **Transportation**: 173 Mt (25%)
- **Buildings**: 81 Mt (11%)
- **Electricity**: 79 Mt (11%)
- **Heavy industry**: 75 Mt (11%)
- **Agriculture**: 72 Mt (10%)
- **Waste and others**: 41 Mt (6%)

**Source:** ECCC

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**2100 WARMING PROJECTIONS**

- **Historical**
- **Baseline**: 4.1 – 4.8°C
- **Current policies**: 3.1 – 3.7°C
- **Pledges**: 2.6 – 3.2°C
- **2°C consistent**: 1.5 – 1.7°C
- **1.5°C consistent**: 1.3 – 1.5°C

**Warming projected by 2100**

**Source:** Climate Action Tracker
Call to Action

The anticipated investment trajectory requires mainstream financial markets

- Globally, over $100 tr. in global investment to achieve Paris Agreement
- Estimate for Canada is $2.5 tr.
- Public sector imperative to make scale and pace clearer
- Financial sector imperative to:
  - Connect savings with investments in sustainable outcomes
  - Help household and businesses manage new climate risks

What gets funded gets done

- Our financial system is capable of the task
- BIG opportunity
- Need to work together, move faster and more decisively
What is Sustainable Finance?

Capital flows (as reflected in lending and investment), risk management (such as insurance and risk assessment) and financial processes (including disclosure, valuation and oversight) that assimilate environmental and social factors as a means of promoting economic growth and the long-term stability of the financial system.

The Panel is particularly focused on engaging mainstream capital markets in sustainable finance.

Examples of sustainable finance in practice could include:

- **A rental car company** issuing a green bond to finance a fleet of hybrid vehicles
- **An oil and gas company** issuing equity or debt to invest in measures to reduce energy consumption or methane emissions in extraction or production
- **A homeowner** taking out a loan for an energy efficiency build or renovation, or resiliency improvements.
- **A venture capital firm** investing in a new cleantech startup
- **An insurance company** offering preferred rates for flood resiliency measures
Global Setting for Sustainable Finance

Financial Stability Board’s Task Force on Climate-related Financial Disclosures

EU High-Level Expert Group on Sustainable Finance

UK Green Finance Taskforce

China’s Green Finance Committee and Green Finance Task Force

United Nations Environment Program (UNEP-FI)

G7, G20, World Bank, OECD

Other Countries Developing Action Plans:

- Italy
- France
- Netherlands
- Norway
- Sweden
- New Zealand
- Australia
- Singapore
Sustainable Finance

Canada’s sustainable finance market is growing, but many of our peers are moving faster.

Official TCFD Supporter by Country

Cumulative Green Bond Issuance by Country (end-2017)

Source: Task Force on Climate-related Financial Disclosures, as of September 26, 2018

Source: Climate Bonds Initiative and Smart Prosperity
Sustainable Finance

Clean Energy Investment as a Share of GDP

<table>
<thead>
<tr>
<th>Country</th>
<th>Clean Energy Investment as a Share of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>0.23%</td>
</tr>
<tr>
<td>Canada</td>
<td>0.31%</td>
</tr>
<tr>
<td>United States</td>
<td>0.32%</td>
</tr>
<tr>
<td>Italy</td>
<td>0.49%</td>
</tr>
<tr>
<td>Japan</td>
<td>0.58%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>0.58%</td>
</tr>
<tr>
<td>Germany</td>
<td>0.70%</td>
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</tbody>
</table>

Source: TCFD, as of August 28, 2018

Carbon Content of Exchange Traded Funds

<table>
<thead>
<tr>
<th>ETF</th>
<th>TCO2e / Millions $ sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>MSCI Japan</td>
<td>0.23%</td>
</tr>
<tr>
<td>MSCI United Kingdom</td>
<td>0.31%</td>
</tr>
<tr>
<td>MSCI Eurozone</td>
<td>0.32%</td>
</tr>
<tr>
<td>SPDR S&amp;P 500</td>
<td>0.49%</td>
</tr>
<tr>
<td>Dow Jones</td>
<td>0.58%</td>
</tr>
<tr>
<td>MSCI China</td>
<td>0.58%</td>
</tr>
<tr>
<td>MSCI Emerging Markets</td>
<td>0.70%</td>
</tr>
<tr>
<td>MSCI Australia</td>
<td>450</td>
</tr>
<tr>
<td>MSCI Canada</td>
<td>450</td>
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</table>

Source: ETF.com (retrieved July 3, 2018)

If we want to capture the market opportunity and establish for ourselves the rules affecting our financial industry and key economic sectors, we need to accelerate.
Sustainable Finance

What we heard in our consultations

- Enthusiasm, commitment to progress
- Financial services are taking action
  - Important pockets of growth in sustainable finance
  - But diffused and uncoordinated
  - Insufficient view of scale of market and pace required
- Until Pan-Canadian Framework is more concrete and implementation demonstrated, market participants will be hesitant
- Climate risks often seen as uncertain or distant relative to cyber, data, regulatory risks and digital disruption
- Even large financial institution with deep resources have difficulty assessing reliable and consistent carbon/climate information

- Climate change knowledge and capacity in financial services support ecosystem (accountants, lawyers, consultants…) low
- Perception among some that fiduciary duty may conflict with ESG issues
- Benchmark indices and ETFs reinforce status quo investment strategies
- Regulators at generally early stage in navigating implications of climate risk
- Need for accelerated and more strategic dialogues between industry, innovators, governments, academia and financial sector
Insurers and Reinsurers

- P&C advanced owing to dramatic increase in weather related damage claims
  - Sophisticated predictive climate models and integrate with strategy
  - Focus on adaptation and resilience
  - Access to reliable and consistent data difficult and expensive
- Life insurers at an earlier stage. Focus is on integrating ESG into investment

Institutional Investors

- Some leaders but generally ESG integration in investment process is early stage
- Confidence that portfolios can be adjusted as climate impacts increase
- Market-based benchmark indices dominant driver of investment allocations
  - But key indices 4-5°C scenario
- Conventional risk modelling not well adapted to climate risk
- Increasing pressure from members to divest carbon-intensive industries

Banks

- More comprehensively involved in the economy with potential to play a big role
- But market, shareholder regulatory signals to address climate change muted
- Endorsed TCFD but early in implementation journey
- More proactive role could extend to building market capacity for sustainable finance products and assisting clients in transition plans
- Considerable activity across most banks but diffused – not driver of strategy
Foundational Elements

Clarity On Climate Policy

Reliable Information

Effective Climate-related Disclosures

Clear interpretation of Fiduciary Duty

Knowledgeable Support Ecosystem

Effective and Consistent Regulation
Clarity On Climate Policy

**Background**

- Financial sector requires clear policy signals to size the market and invest in transition
- Policy can promote pricing of risk, informing effective capital allocation
- Price on carbon lowers the relative cost of projects that reduce emissions, increasing their unattractiveness
- But carbon pricing is insufficient on its own - needs to be part of a broader policy package

**Observations**

- Certainty around climate and carbon policy would help unleash innovation and deploy long-term capital
- The federal government should develop a narrative that will help Canadians understand the importance and benefits of the transition
- Pan Canadian Framework provides comprehensive framework but a more concrete capital plan would allow investors to better understand the nature and scale of the opportunity
Clarity On Climate Policy

Questions for Discussion

- Would a more strategic, practical narrative around execution, capital requirements and intended outcomes for each key element of the PCF provide the clarity and imperative to engage large pools of capital? What elements of the PCF require the most clarity?

- What other critical policy gaps, inconsistencies or confusions are hampering the flow of sustainable finance in Canada overall, and specifically with respect to sustainable infrastructure, innovation/cleantech investment, and promoting energy efficiency?

- Would execution of the federal carbon pricing backstop and complementary regulatory actions to reduce emissions provide the policy clarity that private sector players to need to make “rational” decisions reflecting the cost of pollution and carbon emissions in market pricing?
**Background**

- Access to reliable climate information and the ability to translate into financial outcomes is central to sustainability-related risk assessment.

- Would better inform a wide array of activities, including insurance underwriting decisions, lending and investment decisions, community and infrastructure development.

- The Canadian Climate Information Portal serves as a positive first step in centralizing climate information, but there is a need for translation of this data into decision-useful financial analysis.

**Observations**

- Sophisticated institutions, such as P&C insurers and banks, have expertise to pursue climate-oriented information and analysis, but still difficult.

- The absence of a simple means of assessing climate impacts is impeding the flow of capital into sustainable finance.

- A better understanding is required of what data is currently available, what information needs to be centralized, and in what form.

- Canada could become a leader in industry-relevant environmental analytics and these efforts could play into Canada’s big data and AI initiatives.
Questions for Discussion

- Given the breadth of data needs across industries and roles, what critical areas of data would meet the widest need and should be prioritized? What are the best sources of that information today?

- Would there be significant benefits from combining climate science with financial and economic information and analysis?

- Is there a mutually acceptable means by which proprietary data can be leveraged for public good? If so, what would enable that?

- Could existing organizations collaborate, or be combined and scaled, to manage the collection, organization and distribution of this information, or do we need to build an entity possible means, who might the key players be, and with what mandate?

- Through what channels should it be made available so that it is accessible, reliable and user-friendly?
Effective Climate-related Disclosures

Background

• Effective climate-related disclosures promote more informed credit, investment and insurance underwriting decisions

• In 2017, the Financial Stability Board’s Task Force on Climate-related Financial Disclosures (TCFD) published a set of recommendations for more consistent and comparable climate-related financial risks and opportunities

• Adoption of the TCFD framework has become a global effort and, while it remains early stage, implementation of the TCFD framework may serve as a model for scaled commitment to sustainable finance

Observations

• Progress on implementation of the TCFD recommendations remains nascent, although a subset of large, sophisticated investors are making progress and can influence broader adoption

• There are opposing views on whether the TCFD recommendations should remain voluntary or become mandatory

• Stronger signals are needed from financial regulator and investors on reporting expectations and financial materiality

• Policy interventions should be designed to encourage enhanced practices and not unnecessarily burden issuers
Questions for Discussion

• What would accelerate the adoption of TCFD?
• Should the Government of Canada become an official supported of the TCFD?
• Is there a need for climate-related disclosures to be included in mainstream financial statements, or is that not necessary so long as other conditions are met (i.e. robust oversight and governance of the reporting process and quality)?
• Should larger firms be looked upon to demonstrate leadership to small- and medium-sized enterprises?
• Is there a need to provide further guidance on the relationship between climate-related risks and materiality? How can we improve the understanding of what is material?
• Is there a mechanism for those making appropriate disclosures with uncertain information in good faith to overcome fear or disclosure, such as some form of regulatory safe harbor?
• What is the role of the board – and specifically the audit committee – in overseeing climate-related financial disclosures?
• Are there any other standards that could be combined with the TCFD to reduce reporting burden?
• Are there any important enablers or barriers to adoption of TCFD that have not been discussed?
Background

- Fiduciary duty exists to ensure that those that exercise discretion in managing others’ assets employ due care, skill and prudence in the service of their clients’ or beneficiaries’ interests.

- There is a legacy perception that weighing ESG considerations transgresses fiduciary duty; however, there is growing evidence that consideration of material ESG factors can lead to better investment decisions.

- The lack of clarity regarding whether consideration of ESG factors is breach or requirement of fiduciary duty may be hindering responsiveness to material risks and opportunities.

Observations

- There is a need for broad clarification of why and how ESG factors require due attention by boards and other financial stewards.

- There is also a need for guidance on how fiduciaries can satisfy this obligation; for example, the board structures to best oversee such ESG factors.

- Legal practitioners indicated that fiduciaries who fail to consider relevant, long-term ESG matters could expose themselves to legal liability.
Clear Interpretation of Fiduciary Duty

Questions for Discussion

• Is there a need to more clearly define the scope of fiduciary duty in relation to incorporating climate-related or broader ESG factors to financial evaluation and decision-making in Canada? What would be the best way to effect change and who are the key stakeholders in facilitating this change?

• What is the best way to incorporate ESG into rules or regulations that govern various Canadian financial institutions?

• What are the responsibilities of investment agents and advisors to know and act in accordance with the preferences of their clients regarding sustainability issues? What is the most effective manner for these preferences to be identified and communicated?

• What is the most effective manner for delivering board education on climate risk and ESG/sustainability issues? Does education need to include guidance on effective governance/committee modeling with respect to ESG oversight?
Background

- Canada’s financial sector is supported by an ecosystem of professional services, including auditors, accountants, rating agencies, lawyers and brokers.

- Many companies and investors depend on these supportive bodies to navigate emerging themes.

- Investment by these players in building capacity in specialized expertise is largely demand-driven.

- Circular dynamic with limited climate capacity in support eco-system reflecting modest demand from clients.

Observations

- Several service providers indicated that an early sign of the prospective demand from their clients on climate-related disclosures and other ESG-related emerging themes would give them more confidence to build their capacity in these areas.

- Industry associations play a key role in facilitating awareness and understanding of developing themes within their member bases, but they are also not seeing the necessary demand signals from their members.

- Canada’s financial support ecosystem could potentially benefit from expanded participation in international initiatives.
Given the breadth of climate-related considerations and diverse need across industries, what professional services are most critical today? What are the crosscutting challenges and opportunities that they should focus on first?

What catalysts might accelerate investment in building the necessary capabilities and capacity?

In self-regulated segments of the financial support ecosystem, can associations effectively introduce and deliver necessary education and awareness amongst constituents? If so, should financial regulators ask that relevant associations develop plans for effecting change among their constituents? Would mandatory training programs focused on key topics be effective?

How might the various professional bodies (CFA, CPA, SOA, etc.) coordinate efforts to consistently and efficiently mobilize change and align on best practices in ESG education and capacity?

How could the industry do a better job of plugging into international initiatives?

Should ESG aspects be integrated in university curricula, to build necessary relevance and awareness among future professionals prior to entering the workforce?
Effective and Consistent Regulation

Background

• Financial regulators play a critical role in setting the standards by which financial participants operate.

• International financial regulators are advancing work on how climate-related risks could affect key financial industries.

• While Canada’s financial regulatory structure is somewhat distributed, authorities such as OSFI and the Bank of Canada are well placed to assess the potential impact of climate risks on systemic stability.

Observations

• There is a lack of clarity around how Canadian financial authorities are analyzing climate-related risks and how they intend to interact with the financial sector on the topic.

• Canada’s financial authorities could benefit from greater cross-jurisdictional collaboration to promote knowledge-sharing, capacity building and policy alignment on climate-related financial issues.

• Capital requirements are based on historical experience and may not reflect the evolving nature of risk.
Questions for Discussion

• Are climate risks different from other material financial risks? How could climate risk be best integrated into the financial regulatory oversight process?

• Is there an appropriate dialogue to be initiated between these groups and interested private sector organizations and relevant bodies?

• What expectations, if any, should stock exchanges place on issuers regarding ESG disclosure?

• Are there significant anomalies within the current rule set that have not caught up to some of the realities of differentiated asset class exposures to climate impact or carbon intensity?

• Are there particular areas where financial regulators should accelerate their work? What are the priorities? What can be reprioritized to enable this without undue burden?
Financial Products & Markets

- Building Retrofits for Energy Efficiency and Climate Adaptation
- Sustainable Infrastructure
- Cleantech innovation
- Innovation in Oil and Gas Industries
- Optimized Electricity Generation and Transmission
- Sustainable Asset Management and Financial Products
- Green and Transition-linked Financial Products
Background

• Buildings represent 11% of domestic GHG emissions and retrofits are a critical part of Canada’s transition

• Retrofitting can save energy costs, enhance property values, improve conditions for occupants and create employment opportunities

• Reaching economies of scale will require more investment in specialized skills, technology and financing

Observations

• Most property owners have pledged the property as collateral, making it difficult to secure additional financing for retrofits

• Homeowners often prioritize aesthetics, cost and convenience over energy efficiency or resiliency

• Project aggregation and securitization will be key measures for crowding private capital into the retrofit market

• Preferential insurance and mortgage rates could incentivize retrofit investments

• A centralized platform could help identify projects, collect best practices and pioneer finance structures

• There is support for a mandatory energy efficiency labeling program and an opportunity for the government to pilot it
Background

- Infrastructure is an essential aspect of clean growth and the LCE transition
- Canada has a significant infrastructure deficit, between $150 billion and $1 trillion
- Government of Canada established the Canada Infrastructure Bank (CIB) as a platform for public-private co-investment

Observations

- There is uncertainty around the CIB’s mandate, status and role
- Many commentators supported the application of a sustainability filter across CIB’s investment mandate
- Infrastructure as a distinct asset class and differentiation between early stage and operational assets might improve market efficiency
- Convening the right players early in the infrastructure planning process could help optimize design, insurability and financing
- Regional lending entities or the CIB could add value by bundling and securitizing smaller projects
Cleantech innovation

Background

• Clean, green innovation will be a key driver of economic growth

• Canada is a leader in cleantech R&D, however underperforms in commercialization and scaling

• Greater international, interdisciplinary and cross-sectoral collaboration will be needed

Observations

• Cleantech startups tend to fall outside mainstream investors’ and lenders’ size and risk/return criteria

• Demonstration projects are critical, yet are often too large for venture/angel investors and too small for larger pools of capital

• Cleantech would benefit from policy certainty and streamlining of regulatory procedures

• Companies would benefit from help with navigating public support program proposal processes

• Government can demonstrate and accelerate promising solutions through public procurement
Innovation in Oil and Gas Industries

Background

• Canadas oil and gas sector is an economic powerhouse and a major GHG emitter

• Canada’s energy future will be determined by policy, technology, market access, and infrastructure

• Future market access will hinge on the ability to develop resources sustainably and at low cost

• Investors are transitioning from traditional energy sources to alternatives, and capex is shifting to shorter cycle projects

• Companies can embrace the transition and position Canada as a leader in clean, efficient production

Observations

• Transition of the oil and gas sector is constrained by cost and a concrete market imperative, rather than capacity for change

• Clear policy signaling and capital planning are critical to spur the LCE transition

• Investors are facing intensifying pressure to withdraw from carbon intensive sectors, and international capital may exit

• Transition-linked financial products to support oil and gas companies’ efforts to become more sustainable are needed
Optimized Electricity Generation and Transmission

Background

• Electricity demand is expected to double by 2050 and a greater supply of clean electricity will be required

• Canada is one of the cleanest electricity generators in the world, however clean power varies by province

• Canada exports electricity to the US, but interprovincial trade is limited

• Greater interprovincial transmission could benefit the economy and environment

Observations

• Electrification is a key means of emissions reduction, and an employment source and exportable expertise

• National energy-system planning would assist with managing supply and demand, developing a project pipeline and identifying funding sources

• Regional green banks and the CIB could help source, structure, aggregate and facilitate financing

• Larger projects could be attractive investment opportunities for major infrastructure investors

• Structural barriers, such as local utility business models, need to be addressed
Sustainable Asset Management and Financial Products

Background

- Understanding of financial materiality of climate change is evolving and climate risk may not be fully accounted for today

- Common benchmarks are estimated to align with a 3.5-5°C scenario, which indicates investors may not be in line with a 2-degree target

- There is growing evidence that focused ESG investing may enhance risk-adjusted returns

Observations

- Limited access to reliable, relevant and consistent ESG data is a barrier to wider ESG integration

- Climate-related financial disclosures help asset owners invest, report, and manage climate risk

- Translation of ESG information into investment decisions and forward-looking scenarios is needed

- Unlike traditional risk analysis, climate modeling cannot be calibrated to historical data

- Banks have a role to play in engaging investors and businesses on sustainable investing

- There was support for educating and consulting pension beneficiaries on the sustainability impact of their investments

- Asset owners use company engagement to promote best practices and collaborative initiatives are helpful
Green and Transition-linked Financial Products

Background

• Green bond proceeds are earmarked for environmentally beneficial activities and the market is growing

• Guidelines for green bonds exist, however their scope may overlook some sustainable finance opportunities

• Accurate labeling is important and there is mounting focus on sustainable finance taxonomies

• Transition-linked bonds are an emerging financial instrument available to emission-intensive firms and tie sustainability targets to the firms’ cost of capital

Observations

• Green bonds are useful, but alone may not flow significant mainstream capital into sustainable finance

• Transparency, reporting and verification are essential to avoid “greenwashing” and there is growth in green bond accreditation capacity

• There are diverging views on the definition of “green”

• Engagement with international green standards is important to ensure Canadian considerations are not incompatible

• Green bond market needs to grow in size and liquidity

• Canada could position itself as international centre for transition-linked financial products
The Prize

- **Successful adaptation** of climate change
- Smooth and inclusive **economic transition**
- **Stable** financial system
- Canada’s commercial **competitiveness is enhanced**
- Canada is a **leading hub** of sustainable finance
- **Improved** energy efficiency and **reduced** energy costs
- **Vibrant** clean-tech sector
- **Leader** in clean electrification
Next Steps

- The Panel participating in roundtable discussions for targeted consultations
- A final report with recommendations to the Ministers in Spring 2019

Thank you for your engagement.

Contact Information:

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