Intelligence MEMOS

From: Glen Hodgson

To: Canadians Concerned About Sustained Finance Rules

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Re: **Canadian Sustainable Finance: Lots of Heat, More Light Required**

Climate change is now being embedded in decisions around financing to address both its impacts, and how to pay for the massive investment required to transition to an economy with much lower net GHG emissions.

And while there is much activity in Canadian sustainable finance, we still need clarity on standards, metrics and validating processes.

There is no particular magic to "sustainable finance," a catch-all term that covers explicitly addressing climate risk and improving transparency through common standards and processes along with detailed information and analysis on climate impacts and the transition to lower emissions.

Sustainable finance can apply to equity investment in firms and projects, debt financing from financial institutions and capital markets, and climate-related risk management products from the insurance industry. In all three dimensions, better information is key to informing clients and investors about climate-related risks and potential opportunities.

How is Canada doing?

Most Canadian financial institutions have made a commitment to adopt more sustainable investment and lending practices, although these are still early days. The Canadian green bond market has grown rapidly, expanding by 50 percent in 2019, and should rebound with the recovery. The federal government has also committed to its first green bond issue, although its standards and processes used to define and validate it are still in development.

There has also been a rush by many Canadian businesses to improve their climate-related reporting, usually in the context of an ESG framework. The willingness to improve ESG reporting is welcome, but it is currently based on many competing approaches. And the lack of a common agreement on ESG standards, metrics, validation and reporting in general, and climate-related reporting in particular, raises questions about the adequacy and comparability of ESG reporting.

Meanwhile, the world continues to move ahead quickly. There is now a rapid if uneven evolution toward adoption of the guidelines proposed by the Task Force on Climate-related Financial Disclosures (TCFD), with building momentum on mandatory adoption. New Zealand announced its intention to require mandatory adoption in late 2020, followed by Switzerland, the UK, France, China, Australia, and Hong Kong. The June G7 communique supported mandatory climate reporting based on the TCFD recommendations, a decision subsequently supported by the G20.

North America has lagged on climate-related disclosure, but that is about to change. In the US, the Securities and Exchange Commission has signalled the likelihood of mandatory climate-related disclosure for US firms. Bloomberg recently reported that the SEC is expected to focus on specific firm reporting requirements, likely to include consistent and comparable mandatory disclosures, qualitative reporting on a firm's forward-looking climate adjustment plans, and detailed quantitative metrics related to greenhouse gas emissions.

In Canada, investment oversight is complex, with provinces responsible for overall business securities regulation while the federal government regulates our largest financial institutions. Regulatory institutions such as OSFI are now building capacity to assess climate risks. US decisions on climate-related disclosure will of course be a key factor guiding what happens in Canada.

One area for Canada to play an active role in making the rules, rather than reacting to decisions elsewhere, is in transition finance. Access to capital and risk-management tools will be required to facilitate the transition within oil and gas and other emissions-intensive industries toward much lower GHG emissions. So far, international bodies have been reluctant to set definitions and standards when it comes to transition finance, which creates a window of opportunity for Canadian business and policymakers to help define the rules of the game.

A business-led process has been underway for over a year, centred at the Canadian Standards Association, to develop a Canadian taxonomy for transition finance, which would be an important steppingstone in Canada and globally.

This step would be welcome according to the Investment Industry Association of Canada, which noted "for transition bonds to gain traction and see material issuance in Canada and abroad, there needs to be a concentrated push to develop widely accepted frameworks and taxonomy with a focus to support credible transition projects... credible and measurable standards and data collection will be demanded by investors and provide clarity for underwriters and integrity for issuers."

It has taken the CSA longer than expected to make public its taxonomy on transition finance, although it could be released by the end of September. At that point, it will be important to engage governments and other stakeholders in Canada, and resource-rich international partners like the US and Australia to ensure this transition finance taxonomy is to gain traction.

Momentum is building toward enhanced mandatory climate-related business reporting, and Canadian businesses and governments will likely follow conditions set elsewhere. The possible exception is transition finance, where there is an opportunity to help define the rules of the game – if international support can be built based on a credible Canadian taxonomy, standards and metrics.

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