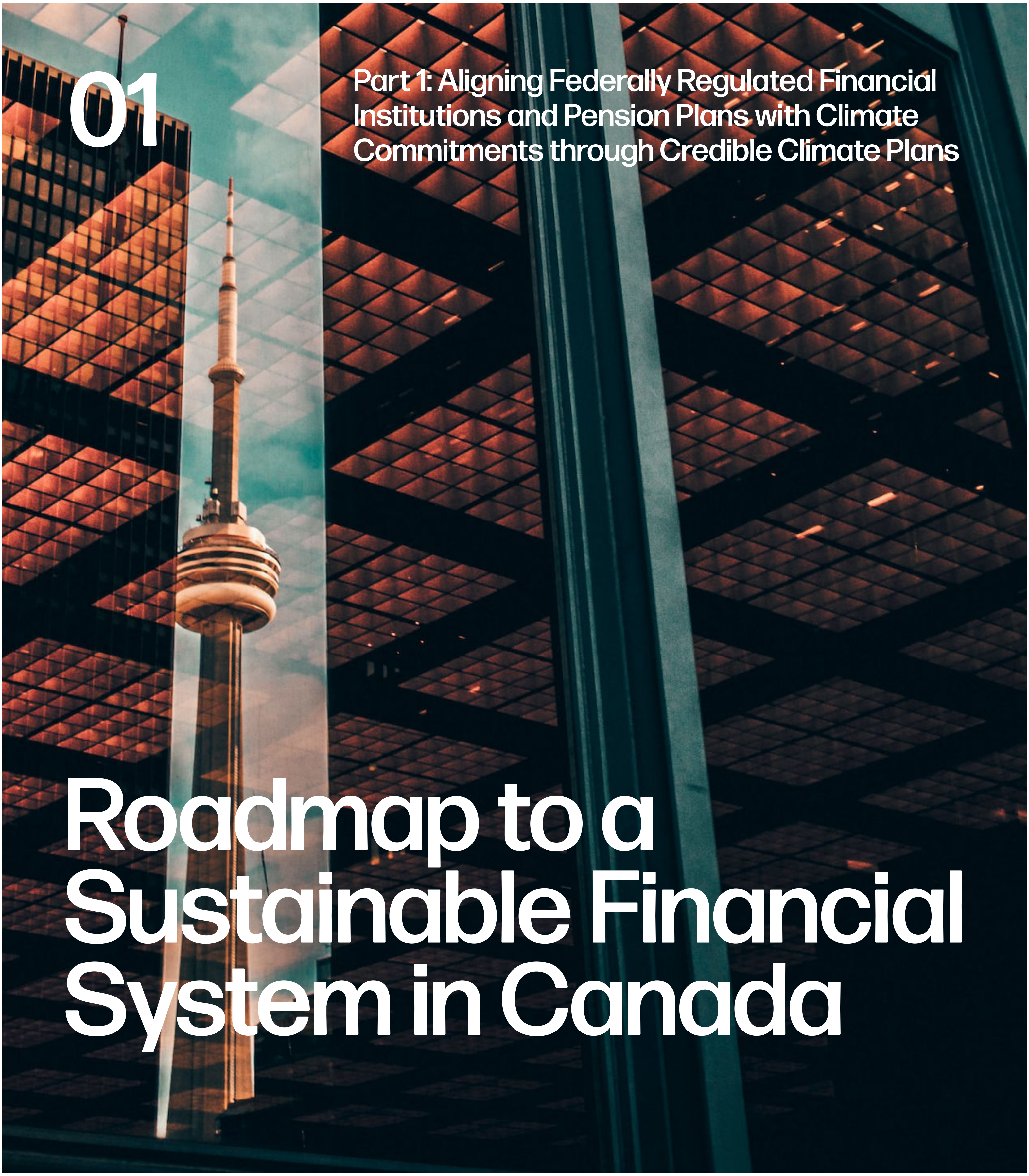


01

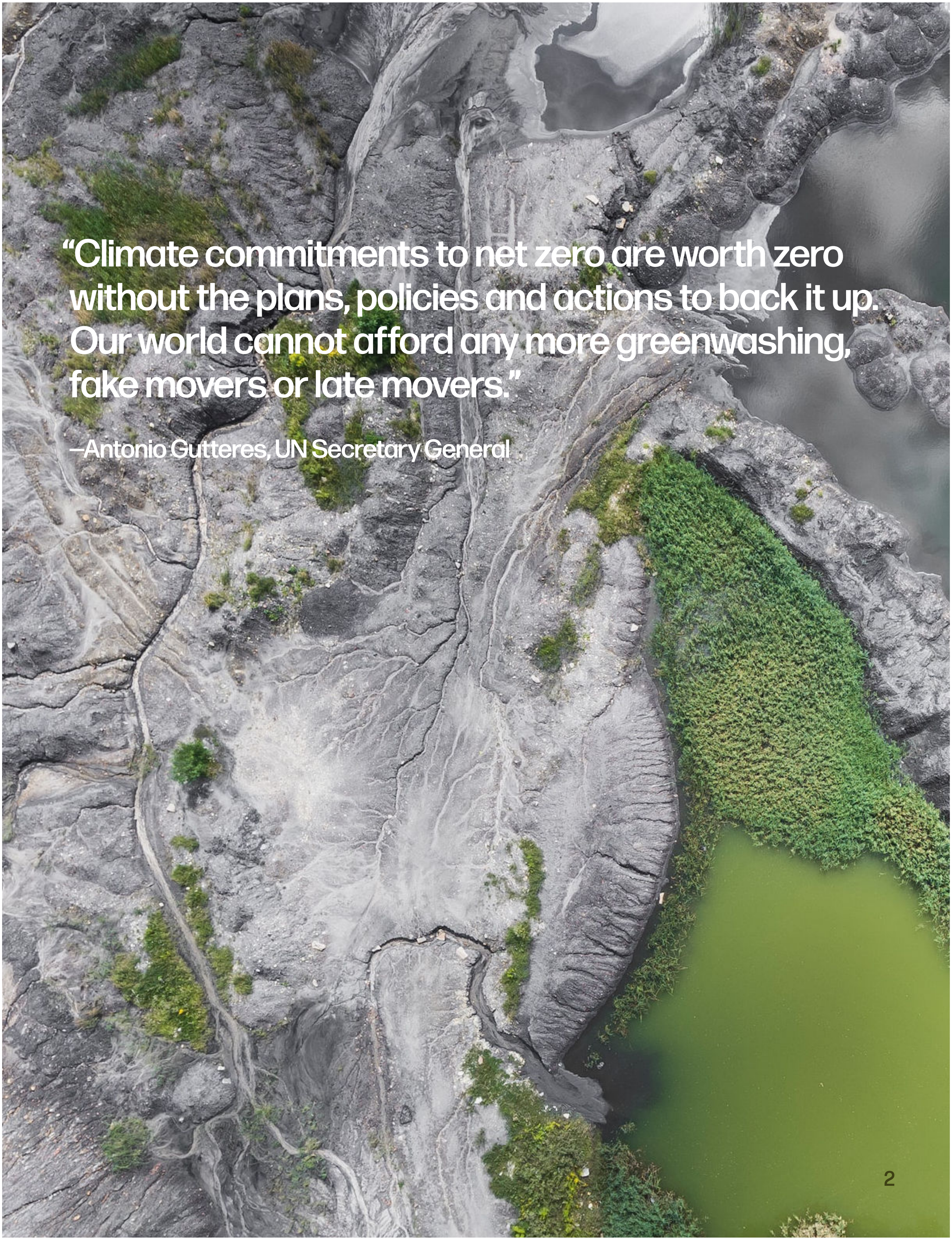
Part 1: Aligning Federally Regulated Financial Institutions and Pension Plans with Climate Commitments through Credible Climate Plans

Roadmap to a Sustainable Financial System in Canada

ecojustice

shift ACTION FOR PENSION WEALTH AND PLANET HEALTH

environmental defence



"Climate commitments to net zero are worth zero without the plans, policies and actions to back it up. Our world cannot afford any more greenwashing, fake movers or late movers."

—Antonio Gutteres, UN Secretary General

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Introduction

When it comes to Canada's climate policies, there is a widely overlooked frontier: finance. In a series of policy briefings, Ecojustice, Shift: Action, and Environmental Defence lay out an actionable pathway to address how Canada should regulate climate-alignment within our financial system. This briefing focuses on Federally Regulated Financial Institutions (FRFIs) and Federally Regulated Pension Plans (FRPPs) and shows how financial alignment is critical to achieving Canada's legally binding climate obligations.

This Briefing proposes a suite of detailed policies and regulations that the federal government and OSFI can introduce to deliver on these promises and lead the way towards a Pan-Canadian approach to sustainable financial regulation.

Credible Climate Plans would give financial institutions and pension plans the flexibility to determine the specific policies and procedures to align with climate goals, but within a consistent framework and clearly defined parameters that are aligned with Canada's legal obligations and the best available climate science. The Briefing also makes recommendations for other complementary policies that would support the development and implementation of Credible Climate Plans by giving OSFI, investors and consumers the information and powers they need to hold financial institutions to account.

The Climate Crisis and the Paris Agreement

We are facing an accelerating global climate emergency. Our inaction has already locked-in significant warming, creating harm and climate disruption all over the globe. Without immediate and unprecedented action to stop greenhouse gas (GHG) emissions, primarily by eliminating global dependency on fossil fuels, the climate emergency will have unthinkable consequences for our economies, our ecosystems, and our society.

As part of the Paris Agreement, Canada pledged to cut emissions by at least 40-45% below 2005 levels by 2030. As part of a commitment to achieve net-zero GHG emissions by 2050, this pledge has been cemented into Canadian law. However, despite setting net-zero related goals across sectors, Canada has yet to ensure alignment of financial flows with its climate goals. Without enforceable rules to address this gap, we will risk exposing our financial system to unmanageable levels of risk.

From disclosure to alignment

Canada has a global reputation for sound financial regulation. But without robust standards, independent oversight, and rigorous enforcement to align the financial sector with its climate commitments, this reputation hangs in the balance. Regulators and financial institutions can no longer focus only on managing exposure to external climate-related risks. Rather, to achieve relative climate safety, they must proactively align financial flows with climate objectives[1].

From voluntary to mandatory

"Voluntary action by non-state actors has had an enormous impact, but alone, it is not enough to achieve the goals of the Paris Agreement alone." [2]

"To effectively tackle greenwashing and ensure a level playing field, non-state actors need to move from voluntary initiatives to regulated requirements for net zero." [3]

1 "Integrity Matters" Report from the United Nations' High Level Expert Group on the Net Zero Emissions Commitments of Non-State Entities: https://www.un.org/sites/un2.un.org/files/high-level_expert_group_n7b.pdf

2 The Pivot Point. Race to Zero. September 2022. p 5 https://climatechampions.unfccc.int/wp-content/uploads/2022/09/R2Z-Pivot-Point-Report.pdf

3 "Integrity Matters" Report from the United Nations' High Level Expert Group on the Net Zero Emissions Commitments of Non-State Entities at p 7: https://www.un.org/sites/un2.un.org/files/high-level_expert_group_n7b.pdf

Enshrining uniformly high standards through regulation is clearly required to restore public trust and ensure a level playing field that rewards leaders and exposes laggards.

FRFIs and FRPPs wield incredible financial resources in Canada, and so have a major impact on climate change. However, they have, and continue to be, financially entrenched in high-emitting industries. Although we are seeing a sectoral trend towards commitments to net-zero under voluntary international climate initiatives, this has not translated into action or concrete plans to align with a credible 1.5°C pathway. Some of these organizations are even continuing to increase financial flows to activities that are incompatible with climate science and are fuelling the climate crisis.

Canadian financial institutions have signed up to an array of voluntary international initiatives that commit to achieving net-zero emissions by 2050. Canada's six largest banks have joined the Net-Zero Banking Alliance (NZBA), three Canadian asset owners have joined the Net-Zero Asset Owner Alliance[4] and several insurance companies who operate in Canada have joined the Net-Zero Insurance Alliance[5]. Many Canadian investors have signed onto the UN Principles of Responsible Investing,[6] and over forty institutional investors have joined the Responsible Investment Association's (RIA) Canadian Investor Statement on Climate Change.[7]

However, these voluntary initiatives alone are insufficient.

First, they lack effective means of enforcement and have not proven able to ensure that their standards are followed.

Second, they set a range of standards and deadlines, use different terminology, and give signatories wide discretion as to how to demonstrate compliance, making it difficult for investors and consumers to differentiate between market leaders and laggards, contributing to confusion and greenwashing.

4 These are: Quebec's public sector pension fund manager, CDPQ; the University of Toronto Asset Management Corporation; and the insurance company, the Co-operators Group. There are also 11 investment managers that are members of the Net-Zero Asset Managers Initiative. See: https://racetozero.unfccc.int/join-the-race/whos-in/.

5 For example, Aviva, Munich re and Swiss re and others. "Members: Net-Zero Insurance Alliance." United Nations Environment Programme Finance Initiative. Accessed October 18, 2022. https://www.unepfi.org/net-zero-insurance/members/.

6 "What are the Principles for Responsible Investment?" Principles for Responsible Investment. Accessed September 23, 2022. https://www.unpri.org/about-us/what-are-the-principles-for-responsible-investment.

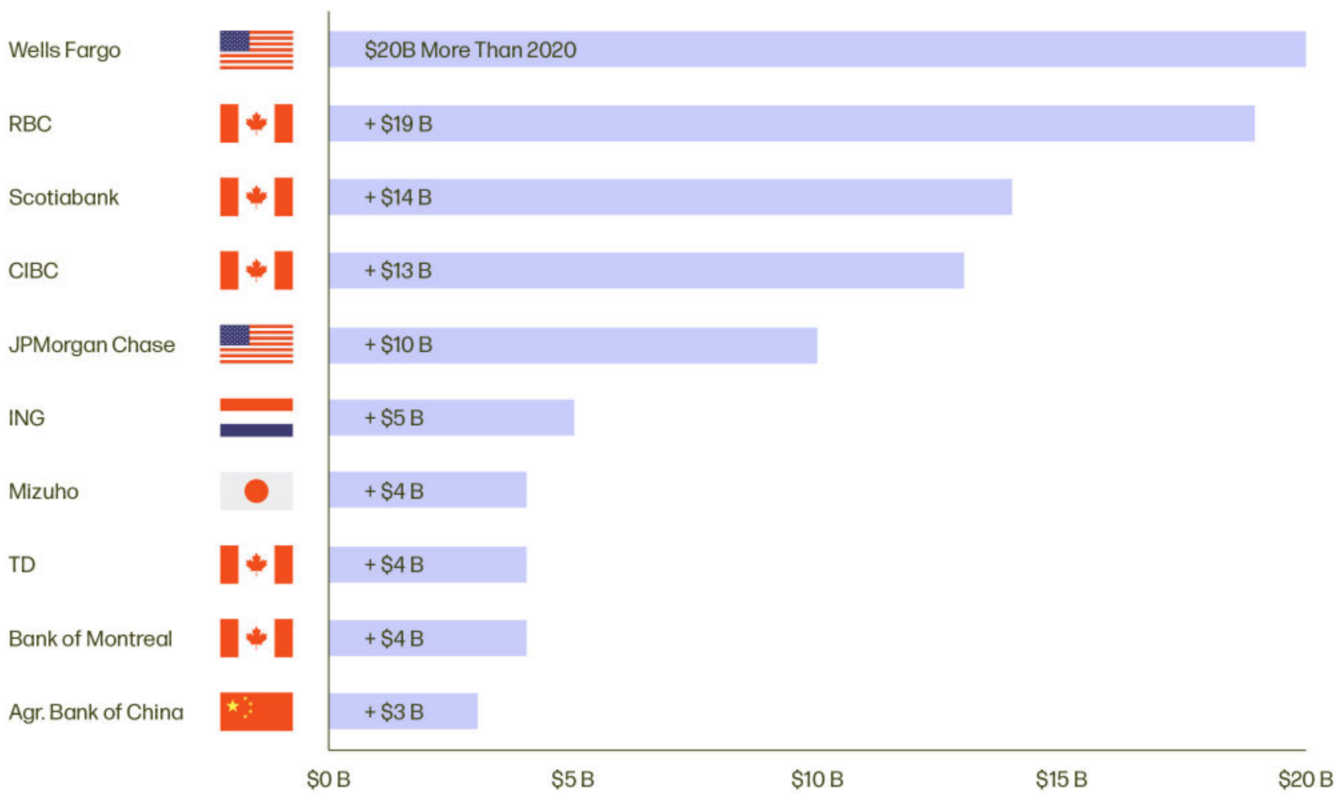
7 RIA, "Canadian Investor Statement."

Finally, by definition, there is no requirement to join voluntary initiatives, so participation has been limited, particularly in the pensions and insurance sectors.

Overall, the quality, consistency, and credibility of net-zero commitments varies considerably. Commitments lack clear or accurate definitions for terms such as "net-zero by 2050," recognizable standards and baselines for comparability, or any sort of credible pathway for achieving these goals.

Despite joining voluntary climate initiatives and committing to net-zero, Canada's largest five banks increased their financial support to the fossil fuel industry from 2020 to 2021. The following chart from the *Banking on Climate Chaos Report* shows all of Canada's big five ranked in the top nine of the banks globally who provided the largest increases in financing of fossil fuels.

Largest Fossil Fuel Financing Increases, 2020-2021 [8]



8 Chart from Banking on Climate Chaos: Fossil Fuel Finance Report 2022, available online: https://www.bankingonclimatechaos.org//wp-content/themes/bocc-2021/inc/bcc-data-2022/BOCC_2022_vSPREAD.pdf. Page 13.

A recent report on two Canadian life and health insurance companies found that despite having made net-zero commitments, they finance emissions equivalent to three-quarters of Canada's national emissions and are ranked in the top three biggest Canadian investors in companies on the Global Coal Exit List.[9]

Voluntary initiatives have led to commitments but not action in the financial sector. Regulation is clearly required to align pathways with required climate action, reward leadership, restore public trust, and ensure a fair and level playing field across financial institutions and pension plans.

Credible Climate Plans are key

Requiring Credible Climate Plans, based on clear, standardized metrics, is the key regulatory tool. The federal government has already committed to requiring FRFIs, FRPPs, and government agencies to issue net-zero plans.[10] The essential elements of a Credible Climate Plan build on the principles from voluntary initiatives. The plans must be given the force of law to ensure accountability, transparency, and comparability across financial institutions and over time.

In addition, we recommend that OSFI takes supportive action in the form of:

- Continuing its program of scenario analysis and stress testing,
- Amending capital adequacy and prudential requirements for high carbon assets, and
- Placing statutory investment and lending limits on those assets.

OSFI has a crucial role to play in overseeing the adoption and implementation of Credible Climate Plans and aligning macroprudential regulation with Canada's climate goals, as part of its statutory mandate to protect the safety and soundness of the financial system. It has made some encouraging progress on climate-related finance to date, such as partnering with the Bank of Canada to model transition-related climate risks, concluding that quicker policy action would reduce risks to the financial system.[11]

9 "Insuring the Climate Crisis: Sun Life & Manulife's Financed Emissions." Investors for Paris Compliance. September 2022, https://www.investorsforparis.com/wp-content/uploads/2022/09/sun-life-manulife-v2.pdf. 4, 22, 24, 31. The Global Coal Exit List is a project by Urgewald that offers key statistics on over 1,000 parent companies and around 1,800 subsidiaries operating along the thermal coal value chain. See "Global Coal Exit List 2022." Global Coal Exit List. Accessed October 18, 2022. https://www.coalexit.org/.

10 https://pm.gc.ca/en/mandate-letters/2021/12/16/deputy-prime-minister-and-minister-finance-mandate-letter

11 Segal, Julie. "Acting Now on Climate Change Is Canada's Best Financial Bet." Canada's National Observer, January 20, 2022. https://www.nationalobserver.com/2022/01/20/opinion/acting-now-climate-change-canadas-best-financial-bet; "Bank of Canada/OSFI Pilot Helps Canadian Financial Sector Assess Climate Change Risks." Office of the Superintendent of Financial Institutions (OSFI). Government of Canada, January 14, 2022. https://www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/Pages/clrsk-mgm_nr.aspx.

Most of the recommendations in this Roadmap can be implemented relatively quickly through a combination of regulations, guidance, and directions made under existing legislation. In view of the need to rapidly shift financial flows towards alignment with Canada's climate goals, this should be favoured wherever possible. However, in the longer-term, legislative change is required, both to ensure that reforms are durable and subject to proper legislative scrutiny, and to implement those recommendations that are not possible through regulation.

Canada has a closing window to limit the worst impacts of a warming world. Policy action is needed now from our governments and regulators to protect the stability and health of both our financial system and our climate. It is time to extend Canada's world-class reputation for effective and prudent financial regulation through these practical and achievable measures.

Recommendation	Implementation
1. Require FRFIs to publish, implement and annually report on Credible Climate Plans.	OSFI Guideline B-15.
OSFI to review Credible Climate Plans and approve or require improvements.	Regulations under relevant sectoral legislation.
2. Require FRPPs to publish, implement and annually report on Credible Climate Plans.	New OSFI Guideline.
OSFI to review Credible Climate Plans and approve or require improvements.	Regulations under the *Pension Benefits Standards Act*[12] (PBSA).
3. OSFI and Bank of Canada to lead an expanded program of stress testing and scenario analysis.	Continuation of existing work.
4. Amend capital and prudential requirements based on at risk high carbon assets.	Regulations under the Bank Act[13], TLCA[14] and ICA[15]. Amendments to Pension Benefits Standards Regulations (PBSR)[16].
5. Place investment and lending limits on assets that are subject to high climate risk.	Amend portfolio limits under relevant sectoral legislation and regulations.
6. Emphasize that the fiduciary duties of corporate directors and pension fiduciaries require assessment, disclosure, and positive action to manage climate change risk and opportunities.	New OSFI guidance.
	Legislative amendments.
7. Empower OSFI to tackle greenwash.	Strengthen OSFI's legislated mandate.

Regulation | Guidance | Legislative

12 *Pension Benefits Standards Act* (PBSA), R.S.C. ch. 32 s. 39(1)(p) (1985).
13 *Bank Act*, S.C. ch. 46 s. 485(2) (1991).
14 TLCA, S.C. ch. 45 s. 473(2) (1991).
15 ICA, S.C. ch. 47 s. 515(2) (1991).
16 *Pension Benefits Standards Regulations* (PBSR), S.O.R./87-19 s. 7.1(1) (1985).

Essential Elements of a Credible Climate Plan

Target →	Plan →	Report →
Set targets that align the financial institution's activities with limiting warming to 1.5°C	Implement policies and procedures to deliver on targets	Report to regulators annually on progress against targets

Guiding Principles

- Respect indigenous rights, sovereignty and governance.
- Prioritize climate equity and justice.
- Advance adaptation and biodiversity, not just mitigation.
- Focus on climate impacts, not just risks.

1. Target

Set targets that align the financial institution's activities with limiting warming to 1.5°C

1.1 Long-term target of net zero by 2050 at the latest

1.2 Interim targets set in five years starting with 2025 and 2030

1.3 Long-term and interim targets to set trajectory consistent with:

- The global carbon budget of available emissions to keep global warming to 1.5° with no/low overshoot.
- Emissions to peak by 2025.
- Maximum effort toward or beyond a fair share of the 50% global reduction in CO_2 emissions by 2030.
- Beating Canada's NDC and legislated GHG targets in view of principles of equity and global fair share.
- Mitigation pathways from credible sources e.a., IPPC, IEA.

1.4 All targets to encompass scope 1-3 emissions

1.5 All targets to encompass all greenhouse gases, including short-lived climate pollutants*

1.6 All targets to be expressed as absolute emissions reductions (as opposed to other metrics such as emissions intensity)

*To include all those greenhouse gases accounted for in Canada's national greenhouse gas emissions inventory: including carbon dioxide (CO2), methane (CH4), nitrous oxide (N2O), perfluorocarbons (PFCs), hydrofluorocarbon (HFC), sulphur hexafluoride (SF6), nitrogen trifluoride (NF3).

2. Plan

Implement policies and procedures to deliver on targets

2.1 Commit to immediate action (within a timeframe of months) to align with currently available science, including the IA's conclusions that fossil fuel expansion and thermal coal are incompatible with its 1.5°C pathway.

2.2 Set out key policies and procedures, including:

- Scaling up investments in green and nature-positive investment areas
- Prioritising emissions reductions ahead of removals and offsets
- Policy for managed phase out of high emitting assets.
- An engagement Escalation Policy
- Aligning executive compensation schemes with objectives of the CCP
- Aligning lobbying activities with the objectives of the CCP

2.3 Explain how policies and procedures will achieve targets, using quantitative and qualitative analysis, and explaining key assumptions and methodologies

2.4 Include a timeline for implementation or key actions, policies and procedures

2.5 Explain how CP is aligned with organization's overall strategy, including financial plans

2.6 Explain how the targets and plan integrate UNDRIP and specifically the principle of Free, Prior and Informed Consent

2.7 Actions to address data limitations.

3. Report

Report to regulators annually on progress against targets

Annually report (through statutory disclosures e.g., annual reports or financial statements) on:

3.1 Climate-related risks and opportunities

3.2 Progress towards interim and long-term targets in terms of quantified, absolute emissions reductions.

3.3 Key challenges experienced and positive action to address them (e.g., data gaps, implementation delays, non-aligned investments)

Reccomendations

1. Mandatory Credible Climate Plans for FRFIs

OSFI has recently proposed guidance[17] on managing climate-related risks for FRFIs. Although the Draft Guideline includes a requirement for FRFIs to have "Climate Transition Plans,"[18] it fails to provide specificity as to the content of those plans. Without prescription on the necessary plan contents the benefits of transparency, comparability, standardization, and financial flow progress will not be realized. In finalizing the guidance, OSFI has an opportunity to require the adoption of Credible Climate Plans with specific standards and enforcement.

OSFI can and should take a phased approach, first applying more rigorous standards to Canada's domestic systemically important banks (D-SIBs)[19] with effect beginning from the end of 2023, then rolling out to smaller banks over time. Currently, Canada's big six banks are already bound by similar timelines via their commitments to NZBA. Importantly, these banks have the sophistication and capacity to deliver on these timelines, and a responsibility due to the significance of their financed emissions.

Crucially, FRFIs should be prohibited from using terms such as "net-zero", "Paris Agreement", or "climate aligned" until they have publicly released a Credible Climate Plan, to protect consumers and investors from greenwashing in the interim and to incentivize early compliance.

17 "OSFI Consults on Draft Guideline B-15: Climate Risk Management." *Office of the Superintendent of Financial Institutions* (OSFI). Government of Canada, May 26, 2022. https://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/b15-dft-let.aspx.

18 OSFI, "Draft Guideline B-15."

19 A D-SIB is a bank that if it fails could disrupt the domestic economy. There are six D-SIBs in Canada – the Bank of Montreal, the Bank of Nova Scotia, Canadian Imperial Bank of Commerce, National Bank of Canada, Royal Bank of Canada and Toronto-Dominion Bank. See "Superintendent formally designates Canadian D-SIBs and sets minimum loss absorbing capacity requirements." *Office of the Superintendent of Financial Institutions* (OSFI). Government of Canada, August 21, 2018. https://www.osfi-bsif.gc.ca/eng/osfi-bsif/med/Pages/nr20180821.aspx.

2. Mandatory Credible Climate Plans for FRPPs

OSFI has yet to propose guidelines for managing climate related financial risk for FRPPs, although has indicated that it will do so. It should do so as a priority, based on the proposals outlined above for FRFIs.

Further, OSFI is a member of the Canadian Association of Pensions Supervisory Authorities (CAPSA), which can create guidelines for all pensions, including non-federally regulated plans. By mandating FRPPs to prepare, implement, publish, and report Credible Climate Plans, OSFI would take a leadership role among pension regulators. This is essential to safeguard the hard-earned pensions of employees in federally regulated industries. OSFI should then work with CAPSA and other appropriate regulators to standardize climate-aligned financial policy across Canadian pension plans.

3. OSFI to review Credible Climate Plans and approve or request amendments

OSFI must take on the role of reviewing Credible Climate Plans submitted by FRFIs and FRPPs to ensure they include essential elements. To protect investors and consumers from being misled by inadequate plans, OSFI should be required to issue a formal decision within a set time period, either approving the Credible Climate Plan, or, where it is deficient in one or more of the essential elements, requesting amendments. To ensure progress in implementing Credible Climate Plans, OSFI should review annual progress reports and issue a decision on whether progress is satisfactory, or if not, setting out specific remedial action to be taken.

Crucially, OSFI should publish all plans, reports, and its decisions, on its website to promote transparency.

4. Expand stress testing and scenario analysis

Pricing climate-related risks accurately is challenging, particularly using backward-looking techniques. OSFI and the Bank of Canada must expand stress testing and scenario analysis. These exercises must align with limiting warming below 1.5°C, assess both physical and transition risk and include regional and sector specific scenarios.

5. Amend capital adequacy requirements

Capital adequacy requirements (or capital requirements) define the amount of capital a bank or other financial institution must have on hand relative to its risk-weighted credit exposure. This percentage ratio is set by the regulator based on perceived risks. Financial institutions are incentivized to make decisions that reduce the capital they must have on hand, so a higher capital requirement would incentivize an investment.

Capital requirements traditionally (yet incorrectly) perceive high-emitting assets as lower risk because they often attract a high credit rating and are profitable over the short-term. This favours climate polluting assets like fossil fuel infrastructure and misconstrues the high risk over the medium- and long-term. Regulators must amend and reinform their risk perception of high-emitting assets based on climate science and 1.5°C demand scenarios. This would naturally increase the risk profile and resulting capital requirements for fossil fuels.

Traditional capital adequacy requirements disincentivize greener investments for the same reason. Although many green technologies, like solar, are mature technologies, they may still be less understood by finance institutions. They are therefore evaluated as higher risk simply due to relative novelty and may be underfunded as a result.

The Bank of Canada recognized that the risk from high-emitting assets is misrepresented without differentiated capital requirements. Not fixing this is "making a sudden repricing of carbon-intensive assets more likely and leaving investors exposed to sudden financial losses. Mispricing can defer investments needed to achieve such a transition."[20]

Fossil fuel activity is significantly exposed to climate-related transition risks (and is a leading cause of worsening the climate crisis through GHG emissions).[21] Expanding fossil fuel infrastructure is particularly risky. OSFI should integrate climate science into its risk analyses, so these activities would be properly recognized as higher risk and so yield higher capital requirements to reflect this risk. OSFI outlined the high transition risk for Canadian fossil fuel assets in its scenario analysis pilot study but has not yet integrated these findings into regulation.[22] Both the risk of the asset, and the systemic risk resulting from the asset, are important: continued combustion of fossil fuels poses a systemic risk to the financial system's stability by worsening climate-related damages. Exploring for and expanding fossil fuel development poses an even higher risk, as this is clearly incompatible with keeping warming below 1.5°C.[23]

The Basel Committee on Banking Supervision recently proposed higher capital requirements for cryptocurrency assets, recognizing these assets risk generating instability throughout the financial system.[24] They proposed a "one-for-one" holding requirement. Based on the risks to the financial system and global climate associated with fossil fuel expansion and exploration, OSFI must similarly apply higher capital adequacy requirements.

Capital requirements for FRFIs must be informed by climate science, including credible pathways consistent with a 1.5°C temperature limit given the systemic risks if this level of warming is exceeded.[25] Similarly, actuaries to FRPPs should be required to consider climate-related risk factors when conducting plan valuations.

20 "Financial System Review-2022." Bank of Canada, June 7, 2022. https://www.bankofcanada.ca/2022/06/financial-system-review-2022/.

21 Semieniuk, Gregor et al., "Stranded Fossil-Fuel Assets," 532.

22 OSFI, "Bank of Canada/OSFI Pilot."

23 IEA "Net Zero by 2050," 51, 102.

24 "Basel Committee Consults on Prudential Treatment of Cryptoasset Exposures." The Bank for International Settlements, June 10, 2021. https://www.bis.org/press/p210610.htm.

25 Chenet, Ryan-Collins and van Lerven, "Finance, climate-change and radical uncertainty," 2-3.

6. Statutory investment and lending limits on high climate risk assets

For certain types of assets that are subject to exceptionally high climate risk (e.g., thermal coal investments and new fossil fuel expansion projects), hard investment and lending limits should be introduced.

7. Align fiduciary duties with climate goals

Responding to the risks and opportunities from climate change will require fiduciaries to take a long-term view of the corporation's or pension beneficiaries' best interests, even if that may involve foregoing high short-term returns (e.g., from high oil prices) to avoid exposure to greater long-term financial risks from the inability to develop fossil fuel reserves or damage to physical assets from increased extreme weather. There needs to be a shift from the overly cautious approach that prioritizes short-term financial gain over long-term financial sustainability. Consistently assessing and managing climate risks in a credible way requires guidance from government.

The government should therefore require that corporations and pension plans not only manage and disclose their exposure to climate risk, but also have Credible Climate Plans that are aligned with Canada's climate targets and the 1.5°C temperature goal. By requiring a Credible Climate Plan, the government can ensure that corporations and pension funds are actually reducing their contribution to climate change and ensure that prudent climate risk management includes alignment with climate goals.

As corporate directors and pension administrators have legal obligations to comply with relevant legislation and regulations, setting out the required elements of a Credible Climate Plan in regulation will establish a clear standard and a more easily enforceable duty on corporate directors and pension administrators to align with climate goals and address climate risks.

As an interim step, OSFI should immediately issue statements emphasizing that the current fiduciary duties of corporate directors and pension administrators not only permit consideration of environmental, social and governance risks including climate change, but imposes a positive obligation to consider and manage any material risks, with a presumption that climate change poses a systemic material risk to all businesses. OSFI should also provide statutory guidance on the application of the duty to managing conflicts of interest for pension plans. However, amendments to key federal legislation and regulations are needed to provide further certainty and establish a clear legal requirement to have a Credible Climate Plan.

8. Strengthen federal regulators

Several key federal regulators should take further action and be strengthened to further climate finance alignment by addressing greenwashing.

Greenwashing leads to lower quality information – driving capital in the wrong direction, delaying climate action, and increasing exposure to climate-related risks. It erodes trust in the financial market by generating cynicism about financial products with green labels. Common greenwashing examples include advertising net-zero commitments without taking science-based action to deliver on them, or selectively disclosing progress on climate-aligned segments of a business while ignoring those that are not (such as financed or exported emissions), or relying on unrealistic levels of emission offsets and removals.[26] Greenwashing can be deliberate (where sustainability is led primarily by marketing teams instead of integration throughout investments) or accidental (where investment teams are built without requisite climate science expertise).

A lack of standards and guidance exacerbates the problem of greenwashing as does the lack of effective enforcement mechanisms.[27] A strong guidance, oversight and enforcement regime would ensure institutions develop and deliver on Credible Climate Plans and would combat greenwashing. The Minister

26 de Freitas Netto et al., "Concepts and Forms of Greenwashing."

27 Greenwashing occurs when a business, like a financial institution, makes misleading or unsubstantiated claims about environmental performance. It is when businesses "mislead and/or overstate advertised performance in the context of climate change." See Bhargava, Akriti, et al. "Climate-Washing Litigation: Legal Liability for Misleading Climate Communications." Providence: The Climate Social Science Network, January 2022. https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2022/01/CSSN-Research-Report-2022-1-Climate-Washing-Litigation-Legal-Liability-for-Misleading-Climate-Communications.pdf. 4

of Finance and the Minister of Innovation, Science and Industry should strengthen the roles of existing federal bodies to support aligning Canada's financial system with 1.5°C. Further, a green taxonomy should be adopted to ensure climate finance claims and advertisements are objectively assessable, comparable, and not rooted in greenwashing along with stronger investigatory and private enforcement options to combat climate misrepresentations in advertising.

A. Office of the Superintendent of Financial Institutions (OSFI)

OSFI has broad regulatory authority with respect to the financial institutions and pension plans it oversees, including advancing a regulatory framework to control and manage risk, supervising the sound financial condition of the entities it regulates and evaluating system-wide or sectoral developments that may negatively impact the financial condition of financial institutions.[28] This gives OSFI a clear mandate to address the systemic climate change risks impacting our financial sector with respect to FRFIs and FRPPs. OSFI should take a leadership role in setting a high standard to influence other federal and provincial regulators. Given the urgency of the climate crisis, OSFI should be using all available tools to ensure that financial institutions and pension plans align with keeping warming below 1.5°C.[29]

OSFI's mandate also requires it to supervise FRFIs' and FRPPs' compliance with their governing statutes.[30] Therefore, once Credible Climate Plans are mandated in legislation (see Step 2 of Recommendations 5A and 5B), OSFI would be required to supervise compliance.

OSFI has a world-leading reputation as a prudential regulator and there are encouraging signs that it is moving towards playing a leadership role in aligning Canada's financial sector with climate commitments. For example, OSFI is engaging in a major hiring drive to staff its work on climate-related finance[31] And its proposed guidance

28 *Office of the Superintendent of Financial Institutions Act* (OSFIA), R.S.C. ch. 18 s. s. 4(2) (1985); "Mandate." *Office of the Superintendent of Financial Institutions* (OSFI). Government of Canada, January 26, 2016. https://www.osfi-bsif.gc.ca/Eng/osfi-bsif/Pages/mnd.aspx#:~:text=OSFI%20advances%20a%20regulatory%20framework%20designed%20to%20control%20and%20manage%20risk.&text=OSFI%20supervises%20federally%20regulated%20financial,meeting%20regulatory%20and%20supervisory%20requirements.

29 Section 5 details the key action that OSFI should take using its existing powers. It has a wide range of regulatory tools under its governing statute and the sectoral legislation.

30 *Office of the Superintendent of Financial Institutions Act* (OSFIA), R.S.C. ch. 18 s.s. 4(2)(a), (2.1)(a) (1985). With respect to FRPPs, OSFI's mandated supervisory role is with respect to compliance with the requirements of the PBSA, PRPPA and related regulations.

on climate risk management, Draft Guideline B-15, is the strongest seen in Canada to date.[32] The Draft Guideline include an expectation that financial institutions develop and implement transition plans,[33] demonstrating that OSFI's mandate is broad enough to encompass requiring the similarly conceptualized Credible Climate Plan outlined in this Roadmap. This view is supported by two of the goals outlined in OSFI's strategic plan: to improve FRFIs and FRPPs preparedness and resilience to the next financial stress event, as well as to better prepare FRFIs and FRPPs to identify and develop resilience to these risks before they negatively affect financial condition.[34] Requiring Credible Climate Plans and providing guidance on and review of such plans falls squarely within these goals.

Despite encouraging signs of progress, OSFI is not yet leveraging all the available tools and is not moving at the pace required given the escalating urgency of the climate crisis. This may be due in part to a narrow interpretation of its mandate.

OSFI's statute should therefore be amended to give it an explicit duty to not just manage the risk posed by climate change to the financial system, but also to reduce the risk Canada's financial sector poses to the global climate system, by promoting alignment with Canada's commitment to the 1.5°C goal. OSFI should also be defined as the principal body for reviewing climate disclosures and Credible Climate Plans and approving them or requiring amendments.

B. Financial Consumer Agency of Canada (FCAC)

FCAC is responsible for monitoring and supervising financial institutions and external complaints bodies that are federally regulated. Its objectives include protecting the rights and interests of consumers of financial products, supervising compliance of federally regulated financial entities with their public commitments, and strengthening

31 "Job Opportunities." Office of the Superintendent of Financial Institutions (OSFI). Government of Canada, August 17, 2022. https://www.osfi-bsif.gc.ca/Eng/osfi-bsif/emp/Pages/default.aspx.

32 OSFI, "Draft Guideline B-15." See Section 5.A. of this Roadmap for recommendations on strengthening this guidance.

33 OSFI, "Draft Guideline B-15," Principle 1.

34 "OSFI Strategic Plan 2019-2022." *Office of the Superintendent of Financial Institutions Canada* (OSFI), n.d. https://www.osfi-bsif.gc.ca/Eng/Docs/strpln1920.pdf. 6.

financial literacy in Canada.[35] FCAC does not appear to engage in climate-related finance to date.

FCAC's Commissioner has the power to review and monitor compliance of any financial institution's voluntary commitment.[36] FCAC has a role, pursuant to its mandate to protect financial consumers, to ensure federally regulated financial entities comply with their public commitments.[37] A financial institution's climate-related commitments, including voluntary engagements like the Glasgow Financial Alliance for Net Zero (GFANZ) and the Net-Zero Banking Alliance (NZBA), meet the standard for a public commitment that warrants FCAC taking action to protect the rights and interests of customers.[38] Once the recommendation in Section 5 is in force (i.e., financial institutions cannot advertise their climate commitments unless they have an approved Credible Climate Plan), FCAC would also be responsible for enforcing this advertising condition. FCAC should act on its mandate to promote and monitor financial institutions' implementation of climate-related commitments.

35 *Financial Consumer Agency of Canada Act* (FCACA), S.C. ch. 9 s.s.ss. 3(2)(b), 3(2)(c) and 3(2)(d) (2001).

36 FCACA, S.C. ch. 9 s. 5(3) (2001).

37 FCACA, S.C. ch. 9 s. 3(2)(c) (2001).

C. Competition Bureau Canada

The Competition Bureau is an independent law enforcement agency that protects and promotes competition. It has enforcement authority and skills in investigating and enforcing against misrepresentations. These powers should be bolstered to combat greenwashing because it hinders competition and fairness in the markets.

The Competition Bureau should take a lead role in investigating and enforcing against climate related misrepresentations, and recruit staff with the necessary expertise in climate and finance to do so.

Amendments to the *Competition Act* would empower the Competition Bureau to better combat greenwashing. The *Competition Act* contains provisions wherein false or misleading representations are offences and are also reviewable by the Competition Bureau.[39] For either provision to be triggered, a representation must be false or misleading in a material respect. Under current guidance, it may be difficult to meet the requisite "material" standard for greenwashing misrepresentations, particularly when the representation relates to an institution's goals or ethos.[40] There are currently two complaints before the Commissioner on misleading advertising of climate-related commitments by a bank and carbon neutral claims by a fossil fuel company.[41] It is not clear how the Competition Bureau currently interprets climate representations in the advertising of businesses and in relation to products.

38 "Climate Commitments: RBC Royal Bank." Royal Bank of Canada, 2022. https://www.rbc.com/community-social-impact/environment/our-commitments.html (states that RBC's role in supporting the economic transition for climate change "is firmly aligned with RBC's Purpose to help clients thrive and communities prosper" and that they "help clients as they transition to net-zero").

39 *Competition Act*, R.S.C. ch. C-34 s.s.ss. 52(1), 74.01(1)(a) (1985).

40 Canada (Commissioner of Competition) v. Sears Canada Inc., 2005 CACT 2 (a representation is considered material if it is so pertinent, germane or essential that it could affect the decision to purchase a product).

41 Ni, Dina. "Greenpeace Canada files Competition Bureau complaint against misleading Shell advertising." Greenpeace Canada, November 10, 2021. https://www.greenpeace.org/canada/en/press-release/50740/driving-carbon-neutral-with-fossil-fuels-greenpeace-canada-files-competition-bureau-complaint-against-misleading-shell-advertising/.

Implementation

1. Require adoption of Credible Climate Plan by FRFIs with review by OSFI

Step 1:
OSFI to revise proposed guidance, Draft Guideline B-15, to: establish the essential elements of a Credible Climate Plan; require inclusion of a Credible Climate Plan in annual financial report; and designate OSFI as the principal body for reviewing Credible Climate Plans and approving or requiring amendments.

Step 2:
Adopt Regulations under the Bank Act,[42] Trust and Loan Companies Act[43] (TLCA), Insurance Companies Act[44] (ICA), and Cooperative Credit Associations Act[45] (CCAA) outlining the minimum content of a Credible Climate Plan and requiring its inclusion in the annual financial statement. Designate OSFI as the principal body for reviewing Credible Climate Plans and approving or requiring amendments. Adopt Regulations[46] to place a prohibition on marketing of climate-related claims unless a bank has published an approved Credible Climate Plan and made required disclosures e.g., fossil fuel holdings, scenario analysis.

42 *Bank Act*, SC 1991, c 46, s. 978.

43 *Trust and Loan Companies Act*, SC 1991, c 45, s. 531(1)(j).

44 *Insurance Companies Act*, SC 1991, c 47, s. 1021(1)(m).

45 *Cooperative Credit Associations Act*, SC 1991, c 48, s. 463(1)(j).

46 *Bank Act*, SC 1991, c 46, s.627.04(c).

2. Require adoption of Credible Climate Plan by FRPPs with review by OSFI

Step 1:
OSFI to issue guidance on climate risk management for FRPPs, either through new guidelines or amending current guidelines to require:

— that Statements of Investment Policies and Procedures acknowledge climate change as a material systemic risk to investments;

— setting targets that align with 1.5°C and adopting a Credible Climate Plan as part of the prudent management of climate change risk in investments;

— the inclusion of an assessment of alignment with 1.5°C in actuarial reports;

— disclosure of a Credible Climate Plan and climate risk reporting in annual regulatory returns;[47] and

— an explanation of how OSFI will use its powers to give directions to administrators where climate risk is not being properly assessed or managed.[48]

Step 2:
Adopt Regulations under the Pension Benefits Standards Act[49] (PBSA) outlining the minimum contents of a Credible Climate Plan and requiring a Credible Climate Plan to be included in an FRPP's annual regulatory returns.[50] Designate OSFI as the principal body for reviewing these Credible Climate Plans and approving or requiring amendments.

3. Require scenario analysis and stress testing

OSFI to build on the pilot project with the Bank of Canada to align scenario analysis and stress testing to limit warming to 1.5°C.

47 *Pension Benefits Standards Act*, 1985, RSC, 1985, c 32 (2nd Supp), ss. 12(1)-(4).

48 *Pension Benefits Standards Act*, 1985, RSC, 1985, c 32 (2nd Supp), s. 11.1.

49 *Pension Benefits Standards Act*, 1985, RSC, 1985, c 32 (2nd Supp), s. 39(1)(p).

50 *Pension Benefits Standards Act*, 1985, RSC, 1985, c 32 (2nd Supp), ss. 12(1)-(4); "Annual Filing Process for Federally Regulated Pension Plan Returns." Office of the Superintendent of Financial Institutions. Government of Canada, February 16, 2021. https://www.osfi-bsif.gc.ca/Eng/fi-if/rtn-rlv/fr-rf/rrs-sdr/Pages/rrs-info.aspx.

4. Amend capital adequacy requirements and align prudential requirements

Option 1:
OSFI to revise the Capital Adequacy Requirements (CAR) Guideline[51] to align with Canada's climate commitments and its scenario analysis, by ensuring that the risk weighting for investment (including loans, bonds or derivatives) for fossil fuel resources or infrastructure is proportionate to the risk. OSFI to amend Life Insurance Capital Adequacy Test (LICAT) Advisory[52] (for federally regulated life insurers) and Minimum Capital Test[53] (MCAT) Guidance (for federally regulated property and casualty insurers) to include chapters on calculation of climaterelated risks. OSFI to issue directions to actuaries under the ICA[54] covering weighting of high-risk assets and higher likelihood of pay out due to climate events. OSFI to issue guidance under the PBSA[55] relating to appropriate assumptions and methods for calculating climate-related risk in actuarial reports.

Option 2:
Adopt regulations under the Bank Act,[56] TLCA[57] and ICA[58] introducing capital requirements based on high-risk carbon holdings. Amend the Pension Benefits Standards Regulation[59] (PBSR) to require that the Statement of Investment Policies and Procedures include policies and procedures pertaining to the differentiated risk weighting of high-risk carbon intense assets.

5. Statutory investment and lending limits

Amend portfolio investing and lending limits to interests in thermal coal and oil and gas expansion under: the Bank Act[60]; the TLCA[61]; and the ICA.[62]

51 "Capital Adequacy Requirements (CAR) Guideline." *Office of the Superintendent of Financial Institutions*. Government of Canada, October 30, 2018. https://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/CAR19_gias.aspx.

52 "Life Insurance Capital Adequacy Test (LICAT) Advisory." *Office of the Superintendent of Financial Institutions* (OSFI). Government of Canada, November 27, 2020. https://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/adv prv/Pages/LICAT19_adv_let.aspx.

53 "Minimum Capital Test for Federally Regulated Property and Casualty Insurance Companies." *Office of the Superintendent of Financial Institutions* (OSFI). Government of Canada, January 1, 2018. https://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl ld/Pages/mct2018.aspx.

54 *Insurance Companies Act*, SC 1991, c 47, s. 365(2).

55 *Pension Benefits Standards Act*, 1985, RSC, 1985, c 32 (2nd Supp), ss. 9(2), 12(2)).

56 *Bank Act*, SC 1991, c 46, s. 485(2).

57 *Trust and Loan Companies Act*, SC 1991, c 45, s. 473(2).

58 *Insurance Companies Act*, SC 1991, c 47, s. 515(2).

59 *Pension Benefits Standards Regulations*, 1985, SOR/87-19, s. 7.1(1).

60 *Bank Act*, SC 1991, c 46, ss. 475-78.

61 *Trust and Loan Companies Act*, SC 1991, c 45, ss. 461-66.

62 *Insurance Companies Act*, SC 1991, c 47, ss. 503-08.