# Recommendations of Task Force on Climate-related Financial Disclosures – review of local relevance

## CANADA

# 1. Background - why this review?

In December 2016, the industry-led Task Force on Climate-related Financial Disclosures (TCFD), convened by the Financial Stability Board at the request of G20 Finance Ministers and Central Bank Governors, released its draft recommendations. The framework aims to promote more informed investment, lending and insurance underwriting decisions, enabling each to better understand climate-related risks and financial system exposure to them, and from there, to integrate climate risk into businesses and their long-term, strategic decision-making, and better protect investments.

This review of Canada's existing regulation describes Canada's existing climate change-related commitments (see Appendix 1), and considers existing regulation and policy on climate-related disclosure for companies, and investors/pension funds. Its analysis builds on the findings of the Fiduciary Duty in the 21st Century Canada Roadmap developed by the PRI, UNEP FI and The Generation Foundation to overcome barriers to integrating ESG throughout the investment chain. It also draws on the regulatory analysis from PRI and MSCI's Global Guide to Responsible Investment Regulation, which examined the breadth of responsible investment-related public policy initiatives across 50 economies, including Canada.

**The PRI's response to Baker McKenzie's findings**

The TCFD's recommendations are voluntary and do not supersede national disclosure requirements. In Canada, the TCFD's recommendations will assist in implementing existing regulation and guidance, bringing quality and consistency to disclosures. Implementation of the TCFD could also support meeting Canada's national climate change commitments under The Paris Agreement (see Appendix 1).

**Three practical actions for better disclosure in Canada**

1. Government: The Government of Canada, and federal and provincial regulators (including the Canadian Securities Administrators) should endorse the TCFD's final recommendations.
2. Stock exchanges: The Toronto Stock Exchange and TSX Venture Exchange should consider referencing the TCFD's recommendations in reporting guidance and in addition, consider joining the Sustainable Stock Exchanges Initiative.
3. Companies and investors should adopt the TCFD's recommendations as a useful voluntary framework for climate-related financial disclosures. Collaboration on implementation challenges: sharing of good practices could assist in overcoming initial challenges, with convergence in reporting frameworks needed in the longer-term.

**Action the PRI will take**

The PRI has over 1,700 signatories in 50 countries, representing over US$72 trillion in assets under management. In 2017-18, the PRI will support Canadian PRI signatories in:

- Active ownership: We will convene collaborative global investor engagement with companies to adopt the TCFD's final recommendations.
- Investor disclosure: We will evolve the PRI's Reporting Framework with the TCFD's guidance for asset owners and asset managers.
- Investment practices: We will advance investment practices in assessment and management of climate-related risks and opportunities.
- Collaboration with policymakers: We will draw on our expertise in responsible investment practices and policy to encourage G20 policymakers to implement the TCFD.
- Addressing barriers around responsibility investment: The PRI has set out its priorities for the next ten years in its Responsible Investment Blueprint, published in May 2017.

Building on these findings, this review concludes that a strong disclosure regime such as that identified by the TCFD under its recommendations would assist materially in ensuring climate risk mitigation in Canada, facilitating better investment decisions and assisting with the maintenance of financial stability, as Canada and its global trading partners seek to transition to a lower carbon economy.

# 2. Private sector regulation

In the early part of 2016, the PRI mapped out all existing responsible investment policy – almost 300 individual policy tools or market-led initiatives, covering the relationship between finance and ESG issues. These measures can be broadly grouped into three main categories which relate to different parts of the investment chain: pension fund regulations, stewardship codes and corporate disclosure requirements.[1]

Canada has limited corporate ESG disclosure measures at the national level and pension fund ESG disclosure measures in some provinces. Climate change is indirectly addressed through the environmental requirements of these broader measures, but is largely not addressed as an individual issue.

## 2.1 Disclosure requirements for companies

The Canadian markets are slow to implement changes that would encourage companies to think about climate related risks differently than they have in the past.

The Canadian Securities Administrators is an informal body of securities regulators from across Canada that co-ordinates and harmonizes regulation for the Canadian capital markets. For public companies in Canada, the Administrators are examining the need for disclosure of climate risk on mandatory financial disclosure documents. While they have considered the issue previously, under current rules, material risks may include climate-related risks, but there is no requirement that they be included separately as such. The Canadian Securities Administrators have previously produced guidance for companies (CSA Staff Notice 51-333 Environmental Reporting Guidance) to help them address these requirements, but that guidance does little to prescribe actual disclosure.

In March 2017, the Canadian Securities Administrators did announce that they would launch a project to scrutinize how well public companies are disclosing risks and financial impacts relating to climate change. This appears consistent with a growing global movement that officials say reflects demand from investors for better information about environmental risks. The project will gather input from issuers and investors through an anonymous online survey. The project will also evaluate Canadian disclosures in comparison with other countries’ policies and international movements to boost climate-related disclosures.

> To view Canada’s complete responsible investment framework, visit the PRI’s Regulation Map.
>
> For each measure, it indicates the nature of the rule, the year of implementation, the authority responsible, whether the measure is voluntary or mandatory, and if it addresses ESG issues in isolation or in combination. It also provides commentary on the key clauses relating to ESG factors and investment.
>
> To view the map and download the full methodology, visit the PRI website.
>
> For further information, email policy@unpri.org

[1] PRI and MSCI. The Global Guide to Responsible Investment Regulation, pages 9-10.

The Canadian Securities Administrators do require mining companies to report on reasonably available information on environmental, permitting, and social or community factors as it relates to mineral exploration, development, and production activities on a mineral property that is material to the issuer. In some cases, this would extend to reporting of climate change issues. The implementation of carbon pricing mechanisms and incentives to shift towards lower emissions energy sources are likely to particularly affect the mining and other fossil-fuel focused sectors, along with other risks – technological, market and reputational. However, it may be that with better and more reliable disclosure by these sectors as a whole, companies within them may be able to distinguish themselves from their competitors by being open regarding the steps they are taking to mitigate climate-related risks to their assets and business models.

Broadly, if any environmental or social information is deemed "material" to a public company, it must be immediately disclosed by a news release and a public report made. These requirements arise under general public company securities laws as well as timely disclosure policies of the Toronto Stock Exchange and the TSX Venture Exchange.

In a December 2016 review of climate-related disclosure by the Chartered Professional Accountants of Canada, it was found that the majority of surveyed companies were making climate-related disclosures, but that the disclosures lacked consistency and context. An investor weighing investment decisions would find it difficult to compare the climate risk disclosed by different companies in different industries.

Federal Canadian environmental legislation requires companies to provide information on specific pollutant emissions for inclusion in the National Pollutant Release Inventory and to participate in the GHG Emissions Reporting Program.

Canadian mutual funds are subject to national regulation, including National Instrument 51-102 Continuous Disclosure Regulations, which sets out the obligations of public issuers. Those obligations include disclosure requirements on environmental and social policies, the operational and financial effects of environmental protection, environmental risks and liabilities.

Company disclosure requirements in Canada can therefore be described as progressing relatively slowly, with some additional requirements on fossil-fuel focused industries than other sectors, and climate disclosure often falling within general environmental reporting obligations rather than being treated as a separate factor with its own financial implications. A key area for development of corporate climate disclosure in Canada appears to be the consistency and context of disclosure obligations and outputs across different companies and different industries.

The PRI, UNEP FI and Generation Foundation Fiduciary Duty in the 21st Century Canada Roadmap recommends for the CSA to engage on the reporting of material ESG factors by Canadian corporations following the release of the FSB TCFD report.[2]

For a complete analysis of the evolving landscape of fiduciary duty in the Canadian market, download the Fiduciary Duty in the 21st Century Canada Roadmap developed by the PRI, UNEP FI and The Generation Foundation.

The roadmap builds on conversations with over thirty key market stakeholders and makes recommendations to implement clear and accountable policy and practice that embraces the modern interpretation of fiduciary duty.

The Canada roadmap is part of a larger work programme on fiduciary duty. For more information, visit www.fiduciaryduty21.org.

[2] PRI, UNEP FI and The Generation Foundation. Fiduciary Duty in the 21st Century Canada Roadmap, page 12.

## 2.2 Climate change-related aspects of pension fund/investor regulation

As noted above, despite Canadian pension plans being some of the largest private investors in the world, little exists in the Canadian regulatory system to specifically require these investors to address climate change issues. Pension plan legislation and case law for trustee obligations varies from one Canadian province to another. Generally, under Canadian law, fiduciary duties are imposed on a person who exercises discretionary power on behalf of another person who has deposited their trust and confidence in that person. A fiduciary's duties to beneficiaries are a duty to act prudently and a duty of loyalty. Other duties then extend out of these two principal duties.

The exact scope of a fiduciary's duties is dependent upon the nature of the fiduciary's relationship with the beneficiaries. In the case of pension plans, pension plan trustees are considered fiduciaries whose duties must be interpreted in a manner consistent with the purposes of a pension plan – usually to provide a retirement income for employees upon retirement. The fiduciary law applicable to pension plan trustees has been established by the courts, modified to apply to the pension context and reflected in pension plan legislation. For example, pension funds in Ontario are required to disclose in their investment policies 'information about whether environmental, social and governance factors are incorporated into the plan's investment policies and procedures and, if so, how those factors are incorporated'. In Canada, pension funds are permitted to take ESG factors into account as long as they are otherwise consistent with the applicable fiduciary standards.

All of the Canadian provinces have legislation affecting the duties of trustees. For example, in British Columbia, the Trustee Act requires a trustee to exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments. The standard of care in the duty of prudence, has, in the pension plan context, been elevated beyond what would normally be required of a fiduciary. Instead of being required to exercise the same degree of care as would a person of ordinary prudence in respect of their own property, the duty of care set out in British Columbia's new Pension Benefits Standards Act, requires an administrator to "exercise the care, diligence and skill that a person of ordinary prudence would exercise when dealing with the property of another person".

The duty of loyalty to pension plan beneficiaries is the paramount duty of pension fund trustees. That duty requires that pension fund fiduciaries act in the best interests of beneficiaries in accordance with the terms of the trust, which in theory introduces a fact specific analysis of the duty. In general, Canadian law imposes duties to:

- treat all beneficiaries impartially;
- act honestly;
- disclose relevant information, inform, and consult; and
- prevent other interests from conflicting with their duty to beneficiaries – for example to
  - not profit from their position
  - not benefit third parties; and
  - not be swayed by personal, political or social/economic belief.

All of the provinces except for Prince Edward Island, have pension benefits legislation dealing with the fiduciary duties of pension trustees and reflecting the duty of loyalty. However, those requirements do not specifically consider climate change risks.

Several large Canadian pension plans (OPTrust, CPPIB, La Caisse de depot et placement du Quebec) have recently announced intentions to review and consider climate change risks. For pension plan trustees, the Canadian system does not make a meaningful distinction between "non-financial" criteria that may affect financial performance and financial criteria; as such trustees must take both into account when making investment decisions. Since climate change risks may affect financial performance, the general conclusion, but untested legal requirement, is that climate change risks must be considered by pension fund fiduciaries where the risk is not too remote.

As for many other countries which regulate investment decision-making by pension funds, the Canadian pension fund regulation is primarily duty-based, requiring decision-makers to exercise judgement in the context of those duties when determining relevant factors for investment decisions, including in relation to climate change. There appears to be no specific guidance or precedent for the integration of climate-related risks into pension fund investment decisions, which leaves it open to individual funds to decide on the extent to which such integration is required in order to discharge their broader statutory duties. This means it may be difficult to meaningfully compare investments by these funds, as they are not necessarily considering climate-related risks to potential or existing investments in a uniform way, or required to be open and transparent about the extent or nature of that consideration.

The Fiduciary Duty in the 21st Century Canada Roadmap recommends for federal and provincial regulators to require ESG disclosure by pension plans, consistent with Ontario's approach.[3]

# 3. Conclusion

Canada's existing regulations requiring climate disclosure are not yet consistent across sectors or in relation to the scope or medium of reporting. As Canada has been relatively slow to implement comprehensive regulations incentivising or compelling companies to consider and disclose climate risk exposure, adoption of a clear framework consistent with the TCFD's recommendations is likely to assist significantly in enabling companies to understand the ideal scope of their disclosures and to integrate climate risk awareness into their businesses and existing (or developing) reporting systems.

Such a framework would improve the quality and consistency of information available to investors, particularly in terms of identifying vulnerable and less vulnerable companies, and particularly companies which are regarding the transition as an opportunity to improve their sustainability and attractiveness to investors.

Climate-related disclosures made as part of mainstream financial filings will not only ensure the quality of information disclosed, but also promote and normalise the inclusion and importance of this information within the corporate and investor communities in Canada, in the context of this slow evolution of regulation on the subject. Additionally, detailed and commercial disclosures will maintain and perhaps improve investor confidence, due to the ability to consider and rely on the types of information the TCFD recommends be disclosed by all sectors, including climate risk consideration at a company's board level, how climate risks and opportunities are contemplated by the company's strategy and its risk management processes, and the quality of the company's methods for measuring and monitoring the impacts of those risks and opportunities on its business.

The disclosure framework would be widely adoptable across sectors, enabling clearer and more consistent comparison between companies within a jurisdiction. This is likely to assist Canadian companies and investors in carrying out effective disclosure and in understanding disclosed information despite Canada's multiple sub-national legal jurisdictions.

Given Canada's unique position regarding climate risks, including its large area and diverse range of likely physical climate-related impacts, and its natural-resource reliant economy, adoption of a reliable and transparent disclosure framework will be a central element in its smooth transition to a lower carbon economy and maintaining the stability of financial markets as the transition occurs.

It is clear from the above analysis that in Canada, implementation of the TCFD's recommendations will assist the financial sector, and those areas of the non-financial sector which face additional risk exposure during and after the transition to a global lower carbon economy, to understand and act effectively upon material climate-related risks.

[3] PRI, UNEP FI and The Generation Foundation. Fiduciary Duty in the 21st Century Canada Roadmap, page 9.

# Appendix 1: Summary of Canada's climate change commitments

Over 146 parties have ratified the Paris Agreement. Its central aim is to strengthen the global response to climate change by keeping a global temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius. The goal is feasible, but only if emissions peak by 2020 at the latest. The Paris Agreement requires all parties to put forward “nationally determined contributions” (NDCs), including a requirement to report regularly on their emissions, and on their implementation efforts. In 2018, parties will take stock of the collective efforts to progress towards the goal set in the Paris Agreement.

Climate disclosure supports the Paris Agreement goals and NDCs, by enabling company and investor management of material climate-related risks and opportunities.

Canada's first NDC consists of a commitment to achieve an economy-wide target to reduce its greenhouse gas (GHG) emissions by 30% below 2005 levels by 2030. Since 2006, the Canadian government has taken the following regulatory actions targeting three key sectors:

1. Transportation: Establishing progressively more onerous GHG emission standards for heavy-duty vehicles (model years 2014-2018) and for passenger automobiles and light trucks (model years 2011-2025);
2. Electricity: Banning the construction of traditional coal-fired electricity generating units, leading to the phase-out of existing coal-fired electricity units without carbon capture and storage; and
3. Renewable fuels: Requiring that gasoline contain an average 5% renewable fuel content and most diesel fuel contain an average 2% content.

Additionally, the federal government is currently developing further regulatory measures that will:

- extend the onerous GHG emission standards for heavy-duty vehicles to post-2018 model years;
- progressively reduce hydrofluorocarbons, which will limit GHG emissions that are expected to increase substantially in the next 10 to 15 years;
- reduce GHG emissions from natural gas-fired electricity, as well as from chemicals and nitrogen fertilizers; and
- reduce methane emissions from the oil and gas sector.

Under the 2009 Copenhagen Accord, Canada had previously pledged to reduce its GHG emissions by 17% below 2005 levels by 2020. While the Canadian government has invested more than $10 billion in green infrastructure, energy efficiency, clean energy technologies, cleaner fuels and smarter grids since 2006, between 2005 to 2013, Canadian GHG emissions have only decreased by 3.1%[4].

[4] Government of Canada, 'Canada's INDC Submission to the UNFCCC', October 2016 http://www4.unfccc.int/ndcregistry/PublishedDocuments/Canada%20First/INDC%20-%20Canada%20-%20English.pdf.

Figure 1 below illustrates the wide disparity between Canada's GHG emission projections in 2020 and 2030 and its targets.

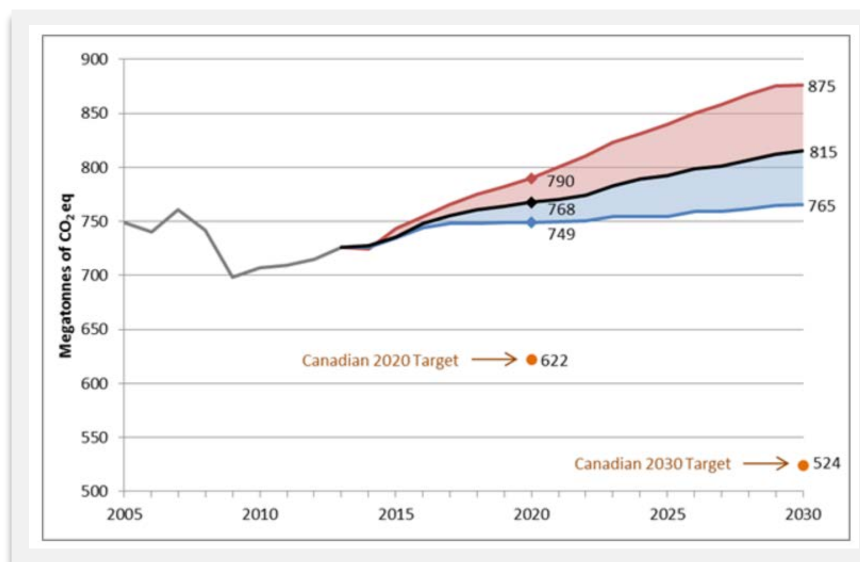


**Figure 1: Canada's Emission Projections in 2020 and 2030 (Mt $CO_2$ eq)** [5]

As a vast Northern nation, Canada faces unique challenges in addressing climate change issues: it has a growing population, extreme temperatures (sometimes in both directions), a large landmass (largely undeveloped), a diversified growing economy with significant natural resources and distinctive cultural populations across the country. As a result, it is challenging to come up with a country-wide NDC. Fortunately the starting point for Canada's position is a relatively good one: Canada has one of the cleanest electricity systems among G7 and G20 nations, with approximately 75% of its electricity supply already emitting no GHGs.

Adding to the geographical challenges, Canadian provinces and territories have significant authority over the areas of natural resources, energy, and the environment. Each has its own legal framework and its own policies and measures which together will form the basis of Canada's attempt to reduce GHG emissions. Mechanisms exist for the federal government to engage with Canadian provinces and territories, as well as other key partners and stakeholders, on climate change, but it remains to be seen where the line will be drawn allocating ultimate responsibility for change.

Although Canada produces less than 2% of the world's GHG emissions, Canada has committed to doing its part to address climate change issues. As noted above, as part of its NDC Canada intends to achieve an economy-wide target to reduce its GHG emissions by 30% below 2005 levels by 2030. The Canadian government maintains that this target is ambitious but achievable despite the challenges presented by the characteristics set out above. Reaching this ambitious target will require new policies in additional sectors and coordinated action in integrated sectors, both of which approaches have proved challenging to date. Canada has also indicated it will use international mechanisms to achieve the target, subject to checks and balances to ensure real and verified emissions reductions are achieved.

[5] Environment and Climate Change Canada, 'Canada's Second Biennial Report on Climate Change', 2016 https://www.ec.gc.ca/ges-ghg/02D095CB-BAB0-40D6-B7F0-828145249AF5/3001%20UNFCCC%202nd%20Biennial%20Report_e_v7_lowRes.pdf.

An additional factor that plays into the analysis of Canada's NDC is the dramatic shift in the Canadian political landscape. While Canada's NDC commitment was submitted by the previous federal government administration, that government was criticized for its overall lack of commitment to action. The since elected new federal government has indicted a much more engaged approach to climate change matters and appears to be attempting to unify the Canadian provinces in generally piecing together an overall Canadian NDC, even if it is isn't uniform across the country. This approach will allow Canadian provinces like Quebec, Ontario, British Columbia and Nova Scotia to take advantage of the efforts already made.

In Canada, there are challenges to immediately reducing GHG emissions from emissions-intensive heavy industry, primary extraction, and certain applications in the transportation sector. Instead, in the short to-medium term, there may be other more cost effective GHG reduction opportunities in other sectors or regions, where abatement technologies are more effective or lower-GHG alternatives exist. Despite these difficulties, Canada has made efforts to transition to lower emission electricity generation and fuel standards that impact the transportation sector. The Canadian NDC is still being refined, but overall presents opportunities for investors due to its focus on technology and innovation, sustainable infrastructure and low carbon energy generation.

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## About the Principles for Responsible Investment

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system. The Principles have over 1,700 signatories globally, representing over US$72 trillion in assets under management.

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