The Sustainable Finance Law Review

Editor
Anna-Marie Slot

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THE SUSTAINABLE FINANCE LAW REVIEW

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PREFACE

Sustainable finance is a relative youngster in the world of finance, but it is growing up fast. Public and private financing of sustainable/green projects, or those with provisions in line with borrowers' and issuers' environmental, social and governance (ESG) commitments, has exploded.

Since the signing of the Paris Agreement in 2015, more than 100 countries have committed to net zero emissions targets. Countries have also acted at a national level with ambitious target-setting and nationally determined contributions (NDC) pursuant to the Paris Agreement. They are not alone. By mid-2022, more than one-third of the world's largest publicly traded companies had net zero targets. Financial institutions have also engaged with various policies introduced to enshrine ESG commitments, in terms of both their own lending targets and the carbon emissions linked to those targets. Investors at both retail and institutional levels increasingly look to the financial markets as an important lever in achieving such targets.

For over three decades the United Nations has brought together almost every country on earth for the global climate summits – known as the Conference of the Parties (COP). At COP26 in 2021, private finance showed up in force to play its role in the transformation of the business ecosystem as we know it. Precisely what that role entails is a live debate and the discussions regarding the purpose of sustainable finance cover a wide spectrum of issues – from greenwashing, to the fundamental shift of credit including the risks and opportunities of ESG considerations. We saw that debate play out in real time during COP27.

Notwithstanding ongoing considerations about the purpose of sustainable finance, financial market participants have reacted by creating a wide variety of financial products marketed as sustainable, green or ESG-friendly. The rapid increase in both supply of and demand for sustainable investment products has, at times, resulted in a lack of consistency, transparency and reliability of disclosures and metrics. Governments and regulatory bodies are increasingly focused on imposing guidelines and frameworks to address these issues.

Although sustainable finance continues to elude strict definition at present, significant efforts are being made globally to ensure quality and transparency in the industry, to impose consistent frameworks such as the International Sustainability Standards Board (ISSB) and disclosure requirements such as those of the Task Force on Climate-related Financial Disclosures (TCFD) that support comparability and interoperability among firms and products, and to provide investors with sufficient information to monitor the impact of their investments.

In this inaugural edition we aim to:

a provide a snapshot of the current state of sustainable finance and the status of regulatory efforts across multiple jurisdictions; and

b track the evolution of sustainable finance and outline key trends for the near future.

I thank all of the contributors for their expertise, hard work and dedication in producing this volume.

Anna-Marie Slot
Ashurst LLP
London
December 2022

Chapter 2

CANADA

Bill G Gilliland[1]

I 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, and 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. Rules have been clarified on disclosures by ESG funds.

II YEAR IN REVIEW

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

a In March 2022, the government of Canada issued a C$5 billion green bond in its first green bond offering.

b 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'.

1 Bill G Gilliland is a partner at Dentons Canada LLP. Bill gratefully acknowledges the assistance of Heather Bonnell, Carly Kist and Charles Lewis, associates at Dentons Canada LLP.

c In February 2022, Tamarack Valley Energy Ltd issued a sustainability-linked bond, bringing that instrument into the high-yield space and demonstrating market acceptance of an oil and gas producer utilising the instrument with emissions intensity targets.

d In October 2021, the major Canadian banks signed on to the Net-Zero Banking Alliance (NZBA) and the disclosure and emissions reduction obligations as part of that grouping.[2]

e The Office of the Superintendent of Financial Institutions (OFSI) proposed a Draft Guideline B-15: Climate Risk Management (Guideline), which proposes a climate-sensitive prudential framework that would apply to all federally regulated financial institutions (FRFIs).[3]

f 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 for comment.[4]

g On 19 January 2022, the CSA released Staff Notice 81-334 ESG-Related Investment Fund Disclosure to provide guidance on the disclosure practices of investment funds as they relate to ESG considerations.[5]

III REGULATION AND POLICY

i Governance regime

Canada is a party to the Paris Agreement[6] and so is required to prepare, communicate and maintain successive nationally determined contributions (NDCs),[7] 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).[8] 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 (Updated NDC).[9] 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.

2 See Section VII.
3 See Section VII.
4 See Section V.
5 See Section V.
6 Paris Agreement, Treaty Series, Vol. 3156 (4 November 2016) (https://unfccc.int/files/meetings/paris_nov_2015/application/pdf/paris_agreement_english_.pdf).
7 ibid. at Article 4, Section 2.
8 UNFCCC, The Paris Agreement (https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement).
9 Canada's 2021 Nationally Determined Contribution Under the Paris Agreement (https://unfccc.int/sites/default/files/NDC/2022-06/Canada%27s%20Enhanced%20NDC%20Submission1_FINAL%20EN.pdf); see also: UNFCCC, NDC Registry (https://unfccc.int/NDCREG).

One of these items is the Canadian Net-Zero Emissions Accountability Act.[10] The Canadian Net-Zero Emissions Accountability Act is the legislation that enshrines Canada's commitment to net zero by 2050.[11] In particular, Section 6 states: 'The national greenhouse gas emissions target for 2050 is net-zero emissions.'[12]

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.[13] Each milestone target must be a progression from the previous one.[14] The Net-Zero Emissions Accountability Act provides that the 2030 GHG emissions target is Canada's NDC for that year under the Paris Agreement.[15] 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.[16]

The Minister is also required to set plans for achieving each target and prepare at least one progress report relating to each milestone year no later than two years before the beginning of the relevant year.[17] 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.[18]

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, 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[19] (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.[20] It is fair to say that the actual enactment of this

10 Canadian Net-Zero Emissions Accountability Act, SC 2021 c 22 (https://laws-lois.justice.gc.ca/eng/acts/C-19.3/page-1.html#right-panel).

11 Canadian Net-Zero Emissions Accountability Act, SC 2021, c.22 [CNZEAA].

12 ibid., Section 6.

13 ibid., Section 7(1).

14 ibid., Section 7(1.1).

15 ibid., Section 7(2).

16 'Canada's 2021 Nationally Determined Contribution Under the Paris Agreement' (2021) (https://unfccc.int/sites/default/files/NDC/2022-06/Canada%27s%20Enhanced%20NDC%20Submission1_FINAL%20EN.pdf).

17 CNZEAA, Note 1, Sections 9 and 14.

18 Net-Zero Advisory Body (nzab2050.ca).

19 Bill S-243, An Act to enact the Climate-Aligned Finance Act and to make related amendments to other Acts, 1st Sess, 44th Parl, 2022 (https://www.parl.ca/DocumentViewer/en/44-1/bill/S-243/first-reading).

20 Government of Canada, How new laws and regulations are created (https://www.justice.gc.ca/eng/laws-lois/index.html).

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.[21] 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[22] and the Net-Zero Emissions Accountability Act.[23]

The Act would require, among other things:

a disclosures, for example:
- 'reporting entities' (defined below) must publicly report their plans and targets;[24] and
- a 'federal financial institution' (as defined below) must disclose how it 'financially facilities'[25] entities in a manner that either aligns or does not align with climate commitments;[26]

b 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;[27] and
- the creation of an action plan to incentivise financial products that support climate commitments and disincentivise those that are inconsistent with climate commitments;[28] and

c climate corporate governance, for example:
- certain enumerated entities must appoint board members with 'climate expertise';[29] and
- directors, officers or administrators of 'reporting entities' (as defined below) exercise their powers in a way that enables alignment with climate commitments.[30]

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.[31]

21 Bill S-243, Table of Provisions, Part 1.
22 Paris Agreement, Treaty Series, Vol. 3156 (4 November 2016).
23 Canadian Net-Zero Emissions Accountability Act, SC 2021 c 22.
24 ibid. at Section 7.
25 'Financially facilitates' means providing assistance or services of any financial value (e.g., debt and equity financing, project or general corporate financing, loans, loan guarantees, insurance, the issuances of any security, and the provision of any advisory, consulting or management services: Bill S-243, Section 2.
26 Bill S-243, Sections 6(6) and 7(1).
27 ibid. at Section 9.
28 ibid. at Section 10.
29 ibid. at Section 12.
30 ibid. at Section 16.
31 ibid. at Section 2.

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.[32]

More specific climate-related disclosure proposals that would apply to all FRFIs have been issued by OFSI.[33] Together with commitments banks have made within the NZBA, these disclosure requirements are expected, over time, to incent the use of sustainable finance instruments.[34]

The CSA have proposed climate-related disclosure rules that would apply to public companies in Canada.[35]

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.[36] It is unclear when this work may result in any published taxonomy.

Any offering in Canada of securities labelled pursuant to one of the sustainable finance labels is regulated by generally applicable securities laws.

IV 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. The government of 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

32 ibid. at Section 17(1).
33 See Section VII.
34 See Section VII.
35 See Section V.
36 Final Report of the Expert Panel on Sustainable Finance – Mobilizing Finance for Sustainable Growth, Government of Canada, 2019.

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).

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 benefitting 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.

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.

V SUSTAINABLE DISCLOSURE REQUIREMENTS AND TAXONOMY

At the time of writing, there are limited legally mandated sustainability disclosure requirements. The principle legal requirements relate to 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:[37]

a on their policies and targets regarding the representation of women on the board of directors and in executive positions;
b how representation of women is taken into account in selecting board and executive officer candidates;
c gender representation on the board and in executive officer positions; and
d term limits.

See also National Instrument 58-101 of the CSA Disclosure of Corporate Governance Practices.[38]

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.[39] 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.[40]

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).

Through 2021, a series of reports and reviews were prepared by the Ontario Securities Commission, the CSA and Corporations Canada, focusing on board and senior management diversity data, term limits and targets, and looking at diversity based on gender, visible minorities, persons with disabilities and indigenous peoples, to provide the basis for consultation towards further regulatory changes. The CSA continue to consider whether the diversity disclosure model should move from comply or explain to mandatory quotas in order to accelerate increased diversity. Further proposals to change the current diversity disclosure framework will be coming.

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

37 TSX Company Manual.
38 Canadian Securities Administrators, National Instrument 58-101 Disclosure of Corporate Governance Practices.
39 Canada Business Corporations Act RSC 1985, c. C-44, as amended, Section 172.1.
40 Diversity of board of directors and senior management guidelines, Corporations Canada, 7 February 2022.

(Climate Disclosure Proposals) for comment.[41] 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:

a 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;

b 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;

c risk management: describing its processes for identifying, assessing and managing climate-related risks and how these processes are integrated into overall risk management; and

d 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 arguably go further than the CSA proposals in a number of areas. Since the Canadian capital markets are very integrated into the North American and global capital markets, it is generally expected that the CSA will seek to avoid creating a unique 'made in Canada' disclosure rule on climate-related matters and will finalise its proposal once there is clarity on the SEC and ISSB final requirements. The CSA is also likely to want to avoid being seen as a 'laggard' in this area by adopting less onerous disclosure requirements, except for some limited circumstances where the nature of Canada's capital markets clearly justifies that approach (e.g., to recognise the significant small public company venture start-up part of the Canadian capital markets). This anticipated approach means that the adoption and implementation schedules for the requirements are somewhat uncertain.

41 Canadian Securities Administrators Consultation Climate-Related Disclosure Update and CSA Notice and Request for Comment; Proposed National Instrument 51-107 Disclosure of Climate-Related Matters, 18 October 2021.

On 19 January 2022, the CSA released Staff Notice 81-334 ESG-Related Investment Fund Disclosure (Notice) to provide guidance on the disclosure practices of investment funds as they relate to ESG considerations.[42] 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.

i Key developments

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.

ii Guidance

The Notice sets out guidance on how existing securities regulatory requirements apply to investment funds as they relate 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.

42 Canadian Securities Administrators CSA Staff Notice 81-334 'ESG-Related Investment Fund Disclosure' 19 January 2022. Description taken from Dentons Canada LLP article 'The Canadian Securities Administrators release ESG-related guidance for investment funds', 11 February 2022.

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 in relation to 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. Such inclusion can provide clarity about how voting rights will be used to further the fund's ESG-related 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-related risk factors are relevant to the fund and to disclose such 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-related 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-related 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-related 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 such 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-related 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 an 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.

VI ESG DATA AND REPORTING

At the time of writing, mandatory reporting relating to sustainable investments is limited to diversity matters.[43] 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

43 See Section V.

principles.[44] 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.[45]

Various proposals are being considered at the time of writing that would impose mandatory data and reporting requirements.[46]

VII 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 incent 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 climate risk management proposal from OSFI and commitments made by financial institutions that have signed on to the NZBA.

OSFI has, for example, proposed a Draft Guideline B-15: Climate Risk Management (Guideline), which proposes a climate-sensitive prudential framework that would apply to all FRFIs.[47] OSFI has announced that it will communicate any subsequent changes to the Guideline's planned publication, although a 2023 release is anticipated, with application potentially for fiscal periods ending on or after 1 October 2023.[48]

On 26 May 2022, OSFI issued a draft version of the Guideline, advancing a climate-sensitive prudential framework that establishes a mandatory climate-related financial disclosure regime.[49] According to OSFI, such 'disclosures incentivize improvements in the quality of the FRFI's governance and risk management practices over time and contribute to public confidence in the Canadian financial system'.[50]

44 See, for example, International Capital Market Association, Green Bond Principles and Sustainability-Linked Bond Principles.

45 Canadian Securities Administrators Consultation Climate-Related Disclosure update and CSA Notice and Request for Comment; Proposed National Instrument 51-107 Disclosure of Climate-Related matters, 18 October 2021.

46 See Section V.

47 Canada, Office of the Superintendent of Financial Institutions, Draft Guideline B-15: Climate Risk Management (Ottawa: Office of the Superintendent of Financial Institutions, 2022) at Annex 2.1 [Draft Guideline B-15].

48 ibid. at Paragraph 25.

49 Office of the Superintendent of Financial Institutions, News Release, 'OSFI consults on expectations to advance climate risk management' (26 May 2022), online: OSFI Public Affairs (www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/Pages/b15-dft_nr.aspx).

50 ibid. at Paragraph 25.

Chapter 2 of the Guideline requires all FRFIs, except for subsidiaries of FRFIs that report consolidated results to OSFI, to make climate-related financial disclosures.[51] As such, all Canadian banks fall within the scope of the Guideline.[52] Importantly, the required disclosures include Scope 1, 2 and 3 emissions.

OSFI's climate-risk related financial disclosure expectations for FRFIs are as follows.[53]

Expectations	Disclosures
Expectations based on the Financial Stability Board's Task Force on Climate-Related Disclosures Framework and the International Sustainability Standards Board's (ISSB) Exposure Draft on Climate-Related Disclosures.	• Governance; • strategy; • risk management; • metrics and targets; • greenhouse gas emissions (Scope 1, 2 and 3); • ISSB cross-industry metrics; and • ISSB industry-specific metrics for banks and insurers.
Other expectations	• Climate transition plan; and • net-zero commitment(s), if the federally regulated financial institution has made one or more, whether through the Net-Zero Banking Alliance or otherwise.

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.[54] On 21 October 2021, 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 became NZBA signatories.[55] 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.[56] 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.[57] 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.[58]

51 Canada, Office of the Superintendent of Financial Institutions, Draft Guideline B-15: Climate Risk Management (Ottawa: Office of the Superintendent of Financial Institutions, 2022) at Annex 2.1 [Draft Guideline B-15].

52 Office of the Superintendent of Financial Institutions, 'Who we Regulate,' online: OSFI (www.osfi-bsif.gc.ca/Eng/wt-ow/Pages/wwr-er.aspx?sc=1&gc=1#WWRLink11/>).

53 ibid. at Annex 2.1.

54 Net-Zero Banking Alliance, Note 16.

55 ibid.

56 UN Environment Programme Finance Initiative, 'Net-Zero Banking Alliance,' online: UNEP-FI (www.unepfi.org/net-zero-banking) [Net-Zero Banking Alliance].

57 Net-Zero Banking Alliance, 'Frequently Asked Questions' (2 August 2022), online (pdf): UNEP-FI (www.unepfi.org/wordpress/wp-content/uploads/2022/06/FAQ-General-3.pdf) [Frequently Asked Questions].

58 ibid.

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.[59] All signatories must commit to the following:

a 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;

b 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;

c 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;

d 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

e to take a robust approach to the role of offsets in transition plans.[60]

VIII 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.[61] 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 or 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.

IX CLIMATE CHANGE IMPACT

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.

X 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

59 Frequently Asked Questions, Note 17.

60 Net-Zero Banking Alliance, Note 16.

61 Final Report of the Expert Panel on Sustainable Finance – Mobilizing Finance for Sustainable Growth, Government of Canada, 2019.

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.

Appendix 1

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Bill G Gilliland is a member of Dentons' corporate, securities and M&A practice group. Bill advises power and energy infrastructure companies on capital markets and M&A transactions, as well as board governance generally. Bill is a leader in ESG finance, representing Dentons Canada as a member of the International Capital Markets Association Green Bond Principles since 2014 and also as a member of the CSA Group's technical committee developing the Made in Canada Transition Finance Taxonomy following the 2019 recommendations of the Federal Government's Expert Panel on Sustainable Finance. Bill is a member of the Advisory Council to the Green and Social Bond Principles Executive Committee. Bill's work includes ESG and sustainable finance, including in the areas of green, transition and sustainability bonds. Bill holds the ICD.D designation from the Institute of Corporate Directors and has completed the board oversight of climate change course. Bill is a co-leader of Dentons Canada's Sustainability Committee.

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PREFACE

Sustainable finance is a relative youngster in the world of finance, but it is growing up fast. Public and private financing of sustainable/green projects, or those with provisions in line with borrowers' and issuers' environmental, social and governance (ESG) commitments, has exploded.

Since the signing of the Paris Agreement in 2015, more than 100 countries have committed to net zero emissions targets. Countries have also acted at a national level with ambitious target-setting and nationally determined contributions (NDC) pursuant to the Paris Agreement. They are not alone. By mid-2022, more than one-third of the world's largest publicly traded companies had net zero targets. Financial institutions have also engaged with various policies introduced to enshrine ESG commitments, in terms of both their own lending targets and the carbon emissions linked to those targets. Investors at both retail and institutional levels increasingly look to the financial markets as an important lever in achieving such targets.

For over three decades the United Nations has brought together almost every country on earth for the global climate summits – known as the Conference of the Parties (COP). At COP26 in 2021, private finance showed up in force to play its role in the transformation of the business ecosystem as we know it. Precisely what that role entails is a live debate and the discussions regarding the purpose of sustainable finance cover a wide spectrum of issues – from greenwashing, to the fundamental shift of credit including the risks and opportunities of ESG considerations. We saw that debate play out in real time during COP27.

Notwithstanding ongoing considerations about the purpose of sustainable finance, financial market participants have reacted by creating a wide variety of financial products marketed as sustainable, green or ESG-friendly. The rapid increase in both supply of and demand for sustainable investment products has, at times, resulted in a lack of consistency, transparency and reliability of disclosures and metrics. Governments and regulatory bodies are increasingly focused on imposing guidelines and frameworks to address these issues.

Although sustainable finance continues to elude strict definition at present, significant efforts are being made globally to ensure quality and transparency in the industry, to impose consistent frameworks such as the International Sustainability Standards Board (ISSB) and disclosure requirements such as those of the Task Force on Climate-related Financial Disclosures (TCFD) that support comparability and interoperability among firms and products, and to provide investors with sufficient information to monitor the impact of their investments.

In this inaugural edition we aim to:

a provide a snapshot of the current state of sustainable finance and the status of regulatory efforts across multiple jurisdictions; and

b track the evolution of sustainable finance and outline key trends for the near future.

I thank all of the contributors for their expertise, hard work and dedication in producing this volume.

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Ashurst LLP
London
December 2022

Appendix 1

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Anna-Marie has over two decades of finance experience acting for investment banks and companies in a wide range of corporate finance and securities transactions, including high yield debt offerings, sustainable finance, liability management including consents and tender offers, refinancings and numerous securities transactions, such as Rule 144A and Regulation S debt offerings, as well as mezzanine debt investments and senior credit facilities.

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