IN-DEPTH

Sustainable Finance Law

CANADA

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Sustainable Finance Law

EDITION 2

Contributing Editor

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In-Depth: Sustainable Finance Law (formerly The Sustainable Finance Law Review) provides a practical global overview of the current state of sustainable finance and related regulatory efforts across multiple jurisdictions. It also tracks the evolution of sustainable finance and outlines key trends for the near future. Topics examined include sustainable disclosure requirements and taxonomies, sustainable finance instruments and incentives, and much more.

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Canada

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Summary

Introduction

In Canada, sustainable finance has developed within the voluntary frameworks and best practices developed through the International Capital Market Association's (ICMA) Green Bond Principles, Sustainability-Linked Bond Principles, Social Bond Principles and the *Climate Transition Finance Handbook*. There is broad market acceptance of the various sustainable finance instruments contemplated within these frameworks.

Growing market understanding of the importance of environmental, social and governance (ESG) considerations to stakeholders has led more companies to adopt voluntary sustainability disclosure frameworks, such as the Task Force on Climate-Related Disclosures (TCFD), but also others, as part of their regular disclosure, which, in turn, has facilitated the utilisation of sustainable financing instruments. More and more companies are adopting net-zero emissions targets in line with Canada's national commitments, including Canada's largest banks.

More regulation around ESG disclosure and sustainable finance is on the horizon, however. The federal government in Canada has recognised the potential for driving emissions reductions through climate-related regulatory requirements in the financial sector. Guidelines have been issued for federally regulated financial institutions, and additional proposed regulations are out for consultation. In response to the adoption of various voluntary ESG disclosure frameworks and different approaches to making those disclosures, the Canadian Securities Administrators (CSA) have issued proposed climate-related disclosure rules for public companies in an effort to standardise the disclosure approach, based on some of the principles from the TCFD. Following the release on 26 June 2023 by the ISSB of its climate-related disclosure standard and its general standard for sustainability-related financial information, the CSA announced its intention to conduct further consultations to adopt disclosure standards based on the ISSB standards with appropriate modifications for the Canadian context.[2] Rules have been clarified on disclosures by ESG funds.

Year in review

There have been a number of significant developments in Canada over the past year concerning sustainable finance.

Following Canada's issue of a C$5 billion green bond in early 2022, the Province of Quebec and the Province of Ontario have issued additional green bonds.

In July 2022, Ontario Power Generation Inc issued its second green bond with a use of proceeds including the development of nuclear power, demonstrating market acceptance of nuclear as 'green'.

Additional corporate issuers of green bonds during late 2022 and early 2023 include TransAlta, Innergex Renewable Energy and Brookfield Renewable Partners.

The trend of financial corporates issuing sustainable bonds has continued, including by iA Financial, OMERS Financial Trust and National Bank of Canada.

The Office of the Superintendent of Financial Institutions (OSFI) released its Guideline B-15: Climate Risk Management (the Guideline), which establishes a climate-sensitive prudential framework applicable to all federally regulated financial institutions (FRFIs).[3]

In September 2022, the Sustainable Finance Action Council issued its 'Taxonomy Roadmap Report'.[4] The stated primary purpose of the report is to mobilise finance for sustainable growth by defining green and transition investment, but the report also proposes that the methodology in the report could be used as a standardised tool to benchmark climate and transition activities. As a discussion document, it is being reviewed by the Canadian federal Minister of Finance and the Minister of Environment and Climate Change.[5]

Following the release on 26 June 2023 by the ISSB of its climate-related disclosure standard and its general standard for sustainability-related financial information, the CSA announced its intention to conduct further consultations to adopt disclosure standards based on the ISSB standards with appropriate modifications for the Canadian context.-[6] In 2021, the CSA published a proposed National Instrument 51-107 Disclosure of Climate-Related Matters and its proposed Companion Policy 51-107CP for comment.[7]

Regulation and policy

i Governance regime

Canada is a party to the Paris Agreement[8] and so is required to prepare, communicate and maintain successive nationally determined contributions (NDCs),[9] being reports that communicate the actions a party will take to adhere to the Paris Agreement (e.g., reduce its greenhouse gas (GHG) emissions and build resilience to adapt to the impacts of rising temperatures).[10] NDCs are to be updated every five years, with each iteration to be more ambitious than the previous one.

Most recently, Canada submitted an updated NDC on 12 July 2021 (the Updated NDC).[11] The most significant change in the Updated NDC is a commitment to reduce emissions by 40 to 45 per cent below 2005 levels by 2030. This is a substantial increase of ambition beyond Canada's original NDC, which had targeted a 30 per cent reduction below 2005 levels by 2030. The Updated NDC also outlines various climate-related action plans and investments that the Canadian government will take to adhere to the Paris Agreement.

One of these items is the Canadian Net-Zero Emissions Accountability Act.[12] The Canadian Net-Zero Emissions Accountability Act is the legislation that enshrines Canada's commitment to net zero by 2050.[13] In particular, Section 6 states: 'The national greenhouse gas emissions target for 2050 is net-zero emissions.'[14]

The Net-Zero Emissions Accountability Act became law on 29 June 2021. Along with setting the 2050 target, the Net-Zero Emissions Accountability Act requires the Minister of the Environment to set national GHG emissions targets for each milestone year with a view to achieving net zero by 2050.[15] Each milestone target must be a progression from the previous one.[16] The Net-Zero Emissions Accountability Act provides that the 2030 GHG emissions target is Canada's NDC for that year under the Paris Agreement.[17] Therefore, the Net-Zero Emissions Accountability Act codifies Canada's NDC, which was updated in

2021, to set the target of reducing emissions by 40 to 45 per cent below 2005 levels by 2030.[18]

The Minister is also required to set plans for achieving each target and prepare at least one progress report for each milestone year no later than two years before the beginning of the relevant year.[19] The Net-Zero Advisory Body was also established pursuant to this Act. The role of the Advisory Body is to give advice on how Canada can achieve its goal of net-zero GHG emissions by 2050.[20]

Pursuant to the Net-Zero Emissions Accountability Act and other legislation, Canada's federal government has started to announce emissions reduction targets for various sectors, including oil and gas, power, transportation and agriculture, to align those sectors' emissions targets with those in Canada's Updated NDC. The exact application of these targets within industries is still being worked out, but those industries understand the direction of travel of government policy and, in turn, have been establishing their own net zero targets.

Directly relevant to sustainable finance is the 2022 introduction of Bill S-243[21] (the Bill), which would enact the Climate-Aligned Finance Act, for a first reading of the Senate on 24 March 2022. Before the Bill can become law, it will be debated at the second reading of the Senate, studied by a parliamentary committee, debated at a third reading of the Senate and then voted on. If the Bill passes the vote at the third reading of the Senate, it will go through the same process in the House of Commons.[22] It is fair to say that the actual enactment of this Bill into law is somewhat uncertain in terms of both timing and eventual content, but it is indicative of the federal government's approach and of its understanding of using the levers available to it to drive certain behaviours in the financial sector.

The purpose of the Climate-Aligned Finance Act is to require certain financial and other federally regulated entities to mitigate and adapt to the impacts of climate change.[23] The Climate-Aligned Finance Act is structured to align with and support the climate commitments that Canada has made under, among other agreements and commitments, the Paris Agreement[24] and the Net-Zero Emissions Accountability Act.[25]

The Act would require, among other things:

1. disclosures, for example:
    - 'reporting entities' (defined below) must publicly report their plans and targets;[26] and
    - a 'federal financial institution' (as defined below) must disclose how it 'financially facilities'[27] entities in a manner that either aligns or does not align with climate commitments;[28]
2. creation of policy, for example:
    - the Superintendent of Financial Institutions must establish guidelines to account for climate-related risks for banks and certain other entities regulated by the Bank Act;[29] and
    - the creation of an action plan to incentivise financial products that support climate commitments and disincentivise those that are inconsistent with climate commitments;[30] and

3. climate corporate governance, for example:
    - certain enumerated entities must appoint board members with 'climate expertise';[31] and
    - directors, officers or administrators of 'reporting entities' (as defined below) exercise their powers in a way that enables alignment with climate commitments.[32]

A 'reporting entity' includes 'federal financial institutions' (as defined below), along with (1) a corporation within the meaning of the Canada Business Corporations Act; (2) a work, undertaking or business within the legislative authority of Parliament that is described in any of Paragraphs (a) to (e) or (j) of the definition of 'federal work, undertaking or business' in Section 2 of the Canada Labour Code; and (3) an entity listed in Schedule III of the Financial Administration Act.[33]

A 'federal financial institution' includes, among other entities: (1) the Bank of Canada; (2) a bank within the meaning of the Bank Act; (3) the Canada Infrastructure Bank; (4) the Canada Deposit Insurance Corporation; (5) the Canada Mortgage and Housing Corporation; (6) Export Development Canada; (7) Farm Credit Canada; and (8) the Canada Pension Plan and the Canada Pension Plan Investment Board.

The Act would also provide the Superintendent of Financial Institutions to make any order they consider appropriate to certain federal financial institutions if, in their opinion, doing so is in alignment with climate commitments.[34]

More specific climate-related disclosure requirements that would apply to all FRFIs have been issued by OSFI.[35] Together with commitments banks have made within the NZBA, these disclosure requirements are expected, over time, to incentivise the use of sustainable finance instruments.[36]

The CSA have proposed climate-related disclosure rules that would apply to public companies in Canada.[37]

ii Regulators

At the time of writing, in Canada, sustainable finance frameworks are voluntary and market-driven. Issuers and banks reference the frameworks established by the ICMA, including the Green Bond Principles, the Social Bond Principles, the Sustainability-Linked Bond Principles and the *Climate Transition Finance Handbook*.

Efforts are under way to develop a 'made in Canada' transition financing taxonomy, pursuant to recommendations of an expert panel on sustainable finance.[38] An overview of the Sustainable Finance Action Council (SFAC)'s proposed taxonomy will follow; however, at the time of writing, the taxonomy has not been finalised. As such, any offering in Canada of securities labelled pursuant to one of the sustainable finance labels is regulated by generally applicable securities laws.

Sustainable finance instruments

Generally, all types of sustainable finance are supported in Canada, including green, social, sustainability and sustainability-linked loans and bonds.

In the Canadian market, it is generally understood that green loans and bonds can be issued by issuers whose business involves fossil fuels, though the use of proceeds cannot be fossil fuel-related (see, for example, Capital Power Corporation's green bond framework). Issuers in these types of industries can issue green bonds and use the proceeds to develop green and renewable power projects, for example, to transition their businesses towards renewable power. Canada has issued a C$5 billion tranche of green bonds. The eligible use of proceeds are terrestrial and aquatic biodiversity conservation, sustainable water management, sustainable management of living natural resources, renewable energy, pollution prevention and control, energy efficiency, eco-efficient products, production technologies and processes, climate change adaptation and clean transportation (see also Ontario Power Generation Inc's green bond issuance where the proceeds have been used to refurbish nuclear power generation facilities).

The Province of Quebec and the Province of Ontario also have issued green bonds, as has the City of Toronto. Other corporates that have more recently issued green bonds include TransAlta, Innergex Renewable Energy and Brookfield Renewable Partners.

Companies in traditional fossil fuel-related businesses have used sustainability-linked products with key performance indicators (KPIs) including emissions and emissions intensity (see, for example, Enbridge Inc's sustainability-linked bond framework and Tamarack Valley Energy Ltd's sustainability-linked bond framework). Enbridge Inc's sustainability-linked financing framework includes a target of reducing Scope 1 and 2 GHG intensity by 35 per cent by 2030 relative to 2018. Tamarack Valley's sustainability-linked financing framework includes the target of reducing Scope 1 and 2 emissions intensity by 39 per cent by 2025 over the 2020 baseline.

The Canadian market has seen the issuance of use of proceeds social bonds. For example, the City of Toronto has issued several tranches of social bonds where the use of proceeds is social and affordable housing, affordable basic infrastructure, access to essential services and socioeconomic advancement and empowerment. Other social bond examples include issuance into Canada by the International Finance Corporation where the use of proceeds was for benefiting underserved communities in emerging markets, including women entrepreneurs and low-income people in need of access to healthcare and essential infrastructure.

Sustainability bonds have been issued in Canada with broad ESG use of proceeds objectives. These typically have been issued by banks with the use of proceeds dedicated to certain uses. The Toronto Dominion Bank issued a sustainability bond with use of proceeds being access to essential services; affordable basic infrastructure; affordable housing; clean transportation; employment generation, including through the potential effect of small and medium-sized enterprise (SME) financing and microfinance; energy efficiency; green buildings; pollution prevention and control; renewable energy; socioeconomic advancement and empowerment; sustainable management of living natural resources; and sustainable water management. ScotiaBank issued a sustainability bond with a use of proceeds being terrestrial and aquatic biodiversity conservation; sustainable water management; sustainable management of living natural resources; renewable energy; pollution prevention and control; green buildings; energy efficiency; employment generation, including through the potential effect of SME financing and microfinance; clean transportation; affordable housing; affordable basic infrastructure; and access to essential services. A portion of the proceeds of the ScotiaBank bond was dedicated to support the Scotiabank Women Initiative, which was intended to help promote businesses owned and led by women. Other recent issuances of sustainable bonds include OMERS Financial Trust, iA Financial and National Bank of Canada.

Companies have also established social and governance-based KPIs and targets for sustainability-linked bonds and loans. Enbridge Inc's sustainability-linked financing framework includes Enbridge's racial and ethnic diversity performance target to boost racial and ethnic diversity to 28 per cent by 2025 from the current 21 per cent level. The framework also includes a target related to achieving 40 per cent female board representation by 2025. Tamarack Valley Energy's sustainability-linked bond includes a target of increasing indigenous workforce participation to 6 per cent or greater by 2025.

Drafting of sustainable finance provisions is still developing but is tending to follow international models.

Sustainable disclosure requirements and taxonomy

At the time of writing, there are limited legally mandated sustainability disclosure requirements.

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i Diversity disclosure

The principle legal requirements concern mandatory diversity disclosure by public companies. For example, since 2014, companies listed on the Toronto Stock Exchange (TSX) have been required to make diversity-related disclosures in their annual disclosure documents on a 'comply or explain' basis, including:

1. on their policies and targets regarding the representation of women on the board of directors and in executive positions; how representation of women is taken into account in selecting board and executive officer candidates;
2. gender representation on the board and in executive officer positions; and
3. term limits.[39]

See also National Instrument 58-101 (NI 58-101) of the CSA Disclosure of Corporate Governance Practices.[40]

Public corporations governed by the Canada Business Corporations Act have been required to make diversity-related disclosure regarding women, indigenous peoples, persons with disabilities and members of visible minorities (designated groups) since 2020 on a comply or explain basis.[41] These requirements include disclosure of term limits or other board renewal mechanisms, a description of written diversity policies for the selection of individuals from the designated groups as board nominees and a description of progress made in achieving the policy's objectives, whether the level of representation of designated groups on the board or in senior management is considered in appointing new candidates, whether targets have been established for representation of the designated groups on the board and in senior management, as well as progress towards those targets, and the number of members of each of the designated groups on the board and in senior management. New guidelines for making this disclosure were published by Corporations Canada in February 2022.[42]

Increasingly, governance ratings organisations and industry groups developing best practices are focusing on gender and other diversity measures as critical elements of measuring or rating corporate governance (see, for example, the Canadian Coalition for Good Governance and The Globe and Mail Board Games).

On 13 April 2023, the CSA issued a notice and request for comment, proposing amendments to NI 58-101 and National Policy 58-201 Corporate Governance Disclosure with revised disclosure requirements in respect of board and executive diversity, including in respect of women, indigenous peoples, racialized persons, persons with disabilities and LGBTQ2SI+ persons, board renewal and board nominations.[43] The CSA continue to consider whether the diversity disclosure model should move from comply or explain to mandatory disclosure around certain diversity categories.

ii Climate-related disclosure

On 18 October 2021, the CSA published a proposed National Instrument 51-107 Disclosure of Climate-Related Matters and its proposed Companion Policy 51-107CP (Climate Disclosure Proposals) for comment.[44] The proposed instrument would apply to public companies in Canada, regardless of jurisdiction of incorporation. For TSX-listed corporations with 31 December year ends, the proposed rules would take effect for annual filings made in early 2024.

Canadian companies have started to make voluntary disclosure of climate-related matters following the various voluntary frameworks and standards. Companies have adopted different approaches to the location, style and content of their disclosure, and one of the stated aims of the CSA proposals is to bring some standardisation to the disclosure to allow greater comparability for investors.

The Climate Disclosure Proposals would require disclosure based on recommendations of the TCFD. The Climate Disclosure Proposals would require issuers to make disclosure in the following areas:

1. governance: describing the board's oversight of climate-related risks and opportunities and management's role in assessing and managing climate-related risks and opportunities;
2. strategy: describing any climate-related risks and opportunities identified over the short, medium and long term, and describing the impact of these risks and opportunities on its business, strategy and financial planning;
3. risk management: describing its processes for identifying, assessing and managing climate-related risks and how these processes are integrated into overall risk management; and
4.

metrics and targets: describing its metrics used to assess climate-related risks and opportunities and targets used to manage these risks and opportunities.

The TCFD contemplates that issuers should disclose GHG emissions (Scope 1, 2 and 3). The Climate Disclosure Proposals would require issuers to make this disclosure or explain why they do not. The Climate Disclosure Proposals would not require issuers to disclose the resilience of their strategy with reference to various climate scenarios – a key element of the TCFD recommendations.

Subsequent to the release of the Canadian proposals, the US Securities and Exchange Commission (SEC) released its own proposal on the same disclosure area, and the International Sustainability Standards Board (ISSB) released two disclosure proposals on sustainability and climate change disclosure. Both the SEC's and the ISSB's proposals went further than the CSA proposals in a number of areas. On 12 October 2022, the CSA announced that it was actively considering the impact of international developments including the ISSB and SEC proposals on its climate-related disclosure proposals.[45] On 26 June 2023, the ISSB published its climate-related disclosure standard as well as its general standard for sustainability-related financial information, intended as a 'global baseline' with the approval of the International Organization of Securities Commissions. Following the release of these two standards, on 5 July 2023, the CSA announced its intention to conduct further consultations to adopt disclosure standards based on the ISSB standards with appropriate modifications for the Canadian context.[46] While the CSA has not announced what those modifications might be, in its submissions to the ISSB on its standards, the CSA recommended that climate-related standards should be developed first, with general sustainability standards in the future, that disclosure standards should be phased in and scaled to accommodate smaller issuers, that industry-specific guidance should be provided that initially would not be mandatory and that disclosure standards should be aligned internationally. At the time of writing, it is unclear when the CSA will publish an updated version of its climate-related disclosure proposals.

iii ESG-related investment fund disclosure

On 19 January 2022, the CSA released Staff Notice 81-334 ESG-Related Investment Fund Disclosure (the Notice) to provide guidance on the disclosure practices of investment funds as they relate to ESG considerations.[47] The issuance of the Notice follows a considerable increase in interest in ESG investing in Canada for both retail and institutional investors.

The CSA have emphasised that the guidance provided in the Notice is based on existing securities regulatory requirements and does not create any new legal requirements or modify existing ones. Rather, the Notice clarifies and explains how the current securities regulatory requirements apply to ESG-related investment fund disclosure, with the view of enhancing and bringing greater clarity to ESG-related disclosure and sales communications to enable investors to make more informed investment decisions.

An increase in ESG interest among investors, as well as the potential for 'greenwashing', whereby a fund's disclosure or marketing intentionally or inadvertently misleads investors about ESG-related aspects of the fund, are cited in the Notice as having led securities regulators and international organisations to directly address issues relating to ESG investing. Notably, the International Organization of Securities Commissions published a final report in November 2021, setting out recommendations for securities regulators and policymakers to improve sustainability-related practices, policies, procedures and disclosure in the asset management industry. In the same month, the CFA Institute published its Global ESG Disclosure Standards for Investment Products with the aim of providing greater transparency and comparability to investors by facilitating clear communication of ESG-related features of investment products from asset managers.

In Canada, the CSA have conducted continuous disclosure reviews of regulatory disclosure documents and sales communications of ESG-related funds. The findings of these reviews are summarised within the Notice. Although the CSA consider current disclosure requirements to be broad enough in scope to address ESG-related disclosure, in their view, additional guidance was needed to clarify how the current disclosure requirements apply to improve the quality of ESG-related disclosure and sales communications.

The Notice sets out guidance on how existing securities regulatory requirements apply to investment funds as they pertain to ESG considerations in the following areas.

Investment objectives and fund names

Under securities laws, an investment fund (in its prospectus) is required to disclose the fundamental investment objectives of the fund, as well as information that describes the fundamental distinguishing features of the fund. To prevent greenwashing, a fund's name and investment objectives should accurately reflect the extent to which the fund is focused on ESG and, where applicable, the particular ESG-related aspects the fund is focused on. To ensure consistency, where a fund's name references ESG, the fundamental investment objectives of the fund are required to reference the ESG-related aspect included in the name.

Fund types

Non-exchange traded mutual funds are required to identify the type of mutual fund that the fund is best characterised as in its prospectus. In the CSA's view, where a fund does not include ESG considerations in its investment objectives, it should not characterise itself as a fund focused on ESG, and, conversely, where ESG considerations are so included, a fund may characterise itself as a fund focused on ESG.

Investment strategies disclosure

The Notice sets out guidance for investment strategies disclosure applicable to all funds and specific guidance applicable only to funds that use any of the following: (1) proxy voting or shareholder engagement as an ESG strategy; (2) multiple ESG strategies; and (3) ESG ratings, scores, indices or benchmarks.

Guidance applicable to all funds

An investment fund is required to provide full, true and plain disclosure of all material facts in its prospectus. To enable investors to understand the ways in which a fund will meet its ESG-related investment objectives, where applicable, and make investments, full, true and plain ESG-related investment strategies disclosure must be made. ESG strategies, if used either principally or as part of its investment selection process, require disclosure of the ESG-related aspects of the fund's investment selection process and strategies. Description of these strategies must be written using plain language.

Further, the CSA take the view that investment strategies disclosure should identify the ESG factors used and explain their respective meanings, as well as how they are evaluated and monitored.

Guidance applicable to certain funds only

Funds that use proxy voting or shareholder engagement as a strategy to select investments are required to disclose how they are used by the fund. In the CSA's view, disclosure should include the criteria used by the strategy, the goal of the strategy and the extent of the monitoring process used to evaluate progress towards such goal.

If multiple ESG strategies are used, disclosure explaining how the different strategies are applied during the investment selection process is required. In addition, if the strategies are not applied simultaneously, disclosure must include the order in which they are applied.

In the CSA's view, where an ESG-related fund uses ESG ratings, scores, indices or benchmarks as part of its principal investment strategies or investment selection process, disclosure in relation to how these ratings, scores, indices or benchmarks are used should be provided.

Proxy voting and shareholder engagement policies and procedures

An investment fund that uses proxy voting as an ESG investment strategy must include a summary of the ESG aspects of the fund's proxy voting policies and procedures in the fund's prospectus or annual information form, as applicable. This inclusion can provide clarity about how voting rights will be used to further the fund's ESG investment objectives.

Further, the CSA encourage investment funds that use shareholder engagement as an ESG strategy to make their shareholder engagement policies and procedures publicly available to achieve greater transparency for investors.

Risk disclosure

In keeping with the requirement for a fund to disclose any material risks associated with an investment in the fund, the CSA encourage all investment funds to consider whether any material ESG risk factors are relevant to the fund and to disclose these risk factors, if applicable.

Suitability

As mentioned above, a fund's name and investment objectives should accurately reflect the extent to which the fund is focused on ESG. Similarly, the CSA highlight that brief statements of a fund's suitability for particular investors should also accurately reflect the extent of the fund's focus on ESG and any particular aspects of ESG that the fund is focused on.

Continuous disclosure

Funds that have ESG investment objectives can help prevent greenwashing by providing useful continuous disclosure that allows investors to monitor and evaluate the fund's ESG performance. ESG-related funds are required to disclose how the composition of the investment portfolio relates to the fund's ESG investment objectives or strategies, as applicable, in its management reports of fund performance. Further, the CSA encourage funds with a measurable ESG outcome to report whether the outcome is being achieved in the same reports. Investment fund managers are also encouraged to regularly assess, measure and monitor the ESG performance of the funds they manage, to ensure that useful disclosure is provided.

If a fund uses proxy voting as an ESG strategy to meet its ESG investment objectives, the fund is encouraged to include disclosure of all of the fund's annual proxy voting records on its websites, despite the current requirement that only the most recent annual proxy voting record be made available. The CSA take the view that this disclosure would provide greater transparency into how the fund has historically made use of proxy voting to meet its ESG considerations. For the same reason, funds that use shareholder engagement as an ESG strategy are also encouraged to provide disclosure of past shareholder engagement activities.

Sales communications

Sales communications containing ESG considerations must not be misleading or untrue and should be consistent with a fund's regulatory offering documents so as to not intentionally or inadvertently mislead investors about ESG aspects of the fund.

Sales communications indicating that a fund is focused on ESG

The extent to which a fund is focused on ESG should be accurately reflected in any sales communication pertaining to the investment fund. Further, the CSA believe that a fund should not indicate that it is focused on ESG in its sales communications unless ESG is referenced in its investment objectives.

Sales communications referencing a fund's ESG performance

A fund must not include misleading statements about ESG performance of the fund in its sales communications.

Sales communications including ESG ratings, scores or rankings

Similarly, sales communications that include fund-level ESG ratings, scores or rankings must not be misleading. In the Notice, the CSA provide specific guidance on how to avoid issues such as: (1) conflicts of interest involving the provider of the ESG rating, score or ranking; (2) cherry-picking ESG ratings, scores or rankings; (3) selecting ESG ratings, scores or rankings that are not representative of the ESG characteristics or performance of the fund; and (4) omission of necessary or appropriate explanations, qualifications or limitations.

ESG-related changes to existing funds

To the extent that any references to ESG are added or removed from the fundamental investment objectives of a fund, that fund will be subject to the requirement that approval of its security holders be obtained prior to the making of any change to the fund's fundamental investment objectives. If an investment fund changes its name to add or remove a reference to ESG, as mentioned above, similar consideration should be given to changing the fund's fundamental investment objectives.

ESG-related terminology

A fund's prospectus should provide a clear explanation of any ESG-related terms that are not commonly understood.

Investment fund manager-level commitments to ESG-related initiatives

If investment fund managers are signatories to certain international or regional ESG-related initiatives and publicly disclose this information, the CSA highlight the importance of clarifying that commitments to these initiatives are at the entity level, rather than at the fund level.

iv Proposed transition taxonomy

In May 2021, the federal government launched the Sustainable Finance Action Council (SFAC) to, among other things, develop a green and transition finance taxonomy for Canada. The Taxonomy Roadmap Report (the Taxonomy Report), which proposes a voluntary taxonomy to benchmark and standardise economic activities to align with Canada's climate commitments, was published by the SFAC in September 2022.[48]

The Taxonomy Report provides guidance on several transition finance-related objectives, including climate-related disclosures and the classification of financial instruments and related projects as 'green' or 'transition', or both.[49] The Taxonomy Report outlines a set of general requirements an issuer must abide by to support a credible transition plan. These requirements are: (1) setting a credible and science-based, net-zero emissions target for 2050 or earlier and an interim target for 2030 on the path toward net-zero, and preferably at least one more additional interim targets between 2030 and 2050 and using a 1.5C degree target; (2) report publicly on progress annually and review and update plans every five years; and (3) prepare climate-related disclosures for the public, basing them on the recommendations of the TCFD in the short-term, and then in compliance with emerging domestic regulatory requirements and international standards. All Scope 1, 2 and 3 emissions are to be considered. A number of principles are outlined in the report for assessing whether a particular activity is eligible for the 'transition' label. Generally these principles require assessing the proportionality of an activity's Scope 3 emissions against the expected decline in global demand for the activity's output (i.e., the extent of carbon lock in), and then assessing whether the activity significantly reduces Scope 1 and Scope 2 emissions and avoids supply side carbon lock in.

The Taxonomy Report also incorporates do no significant harm criteria, which is intended to be informed by the European Union criteria, but are adapted to meet unique Canadian needs. The specified criteria are a work in progress, but currently require that an activity complies with the following:

1. no significant harm to environmental outcomes: the activity must meet minimum requirements for water, biodiversity, pollution and waste impacts;
2. no significant harm to climate resilience: the activity incorporates best practices to reducing physical risk;
3. no significant harm to indigenous rights: the activity demonstrates adherence to the UN Declaration on the Rights of Indigenous Peoples; and

no significant harm to workers or just 's Deputy Prime Minister and Minister of Finance as well as the Minister of Environment and Climate Change for consideration and action in the autumn of 2022. To date, the Ministers have not provided their response. In the interim, the SFAC is directing the development of the taxonomy introduced in the Taxonomy Report with a focus on establishing voluntary issuance requirements and green and transition criteria for an initial set of priority sectors and activities. At this point, the status of the Taxonomy Report is unclear though it is expected that it will inform federal government policy.

v Federally regulated financial institutions

In March 2023, OSFI, which is the federal government agency that regulates and supervises FRFIs, issued 'Guideline B-15: Climate Risk Management', which specifies climate-related disclosure for FRFIs. See Section VII.

ESG data, ratings and reporting

At the time of writing, beyond FRFIs, mandatory reporting relating to sustainable investments is limited to diversity matters.[50] Broadly applicable industry-specific regulation can require reporting of various metrics to applicable regulators, and some of this reporting includes information relevant to sustainability topics. Some of this reporting is public and some is confidential. Since this type of reporting is not tied to sustainable investments, it is not dealt with further in this chapter. Its existence is relevant to note, however, since the argument for more sustainability disclosure is often based on the fact that disclosure is being made to regulators in any event.

Reporting relating to sustainable investments is being made by numerous companies on a voluntary basis. This disclosure is being made under voluntary frameworks and standards like the TCFD, or in the context of specific issuances in accordance with the relevant ICMA principles.[51] This has led to an environment where disclosure varies across companies in terms of location, content and style (and in some cases not at all), which, in turn, has led investors to push for mandatory disclosure requirements.[52]

Various proposals are being considered at the time of writing that would impose mandatory data and reporting requirements.[53] These proposals generally are intended to apply to public companies.

At the time of writing, there are no regulatory requirements that apply specifically to ESG ratings services.

Sustainable finance incentives

At the time of writing, there are no direct government incentives to use sustainable finance instruments. There are, however, indirect longer-term, market-based incentives developing to push companies towards adopting sustainable finance instruments. Major providers of capital in Canada will become subject to climate-related disclosure obligations that will incentivise those institutions to prefer to lend pursuant to sustainability-type financing instruments so that they are comfortable that their lending portfolios will, over time, represent lower GHG emissions. The most immediate disclosure obligations on the horizon are those in the OSFI climate risk management Guideline B-15 and commitments made by financial institutions that have signed on to the NZBA.

At the time of writing, there are no direct government incentives to use sustainable finance instruments. There are, however, indirect longer-term, market-based incentives developing to push companies towards adopting sustainable finance instruments. Major providers of capital in Canada will become subject to climate-related disclosure obligations that will incentivise those institutions to prefer to lend pursuant to sustainability-type financing instruments so that they are comfortable that their lending portfolios will, over time, represent lower GHG emissions. The most immediate disclosure obligations on the horizon are those in the OSFI climate risk management Guideline B-15 and commitments made by financial institutions that have signed on to the NZBA.

i Guideline B-15

In March 2023, OSFI, which is a federal government agency that regulates and supervises FRFIs issued 'Guideline B-15: Climate Risk Management' (the Guideline). The Guideline applies to all FRFIs, with the exception of foreign bank branches[54] and sets out expectations the management of climate-related risks by FRFIs and imposes a mandatory climate-related financial disclosure framework for FRFIs. These Guidelines are broadly consistent with the climate-related disclosure standards published by the ISSB in June 2023.

Chapter 1 of the Guideline set out expectations to the governance and risk management of climate-related risks. Specifically, FRFIs are required to develop and implement a climate transition plan (the Plan) that both identifies physical and transitional risks related to climate change and addresses the FRFI's management and mitigation thereof.[55] To measure progress, performance metrics and targets are to accompany the Plan. In addition, FRFIs are expected to use climate scenario analysis and stress testing to evaluate the efficacy of business strategies and business models and to maintain sufficient capital and liquidity with which to buffer any climate-related risks.[56]

Chapter 2 of the Guideline establishes a mandatory climate-related financial disclosure regime. This chapter applies to all FRFIs in the scope of the Guideline, except for subsidiaries of FRFIs that report consolidated results to OSFI.[57] The minimum mandatory climate-related financial disclosure expectations are divided into four categories[58] as follows:

1. governance;
2. strategy;
3. risk management; and
4. metrics and targets

Governance disclosure expectations are to:

1. describe the board of director's oversight of climate-related risks and opportunities; and
2. state management's role in assessing and managing climate-related risks and opportunities.

Strategy disclosure expectations are to:

1. describe the climate related risks and opportunities the FRFI has identified over the short, medium, and long term.
2. state the impact of climate-related risks and opportunities on the FRFI's businesses, strategy, and financial planning.
3. describe the FRFI's Plan (implementation date to be determined); and
4. describe the resilience of the FRFI's strategy, taking into consideration different climate-related scenarios, including a scenario which limits warming to the level aligned with the latest international agreement on climate change, or lower (implementation date to be determined).

Risk Management disclosure expectations are to:

1. describe the FRFI's processes for identifying and assessing climate-related risks;
2. describe the FRFI's processes for managing climate related risks.
3. state how processes for identifying and managing climate related risks are integrated into the FRFI's overall risk management.

Metrics and targets disclosure expectations are to:

1. disclose the metrics used by the FRFI to assess climate-related risks and opportunities in line with its strategy and risk management (implementation date to be determined and eventually to be supplemented with (1) OSFI-specified prudential cross-industry metrics; and (2) OSFI-specified prudential industry-specific metrics);
2. disclose the FRFI's Scope 1 and 2 GHG emissions (absolute basis) for the period. If the reporting standard used by the FRFI is not the GHG Protocol Corporate

Standard, disclose how the reporting standard used by the FRFI is comparable with the GHG Protocol Corporate Standard;

3. disclose the FRFI's Scope 3 GHG emissions for the period (absolute basis) and the related risks. If the reporting standard used by the FRFI for Scope 3 emissions is not the Corporate Value Chain (Scope 3) Accounting and Reporting Standard, disclose how the reporting standard used by the FRFI is comparable with the Corporate Value Chain (Scope 3) Accounting and Reporting Standard. For financed, facilitated and insured Scope 3 GHG emissions, if the reporting initiative used by the FRFI is not the PCAF Standard, then disclose how the reporting initiative used by the FRFI is comparable to the PCAF Standard;
4. state the targets used by the FRFI to manage climate-related risks and opportunities and the FRFI's performance against these targets; and
5. disclose any public climate-related commitments, if the FRFI has made one or more, through an industry-led Net-Zero alliance (e.g., NZBA).[59]

Most of the Guideline disclosure requirements will be in effect for domestic systemically important banks (D-SIBs) and internationally active insurance groups headquartered in Canada at fiscal year end 2024, with other FRFIs to begin disclosures for fiscal year ends 2025 and 2026 in accordance with Annex 2-2 of the Guideline. Once the Guideline becomes effective, FRFIs are required to make applicable disclosures no later than 180 days after fiscal year end and must publish their relevant disclosures on an annual basis.

At some point, banks will be looking to their borrowers to provide information the banks will need to determine their Scope 3 GHG emissions.

ii NZBA

At the time of writing, eight Canadian institutions have joined the NZBA. The first Canadian member was Vancity, which became a founding signatory on 21 April 2021.[60] On 21 October 2021, the D-SIBs, being the Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, National Bank of Canada, Royal Bank of Canada and Toronto Dominion Bank, also became NZBA signatories.[61] In the months that have followed, Coast Capital Savings, a credit union operating wholly in British Columbia, is the only other Canadian institution to join.

The NZBA was convened by the United Nations Environment Programme Finance Initiative. It represents a group of banks committed to aligning their lending and investment portfolios with net-zero emissions by 2050.[62] Two structures drive the NZBA's goal towards net-zero emissions. First, it establishes a platform for members to demonstrate leadership, consistency and credibility of action.[63] To this end, the NZBA provides a common standard for '1.5 degrees trajectory', which, in turn, enhances accountability to the commitment. Second, it provides a structured forum to support member transitions by showcasing potential implementation approaches, sharing experiences to accelerate progress and facilitating the transfer of resources, methodologies and leading practices.[64]

To join the NZBA, each bank must have its chief executive officer sign a commitment statement that describes the target-setting and reporting process said to be the primary catalyst for achieving the net-zero transition.[65] All signatories must commit to the following:

1. to transition the operational and attributable GHG emissions from their lending and investment portfolios to align with pathways to net zero by 2050 or sooner;
2. within 18 months of joining, to set 2030 targets (or sooner) and a 2050 target, with intermediary targets to be set every five years from 2030 onwards;
3. the banks' first 2030 targets will focus on priority sectors where the bank can have the most significant impact (i.e., the most GHG-intensive sectors within their portfolios), with further sector targets to be set within 36 months;
4. to publish absolute emissions and emissions intensity annually in line with best practice, and within a year of setting targets disclose progress against a board-level reviewed transition strategy, setting out proposed actions and climate-related sectoral policies; and
5. to take a robust approach to the role of offsets in transition plans.[66]

At the time of writing, seven of the eight the Canadian institutions that have joined the NZBA have met their commitment to set targets for 2030, which can be found online.[67]

Carbon markets and carbon trading

As more and more Canadian companies and organisations pledge to their consumers, stakeholders, investors that they will achieve net zero or reduce emissions, interest in participating in carbon markets to meet ESG goals has skyrocketed. In Canada, the implementation of carbon pricing mechanisms has been a key government strategy for addressing climate change and is receiving increased interest from investors as the benefits of emphasising the calculable reductions in carbon-intense activities are recognised. In particular, Canada's 'compliance' markets, where an emitter of GHGs is obligated to reduce its emissions to remain compliant with the regime, incentivises the development of clean technologies and the implementation of these technologies as best practices.[68] The compliance carbon markets in Canada employ various pricing mechanisms, including carbon taxes, cap-and-trade systems and hybrid approaches. Carbon taxes impose a fee on each ton of carbon emitted, incentivising emission reductions. Cap-and-trade systems set a limit on emissions and allow entities to trade emission allowances, promoting market-driven emission reduction efforts. Hybrid approaches combine elements of both systems to optimise effectiveness.[69]

The Province of Alberta, while being an early creator of a compliance regime and having a well-established, robust market, is more recently receiving substantial interest by ESG-focused investors and renewables developers due to its carbon offset creation protocols for renewables, pneumatics and carbon capture, usage and storage (CCUS). While participation in the Technology Innovation and Emissions Reduction Regulation[70] (TIER) is required by large-scale industrial facilities emitting 100,000 million tons or more of GHG emissions annually, there is also an opt in process for other facilities, which is increasingly being utilized by smaller emitters to measure, track and validate compliance. Options to meet a compliance include: (1) paying into the TIER fund; and (2) buying, or producing, emission offsets generated by facilities that voluntarily reduce or sequester GHG emissions – and retiring these offsets against one's obligations.[71]

] An Alberta-situated company can create emission offsets under the TIER programme if it does so in accordance with a wide range of approved protocols, creating an incentive to implement certain technologies or to invest in renewables. Credit usage is currently limited to 60 per cent of an emitter's compliance requirement for the 2023 compliance year, and will be raised by 10 per cent until it reaches 90 per cent in 2026.[72] Once those offsets are created, developers can sell them into the market – to an intermediary such as a broker or retailer or directly to a party wishing to retire the credits.

Quebec's cap-and-trade system for regulating GHG emission allowances has been in existence for over a decade. Since 1 January 2014, Quebec has linked the CITSS carbon credit market with California (where the governing body is the California Air Resources Board), forming the largest carbon market in North America.[73] Regulated emitters may only use offset credits to satisfy up to 8 per cent of their emission target.[74] However, the Quebec system, similar to Alberta, is open to non-regulated entities to participate and voluntarily opt in to participate in the purchase, hold, sale, transfer and withdrawal of emission allowances.

More recent and rapidly expanding markets are the British Columbia compliance market and the Federal CFR.

In British Columbia, compliance carbon credit trading and use is governed by the Greenhouse Gas Industrial Reporting and Control Act (GGIRCA)[75] and its associated regulations. The GGIRCA legislative regime creates an output-based pricing system for liquefied natural gas projects and facilities that produce 10,000 tonnes or more of carbon dioxide equivalent during a reporting period. Canada's Clean Fuel Regulations[76] (CFR) are a set of rules and requirements implemented by the federal government to reduce GHG emissions from the transportation sector. These regulations aim to encourage the use of cleaner fuels and technologies to mitigate climate change by implementing emission reduction strategies, supplying more low-carbon fuels and fuel switching. Obligatory as of 1 July 2023, the CFR take a life cycle approach to emissions calculations – taking into account the emissions associated with all stages of fuel production and use – from extraction through processing, distribution and end use.[77] The demand for CFR credits will ideally create a market signal for new and expanded investment in low carbon intensity fuels and technologies, including for voluntary parties such as biofuel producers and other lower carbon fuel producers to create and sell credits.[78] Similarly, CFR is intended to create opportunities for feedstock providers to produce low-carbon fuel.[79]

Enhancing investor education and awareness as to the role carbon markets can play in sustainable finance is essential to drive further investment in green projects. Opportunities to scale up investment in carbon-reducing or carbon-avoiding technologies in Canada will become increasingly available and given the obligatory nature of Canada's compliance markets, present a unique opportunity to participate in actual, measurable reductions or mitigations.

Green technology

Sustainable finance in Canada is being shaped by the significance of resource extraction, transportation and processing industries in the economy and the transition these industries are making to a lower carbon world.[80] The transition means, of course, that there are investments that fall squarely in the typical use of proceeds for green bonds. These include renewable power generation and green buildings.

However, many companies whose business involves fossil fuels see sustainability and sustainability-linked instruments as more aligned with their capital spending programmes that may include carbon capture utilisation and storage, efficiency projects and grey hydrogen, for example. Some of these companies that may not yet be perceived as strong sustainability actors have stayed away from issuing green bonds to avoid any risk of greenwashing allegations, even when they do have typical green spending plans.

Climate change, nature and biodiversity impacts

The regulatory framework around sustainable finance in Canada is in the developmental phase, and, at this point, the real impact of sustainable finance on climate change is an awareness that there is the potential for sustainable finance to have an impact on reducing GHG emissions and the achievement of other ESG targets.

Greenwashing and climate litigation risks

Regulators in Canada are looking at issues around greenwashing. The CSA has issued a staff notice identifying overly promotional disclosure pertaining to environmental, social and governance matters as a key area for improvement in issuers' continuous disclosure.[81] In particular, the CSA has noted that issuers need to ensure consistency between voluntary and required disclosures, and that some issuers are making potentially misleading, unsubstantiated or otherwise incomplete claims about environmental, social and governance matters and sustainability-related aspects of their business. In addition, numerous investigations and actions have been brought by the Competition Bureau of Canada concerning false or misleading representations and deceptive marketing practices by Canadian companies around environmental claims, including claims of carbon neutrality, assertions that natural gas is a 'clean' fuel and representations around emissions reductions by fossil fuel producers that do not take account of Scope 3 emissions.[82]

To date these regulatory concerns have not been positioned in the context of sustainable finance per se. There have been shareholder proposals and proxy solicitation battles at public company annual shareholder meetings targeting issuers' and banks' involvement in sustainable finance offerings where the particular industry sector has not been perceived as 'sustainable' or key performance indicators and targets have not been perceived as being sufficiently ambitious.

Climate litigation generally is continuing to develop in Canada but is still in its early days. Litigation has been brought against governments for taking insufficient action to protect the environment, and steps are being taken by certain municipalities to assemble budget funds for litigation against large carbon emitters. While in its infancy, climate litigation is expected to continue to grow, including based on the success of various claims in the United States and in the UK, and is considered a business risk.

Outlook and conclusions

Over the coming year, it is anticipated that many of the regulatory proposals around ESG disclosures and sustainable finance will have solidified or been adopted, in most cases contemplating prospective application. The regulatory road map around these issues will become clearer, though the direction of travel of regulation is understood to be well articulated in the proposals, which seems unlikely to change. This should facilitate the continuing development of sustainable finance in Canada as capital markets participants prepare for compliance timelines.

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