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Witness Brief to the Standing Senate Committee on Banking, Commerce and the Economy
Topic: Bill S-243 on "Enacting Climate Commitments Act"

As is well documented by the Basel Committee on Banking Supervision, the financial supervisors Network for Greening the Financial System (NGFS) and many others, climate change poses risks to the financial system. Misalignment with global climate objectives (i.e. net-zero) may result in short-, medium- and long-term financial risks for financial institutions individually as well as threaten financial stability overall. Going beyond the climate tipping points could trigger abrupt changes in risks, potentially causing widespread disruptions across the financial system.

From a regulatory perspective, there is a dual rationale to prioritize climate alignment in financial regulation. First, climate alignment can enhance the risk-based approach by providing a forward-looking view and enhancing its effectiveness. An enhanced risk-based approach to climate risk, for example considering the risks stemming from economic activities' misalignment with net-zero targets, would address longer-term systemic risks and strengthen the focus on regulatory tools not just for medium term stability but for ensuring long-term safety and soundness of financial markets. Second, climate alignment can empower financial institutions to act as catalysts in driving the transition towards a sound and sustainable economy and accelerate transition focused financing.

In recent years, regulatory sustainable finance initiatives have increased substantially across jurisdictions, aiming at, for example (i) increasing transparency of sustainability information,

(ii) addressing greenwashing, and (iii) strengthening climate-related risk management practices. These developments are an important prerequisite for intensified net-zero alignment across the financial system and the entire economy. Regulatory instruments can support deep emissions reductions and climate resilience if scaled up and applied widely.

In line with global developments and to address the financial stability implications of climate change, Canada has expressed its commitment to transition to a carbon neutral economy and society. The Canadian Net-Zero Emissions Accountability Act is foundational for further policy action and we congratulate the Canadian government on this important step. Equally, we welcome Canada's recognition that the private sector, and particularly the finance industry, have a key role to play in achieving the overall net-zero policy agenda. The establishment in 2018 of the Canadian Expert Panel on Sustainable Finance and in 2021 of the Sustainable Finance Action Council are important steps in this regard.

Voluntary commitments have been critical in raising the overall commitment in the financial sector and in defining its contribution to the sustainability transition. Many financial institutions, including leading Canadian banks, insurers and investors, have already begun integrating sustainability considerations into their operations. For example, they identify sustainability as a key priority within their business strategy and reflect this in their governance and compensation policies. They establish systems to analyze the climate-related risks and impact of their financing and have begun making sustainability disclosures. Most of this is done on a voluntary basis, at least so far. The private sector needs room to innovate but voluntary leadership from industry and regulatory action from government needs to work hand in hand, each signaling the other towards market uptake, learning and ever-increasing ambition and innovation.

To play their role and accelerate the decarbonization of their portfolios, Canadian and global financial institutions need a predictable and enabling policy environment. Specifically, in order to meet net-zero commitments, there is a need to reinforce the predominantly backward-looking risk-based approach with more forward-looking and longer-term tools. This is key for accelerating transition finance and proactively preventing potential disruptive impacts stemming from climate change to the financial system.

To enable the transition, financial institutions need the policy environment to be increasingly forward-looking. Many sustainable finance rules tend to concentrate on what is sustainable today and the reorientation of capital in that direction. This is only part of the solution. More emphasis is needed on the dynamic process of companies becoming sustainable and the financing thereof.

We therefore welcome CAFA's focus on enhancing the reporting and disclosure of companies' efforts to align their activities with net-zero commitments in welcome. Such reporting is important for enhancing the transparency, credibility and ultimately the effectiveness of net-zero commitments across the economy and ultimately to ensure the integrity of the transition. The development of international disclosure standards should be advanced as to ensure optimal allocation of capital to the net-zero transition. In particular, transition plans are a valuable forward-looking tool that reflects how banks and non-financial corporates will meet and contribute to global climate objectives. A uniform transition plan requirement for banks, aligned with transition plan requirements for the real economy, that serves the information needs by various stakeholders is needed to ensure credibility, consistency, and operability of the plan. Disclosure and transition plan requirements should be coordinated and aligned internationally as best as possible, while maintaining a sufficient level of ambition.

The requirements set forth by CAFA, and Canada's wider net-zero transition, will be most effective if embedded in a regulatory enabling environment. At a high level, the role of sustainable finance policy can only be effective I embedded in a whole-of-government approach. Global climate objectives should be integrated into policymaking across various domains to increase its effectiveness. A key aspect of this is the development of relevant sector emission reduction pathways for the real economy.

Also, the potential for a Canadian taxonomy to be used as a forward-looking tool to accelerate the net-zero transition is key. Taxonomies are often considered a static tool focused on defining green today. But if coupled with forward-looking disclosure metrics, such as capital expenditure metrics, they can provide a dynamic picture of the concrete actions that corporates are taking to align with taxonomy requirements in the future. Over 40 countries have developed/are in the process of developing taxonomies for climate mitigation and adaptation. Recent announcements in the Fall Economic Statement that the government of Canada will undertake next steps to develop a taxonomy that is aligned with reaching net-zero by 2050 are hence very encouraging.

Another aspect of such an enabling environment is that financial institutions must be empowered to unlock transition opportunities through sharing client engagement best practices. Meaningful client engagement not only allows banks to mitigate transition risks but also creates the opportunity to develop new financing solutions and non-financial services in relation to the client's transition capacity and needs. Supervisors should empower banks to seize transition opportunities through active client engagement by sharing guidance and best practices.

The risk of regulatory fragmentation is serious, making it harder to implement a diverse set of requirements across borders. This risks making sustainable finance a compliance exercise and a missed opportunity for banks and other FIs to play their part in enabling the transition. Banks need globally consistent regulatory standards and definitions in order to focus on the transition challenges ahead. What is needed are internationally aligned and coordinated transition requirements. As described above, banks and other financial institutions have gone a long way to commit to and implement voluntary commitments such as the UN Principles for Responsible Banking and net-zero alliances. As far as possible, regulatory developments should be aligned with voluntary principles for greater consistency. Voluntary initiatives can provide leadership and best practice, but what is leadership today should become mainstream over time. Policy and regulation can help achieve this. We therefore highly welcome that CAFA draws on international best-practice and recommendations to support global alignment of sustainable finance frameworks.

Thank you for your time and consideration.

Sincerely,

Eric Usher