



Government
of Canada

Gouvernement
du Canada

Canada



THE EXPERT PANEL **ON SUSTAINABLE FINANCE**

EXECUTIVE SUMMARY

Cat. No.: En4-350/2018E-PDF

ISSN: 978-0-660-28204-6

Unless otherwise specified, you may not reproduce materials in this publication, in whole or in part, for the purposes of commercial redistribution without prior written permission from Environment and Climate Change Canada's copyright administrator. To obtain permission to reproduce Government of Canada materials for commercial purposes, apply for Crown Copyright Clearance by contacting:

Environment and Climate Change Canada

Public Inquiries Centre

12th Floor, Fontaine Building

200 Sacré-Coeur Boulevard

Gatineau QC K1A 0H3

Telephone: 819-938-3860

Toll Free: 1-800-668-6767 (in Canada only)

Email: ec.enviroinfo.ec@canada.ca

Cover photo: © Getty Images

© Her Majesty the Queen in Right of Canada, as represented by the Minister of Environment and Climate Change, 2018

Aussi disponible en français

EXECUTIVE SUMMARY

The Expert Panel on Sustainable Finance

In Spring 2018, the Minister of the Environment and Climate Change and the Minister of Finance appointed us to form an Expert Panel on Sustainable Finance. Our mandate is to engage with a wide range of stakeholders on sustainable finance in Canada to articulate the key challenges and opportunities and to provide next step recommendations to the Government of Canada.

This **Interim Report** provides an overview of the state of sustainable finance in Canada based on measurable factors and, more importantly, on the feedback we received through open and diverse conversations with a wide range of stakeholders across the financial services, business, public sector, think tanks and academic communities.

This **Interim Report** also seeks to expand our understanding of how to enable our financial services industry to develop and scale markets and products that will support investment in climate resilience and low-carbon growth. Our final Report, targeted for Spring 2019, will move from understanding to recommendations.

Our Call to Action: Canada's Imperative

- **Climate Effects are Significant and Growing**

There is near universal recognition that the global climate is changing and that this will have increasingly dramatic implications for all world economies. Already, weather-related events are becoming more frequent and intense, and the financial consequences can and have been severe. Looking ahead, most scientific advice indicates that rising global temperatures—which will bring more extreme weather events and changing weather patterns—will directly or indirectly affect every sector of the economy. With this reality comes a global need to invest in climate adaptation and transition to low-carbon growth.

Canada stands as one of 197 countries, nations and territories that have signed the Paris agreement with the goal of limiting global temperature increase to well below 2 degrees Celsius. In doing so, we are part of the global movement to focus on climate change resilience and mitigation, aiming to accelerate our transition to lower carbon activities, sector by sector, throughout our economy.

- **Canada's Economy is Carbon Intensive: We Must Invest in Transition**

Many of the sectors underpinning the Canadian economy are carbon intensive, meaning Canadians are exposed. To retain and enhance our long-term economic competitiveness and to provide a pathway to sustainable and inclusive growth, it is essential that we begin a strategic transition towards a low-carbon economy. The Pan-Canadian Framework (PCF) was developed as a collective plan to grow the economy while reducing emissions to 30% below 2005 levels by 2030. Scientific evidence overwhelmingly suggests that beyond 2030, considerably more ambitious emissions reductions will be required to meet the Paris temperature goals. This transition to 2030 and beyond will be challenging and will require a considerable deployment and recalibration of investment flows, together with a broad suite of actions by governments, businesses and households.

- **The Financial Services Industry Has a Key Role to Play**

The magnitude of investment required is substantial and requires partnership between the public and private sectors. The public sector has a vital imperative to make the scale of the opportunity and the pace of action required clearer and more tangible, and to show leadership in its own activities. The financial services sector has a critical role to play in connecting investments with sustainable outcomes, and helping households and businesses manage new climate risks.

Our financial sector is capable of the task. It is strong, internationally competitive and deeply engaged in the economy. Our large Canadian banks and insurance companies are competing successfully in global markets, and our institutional investors represent some of the largest pools of deployable capital in the world. Our financial sector leaders are capable of working together and have reason to be highly vested in our economy's long-term outcome.

The scale of the investment required to transition to low carbon growth and adapt to climate change presents a big opportunity. The ambition is to grow the economy in a manner that yields sustainable environmental outcomes and meaningful economic opportunities for Canadian businesses and workers, while successfully managing the impacts of inevitable climate change on our communities.

Sustainable Finance in Canada

There is no universally accepted **definition of Sustainable Finance**. For the purposes of discussion, the Panel views it as 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 sustainable economic growth and the long-term stability of the financial system.

Both observable measures and the feedback from our consultations suggest that sustainable finance is growing in Canada, but overall, we are not moving with sufficient determination or at the pace of many of our peers. The Panel heard considerable enthusiasm and commitment to the objectives of sustainable finance across many stakeholders. At the same time, the Panel heard that Canada is generally acting reactively, tentatively, and in only a loosely-coordinated fashion. With the impact of climate change seemingly distant and uncertain, the financial services industry is often more focused on what appear to be more pressing and immediate issues.

If we want to capture the large market opportunities and establish the rules affecting our financial industry and our key economic sectors for ourselves, we need to move faster and more decisively. It is difficult within an interconnected system for individuals and companies to act alone. As a result, a more systemic, proactive, coordinated and strategic approach is required by industry leaders to facilitate the required investment in resilience and mitigation through economic transition. By acting in this manner, we can capture opportunity to expand our economic base and enhance international competitiveness for both the real economy and our financial sector.

Canada should focus on areas where we can significantly move the needle. This encompasses environmental impact and economic opportunity for the long-term, including a focus on harnessing innovation.

Applying Finance to Sustainability

Our discussions with stakeholders highlighted that a number of underpinning *Foundational Elements* are essential to increased investment in sustainable activities. Without these, market development will continue to be slow and sustainable finance will remain an add-on to the financial system, rather than core to mainstream financial markets.

Beyond these Foundational Elements, there are also several *Financial Markets and Products* that would support the required transition in Canada's large emitting sectors. Following are six Foundational Elements and seven Financial Markets and Products.

FOUNDATIONAL ELEMENTS

Clarity on climate and carbon policy

This is critical for the rational pricing of risk to support informed, efficient capital allocation decisions. Clear policy signals, especially with regard to carbon pricing, allows the market to make long-term choices with regard to sustainability. Stakeholders said the importance of certainty around climate policy is a vital prerequisite to unleashing innovation and providing a sufficiently reliable trajectory to put long-term capital to work. The Panel also heard repeatedly that a cohesive national investment plan that is aligned with the PCF would help accelerate investment by all parties.

Reliable information

Obtaining reliable, consistent climate data and translating it into financial insights will be central to sustainability-related financial decision-making and risk assessment. There is overarching private sector support for a centralized source(s) of climate data and financial analysis. Many players are willing to actively support its development and help define its requirements.

Effective climate-related financial disclosures

Disclosure is critical for informed decision-making. The industry-led Task Force on Climate-related Financial Disclosures (TCFD) has published recommendations for how firms could put forward more consistent and comparable disclosures of climate-related financial risks and opportunities. Most participants agree on their criticality, and that implementation of these recommendations is a journey involving collective industry efforts. Clarity surrounding the anticipated implementation pathway is needed.

Clear interpretation of fiduciary and legal duties

A clear view of fiduciary duty is essential for financial services professionals who invest for and advise others. Many noted that widely used interpretations of fiduciary duty and materiality are lagging the evolving reality of climate change and its financial implications. Improved clarity and broader education is required.

A knowledgeable support ecosystem

The financial sector has strong support from its existing ecosystem of professional services such as lawyers, accountants, auditors, rating agencies and others. Their expertise in climate-related issues should be strengthened. This support system helps with disclosure of financial risks and the consideration of new opportunities. There is a common view that Canada's system of professional services is strong and well developed. However, expertise concerning climate-related issues remains nascent and requires further capacity building.

Effective and consistent financial regulation

As climate change effects continue to materialize, a maturation in understanding and focus will become increasingly important for Canada's financial industry leaders and the financial system's regulatory authorities. There was a common suggestion that Canada's financial authorities could benefit from greater cross-jurisdictional collaboration (both domestically and internationally) to promote knowledge sharing, capacity building and policy consistency on climate-related financial issues.

FINANCIAL PRODUCTS AND MARKETS

Building Retrofits for Energy Efficiency and Climate Adaptation

In Canada, buildings are a major source of GHG emissions, as our building stock is more energy intensive relative to other countries, including those with similar climates. As a result, there is tremendous opportunity to reduce Canada's footprint by retrofitting our existing building sector. Building retrofitting has the potential to be a winning proposition for all stakeholders, with energy savings for building owners, jobs for the construction industry, and increased lending activity at financial institutions. Many commentators suggested that there could be an opportunity to aggregate, warehouse and/or securitize retrofit projects.

Sustainable Infrastructure

Like many other parts of the world, Canada has a significant infrastructure gap. Given the related funding gap, we need to 'crowd in' substantial private sector capital toward sustainable infrastructure development, including the transformation needed in energy systems and transportation. The Panel heard that the Canada Infrastructure Bank is one such step, but that further avenues for attracting private investment in sustainable infrastructure may be required.

Cleantech Innovation

Cleantech is a massive cross cutting opportunity that provides a key link between increased economic efficiency and environmental outcomes, as well as jobs and wealth creation for our communities. It is integral to the solutions needed for buildings, infrastructure, and the oil and gas and electricity sectors. Participants noted a number of barriers to scaling up new technologies, but also identified a number of potential solutions such as green banks, reforms to government procurement, and pooled venture funds focused on commercializing and scaling up new companies.

Innovation in the Oil & Gas Industry

Canada has an outsized position in the global oil and gas industry, which will have continued importance during the transition. This sector faces pressure on many fronts, including the cost of and access to capital, market access, environmental performance, and investor actions towards divestment or exclusion from indices. We anticipate that future investment flows will be dependent on cost and environmental factors. We heard an imperative to focus on financing mechanisms to support innovation in this sector as a key enabler to its transition.

Optimized Electricity Generation and Transmission

Canada is one of largest and cleanest electricity generators in the world, and its electricity demand will grow under a transition to a low-carbon economy. Electricity has the potential to provide cost effective emission reductions related to transportation and heating and cooling, making it an important aspect of the transition. A well-connected electricity grid between key provinces could provide substantial benefits, and many expressed that financial structures could be created that would be attractive to infrastructure investors. We also heard that there is a significant investment opportunity at the local and regional levels, whether through decentralized, renewables-based micro grids or deployment of digitalization and smart grid technology. Strong support for these smaller, geographically targeted projects could come from green banks or other

centralized bodies that can source, structure and aggregate high potential projects into structured financing vehicles for public/private co-investment.

Sustainable Asset Management and Financial Products

Current practices in investment management and consulting, including the use of benchmarks, do not generally incorporate consideration for climate change. Furthermore, it is difficult for consumers to be aware of their investments' sustainability credentials. There was a consensus view that more reliable information and more reliable and analytical frameworks will be prerequisites for broader integration of Environmental, Social and Governance (ESG) factors. Integrating transition risks and opportunities into asset management will require a multi-faceted approach.

Green and Transition linked Financial Products

Green bonds and loans have proliferated as means for public or private institutions to fund sustainability-based projects, and for investors to put money to work in a sustainable manner. Nevertheless, the market remains relatively small and less liquid. Beyond green bonds, transition-linked bonds and loans are an emerging category of financial instrument that could help incentivize firms to meet their sustainability targets, by directly tying achievement of such targets to the firms' cost of capital. Many expressed interest in how a market for transition-linked financial products could help bridge the gap between green-focused investors and firms in emissions-intensive industries that are transitioning to more sustainable business processes.

Next Steps

Intended as a discussion paper, this Interim Report provides a snapshot of what the Expert Panel has heard and observed throughout its early consultations. The Report outlines the themes that have emerged as foundational to the mainstream uptake of sustainable finance in Canada. Building on those foundational elements, we also discuss a range of financial markets, activities and products for which there is considerable potential for Canadian strategic and commercial leadership in the trajectory to a more sustainable economic future.

This Interim Report also outlines a number of questions and ideas that we plan to explore further in consultations across Canada through the fall. Our intention is to move from identifying areas that require more attention to developing practical, actionable recommendations for the Government of Canada. While the Panel's recommendations will speak to the realm of federal jurisdiction, it is difficult within an interconnected system to act alone. Canada's clean growth trajectory is a long play, and will involve a broad suite of actions on the part of governments and businesses as well as integrated, multi-jurisdictional, multi-sector collaboration. Our aim is to deliver a final report of findings and recommendations to the Minister of Environment and Climate Change and the Minister of Finance in Spring 2019.

We are very grateful to the Ministers of ECCC and Finance for their foresight in establishing this panel, and to the many stakeholders that have taken the time to contribute thus far. We look forward to further engagement and delivering our final Report. The Panel would also like to thank the Ministers for their outstanding forethought and commitment to an inclusive and enduring future for Canada.



Tiff Macklem, Chair

Dean, Rotman School of Management

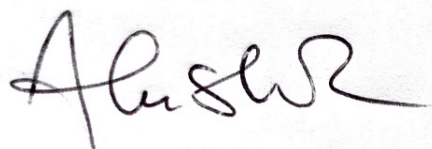
Director of Scotiabank, and former Senior Deputy of the Bank of Canada



Barbara Zvan

Chief Risk and Strategy Officer, Ontario Teachers' Pension Plan, and

Director Cadillac Fairview



Andy Chisholm

Director Royal Bank of Canada, and former Senior Global Strategy Officer and

Head of the Financial Institutions Group at Goldman Sachs



Kim Thomassin

Executive Vice-President of Legal Affairs and Secretariat at Caisse de dépôt et placement du Québec