



TIME TO ACT

Response to questions posed by the Expert Panel on Sustainable Finance on Fiduciary Obligation and Effective Climate-related Financial Disclosures

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Janis Sarra and Cynthia Williams*

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Executive Summary

The Expert Panel on Sustainable Finance has been commissioned by the Canadian Government to determine how best to generate sustainable finance, a significant challenge given the carbon intensity of Canada's economy. The Expert Panel has defined sustainable finance as capital flows, risk management activities and financial processes that assimilate environmental and social factors as a means of promoting sustainable economic growth and the long-term stability of the financial system. While there are numerous strategies to be deployed to move Canada to a financially sustainable future, this report addresses two critically important issues: fiduciary obligation of corporate- and pension-fiduciaries, and national action on environmental, social and governance ("ESG") financial disclosure, including climate-related financial risk disclosure.

Our economy is facing significant challenges and disruptions in the transition to a lower carbon world. Our view is that absent clear and innovative steps to ensure our corporations and financial institutions act to address carbon emissions and other environmental, social and governance risks and opportunities, we will be seriously prejudiced in a world that is rapidly moving towards greener and more sustainable economic activity.

Our report offers a comprehensive set of recommendations on these fiduciary obligation and disclosure. Our four top priorities are:

- Amend the *Canada Business Corporations Act*, the *Bank Act* and the *Insurance Companies Act* to embed ESG factors, including climate-related risks and opportunities, in the fiduciary obligation of directors and officers.
- Embed ESG matters in financial statements and enhance corporate disclosure on ESG, including climate-related financial risk, in reporting requirements of publicly-listed companies.
- Require institutional investors and asset managers, including pension funds and mutual funds, to disclose how their portfolio management, voting and engagement activities are contributing to a lower carbon economy.
- Endorse the TCFD disclosure framework and work with accounting standards setters and securities authorities to align climate-related financial disclosure.

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It is time for the federal government to act to build further on the fiduciary obligation that already exists at Canadian common law and in corporate law with respect to directors and officers, as well as to codify the obligations that already exist in order to provide greater transparency to the public. We also make recommendations to align sustainability disclosure requirements with developments nationally and internationally. It is the moment for Canada to show leadership on the issue of transparency regarding factors that pose material risks and opportunities so that Canada will truly transition to a greener economy. We want corporate boards to be identifying ESG material risks and opportunities, and to be disclosing their thinking and activities on those risks and opportunities to their stakeholders, without fear of liability when they are duly diligent in their consideration of these issues.

There are currently 120 Canadian corporate and investment firm signatories to the UN Principles for Responsible Investment, representing assets under management of over \$4 trillion. These firms have committed to the integration of ESG issues into corporate and investment analysis and decision-making processes. That level of support speaks to the growing recognition that effective corporate governance includes addressing ESG risks and opportunities.

The Expert Panel has received opinions concerning many broad policy considerations and a great deal of advice from participants in the financial sector. Our report is purposely very detailed as to the precise statutory amendments that the federal government should enact now to meaningfully move Canada forward on sustainable finance. Our 25 recommendations serve as a practical guide to changes in statutory language that are required based on the type of legislation and area of fiduciary obligation and disclosure discussed. The majority of the 72 questions posed by the Expert Panel will not likely require legislative change, but rather, will require innovative thinking, new finance, a principled commitment to a lower carbon economy backed by meaningful economic and technological strategies, and strong partnerships between governments, the private sector, the not-for-profit and non-governmental organization sectors. Our recommendations are “legislatively focused” in this submission because they build on existing statutory duties. The improvements suggested are aimed at providing a baseline commitment, across the board, for all federally-regulated corporations, financial institutions, investment funds and pension funds, to embed sustainable thinking in the discharge of their fiduciary obligations. They are largely principles-based, setting threshold standards, which directors and officers can then implement as they believe appropriate for their organization. Our recommendations are timely and practical, and give specifics on how changes can be accomplished at the federal level.

A priority is to amend the *Canada Business Corporations Act (CBCA)* to contain four new provisions regarding directors’ fiduciary obligations. First, amend the statute to require directors and officers to “consider” ESG factors with a view to the corporation’s best interest. In considering ESG factors, directors and officers may conclude that ESG factors *are* or *are not* factors posing a material risk or opportunity to the corporation. Corporate stakeholders would be confident that such factors have been considered by directors and officers if there is a clear statutory obligation to do so. Second, amend the *CBCA* to require directors and officers to address material ESG factors, an obligation that arises only where ESG factors are material to the best interests of the corporation. One option for wording, taken from federal environmental legislation, is that directors and officers are to “take all reasonable care” to address material ESG issues, which would place a reasonableness standard on these obligations.

Third, we recommend codifying the common law in a new section 122(2) of the *CBCA*, enacting specific wording based on Canadian judgments that directors and officers may consider the interest of multiple stakeholders in making decisions. The Supreme Court of Canada has held that directors and officers are to act with a view to the best interests of the corporation, “having regard to all relevant considerations, including, but not confined to, the need to treat affected stakeholders in a fair manner, commensurate with the corporation’s duties as a responsible corporate citizen”. This amendment would create greater certainty and transparency for all stakeholders and would encourage directors’ oversight of the corporation with a view to long-term sustainability without fear of their decisions being attacked by “impatient investors”. Directors’ good faith decisions would be protected by the defence under the *CBCA* that already serves duly diligent directors well. Fourth, we recommend that the *CBCA* be amended to require discussion of management’s approach to material ESG risks and opportunities in the management proxy circular distributed before each annual meeting. Such information about management’s thinking about sustainability issues is directly relevant to the election or re-election of directors.

Many of our recommendations are modelled on UK developments, where publicly-traded companies must now explain how they are managing issues such as environmental performance, diversity, human rights, and social and community involvement; and must report on certain statistics such as CO₂ emissions.

Imprecision in respect of information available on long-term climate-related financial risk or other ESG risks is not a bar to directors and officers acting now with a view to the best interests of the corporation. The Supreme Court of Canada has held that the defences of good faith and acting on a prudent and reasonable basis are very strong, even in the face of less than full information. The amendments would enhance corporate governance and encourage corporate boards to engage in oversight and undertake strategic planning in the interests of the long-term sustainability of the corporation. At the same time, we are cognizant of the regulatory burden on companies and make some recommendations that would ease current requirements that may be outdated and allow companies to shift some resources towards climate-related and ESG risk management.

There are a host of other federally-regulated companies that would benefit from this enhanced language of fiduciary obligation and ESG consideration, and while this report examines all of them, the priority should be the *Bank Act* and the *Insurance Companies Act*. Directors pursuant to these statutes have the same obligations as under the *CBCA* and have the good faith reliance defence under the relevant enabling statutes. Moreover, they are some of the most financially significant, with the most developed risk management and governance structures, and thus most able to assist in shifting the trajectory towards a greener economy. As has often been done in the past, once there is experience with the *CBCA*, other statutes should be amended to align.

We also recommend amending of the Canada *Pension Benefits Standards Act* to add the obligation to consider ESG factors when investing the assets of a pension fund in a manner that a reasonable and prudent person would. The pension administrator should provide information on ESG factors to members, former members, survivors or former spouses for their consideration. The Pension Benefits Standards Regulation should be amended to require that the Statement of Investment Policies and Procedures must contain information on how ESG factors are being incorporated. These amendments go one step further than developments in Ontario, but mirror developments in the United Kingdom and Europe.

With respect to the series of questions that the Expert Panel asked about the TCFD disclosure framework, we also have a suite of recommendations. First, as a policy matter, we urge the Expert Panel to broaden its consideration to questions of expanded ESG disclosure generally, while recognizing the TCFD framework as an important framework for climate-related financial disclosure. Thus, we recommend that material ESG risks, costs and assets be included in the company's financial statements and notes thereto. Requirements for such integration should be accomplished by regulations under Canadian accounting standards, adopting internationally developing sustainability accounting standards. Integrating ESG matters in corporate financial statements will allow greater transparency and accountability. Where accounting methods are developing, the notes to the financial statements should make clear the basis on which metrics are being reported and changes year over year, allowing for reporting of currently known ESG risks and opportunities.

We also recommend that the new Capital Markets Regulatory Authority pursuant to the Cooperative Capital Markets Regulatory System work to require expanded disclosure according to the TCFD framework. Given the systemic, non-diversifiable nature of the financial risks inherent in climate change and the transition to a lower-carbon economy, our analysis is that the new Regulatory Authority has the authority to enact such requirements, but may also want to work first cooperatively with the provinces and territories. We have a number of recommendations for improving the quality of disclosure as new requirements are being developed, from clarifying the concept of materiality to acting to celebrate ESG and climate disclosure leaders. We suggest changes to reporting periods that would ease the regulatory burden of reporting material ESG risks, while protecting the continuous disclosure system and advancing financial sustainability.

We recommend an ESG disclosure "safe harbour" to protect duly diligent directors and officers, recognizing that as ESG disclosure and metrics develop, readers of the information should understand that it is evolving and that the disclosure may change as understandings of risks, opportunities and how to measure them improve. Such a safe harbour will encourage longer-term sustainability planning and provide protection against short-termism pressure by "impatient capital". The safe harbour is a method under securities law to protect directors and officers in their duly diligent efforts to disclose material information to investors, regulators and the broader public. A protection for investors regarding ESG reporting in financial statements is that directors and officers are required to explain changes in methodology or metrics year over year.

On climate-related financial risk more specifically, we recommend that the federal government adopt requirements that institutional investors and asset managers, including mutual funds and pension funds, disclose annually the financial risks related to the effects of climate change and the investor's measures to reduce them, including how they are implementing a low-carbon strategy in their portfolio construction and management, corporate engagement and voting policies.

We offer a number of practical approaches regarding how to effect legislative change federally, as well as how the federal government should work cooperatively with provincial regulators. Finally, we conclude with a recommendation that the federal government create a Sustainable Finance Institute aimed at accelerating green finance and a sustainable Canadian economy, including working with the private sector, regulators, universities, non-governmental organizations, and green finance institutes internationally to further develop green finance policy, innovative strategies, data and metrics. For ease of reference, all our recommendations are contained in Appendix 1 of the report at page 115.

ACKNOWLEDGEMENTS

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TABLE OF CONTENTS

<i>Executive Summary</i>	1
<i>Acknowledgments</i>	5
I. INTRODUCTION	10
1. <i>Context and methodology of our submission</i>	14
2. <i>Understanding what is meant by environmental, social and governance risks and opportunities</i>	15
II. FIDUCIARY OBLIGATION	16
<i>Expert Panel Question 3.4 (1)</i>	16
1. <i>Amend the Canada Business Corporations Act to enhance good governance practice and to codify the common law</i>	19
Recommendation 1	24
2. <i>The existing defence under the CBCA is strong</i>	26
3. <i>Amending the CBCA to incorporate ESG factors in the statutory fiduciary duty is unlikely to result in forum shopping to jurisdictions with lower standards</i>	28
4. <i>Amend the Canada Not-for-profit Corporations Act to incorporate ESG factors</i>	29
Recommendation 2	29
5. <i>Canada can learn from the experience of the United Kingdom, which has incorporated ESG factors, as well as consideration of stakeholder interests, in its corporate law</i>	30
6. <i>Amend the Canada Pension Plan Investment Board Act fiduciary duty</i>	34
Recommendation 3	35
7. <i>Amend the Canada Pension Benefits Standards Act and the Canada Pension Benefits Standards Regulation</i>	36
Recommendation 4	39
Recommendation 5	41
i. <i>Other jurisdictions have already incorporated ESG factors in their statements of pension fund investment policy</i>	41

8.	<i>Require federal Crown corporations to consider ESG factors and address material ESG risks and opportunities</i>	43
	Recommendation 6	44
	<i>Expert Panel Question 3.4(2)</i>	44
1.	<i>The significance of Canadian financial institutions to the Canadian economy</i>	44
2.	<i>Amend the fiduciary obligation provisions under the Bank Act to incorporate ESG factors</i>	45
	Recommendation 7	46
3.	<i>Include federally-regulated credit unions in the amended fiduciary obligation provisions under the Bank Act, and amend the fiduciary obligation provisions of the Canada Cooperatives Act and the Cooperative Credit Associations Act to align</i>	48
	Recommendation 8	50
	Recommendation 9	50
4.	<i>Amend the fiduciary obligation provisions under the Canada Trust and Loan Companies Act</i>	52
	Recommendation 10	52
5.	<i>Federally-regulated insurance companies and fiduciary duty</i>	52
	Recommendation 11	54
6.	<i>The Office of the Superintendent of Financial Institutions should assist in shifting governance practices</i>	56
	Recommendation 12	57
7.	<i>Amend the Bank of Canada Act to include ESG factors</i>	57
	Recommendation 13	59
	<i>Expert Panel Question 3.4(4)</i>	60
	1. <i>Board education is critically important</i>	60
III.	FINANCIAL SERVICES ADVISORS AND ESG CONSULTATIONS	62
	<i>Expert Panel Question 3.4 (3)</i>	62
1.	<i>Require financial services advice to include information on material ESG factors and work towards a “best interests of the client” standard of financial advice in the future</i>	62
	Recommendation 14	65

2.	<i>Investment agents and advisors should be responsive to client preferences regarding ESG</i>	66
	Recommendation 15	66
IV.	EFFECTIVE FINANCIAL DISCLOSURES THAT WILL ADVANCE THE PATH TO SUSTAINABILITY	67
	<i>Expert Panel Question 3.3(3)</i>	67
1.	<i>Include material ESG risks, costs and assets in financial Statements</i>	67
	<i>i. Canada can look to international standards</i>	70
	Recommendation 16	74
2.	<i>Require disclosure of management’s approach to material ESG risks and opportunities in management’s proxy circular in conjunction with the annual meeting</i>	74
	Recommendation 17	76
3.	<i>The Supreme Court of Canada judgment in Reference re Pan-Canadian Securities Regulation offers another avenue for dealing with systemic risk</i>	76
4.	<i>Can the federal government relieve some of the regulatory burden of requiring climate-related or ESG factors to be included in financial statements?</i>	81
	Recommendation 18	81
	<i>Expert Panel Question 3.3(1)</i>	82
1.	<i>The rationale for requiring disclosure pursuant to TCFD framework</i>	82
	<i>i. Overview of recommendations</i>	82
	<i>ii. Implementing the TCFD’s disclosure framework</i>	84
2.	<i>Federal jurisdiction under the draft Capital Markets Stability Act: Climate change as systemic risk</i>	86
3.	<i>The federal government should also work with provincial securities regulators to encourage provincial securities law to require TCFD disclosure</i>	88
4.	<i>Concerns and barriers to requiring TCFD disclosure</i>	88
	Recommendation 19	90
	<i>Expert Panel Question 3.3(2)</i>	90
1.	<i>The extensive process underpinning the TCFD framework</i>	

	<i>is one that the Government of Canada should recognize</i>	90
	Recommendation 20	92
	Expert Panel Question 3.3(4)	92
	1. <i>Cultivate leadership by size of enterprise</i>	92
	Recommendation 21	93
	Expert Panel Question 3.3(5)	93
	1. <i>Guidance on the materiality of environmental information</i>	95
	<i>i Purpose of Staff Notice 51-333</i>	96
	<i>ii Materiality of environmental information</i>	96
	2. <i>Improving the understanding of what is material</i>	98
	Recommendation 22	99
	Expert Panel Question 3.3(6)	99
	1. <i>A safe harbour for ESG disclosure</i>	99
	Recommendation 23	101
	Expert Panel Question 3.3(7)	104
	1. <i>Both the board and the audit committee are vitally important to effective oversight of ESG financial disclosures, including climate-related financial disclosures</i>	104
	Expert Panel Question 3.3(8)	106
	1. <i>Canada can benefit from international reporting standards already developed</i>	106
V.	AN ENHANCED ROLE FOR LENDERS AND INSTITUTIONAL INVESTORS IN THE TRANSITION TO A SUSTAINABLE ECONOMY	107
	Recommendation 24	110
VI.	INITIATING THE REFORM PROCESS	111
VII.	A MECHANISM FOR ONGOING DIALOGUE AND POLICY DEVELOPMENT	112
	Recommendation 25	114
VIII.	CONCLUSION	114
	APPENDIX 1 Summary of Recommendations	115

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Janis Sarra and Cynthia Williams*

I. INTRODUCTION

Climate change represents a significant risk in financial and other markets; it could substantially affect the valuation of many publicly-listed companies and place some investment portfolios at risk.¹ The allocation of capital in business and investment have an impact on and are impacted by climate change.² Globally, the OECD estimates that \$6.9 trillion US each year is required up to the year 2030 to meet climate and sustainable development objectives.³ While that scale applies globally, there is no question that Canada has to deploy significant resources to ensure that climate objectives are met. There is also no doubt that sustainable finance presents new opportunities for Canada. For example, globally, investments in renewable electric technologies were \$298 billion US in 2017, more than double the annual investment in fossil fuel generation.⁴ According to the Global Commission on the Economy and the Climate, the clean economy is expected to grow to \$26 trillion US and create 65 million jobs worldwide by 2030.⁵

In this respect, Canada needs to develop timely and proactive strategies to address climate-related challenges and to devise a going-forward strategy. However, it is necessary to look beyond climate-related financial risk and consider the environmental, social and governance factors that may present important risks and opportunities in the transition to a sustainable Canadian

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¹ Janis Sarra, “Fiduciary Obligations in Business and Investment: Implications of Climate Change” (April 2018) CCLI (Oxford and Canada), online (pdf): CCLI Oxford <https://ccli.ouce.ox.ac.uk/wp-content/uploads/2018/08/Janis-Sarra_Fiduciary-Obligation-in-Business-and-Investment.pdf> [Sarra, “Fiduciary Obligations”]. See also World Economic Forum, *The Global Risks Report 2017* (11 November 2017), online: WEF <<http://reports.weforum.org/global-risks-2017/>> and Cynthia Williams, “Disclosure of Information Concerning Climate Change: Liability Risks and Opportunities” (April 2018) CCLI (Oxford and Canada), online (pdf): CCLI Oxford <https://ccli.ouce.ox.ac.uk/wp-content/uploads/2018/08/Cynthia-Williams_Disclosure-of-Information-Concerning-Climate-Change.pdf>.

² Sarra, *ibid* at 1, 47.

³ OECD and World Bank, “Financing Climate Futures” (2018) at 15, DOI: <<https://doi.org/10.1787/9789264308114-en>>.

⁴ *Ibid* at 22, citing International Energy Agency, “The Future of Cooling: Opportunities for energy-efficient air conditioning” (2018).

⁵ Global Commission on the Economy and the Climate, quoted in Government of Canada, Prime Minister of Canada, *Government of Canada fighting climate change with price on pollution* (23 October 2018), online: Government of Canada <<https://pm.gc.ca/eng/news/2018/10/23/government-canada-fighting-climate-change-price-pollution>> [Prime Minister, *Price on Pollution*].

economy. Transition needs to benefit everyone and not disproportionately impact economically vulnerable Canadians or strand communities highly dependent on carbon intensive economic activity.⁶

The Intergovernmental Panel on Climate Change's (IPCC) 2018 Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas ("GHG") emission pathways reported further scientific evidence that human-induced global warming has now reached 1°C above preindustrial levels, with some impacts predicted to be long-lasting or irreversible, such as the loss of ecosystems.⁷ The IPCC reports that without stepping up climate action, global average temperature increase could reach 2°C soon after 2060 and continue rising.⁸ The IPCC reports that approximately 4% of the global land area is projected to undergo a transformation of ecosystems from one type to another now that we are at 1°C of global warming, and will increase to 13% at 2°C temperature change,⁹ significantly and directly affecting coastal areas and deltas and increasing risks associated with sea level rise for many human and ecological systems.¹⁰

The recent United States ("US") National Climate Assessment Report notes that adaptation "entails iterative risk management", a continuing risk management process that does not have an end point.¹¹ It highlights that individuals and organizations need to assess risks and vulnerabilities from climate and other drivers of change such as economic, environmental, and societal, take actions to reduce those risks, and understand that learning will take place over time.¹² It notes that timescale differences relate to resilience, ranging from the ability to withstand and recover from current shocks and stressors while retaining basic functions to the ability to transform in desirable ways over time as the magnitude of change increases; to maximize benefits in the near term and identify the most important opportunities for longer-term resilience.¹³

The highly respected scientific journal, *Nature*, has published an empirical report that says globally, a third of oil reserves, half of gas reserves and over 80% of current coal reserves should remain unused from 2010 to 2050 in order to meet the target of 2°C.¹⁴ The study finds that

⁶ *Ibid* at 28.

⁷ Intergovernmental Panel on Climate Change (IPCC), "Global warming of 1.5°C – An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty" (October 2018) at 7, online: IPCC <<https://www.ipcc.ch/sr15/>>.

⁸ *Ibid* at 8.

⁹ For example, 99% of coral reefs are projected to disappear globally at a temperature increase of 2°C. Irreversible loss of the Greenland ice sheet could be triggered at around 1.5°C to 2°C of global warming. *Ibid*.

¹⁰ *Ibid* at 10.

¹¹ National Climate Assessment, "Fourth National Climate Assessment, Chapter 28: Reducing Risks Through Adaptation Actions" (2017), online: NCA <<https://nca2018.globalchange.gov/chapter/28/>> [NCA, "Fourth National Climate Assessment"].

¹² *Ibid*.

¹³ *Ibid*.

¹⁴ Christophe McGlade and Paul Ekins, "The geographical distribution of fossil fuels unused when limiting global warming to 2°C" (7 January 2015) 517 *Nature* 187-190, online: *Nature*

trillions of dollars of known and extractable coal, oil and gas cannot be exploited if the global temperature rise is to be kept under the 2°C safety limit agreed by the world’s nations.¹⁵ Considerable financial and reputational risks to corporations will arise from the physical, ecological, human health and human rights claims and impacts associated directly with the corporation’s role in contributing to GHG emissions and increased climate-change risk. These observations, among the thousands now generated, illustrate why it is time for the Canadian government to act to do its share to avert a global environmental and financial tragedy.

The Expert Panel on Sustainable Finance¹⁶ has been commissioned by the Canadian Government to determine how best to generate sustainable finance, a significant challenge when Canada’s economy is very carbon intensive. While “sustainable finance” has a number of definitions, the Expert Panel has defined it as “capital flows (as reflected in lending and investment), risk management activities (such as insurance and risk assessment), and financial processes (including disclosures, valuation, and oversight) that assimilate environmental and social factors as a means of promoting sustainable economic growth and the long-term stability of the financial system.”¹⁷

While there are numerous strategies to be deployed to move Canada to a financially sustainable future, this report address two critically important issues in the governance and oversight of this transition: first, fiduciary obligation of corporate- and pension-fiduciaries, and second, national action on climate-related financial disclosure and broader environmental social and governance (“ESG”) financial disclosure.

Our economy is facing significant challenges and disruptions in the transition to a lower carbon world. Our view is that absent clear and innovative steps to ensure our corporations and financial institutions act to address carbon emissions and other environmental, social and governance risks and opportunities, we will be seriously prejudiced in a world that is rapidly moving towards greener and more sustainable economic activity.

It is time for the federal government to act to codify and build further on the fiduciary obligation that already exists at common law and in corporate law in Canada with respect to directors and officers of federally-registered corporations. We also make recommendations to align statutory fiduciary obligation and disclosure requirements with developments nationally and internationally. It is also the moment for Canada to show leadership on the issue of transparency and disclosure regarding factors that pose materials risks and opportunities as Canada transitions to a greener economy.

<<https://www.nature.com/articles/nature14016>>. The authors use “a single integrated assessment model that contains estimates of the quantities, locations and nature of the world’s oil, gas and coal reserves and resources, and which is shown to be consistent with a wide variety of modelling approaches with different assumptions, to explore the implications of this emissions limit for fossil fuel production in different regions.”

¹⁵ *Ibid*, including most Canadian tar sands, all Arctic oil and gas and much potential shale gas.

¹⁶ Expert Panel on Sustainable Finance, *Interim Report of the Expert Panel on Sustainable Finance* (Ottawa: Department of Finance, 25 October 2018), online (pdf): Government of Canada

<http://publications.gc.ca/collections/collection_2018/eccc/En4-350-1-2018-eng.pdf> [Expert Panel].

¹⁷ *Ibid* at 3.

Underpinning the recommendations throughout this report is the fact that the transition to a sustainable economy carries with it tremendous opportunities in addition to risks. For example, five years ago, Alberta-based TransAlta Corporation spun off TransAlta Renewables in an initial public offering, and today its assets include 20 wind facilities, 13 hydroelectric facilities and one solar power facility.¹⁸ TransAlta Renewables has tripled in value and is now worth more than its parent corporation.¹⁹ The European Commission reports that “between 1990 and 2016, energy use was reduced by almost 2%, and greenhouse gas emissions by 22%, while GDP grew by 54%.”²⁰ The European Commission has estimated the upside economic benefits of energy efficiency digitalization, renovation and fuel switching, more efficient products and appliances, smart buildings management systems, and improved materials for insulation.²¹ In addition to financial benefits and reduction of carbon emissions, the European Commission has observed that achieving a net-zero GHG economy will reduce pre-mature deaths caused by fine particulate matter by more than 40% and health damage by around €200 billion per annum.²² Responsible investing considering ESG risks and opportunities, compared to traditional investment approaches, has been shown to potentially lead to positive investment outcomes over the long-term.²³

Our 25 recommendations serve as a practical guide to changes in statutory language that are required based on the type of legislation and area of fiduciary obligation and disclosure discussed. The majority of the 72 questions posed by the Expert Panel will not likely require legislative change, but rather, will require innovative thinking, new finance, a principled commitment to a lower carbon economy backed by meaningful economic and technological strategies, and strong partnerships between governments, the private sector, the not-for-profit and non-governmental organization sectors. Our recommendations are “legislatively focused” in this submission because they build on existing statutory duties. The improvements suggested are aimed at providing a baseline commitment, across

¹⁸ TransAlta Renewables, “Reports on Voting Results From The 2018 Annual Meeting of Shareholders” (10 May 2018), online: TransAlta <<https://www.transaltarenewables.com/2018/05/10/transalta-renewables-inc-reports-on-voting-results-from-the-2018-annual-meeting-of-shareholders/>>.

¹⁹ Expert Panel, *supra* note 16 at 26.

²⁰ European Commission, *A Clean Planet for all – A European strategic long-term vision for a prosperous, modern, competitive and climate neutral economy* (COM 773 final, 28 November 2018) at 4, online (pdf): <https://ec.europa.eu/clima/sites/clima/files/docs/pages/com_2018_733_en.pdf>.

²¹ *Ibid* at 8.

²² *Ibid* at 16. In 2018, more than half of Europe's electricity supply is free from GHG emissions, anticipated to move to more than 80% of electricity will be coming from renewable energy sources. It has allocated €70 billion for the implementation of the Energy Union Strategy. EFSI 2.0 focuses even more on sustainable investments in all sectors to contribute to meeting the Paris Agreement's objectives and to help to deliver on the transition to a resource efficient, circular and low-carbon economy, *ibid* at 17. See also the Juncker Plan – one pillar of which is the European Fund for Strategic Investment (EFSI). The European Commission proposal to step up climate mainstreaming to at least 25% in the next Multiannual Financial Framework demonstrates the EU budget would continue to act as a catalyst to leverage sustainable private and public investment and channel EU support for the clean energy transition to where it is most needed. It is also a key part of the EU's credibility in advocating for net-zero greenhouse gas emissions in 2050, *ibid* at 17-18.

²³ World Business Council on Sustainable Development, “Aligning Retirement Assets develops new resource to help companies meet the growing demand for responsible investing” (4 December 2018), online: WBCSD <<https://www.wbcd.org/Programs/Redefining-Value/Investor-decision-making/Aligning-Retirement-Assets/News/new-resource-to-help-companies-meet-the-growing-demand-for-responsible-investing>>.

the board, for all federally-regulated corporations, financial institutions, investment funds and pension funds, to embed sustainable thinking in the discharge of their fiduciary obligations. They are largely principles-based, setting threshold standards, which directors and officers can then implement as they believe appropriate for their organization. Our recommendations are timely and practical, and give specifics on how changes can be accomplished at the federal level.

This report is organized by direct responses to questions posed by the Expert Panel on Sustainable Finance in its interim report,²⁴ specifically, the questions posed by the Expert Panel under two sections of the interim report: “3.4 Clear Interpretation of Fiduciary Duty” and “3.3 Effective Climate-Related Financial Disclosures”. For ease of reference, we have sub-labelled the questions 3.4(1) to (4) and 3.3(1) to (8) in the discussion below. The recommended changes to corporate and financial services legislation should be made immediately as they are clearly within federal parliamentary authority. The changes in the securities law domain will likely take longer, given the importance of federal, provincial and territorial cooperation.

1. Context and methodology of our submission

This report builds on ongoing work of the authors as part of the Canada Climate Law Initiative. We are also the principal Canadian investigators in the Commonwealth Climate and Law Initiative (“CCLI”), an interdisciplinary research, education, and theory development project. The global CCLI initiative is organized by Ben Caldecott, Director of Sustainable Finance at the Smith School of Enterprise and the Environment at Oxford University, UK, in collaboration with the Prince’s Accounting for Sustainability, our law schools and a number of international partners. As Canadian partner and full participants in the global CCLI, in 2017 and 2018, we conducted research and wrote reports; conducted expert meetings in Vancouver, Calgary, Ottawa, and Toronto with industry and legal specialists; organized two major conferences in Vancouver and Toronto on director and officer obligations and climate change financial risk management; and participated in both Canadian and international fora on how best to transition to a lower carbon economy, given current challenges in law and finance.

With financial support for our research from the Ivey Foundation, the University of British Columbia and York University, we examined the legal basis for corporate directors in Canada to be required to take account of, disclose, and manage climate change risks under prevailing statutory and common laws.²⁵ We assessed the materiality of these considerations, in terms of disclosure and the potential implications for company and investor decision-making in the real economy.²⁶ We also examined the legal basis for pension trustees, pension investment managers and other pension fiduciaries in Canada to take account of, disclose, and manage climate change risks under prevailing statutory and common law.

²⁴ *Ibid.*

²⁵ Janis Sarra, “Fiduciary Obligations in Business and Investment: Implications of Climate Change”, *supra* note 1.

²⁶ Cynthia Williams, “Disclosure of Information Concerning Climate Change: Liability Risks and Opportunities”, *supra* note 1; Cynthia Williams and Janis Sarra, “Directors’ Liability and Climate Risk: Canada – Country Paper: Commonwealth Climate and Law Initiative” (April 2018).

In preparation for this report, in addition to extensive research on developments globally and careful analysis of Canadian corporate, securities, pensions and financial institutions legislation, we met with more than 30 institutional investors and asset managers, portfolio managers, lawyers, accountants, corporate executives, securities regulators, and several umbrella accounting and corporate governance associations. We circulated a draft report on 5 December 2018 on a confidential basis to 18 of these market participants; conducted a series of phone calls and in-person discussions with each of these individuals and organizations; and incorporated their helpful suggestions in this report. As a result, we believe our recommendations are well grounded, timely and realistic.

2. Understanding what is meant by environmental, social and governance risks and opportunities

The European Commission has defined sustainable finance as the process of taking due account of environmental and social considerations in investment decision making, which will lead to increased investments in longer-term and sustainable activities.²⁷ There are now many definitions for ESG considerations, most of which address the same factors. For purposes of our discussion in this submission, we use the definition recommended by the Sustainability Accounting Standards Board (“SASB”) for sustainability accounting purposes. It reports that:

Sustainability accounting reflects the management of a corporation’s environmental and social impacts arising from production of goods and services, as well as its management of the environmental and social capital necessary to create long-term value. It also includes the impacts that sustainability challenges have on innovation, business models, and corporate governance and vice versa.²⁸

SASB proposes accounting metrics under five broad sustainability dimensions of ESG:

Environment, including environmental impacts, either through the use of non-renewable, natural resources as inputs to the factors of production or through harmful releases into the environment that may result in impacts to the company’s financial condition or operating performance. It includes accounting for GHG emissions, air quality, energy management, water management, waste management and ecological impacts.

Social Capital, which relates to the expectation that a business will contribute to society in return for a social license to operate. It addresses the management of relationships with key outside parties, such as customers, local communities, the public, and the government; includes issues related to human rights, protection of vulnerable groups, local economic development, access to and quality of products and services, affordability,

²⁷ European Commission, *The Action Plan: Financing Sustainable Growth* (2018), online: EC <<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0097>>.

²⁸ SASB, “Sustainability Framework” (2018), <<https://www.sasb.org/standards-overview/materiality-map/>>.

responsible business practices in marketing, customer privacy, data security, and selling practices and product labelling.

Human Capital, which addresses the management of a company's human resources (employees and individual contractors) as key assets to delivering long-term value; and includes issues that affect the productivity of employees, diversity, management of labour relations and of the health and safety of employees, and the ability to create a safety culture.

Business Model and Innovation, which addresses the integration of environmental, human, and social issues in a company's value-creation process, including resource recovery, other innovations in the production process, business model resilience, managing the physical impacts of climate change, supply chain management, and product innovation, including efficiency and responsibility in the design, use phase, and disposal of products.

Leadership and Governance, including the management of issues that are inherent to the business model or common practice in the industry and that are in potential conflict with the interest of broader stakeholder groups, and therefore create a potential liability or a limitation or removal of a license to operate. It includes systemic risk management, critical incident risk management, regulatory compliance, business ethics, safety management, supply-chain and materials sourcing, conflicts of interest, anticompetitive behaviour, and corruption and bribery.²⁹

II. FIDUCIARY OBLIGATION

The Canadian government has an important opportunity to provide leadership by enacting legislation across a range of federal statutes to clarify fiduciary obligation and modernize its scope to align with existing Canadian common law and with developments internationally. The most logical place for a clarified duty on corporate directors and officers would be in the statutory fiduciary obligation provisions in corporations statutes. This obligation should apply to all federally-incorporated companies, whether publicly-listed or privately held. Our focus in responding to this question of the Expert Panel is on federal legislation, although one would hope that provincial and territorial governments would follow suit. Essentially, we want corporate boards to be identifying ESG material risks and opportunities, and disclosing them to their stakeholders without fear of liability when they are duly diligent in their consideration of these issues. To this end, we require immediate and medium-term action to shift governance practice.

Expert Panel Question 3.4 (1):

Is there a need to more clearly define the scope of fiduciary duty with respect to the evaluation of climate-related or broader ESG factors in financial decision-making in

²⁹ *Ibid.*

Canada? What would be the best ways to effect change, and who are the key stakeholders in facilitating this change?

The Supreme Court of Canada (“SCC”) judgment in *Peoples Department Stores*³⁰ clarified the fiduciary obligations of corporate directors and officers 15 years ago. The scope of directors’ and officers’ fiduciary obligations to act in the best interests of the corporation applies equally to privately-held and publicly-listed corporations. The *Peoples Department Stores* case involved the duties of directors and officers of a privately-held corporation that was wholly-owned by a closely-held publicly-listed company.³¹ The SCC judgment in *BCE Inc v 1976 Debentureholders* in 2008, made clear that these obligations apply to publicly-listed corporations as well.³²

In *Peoples Department Store*, the SCC held that section 122(1) of the *Canada Business Corporations Act* establishes two distinct duties to be discharged by directors and officers in managing, or supervising the management of, the corporation.³³ Section 122(1)(a) specifies that every director and officer of a corporation, in exercising their powers and discharging their duties, shall act honestly and in good faith with a view to the best interests of the corporation, what the Court referred to as the “duty of loyalty” and “statutory fiduciary duty”. The SCC held that “The statutory fiduciary duty requires directors and officers to act honestly and in good faith with a view to the best interests of the corporation.”³⁴ “They must respect the trust and confidence that have been reposed in them to manage the assets of the corporation in pursuit of the realization of the objects of the corporation.”³⁵ The SCC further held that: “We accept as an

³⁰ *Peoples Department Stores Inc (Trustee of) v Wise*, [2004] 3 SCR 461, 2004 SCC 68 [*Peoples Department Stores*].

³¹ *Ibid.* Wise Stores Inc. acquired Peoples Department Stores Inc from Marks and Spencer Canada Inc (“M & S”). The three Wise brothers were sole directors and majority shareholders and officers of Wise, controlling 75% of the firm’s equity. Because of covenants imposed by M & S, Peoples could not be merged with Wise until the purchase price had been paid. Wise was founded in 1930 as a small clothing store, expanded and listed on the Montreal Stock Exchange in 1986. Peoples was incorporated in 1991 by its parent M & S plc, *ibid* at paras 5, 7. Wise incorporated a company, 2798832 Canada Inc., for the purpose of acquiring all of the issued and outstanding shares of Peoples from M & S. The \$27-million share acquisition proceeded as a fully leveraged buyout, at para 9. To protect its interests, M & S took the assets of Peoples as security (subject to a priority in favour of the TD Bank) and negotiated strict covenants concerning the financial management and operation of the company. Among other requirements, 2798832 Canada Inc. and Wise were obligated to maintain specific financial ratios, and Peoples was not permitted to provide financial assistance to Wise. In addition, the agreement provided that Peoples could not be amalgamated with Wise until the purchase price had been paid, *ibid* at para 11. In January 1993, 2798832 Canada Inc. was amalgamated with Peoples, the new entity retaining Peoples’ corporate name. Upon amalgamation the new Peoples became a subsidiary directly owned and controlled by Wise, the three Wise brothers were Peoples’ only directors, *ibid* at para 12.

³² *BCE Inc v 1976 Debentureholders*, 2008 SCC 69 at para 39, [2008] 3 SCR 560 [*BCE Inc v 1976 Debentureholders*].

³³ *Peoples Department Stores*, *supra* note 30 at para 4. *Canada Business Corporations Act*, RSC, 1985, c C-4, as amended, online (pdf): Government of Canada <<https://laws-lois.justice.gc.ca/pdf/C-44.pdf>> [CBCA].

³⁴ *Peoples Department Stores*, *ibid* at para 32.

³⁵ *Ibid* at para 35. The SCC cites *820099 Ontario Inc v Harold E Ballard Ltd* (1991), 3 BLR (2d) 123 (Ont Ct (Gen Div), (aff’d (1991), 3 BLR (2d) 113 (Ont Div Ct)), in which Farley J “correctly observes that in resolving a conflict between majority and minority shareholders, it is safe for directors and officers to act to make the corporation a “better corporation””, at para 41.

accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.”³⁶

The SCC held that the second duty, the “duty of care”, “imposes a legal obligation upon directors and officers to be diligent in supervising and managing the corporation’s affairs”.³⁷ The SCC held that the duty of care is to be assessed against an objective standard, taking into account the context in which a decision was made.³⁸ The Court held that the contextual approach to assessment of the duty of care not only emphasizes the primary facts, but also permits prevailing socio-economic conditions to be taken into consideration.³⁹

Several years later, the SCC in *BCE Inc v 1976 Debentureholders* held that:

[66] Directors, acting in the best interests of the corporation, may be obliged to consider the impact of their decisions on corporate stakeholders, such as the debentureholders in these appeals. This is what we mean when we speak of a director being required to act in the best interests of the corporation viewed as a good corporate citizen. However, the directors owe a fiduciary duty to the corporation, and only to the corporation.

...

[81] As discussed, conflicts may arise between the interests of corporate stakeholders *inter se* and between stakeholders and the corporation. **Where the conflict involves the interests of the corporation, it falls to the directors of the corporation to resolve them in accordance with their fiduciary duty to act in the best interests of the corporation, viewed as a good corporate citizen.**

[82] The cases on oppression, taken as a whole, confirm that the duty of the directors to act in the best interests of the corporation comprehends a duty to treat individual stakeholders affected by corporate actions equitably and fairly. There are no absolute rules. **In each case, the question is whether, in all the circumstances, the directors acted in the best interests of the corporation, having regard to all relevant considerations, including, but not confined to, the need to treat affected stakeholders in a fair manner, commensurate with the corporation’s duties as a responsible corporate citizen.**⁴⁰

[emphasis added]

It is important to draw attention once again to the precise wording of the statutory fiduciary obligation in Canada, because any need to “clarify” the duty in corporations statutes is really the

³⁶ *Ibid* at para 42. The SCC held that “The directors’ fiduciary duty does not change when a corporation is in the nebulous “vicinity of insolvency”.” *Ibid* at para 46.

³⁷ *Ibid* at para 32.

³⁸ *Peoples Department Stores Inc*, *supra* note 30 at paras 62 and 63.

³⁹ *Peoples Department Stores Inc*, *ibid* at para 64.

⁴⁰ *BCE Inc v 1976 Debentureholders*, *supra* note 32.

idea of codifying what is already the law in Canada, in order to provide greater certainty. Codification will make the duties more transparent and accessible to all individuals performing duties within Canadian corporations or stakeholders interacting with corporations, including both the scope and limitations of these duties. It is also timely to enhance the scope of duties by adopting language creating an express duty to consider ESG factors, and to act reasonably where those factors are material, as discussed in the next part.

Much of this report is focused on statutory reform. While very detailed, the goal is to set out a detailed blueprint of what is doable in the immediate to short term with respect to fiduciary obligation and corporate disclosure, in a manner that is consistent with the current statutory and regulatory frameworks that allow corporations and financial institutions to operate in Canadian capital and financial markets.

1. Amend the Canada Business Corporations Act to enhance good governance practice and to codify the common law

There are currently 310,000 corporations incorporated under the *Canada Business Corporations Act (CBCA)*.⁴¹ Both the statutory language of Canadian corporate law and guidance from the Supreme Court of Canada make clear that the current fiduciary obligation of directors and officers of corporations is to manage or supervise management of the corporation in the best interests of the corporation. The *CBCA* should be amended to codify Canada's common law, thus aligning the statutory wording to the obligations of directors and officers that have been clarified by the common law for many years. Equally, it is important to make absolutely clear the importance of considering and addressing material risks and opportunities.

In terms of whether the statutory amendments should relate only to climate change risk or ESG factors more generally, ESG makes the most sense and most closely aligns with the common law. Our view is that directors and officers already have a fiduciary obligation to inquire whether ESG factors present a material risk or opportunity for the company in terms of its long-term sustainability. The corporate board has a responsibility to ensure that all material risk factors, including ESG factors, are managed, which includes oversight of officers charged with managing these risks and their impact on the business.

However, some institutional investors have observed that there is an uneven level of understanding of these obligations throughout Canada. While Canadian courts have been very consistent in their findings on the scope of obligations in acting in the best interests of the corporation, there has not, to our knowledge, yet been a judgment on the specific issue of

⁴¹ *Canada Business Corporations Act*, RSC, 1985, c C-44, as amended, online (pdf): Government of Canada <<https://laws-lois.justice.gc.ca/pdf/C-44.pdf>> [CBCA]. Number of CBCA corporations is from Marketplace Framework Policy Branch Innovation, Science, and Economic Development Canada (27 November 2017): Canada, Parliament, Senate, Standing Senate Committee on Banking, Trade and Commerce, *Evidence*, 42nd Parl, 1st Sess (30 November 2017), online: Senate of Canada <<https://www.sencanada.ca/en/Content/Sen/Committee/421/BANC/53684-e>>.

directors' and officers' obligations to consider material ESG risks. It may take another decade for a court decision specifically on an ESG issue such as climate-related financial risk fiduciary obligation to reach the Supreme Court of Canada. Corporate and pension fiduciaries should benefit now from clear language under Canadian statutes. It also makes sense to codify ESG factors in the statutory fiduciary obligation to align with developments internationally.

A survey of corporate directors undertaken by the Canadian Coalition for Good Governance ("CCGG") found that no company is too early in its development or too small not to be thinking about how environmental and social factors are or may become important to business strategy and what risk management practices need to be implemented.⁴² Directors need to ensure timely and accurate information if they are to fulfill their risk management and capital decision obligations. The CCGG observes that environmental and social issues can impact a corporation's assets and liabilities, both tangible and intangible, and that even smaller companies need to focus on longer-term issues if they want to be successful in the long term, noting that practices and measures can evolve with company maturity and scale.⁴³

ESG considerations are already high on the Canadian corporate agenda. As of December 2018, there are 120 Canadian signatories to the UN Principles for Responsible Investment (UN PRI), representing assets under management of over 4 trillion CAD.⁴⁴ By signing the UN PRI, Canadian corporations and investors commit to the integration of ESG issues into investment analysis and corporate and investment decision-making processes. That level of support speaks to the growing support for effective governance, including addressing ESG risks and opportunities.

As the SCC has ruled, "Considerable power over the deployment and management of financial, human, and material resources is vested in the directors and officers of corporations."⁴⁵ "In deciding to invest in, lend to or otherwise deal with a corporation, shareholders and creditors transfer control over their assets to the corporation, and hence to the directors and officers, in the expectation that the directors and officers will use the corporation's resources to make reasonable business decisions that are to the corporation's advantage."⁴⁶

While fewer than 1% of the 310,000 federally-registered companies are publicly-listed companies, they are some of Canada's most significant corporations. While we could not get precise numbers of publicly-listed federally-registered companies, the Toronto Stock Exchange ("TSX") was very helpful in supplying information regarding the market value of corporations

⁴² Canadian Coalition for Good Governance (CCGG), "The Directors' E&S Guidebook, Practical insights and recommendations for effective board oversight and company disclosure of environmental and social ("E&S") matters" (May 2018) at 6, online (pdf): CCGG
<https://www.ccg.ca/site/ccgg/assets/pdf/the_directors__e_s_guidebook.pdf> [CCGG Guidebook].

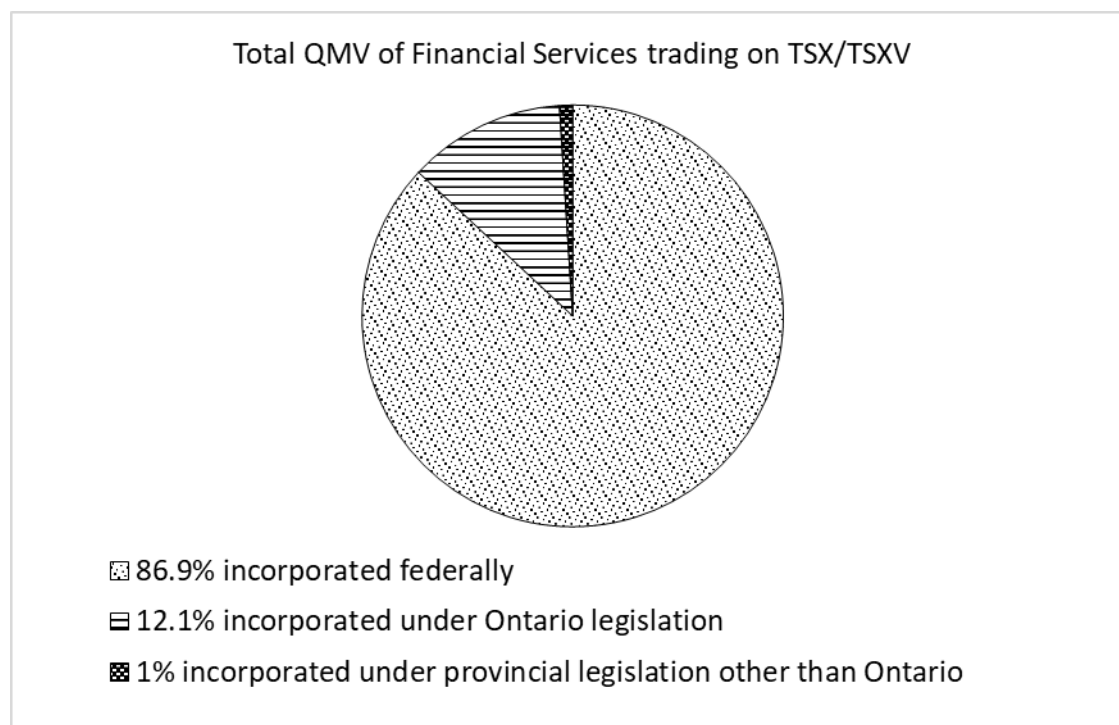
⁴³ *Ibid* at 7.

⁴⁴ Nalini Feuilloley, UN Principles for Responsible Investment (UN PRI), "Signatories by country, Canada" (27 November 2018), online: UN PRI
<<https://www.unpri.org/searchresults?qkeyword=canada&PageSize=10¶metrics=WVSECTION%7Csignatories&cmd=ReplaceKeyword&val=canada>>. Reported as 3 trillion USD, converted using Bank of Canada currency converter 6 January 2019.

⁴⁵ *Peoples Department Stores, supra* note 30 at para 34.

⁴⁶ *Ibid*.

listed on the TSX and TSX Venture Exchange (“TSXV”) by jurisdiction of registration.⁴⁷ As the graph below illustrates, at October 2018, federally-registered corporations account for 86.9% of market value of all corporations listed on the TSX and TSXV. That represents a market value of 719.4 billion CAD.⁴⁸



Source of data: TSX November 2018⁴⁹

It means that if the federal government acts to clarify the corporations statutes by codifying the common law and acts to enhance disclosure of systemic risks, it is covering the vast majority portion of publicly-listed companies in Canada by market value.

Our recommendation for amendment to the *CBCA* is four-fold. First, amend the statute to require directors and officers to “consider” ESG factors with a view to the corporation’s best interest. In considering ESG factors, directors and officers may conclude that ESG factors *are* or *are not* factors posing a material risk or opportunity to the corporation. Corporate stakeholders would be confident, however, that such factors have been considered by directors and officers. Second, amend the *CBCA* to require directors and officers to “address” ESG factors where they are material. This second obligation arises only where ESG factors are material to the best interests

⁴⁷ Our thanks to Cheryl Mascarenhas, Specialist, Market Intelligence, TMX Group and other staff at the TSX and TSXV for their assistance in providing data [TSX].

⁴⁸ Data on file with authors: TSX, *ibid*. Actual figure at 31 October 2018: \$719,383,487,832.20. Total QMV of Financial Services trading on TSX/TSXV: Incorporated in Canada \$719.4 billion; Incorporated in Ontario \$99.9 billion; Incorporated in All Other Provinces \$8.3 billion, Total: \$827,565,325,983.14.

⁴⁹ *Ibid*. Data on file with authors.

of the corporation. One option for wording to qualify what they are to address, drawn from federal environmental legislation, is that directors and officers are to “take all reasonable care” to address material ESG issues.⁵⁰ The importation of this language would place a reasonableness standard on the requirement to address material ESG risks and opportunities.

Third, for greater certainty, codify in the *CBCA* the wording in the Supreme Court of Canada judgments that directors and officers may consider the interests of multiple stakeholders in making those decisions by adding a new section 122(2) to the *CBCA*. New section 122(2) would specify that directors and officers “may consider” multiple interests. As with the common law, the board is to act with a view to the best interests of the corporation, “having regard to all relevant considerations, including, but not confined to, the need to treat affected stakeholders in a fair manner, commensurate with the corporation’s duties as a responsible corporate citizen”.⁵¹ In the list of stakeholders to consider, our recommendation is to include retirees in the list given by the SCC, as recent cases have illustrated that their interests are relevant to the best interests analysis. A fourth recommended amendment to the *CBCA* on disclosure is discussed in Part IV below.

There is a substantial body of empirical study now that links management of ESG factors with positive corporate financial performance. In a meta-study of 2,200 empirical studies on ESG and financial performance, Friede, Busch and Bassen found that the large majority report positive corporate financial performance when the companies integrate ESG considerations, and for 90% of the total, there was at least a non-negative relationship between ESG and corporate financial performance.⁵² The study reported that the positive ESG impact on corporate financial performance appears stable over time; and the results show that the business case for ESG investing is empirically very well-founded.⁵³ Friede, Busch, and Bassen conclude that the orientation toward long-term responsible investing, including integrating ESG factors, should be important for all kinds of rational investors in order to fulfill their fiduciary duties, and may better align investors’ interests with the broader objectives of society.⁵⁴ Investors globally are engaging with corporate boards on ESG issues, one study reporting that asset managers with €2 trillion

⁵⁰ For example, section 280.1 of the *Canadian Environmental Protection Act*, SC 1999, c 33, as amended, specifies that: “Duties of directors and officers 280.1 (1) Every director and officer of a corporation shall take all reasonable care to ensure that the corporation complies with (a) this Act and the regulations, other than Division 3 of Part 7 and regulations made under that Division; and (b) orders and directions of, and prohibitions and requirements imposed by, the Minister, enforcement officers and review officers, other than those issued or imposed in connection with obligations or prohibitions under that Division or regulations made under that Division.” Similar language is used provincially, for example, the Ontario *Environmental Protection Act*, RSO 1990, c E 19, as amended, specifies: “Duty of director or officer 194 (1) Every director or officer of a corporation has a duty to take all reasonable care to prevent the corporation from, (a) discharging or causing or permitting the discharge of a contaminant, in contravention of, (i) this Act or the regulations . . .”

⁵¹ *BCE Inc v 1976 Debentureholders*, *supra* note 32.

⁵² Gunnar Friede, Timo Busch and Alexander Bassen, “ESG and financial performance: aggregated evidence from more than 2000 empirical studies” (2015) 5:4 *Journal of Sustainable Finance & Investment* 210-233, DOI: <<http://dx.doi.org/10.1080/20430795.2015.1118917>>.

⁵³ *Ibid* at 212.

⁵⁴ *Ibid* at 227, observing that it requires a detailed and profound understanding of how to integrate ESG criteria into investment processes in order to harvest the full potential of value-enhancing ESG factors.

under management are now engaging with corporate boards.⁵⁵ Another example is BlackRock, which as of December 2018 has \$5.98 trillion US in assets under management and has a team of 40 professionals engaged specifically in ESG and sustainable stewardship.

A number of other empirical studies offer broad evidence from capital markets that supports the notion that corporate social responsibility (“CSR”) and ESG factors matter to a company’s financial performance and to its cost of capital.⁵⁶ Integrating ESG factors can result in better access to finance;⁵⁷ lower the cost of capital,⁵⁸ including both debt and equity capital;⁵⁹ and may reduce the likelihood that companies face major capital constraints.⁶⁰ Another empirical study showed that the level of engagement with ESG matters reduces firm risk and increases firm value; including evidence that an improvement in CSR ratings are likely to decrease the risk of government litigation and reduce the likelihood of an environmental or social crisis that could negatively affect firm’s cash flows.⁶¹ Another empirical study found that firms with strong ESG and CSR significantly outperform firms with weak CSR in the mid- and long-term in certain areas of activity and regions.⁶²

⁵⁵ Frank AJ Wagemans, CSA van Koppen and Arthur PJ Mol, “Engagement on ESG issues by Dutch pension funds: is it reaching its full potential?” (2018) 8:4 *Journal of Sustainable Finance & Investment* 301-322, DOI: <<https://doi.org/10.1080/20430795.2018.1485379>>.

⁵⁶ Dan Dhaliwal, Suresh Radhakrishnan, Albert Tsang, and Yong George Yang, “Nonfinancial Disclosure and Analyst Forecast Accuracy: International Evidence on Corporate Social Responsibility Disclosure” (May 2012) 87:3 *The Accounting Review* 723-759, DOI: <<https://doi.org/10.2308/accr-10218>>; Marc Orlitzky, Frank Schmidt, and Sara Rynes “Corporate Social and Financial Performance: A Meta-Analysis” (2003) 24:3 *Organization Studies* 403-441, DOI: <<https://doi.org/10.1177/0170840603024003910>>; Christophe Revelli and Jean-Laurent Viviani, “Financial performance of socially responsible investing (SRI): what have we learned? A meta-analysis” (2015) 24:2 *Business Ethics: A European Review*, DOI: <<https://doi.org/10.1111/beer.12076>>; Rob Bauer and Daniel Hann, “Corporate Environmental Management and Credit Risk” (2010) [unpublished], DOI: <<http://dx.doi.org/10.2139/ssrn.1660470>>.

⁵⁷ B Cheng, I Ioannou and G Serafeim, “Corporate Social Responsibility and Access to Finance” (2014) 35:1 *Strategic Management Journal* 1-23 [Cheng, Ioannou, Serafeim]; Marwa Samet, Khairiddine Mouakhar and Anis Jarbouï, “Exploring the relationship between CSR performance and financial constraints: empirical evidence from European firms” (2018) 76:4 *Review of Social Economy*, 480-508 at 502 (using a panel dataset consisting of 397 European companies listed in the STOXX Europe 600 during 2009–2014), DOI: <<https://doi.org/10.1080/00346764.2018.1480795>> [Samet, Mouakhar and Jarbouï].

⁵⁸ D Dhaliwal, O Li, AH Tsang, and YG Yang, “Voluntary Non-Financial Disclosure and the Cost of Equity Capital: The Case of Corporate Social Responsibility Reporting” (2011) 86:1 *The Accounting Review* 59–100; S El Ghoul, O Guedhami, CCY Kwok, and D Mishra, “Does Corporate Social Responsibility Affect the Cost of Capital?” (2011) 35:9 *Journal of Banking and Finance* 2388–2406; M Nandy and S Lodh, “Do Banks Value the Eco-Friendliness of Firms in Their Corporate Lending Decision? Some Empirical Evidence” (2012) 25 *International Review of Financial Analysis* 83-93; Cheng, Ioannou, Serafeim, *ibid* at 20-23.

⁵⁹ M Orlitzky, “Corporate Social Performance and Financial Performance: A Research Synthesis” in A Crane *et al*, eds, *The Oxford Handbook of Corporate Social Responsibility* (Oxford: OUP, 2008).

⁶⁰ Samet, Mouakhar and Jarbouï, *supra* note 57 at 502.

⁶¹ Mohammed Benlemlih, Jamil Jaballah and Jonathan Peillel, “Does it really pay to do better? Exploring the financial effects of changes in CSR ratings” (2018) 50:51 *Applied Economics* 5464-5482, DOI <<https://doi.org/10.1080/00036846.2018.1486997>>. The study used three hypotheses and sample of 1,621 publicly traded US companies from the Kinder, Lydenberg, and Domini (KLD Research and Analytics) database during the period 1996–2011.

⁶² Gregor Dorfleitner, Sebastian Utz and Maximilian Wimmer, “Patience pays off – corporate social responsibility and long-term stock returns” (2018) 8:2 *Journal of Sustainable Finance & Investment* 132-157 at 152, DOI:

Other studies indicate that industry-specific classifications of materiality identify ESG information that is value relevant and predictive of companies' future financial performance.⁶³ One survey found that 82% of respondents suggest that they use ESG information because it is financially material to investment performance.⁶⁴ The 2018 RBC Global Asset Management Responsible Investing Survey, reporting on 540 investment firm, portfolio manager and asset manager responses, found that over 90% believe ESG-integrated portfolios are likely to perform as well or better than non-ESG-integrated portfolios and 67% view ESG as a risk mitigator.⁶⁵

Recommendation 1:

The current fiduciary obligation under the *CBCA* should be amended to incorporate ESG factors as follows (in red italics):

Duty of care of directors and officers

122 (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall

- (a) act honestly and in good faith with a view to the best interests of the corporation;
- (b) consider environmental, social and governance factors with a view to the best interests of the corporation;*
- (c) take all reasonable care to address any material issues relating to environmental, social and governance factors with a view to the best interests of the corporation;* and
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

122(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

For greater certainty, the new section 122(2) makes transparent the fact that directors and officers already have the option of considering multiple stakeholder interests, as the *CBCA* has

<<https://doi.org/10.1080/20430795.2017.1403272>>, using a novel classification of activities into nine areas, each belonging to one of the standard environment, social, and governance (ESG) dimensions.

⁶³ Amir Amel-Zadeh and George Serafeim, "Why and How Investors Use ESG Information: Evidence from a Global Survey" (2018) 74:3 *Financial Analysts Journal* 87-103 at 87, DOI: <<https://doi.org/10.2469/faj.v74.n3.2>> [Amel-Zadeh and Serafeim], surveying investment firms with the collaboration of Bank of New York Mellon, with respondents, on a value-weighted basis, with \$31 trillion US in assets under management (AUM), comprised 43% of global institutional AUM. See also M Khan, G Serafeim, and A Yoon, "Corporate Sustainability: First Evidence on Materiality" (2016) 91(6) *Accounting Review* 1697-724.

⁶⁴ Amel-Zadeh and Serafeim, *ibid* at 88.

⁶⁵ 2018 RBC Global Asset Management Responsible Investing Survey, "Charting a Sustainable Advantage" (2018) at 5-6, online (pdf): RBC <<http://www.rbcgam.com/corporate-governance-and-responsible-investment/pdf/esg-executive-summary.PDF>>.

been interpreted by the SCC. However, it would give directors and officers more confidence that such consideration would not be attacked by shareholders that have only a short-term interest. It would assist with corporations making decisions in the longer term best interests of the corporation as it would counter-balance pressure for short-term returns to the potential harm to the sustainability of the corporation.

Incorporating ESG considerations in section 122 of the *CBCA* would mean that directors' good faith decisions would be protected by the defence under the *CBCA* that already serves duly diligent directors well:

Defence — good faith

123(5) A director has complied with his or her duties under subsection 122(1) if the director relied in good faith on

(a) financial statements of the corporation represented to the director by an officer of the corporation or in a written report of the auditor of the corporation fairly to reflect the financial condition of the corporation; or

(b) a report of a person whose profession lends credibility to a statement made by the professional person.⁶⁶

Consideration of ESG factors aligns completely with direction given by the Supreme Court of Canada in respect of how directors and officers are to approach their obligations to act in the best interests of the corporation, whether privately held or publicly-listed, looking to its long-term interests. In *BCE Inc v 1976 Debentureholders*, the SCC reiterated its conclusions in *Peoples Department Stores* that “In considering what is in the best interests of the corporation, directors may look to the interests of, *inter alia*, shareholders, employees, creditors, consumers, governments and the environment to inform their decisions.”⁶⁷ The SCC further held that:

The fiduciary duty of the directors to the corporation is a broad, contextual concept. It is not confined to short-term profit or share value. **Where the corporation is an ongoing concern, it looks to the long-term interests of the corporation.** The content of this duty varies with the situation at hand. At a minimum, it requires the directors to ensure that the corporation meets its statutory obligations. But, depending on the context, there may also be other requirements. In any event, the fiduciary duty owed by directors is mandatory; directors must look to what is in the best interests of the corporation.⁶⁸

[emphasis added]

In considering the specific substance of the fiduciary duty based on the relationship of directors to corporations, the SCC held that the phrase the “best interests of the corporation” should be read not simply as the “best interests of the shareholders”; that from an economic perspective, the “best interests of the corporation” means the maximization of the value of the corporation,

⁶⁶ *CBCA*, *supra* note 41.

⁶⁷ *BCE Inc v 1976 Debentureholders*, *supra* note 32 at para 39.

⁶⁸ *Ibid* at para 38.

but that various other factors may be relevant in determining what directors should consider in soundly managing with a view to the best interests of the corporation.⁶⁹ The fiduciary obligation of directors and officers is clear in the caselaw. The proposed amendments to the *CBCA* would make these duties even clearer.

If these amendments are enacted, board approval processes and practices should improve, and boards will ensure that they have allocated appropriate time and examined relevant information to assess whether material ESG risks are being considered and addressed along with other material risks, including in capital allocation decisions. By codifying the requirement to consider ESG factors with a view to the best interests of the corporation, oversight of risk and opportunities will be enhanced. Coupled with increased disclosure to investors, as discussed at length in Part IV below, the amendments will provide greater transparency and enhance governance. It will encourage boards to undertake strategic planning in the interests of the long-term sustainability of the corporation. Boards should also consider aligning the compensation of senior officers and other staff with achievement of sustainability goals.

2. *The existing defence under the CBCA is strong*

The defence under the *CBCA* specifies that a director has complied with his or her fiduciary duty and duty of care if he or she relied on a report of a person whose profession lends credibility to a statement made by the professional. In other words, directors that make inquiries of professionals in regard to ESG factors that affect the best interests of the company and in good faith make decisions based on that advice, are not liable for decisions taken. This defence has protected duly diligent directors for years.

Imprecision in respect of information available on long-term climate-related financial risk or other ESG risks is not a bar to directors and officers acting now with a view to the best interests of the corporation. The defences of good faith and acting on a prudent and reasonable basis are very strong, even in the face of less than full information. The SCC has held that:

the contextual approach dictated by s 122(1)(b) of the *CBCA* not only emphasizes the primary facts but also permits prevailing socio-economic conditions to be taken into consideration. The emergence of stricter standards puts pressure on corporations to improve the quality of board decisions. **The establishment of good corporate governance rules should be a shield that protects directors from allegations that they have breached their duty of care. . . . Many decisions made in the course of business, although ultimately unsuccessful, are reasonable and defensible at the time they are made. Business decisions must sometimes be made, with high stakes and under considerable time pressure, in circumstances in which detailed information is not available.** It might be tempting for some to see unsuccessful business decisions as unreasonable or imprudent in light of information that becomes available *ex post facto*. Because of this risk of

⁶⁹ *Ibid* at para 42.

hindsight bias, Canadian courts have developed a rule of deference to business decisions.⁷⁰

[emphasis added]

This deference in the face of uncertainty is apparent in many other Canadian corporate law judgments. For example the Ontario Court of Appeal has held:

The court looks to see that the directors made a reasonable decision not a perfect decision. Provided the decision taken is within a range of reasonableness, the court ought not to substitute its opinion for that of the board even though subsequent events may have cast doubt on the board's determination. As long as the directors have selected one of several reasonable alternatives, deference is accorded to the board's decision.⁷¹

The SCC is very clear about the defences available and the deference that will be given to fiduciaries' decisions:

Directors and officers will not be held to be in breach of the duty of care under s 122(1)(b) of the CBCA if they act prudently and on a reasonably informed basis. The decisions they make must be reasonable business decisions in light of all the circumstances about which the directors or officers knew or ought to have known. In determining whether directors have acted in a manner that breached the duty of care, it is worth repeating that perfection is not demanded. **Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making, but they are capable, on the facts of any case, of determining whether an appropriate degree of prudence and diligence was brought to bear in reaching what is claimed to be a reasonable business decision at the time it was made.**⁷²

[emphasis added]

As the Supreme Court has held, directors' decisions are not going to be assessed based on hindsight bias.⁷³ Even more so in respect of climate-related risks or ESG that are evolving as new

⁷⁰ *Peoples Department Stores*, *supra* note 30 at para 64.

⁷¹ *Maple Leaf Foods Inc v Schneider Corp* (1998), 42 OR (3d) 177 at p 192, cited with approval in *Peoples*, *ibid* at para 65.

⁷² *Peoples Department Stores*, *ibid* at para 64.

⁷³ The Supreme Court of Canada has said: "Many decisions made in the course of business, although ultimately unsuccessful, are reasonable and defensible at the time they are made. Business decisions must sometimes be made, with high stakes and under considerable time pressure, in circumstances in which detailed information is not available. It might be tempting for some to see unsuccessful business decisions as unreasonable or imprudent in light of information that becomes available *ex post facto*. Because of this risk of hindsight bias, Canadian courts have developed a rule of deference to business decisions called the "business judgment rule", adopting the American name for the rule." *Peoples Department Stores*, *ibid* at para 64.

information and insights on financial risk develop. Similar recommendations are below made in respect of Canadian financial institutions.⁷⁴

Another option would be to amend the *CBCA* regulations to embed ESG considerations in the manner we have recommended amending the statute. In our view, while this strategy may be accomplished more quickly, it lacks the transparency of statutory language, in terms of assisting companies to be aware of their obligations and manage their oversight accordingly and in terms of clarity and certainty for stakeholders.

3. Amending the *CBCA* to incorporate ESG factors in the statutory fiduciary duty is unlikely to result in forum shopping to jurisdictions with lower standards

Given that the proposed amendments are essentially codification and clarification of existing common law, the argument that corporations will “forum shop” to another jurisdictions with lower standards is without merit. The SCC’s clarification 15 years ago did not result in a mass move to incorporate in the US or other jurisdictions. Registration (both incorporation and continuation) under the *CBCA* allows corporations to operate nationally, an important feature of *CBCA* registration. Moreover, many Canadian institutional investors have made clear that they expect directors and officers to consider ESG factors and their level of engagement with boards means that companies are unlikely to risk loss of significant investors.

It is possible they could incorporate under provincial corporate statutes, but it is also unlikely as the fiduciary obligation to act in the best interests of the corporation exists across the country. An example that statutory amendment will likely not lead to forum shopping was the amendment to the Ontario *Business Corporations Act (OBCA)* after the SCC’s judgment in *Peoples Department Stores*.⁷⁵ The SCC held that the duty of care can be owed to creditors in addition to shareholders, given that the statutory language does not specify that the duty of care is owed solely to the corporation.⁷⁶ This ruling that the duty of care could open directors up to actions by creditors⁷⁷ led the Ontario government to change the *OBCA* in 2007 to provide that directors owe their statutory duty of care exclusively to the corporation.⁷⁸ There was a great deal of speculation at

⁷⁴ See the discussion under Expert Panel Question 3.4(2).

⁷⁵ Ontario *Business Corporations Act*, RSO 1990, c B16, as amended [*OBCA*].

⁷⁶ *Peoples Department Stores*, *supra* note 30 at para 57.

⁷⁷ The SCC held: “Indeed, unlike the statement of the fiduciary duty in s. 122(1) (a) of the *CBCA*, which specifies that directors and officers must act with a view to the best interests of the corporation, the statement of the duty of care in s. 122(1) (b) of the *CBCA* does not specifically refer to an identifiable party as the beneficiary of the duty. Instead, it provides that “[e]very director and officer of a corporation in exercising their powers and discharging their duties shall . . . exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.” Thus, the identity of the beneficiary of the duty of care is much more open-ended, and it appears obvious that it must include creditors.” *Peoples Department Stores*, *ibid* at para 57.

⁷⁸ *OBCA*, *supra* note 75, s 134 (1) Every director and officer of a corporation in exercising his or her powers and discharging his or her duties to the corporation shall, (a) act honestly and in good faith with a view to the best interests of the corporation; and (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances [emphasis added].

the time that many companies would shift place of registration to Ontario to limit the scope of their duty of care obligations. That was not the case.

4. *Amend the Canada Not-for-profit Corporations Act to incorporate ESG factors*

There are a growing number of not-for-profit corporations in Canada. The federal government has recognized their importance in its recent allocation of \$755 million to help not-for-profit corporations, charitable and other social purpose organizations access new financing that will drive positive social change.⁷⁹ The federal government expects that its new Social Finance Fund could generate up to \$2 billion in economic activity, and help create and maintain as many as 100,000 jobs over the next decade.⁸⁰

Thus it makes sense to amend the *Canada Not-for-profit Corporations Act*⁸¹ to align with the clarified fiduciary obligation in the *CBCA*. The rationale is the same as for directors and officers under the *CBCA*. Directors pursuant to the *Canada Not-for-profit Corporations Act* have the same obligations as under the *CBCA* and have the good faith reliance defence under the statute.

One question is whether this enhanced duty should apply to all not-for-profit corporations or only those corporations that are a particular size. The federal government should commence with larger not-for-profit corporations (by amount of capitalization) and then move to smaller corporations. However, there is not really a cogent argument to exclude smaller not-for-profit corporations, as their governance and financial decisions are likely to be less complex and ESG factors less material, and thus, the time and resource costs of directors and officers putting their minds to ESG risks and opportunities should be manageable. As discussed below under question 3.3(7), the federal government should play an important role in ensuring clear and accessible tools are made available to smaller corporations to identify and address material ESG factors.

Recommendation 2:

Amend section 148 of the *Canada Not-for-profit Corporations Act* to read (in red italics):

Duties of directors and officers

The amendments to the *OBICA* also added a new statutory defence of due diligence and good faith reliance that aligns Ontario legislation with the *CBCA*. The expanded defences are aimed at providing more flexibility to directors in allowing them to rely on due diligence or reports of corporate officers or employees outside of financial statements in their decision-making.

⁷⁹ Announcement of Social Finance Fund appeared in Government of Canada, “Fall Economic Statement (21 November 2018), online: Government of Canada <<https://www.budget.gc.ca/fes-eea/2018/docs/nrc/2018-11-21-en.html>>. Additionally, the Government proposes to invest \$50 million over two years in an Investment and Readiness stream, for social purpose organizations to improve their ability to successfully participate in the social finance market.

⁸⁰ *Ibid.*

⁸¹ *Canada Not-for-profit Corporations Act*, SC 2009, c 23, as amended [*NFP Corporations Act*].

148 (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall

(a) act honestly and in good faith with a view to the best interests of the corporation;

(b) consider environmental, social and governance factors with a view to the best interests of the corporation;

(c) take all reasonable care to address any material issues relating to environmental, social and governance factors with a view to the best interests of the corporation; and

(d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

148(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, members, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

Director — good faith

149 (2) A director has complied with his or her duties under subsection 148(1) if the director relied in good faith on

(a) financial statements of the corporation represented to the director by an officer of the corporation or in a written report of the public accountant of the corporation fairly to reflect the financial condition of the corporation; or

(b) a report of a person whose profession lends credibility to a statement made by that person.

The existing section 149(2) defence under the *Canada Not-for-profit Corporations Act* would be available to directors that acted in good faith and relied on professional advice in respect to consideration of ESG factors. Such an amendment would result in a consistent and transparent set of fiduciary duties.

5. Canada can learn from the experience of the United Kingdom, which has incorporated ESG factors, as well as consideration of stakeholder interests, in its corporate law

The United Kingdom (“UK”) has fully embraced the importance of ESG in corporate governance. The UK government has incorporated ESG in several statutes on the premise that “companies that address ESG concerns can achieve higher growth rates and increased profitability, better stakeholder reputation and improved brand strength” and based on the conclusion that “ESG risks can seriously undermine investor confidence and the long-term prospects for businesses.”⁸²

⁸² Michael Hutchinson and Kate Ball-Dodd, “Environment, Social and Governance (“ESG”): New UK Mandatory Reporting Rules” (September 2013), online (pdf): Mayer Brown <https://www.mayerbrown.com/files/Publication/123b4ac7-a050-46f2-9449-0b6740327749/Presentation/PublicationAttachment/57d4f570-4b22-4a0b-8376-1e639889272e/UK_Mandatory_Reporting_Sep13.pdf> [Hutchinson and Ball-Dodd].

The UK *Companies Act* now requires directors, in specified circumstances, to consider ESG factors and to report on them. There is strong language in government reports and guides, the Corporate Code of Conduct and in publications of the London Stock Exchange that good governance means considering and addressing ESG factors. There is confidence that having to report on the issues requires directors to focus on them. For example, the *Companies Act 2006* requires companies to disclose climate change risks where they are financially material.⁸³ The UK House of Commons Environmental Audit Committee has reported that: “Environmental, social and governance (ESG) refers to the three central factors in measuring the sustainability and ethical impact of an investment in a company or business.”⁸⁴

The duty of directors and officers under section 172 of the UK *Companies Act* has been modified to create a duty on directors to act to promote the success of the company for the benefit of its members as a whole, by considering the interests of multiple stakeholders, including: the likely consequences of any decision in the long term, the interests of the company's employees, relationships with suppliers, customers and others, the impact of the company's operations on the community and the environment.⁸⁵

The UK *Companies Act 2006* (Strategic Report and Directors' Report) Regulations 2013 require that quoted companies must provide, in their strategic report, “to the extent necessary for an understanding of the development, performance or position of the company's business, information about human rights issues alongside social and community issues; a gender breakdown at the end of the financial year of the directors of the company, the senior managers and employees of the company.”⁸⁶ The Strategic Report Regulations also introduced a new requirement on quoted companies to state the annual quantity of emissions expressed in terms of tonnes of carbon dioxide equivalent arising from the activities for which that company and its

⁸³ UK House of Commons, Environmental Audit Committee, *Greening Finance: embedding sustainability in financial decision making* (HC 2017-19, 1063-VII, 4 June 2018) [UK House of Commons].

⁸⁴ *Ibid* at 6.

⁸⁵ *Companies Act 2006*, c 46 (UK): s 172 Duty to promote the success of the company

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—(a) the likely consequences of any decision in the long term, (b) the interests of the company's employees, (c) the need to foster the company's business relationships with suppliers, customers and others, (d) the impact of the company's operations on the community and the environment, (e) the desirability of the company maintaining a reputation for high standards of business conduct, and (f) the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieve those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

⁸⁶ *The Companies Act 2006* (UK), Amendment of Part 25, *The Companies Act 2006* (Strategic Report and Directors' Report) Regulations 2013 (entered into force 1 October 2013) [*The Companies Act 2006* (Strategic Report and Directors' Report)].

consolidated undertakings are responsible (for example, from direct emissions to the atmosphere) and arising from the purchase of energy for heating or cooling.⁸⁷

The company's strategic report must contain (a) a fair review of the company's business, and (b) a description of the principal risks and uncertainties facing the company.⁸⁸ The review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include (a) analysis using financial key performance indicators, and (b) where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters.⁸⁹ In the case of a quoted company, the strategic report must, to the extent necessary for an understanding of the development, performance or position of the company's business, include:

- 414C (7)(a) the main trends and factors likely to affect the future development, performance and position of the company's business, and
- (b) information about—
 - (i) **environmental matters (including the impact of the company's business on the environment),**
 - (ii) the company's employees, and
 - (iii) **social, community and human rights issues,** including information about any policies of the company in relation to those matters and the effectiveness of those policies.

If the report does not contain information of each kind mentioned in paragraphs (b)(i), (ii) and (iii), it must state which of those kinds of information it does not contain.⁹⁰

[emphasis added]

The strategic report must be approved by the board of directors and signed on behalf of the board by a director or the secretary of the company.⁹¹

⁸⁷ *Ibid.* See also Hutchinson and Ball-Dodd, *supra* note 82.

⁸⁸ *The Companies Act 2006* (UK) (Strategic Report and Directors' Report), *supra* note 86, s 414C.

⁸⁹ *Ibid.*, s 414C(4). The regulation specifies that: "(5) In subsection (4), "key performance indicators" means factors by reference to which the development, performance or position of the company's business can be measured effectively. (6) Where a company qualifies as medium-sized in relation to a financial year (see sections 465 to 467), the review for the year need not comply with the requirements of subsection (4) so far as they relate to non-financial information."

⁹⁰ *Ibid.*, s 414C (11). This provision also contains gender diversity disclosure requirements. The strategic report may also contain matters otherwise required by regulations made under section 416(4) to be disclosed in the directors' report as the directors consider are of strategic importance to the company.

⁹¹ *Ibid.*, s 414D (1).

The UK *Companies Act* uses a comply or explain approach.⁹² Revisions effective in 2018 to the UK Corporate Governance Code apply to accounting periods beginning on or after 1 January 2019.⁹³ The Code is applicable to all companies with a premium listing, whether incorporated in the UK or elsewhere.⁹⁴ The principles state that: “A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society.”⁹⁵ The board should understand the views of the company’s other key stakeholders and describe in the annual report how their interests have been considered in board discussions and decision-making.⁹⁶

UK-incorporated quoted companies, ie, those with equity shares listed on London Stock Exchange Main Market, EEA regulated, NYSE or NASDAQ, are expected to explain how they are managing issues such as environmental performance, human rights, social and community involvement and diversity.⁹⁷ They are also expected to report on certain statistics, for example Scope 1 and 2 CO₂ emissions and gender diversity at board, senior management and whole-company levels.⁹⁸ Requirements differ for companies of different sizes and listed status; all companies are expected to disclose principal business risks, and medium-sized companies are not expected to include an analysis of non-financial key performance indicators.⁹⁹ Furthermore, only listed companies are required to contain an overview of the business strategy and model as well as environment, employee, social, community, human rights and diversity information in the strategic report.¹⁰⁰

⁹² Financial Reporting Council, “The UK Corporate Governance Code” (April 2016) at 1, 4, online (pdf): FRC <<https://www.frc.org.uk/getattachment/ca7e94c4-b9a9-49e2-a824-ad76a322873c/UK-Corporate-Governance-Code-April-2016.pdf>>.

⁹³ Financial Reporting Council, “UK Corporate Governance Code” (July 2018), online: FRC <<https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code>>.

⁹⁴ *Ibid.*

⁹⁵ *Ibid.* The principles further state: B. The board should establish the company’s purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture. C. The board should ensure that the necessary resources are in place for the company to meet its objectives and measure performance against them. The board should also establish a framework of prudent and effective controls, which enable risk to be assessed and managed. D. In order for the company to meet its responsibilities to shareholders and stakeholders, the board should ensure effective engagement with, and encourage participation from, these parties. E. The board should ensure that workforce policies and practices are consistent with the company’s values and support its long-term sustainable success. The workforce should be able to raise any matters of concern. *Ibid* at 4.

⁹⁶ *Ibid* at 5, citing also that: “The Companies (Miscellaneous Reporting) Regulations 2018 require directors to explain how they have had regard to various matters in performing their duty to promote the success of the company in section 172 of the Companies Act 2006.”

⁹⁷ London Stock Exchange Group, “Revealing the Full Picture, Your guide to ESG reporting: Guidance for issuers on the integration of ESG into investor reporting and communication” (2018) at 19, online (pdf): LSEG <https://www.lseg.com/sites/default/files/content/images/Green_Finance/ESG/2018/February/LSEG_ESG_report_January_2018.pdf> [London Stock Exchange].

⁹⁸ *Ibid.*

⁹⁹ *Ibid.*

¹⁰⁰ *Ibid.*

The UK amendments broaden the definition of governance and emphasize the importance of positive relationships between companies, shareholders and stakeholders.¹⁰¹ Companies are to demonstrate how the governance of the company contributes to its long-term sustainable success and achieves wider objectives.¹⁰² The London Stock Exchange has also issued guidance on ESG reporting in the UK.¹⁰³ It observes that the UK governance and reporting framework encourages reporting of ESG through the Guidance on the Strategic Report and Corporate Governance Code requirements for disclosure of principal risks and uncertainties and a viability statement.¹⁰⁴

6. Amend the Canada Pension Plan Investment Board Act fiduciary duty

Other federally-regulated incorporation or registration statutes should be amended to align fiduciary obligations with the proposed changes to the *CBCA*. The federal government should amend the *Canada Pension Plan Investment Board Act*¹⁰⁵ to align the fiduciary duty provisions with the proposed amendments to the *CBCA*. The *Act* establishes the Canada Pension Plan Investment Board (“CPPIB”). Its objects are: (a) to assist the Canada Pension Plan in meeting its obligations to contributors and beneficiaries under the Canada Pension Plan (“CPP”); (b) to manage any amounts transferred to it under sections 108.1 and 108.3 of the CPP, and its right, title or interest in any designated securities, in the best interests of the contributors and beneficiaries; and (c) to invest its assets with a view to achieving a maximum rate of return, without undue risk of loss, having regard to the factors that may affect the funding of the CPP and the ability of the CPP to meet its financial obligations on any given business day.¹⁰⁶ The CPPIB board of directors is required to manage or supervise the management of the business and affairs of the Board.¹⁰⁷

The CPPIB is a large institutional investor that manages and invests the funds of the Canada Pension Plan on behalf of its 20 million Canadian contributors and beneficiaries.¹⁰⁸ CPPIB states that it has a profound responsibility: to invest the assets belonging to millions of Canadians to help ensure the sustainability of the Canada Pension Plan.¹⁰⁹ As of December 2018, CPPIB has

¹⁰¹ Financial Reporting Council, “Revised UK Corporate Governance Code 2018 highlights” (2018) at 1, online (pdf): FRC <<https://www.frc.org.uk/getattachment/524d4f4b-62df-4c76-926a-66e223ca0893/2018-UK-Corporate-Governance-Code-highlights.pdf>>.

¹⁰² *Ibid* at 2.

¹⁰³ London Stock Exchange, *supra* note 97 at 19.

¹⁰⁴ *Ibid* at 19.

¹⁰⁵ *Canada Pension Plan Investment Board Act*, SC 1997, c 40, as amended [*CPPIBA*].

¹⁰⁶ *Ibid*, ss 3, 5.

¹⁰⁷ *Ibid*, s 8(1). See also *ibid*, s 8 Specific duties (2) Without limiting the generality of subsection (1), the board of directors shall (a) establish written investment policies, standards and procedures in accordance with section 35; (b) establish procedures for the identification of potential conflicts of interest and procedures to resolve those conflicts; (c) establish a code of conduct for officers and employees of the Board; and (d) designate a committee of the board of directors to monitor application of the conflict of interest procedures and the code of conduct.

¹⁰⁸ CPPIB, “Who we are” (January 2019), online: CPPIB <<http://www.cppib.com/en/who-we-are/>>.

¹⁰⁹ *Ibid*.

\$368.3 billion in assets under management.¹¹⁰ Its net income in Q2 of fiscal 2019 after all CPPIB costs was \$8.9 billion.¹¹¹ Thus, the CPPIB has enormous potential to help shift governance practice to meet the issues discussed in this report.

Recommendation 3:

The fiduciary obligation of the directors and officers pursuant to the *Canada Pension Plan Investment Board Act*¹¹² is virtually the same as many other federal statutes and section 14 of the Act should be amended to incorporate ESG as follows (in red italics)

Duty of care

14 (1) Every director and officer of the Board in exercising any of the powers of a director or an officer and in discharging any of the duties of a director or an officer shall

- (a) act honestly and in good faith with a view to the best interests of the Board;
- (b) consider environmental, social and governance factors with a view to the best interests of the corporation;*
- (c) take all reasonable care to address any material issues relating to environmental, social and governance factors with a view to the best interests of the corporation;* and
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

Special knowledge or skill

14(2) A director or officer of the Board who in fact possesses, or by reason of profession or business ought to possess, a particular level of knowledge or skill relevant to the director's or officer's powers or duties shall employ that particular level of knowledge or skill in the exercise of those powers or the discharge of those duties.

14(3) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

Reliance on statements

14(3) A director or an officer of the Board is deemed to comply with subsections (1) and (2) if they rely in good faith on

- (a) financial statements of the Board represented by an officer of the Board, or represented in a written report of the Board's auditor, to be a fair reflection of the financial condition of the Board; or

¹¹⁰ CPPIB, "Our Performance" (January 2019), online: CPPIB <<http://www.cppib.com/en/our-performance/>>.

¹¹¹ *Ibid.*

¹¹² *CPPIBA*, *supra* note 105, s 14.

(b) a report of an accountant, lawyer, notary or other professional person whose profession lends credibility to a statement made by the person.

CPPIB is already committed to ESG in its public statements: “We believe that organizations that manage Environmental, Social and Governance (ESG) factors effectively are more likely to create sustainable value over the long-term than those that do not. As we work to fulfill our mandate, we consider and integrate ESG risks and opportunities into our investment decisions.”¹¹³ As a long-term investor, CPPIB reports that it is investing for multiple generations of beneficiaries, today and well into the future. It is positioning its portfolio to perform well through the transition to a low-carbon economy. CPPIB states that “as a significant long-term investor we believe we can have a powerful influence on the companies in which we invest. We seek to create change from the inside by engaging with numerous Canadian and global companies that are high emitters of greenhouse gas emissions.”¹¹⁴ Codifying the duty would make that fiduciary obligation transparent to all Canadian stakeholders.

7. Amend the Canada Pension Benefits Standards Act and the Canada Pension Benefits Standards Regulation

Pension funds safeguard the financial security of our aging population.¹¹⁵ The fiduciary obligation of pension administrators, trustees and other pension fiduciaries is evident in both statutory and common law, requiring positive actions on the part of fiduciaries.¹¹⁶ In determining asset allocation between short-term and long-term investments, the fiduciary obligation precludes short-term investments that prejudice long-term investments, as the fund must be sustained over the long-term, and thus, trustees must take account of systemic risks.¹¹⁷ The duty of impartiality requires trustees and fund managers to balance intergenerational interests in their investment decisions, recognizing that the time horizon for older workers is much different than for workers just entering the workforce.¹¹⁸

The federal government has the opportunity to amend its federal pension legislation, the *Canada Pension Benefits Standards Act*,¹¹⁹ to clarify the fiduciary obligations of pension fiduciaries. The Act currently addresses the duties of administrators, corporate and individual trustees as follows:

Administrator

¹¹³ CPPIB, “Sustainable Investing” (January 2019), online: CPPIB <<http://www.cppib.com/en/how-we-invest/sustainable-investing/>>.

¹¹⁴ *Ibid.* See also the discussion in Sarra, “Fiduciary Obligations”, *supra* note 1 at 47-49.

¹¹⁵ For a discussion, see Sarra, “Fiduciary Obligations”, *ibid* at 45-57.

¹¹⁶ *Hodgkinson v Simms*, [1994] 3 SCR 377 at 419 [*Hodgkinson v Simms*]; *Sun Indalex Finance, LLC v United Steelworkers*, [2013] 1 SCR 2; Sarra, “Fiduciary Obligations”, *ibid* at 47.

¹¹⁷ James Hawley, Keith Johnson and Ed Waitzer, “Reclaiming Fiduciary Duty Balance” (2011) 4 *Rotman International Journal of Pension Management* 2 at 13.

¹¹⁸ Ronald B Davis, *Democratizing Pension Funds, Corporate Governance and Accountability* (Vancouver: UBC Press, 2008) at 54 [Davis]; Sarra, “Fiduciary Obligations”, *supra* note 1.

¹¹⁹ *Canada Pension Benefits Standards Act, 1985*, RSC, 1985, c 32 (2nd Supp) [*Canada Pension Benefits Standards Act*].

7 (1) The administrator of a pension plan shall be

(a) in the case of a multi-employer pension plan established under one or more collective agreements, a board of trustees or other similar body constituted in accordance with the terms of the plan or the collective agreement or agreements to manage the affairs of the plan;

(b) in the case of a multi-employer pension plan not described in paragraph (a), a pension committee constituted in accordance with the terms of the plan, subject to section 7.1, to manage the affairs of the plan; or

(c) in the case of a pension plan other than a multiemployer pension plan,

(i) the employer, or

(ii) if the plan is established under one or more collective agreements and the terms of the plan or the collective agreement or agreements to manage the affairs of the plan provide for the constitution of a board of trustees or other similar body, that body.

...

Administration of pension plan and fund

8(3) The administrator shall administer the pension plan and pension fund as a trustee for the employer, the members of the pension plan, former members, and any other persons entitled to pension benefits under the plan.

Standard of care

8(4) In the administration of the pension plan and pension fund, the administrator shall exercise the degree of care that a person of ordinary prudence would exercise in dealing with the property of another person.

Manner of investing assets

8(4.1) The administrator shall invest the assets of a pension fund in accordance with the regulations and in a manner that a reasonable and prudent person would apply in respect of a portfolio of investments of a pension fund.

...

Administrator's duty

8(4.3) If a pension plan permits a member, former member, survivor or former spouse or former common law partner of a member or former member to make investment choices, the administrator must offer investment options of varying degrees of risk and expected return that would allow a reasonable and prudent person to create a portfolio of investments that is well adapted to their retirement needs.

Deemed compliance with subsection (4.1)

8(4.4) With respect to the account for which an investment choice is made by a member, former member, survivor or former spouse or former common law partner of a member or former member, if an administrator offers investment

options in accordance with subsection (4.3) and the regulations, that administrator is deemed to comply with subsection (4.1).

Investment choices

8(4.2) A pension plan may permit a member, former member, survivor or former spouse or former common law partner of a member or former member to make investment choices with respect to their account maintained in respect of a defined contribution provision or with respect to their account maintained for additional voluntary contributions.

Special knowledge or skill

8(5) Without limiting the generality of subsection (4), an administrator who in fact possesses, or by reason of profession or business ought to possess, a particular level of knowledge or skill relevant to the administration of a pension plan or pension fund shall employ that particular level of knowledge or skill in the administration of the pension plan or pension fund.

Administrator not liable

8(5.1) An administrator is not liable for contravening subsection (4), (4.1) or (5) if the contravention occurred because the administrator relied in good faith on (a) financial statements of the pension plan prepared by an accountant, or a written report of the auditor or auditors of the plan, that have been represented to the administrator as fairly reflecting the financial condition of the plan; or (b) a report of an accountant, an actuary, a lawyer, a notary or another professional person whose profession lends credibility to the report.

The standard of fiduciary obligation of pension administrators and trustees is a standard that has been set by the common law, now accompanied by amendments to pension law. Fiduciary duties are imposed on a person who exercises discretionary power on behalf of another person who has reposed their trust and confidence in that person.¹²⁰ A pension fiduciary's duties are a duty to act prudently and a duty of loyalty.¹²¹ Pension fiduciaries must act with a view to the best interests of the pension plan, aimed at providing a retirement income for employees when they retire.¹²² As the statutory language above indicates, pension fiduciaries, in the administration of the pension plan and pension fund, must exercise the degree of care that a person of ordinary prudence would exercise in dealing with the property of another person.¹²³ Canadian pension fund trustees have a fiduciary obligation to pension beneficiaries to act prudently in their best interests in making investment decisions regarding fund portfolios.¹²⁴

¹²⁰ *Hodgkinson v Simms*, *supra* note 116 at 419. See generally, Davis, *supra* note 118.

¹²¹ *Hodgkinson v Simms*, *ibid.* See also *Blueberry River Indian Band v Canada (Department of Indian Affairs and Northern Development)*, [1995] 4 SCR 344.

¹²² A Kaplan and M Frazer, *Pension Law* (Toronto: Irwin Law, 2006).

¹²³ Section 8(4), *Canada Pension Benefits Standards Act*, *supra* note 119.

¹²⁴ See Sarra, "Fiduciary Obligations", *supra* note 1 at 47. Arguably, there are also foundations with an asset pool for which the same arguments can be made with respect to fiduciary obligation.

When the courts assess whether pension fiduciaries have met their obligations, the duties are assessed based on the express language in the pension plan, and the relevant pension and trust legislation.¹²⁵ For example, for a defined benefit pension plan, the objective is to build a life income for the future retiree. Pension plans have an obligation to make investment decisions that create sustainable pension funds, addressing intergenerational pressures such as the need to fund pensions in the short to medium term, and the need to look ahead to future generations of beneficiaries.¹²⁶

Waitzer and Sarro have observed that systemic factors are critically important for long term pension investments.¹²⁷

It is now broadly accepted that most investment returns come from general exposure to the market (*beta*) rather than from seeking market benchmark outperformance strategies (*alpha*). As a result, systemic market factors have become critical to fiduciary responsibility. Investments are increasingly expected to look past current market benchmarks and consider questions of future value—to “assess the impact of their investment decisions on others including generations to come.” Risk management means considering such factors as market integrity, systemic risks, governance risks, advisor risks, and the like. There is also a growing recognition that asset classes of longer duration often yield the highest private (as well as societal) returns.¹²⁸

Arguably, therefore, the current standard of fiduciary obligation requires pension fiduciaries to consider ESG risks and opportunities. However, as with corporations law, codification of the duty would provide greater certainty and transparency for pension fiduciaries, pension beneficiaries, investors and other stakeholders.

Recommendation 4:

Amend sections 8(4.1) and 8(4.2) of the Canada *Pension Benefits Standards Act* by adding the follow language (in red italics):

Manner of investing assets

8(4.1) The administrator shall invest the assets of a pension fund in accordance with the regulations and in a manner that a reasonable and prudent person would apply in respect of a portfolio of investments of a pension fund, *and in exercising this authority, will consider environmental, social and governance factors.*

Investment choices

¹²⁵ *Burke v Hudson’s Bay Co*, [2010] 2 SCR 273 at para 41; *Nolan v Kerry (Canada) Inc*, [2009] 2 SCR 678 at para 187.

¹²⁶ Davis, *supra* note 118.

¹²⁷ D Sarro and E Waitzer, “Fiduciary society unleashed: The road ahead for the financial sector” (2014) 69 *Business Lawyer* 1081.

¹²⁸ *Ibid* at 1093.

8(4.2) A pension plan may permit a member, former member, survivor or former spouse or former common law partner of a member or former member to make investment choices with respect to their account maintained in respect of a defined contribution provision or with respect to their account maintained for additional voluntary contributions, *and to inform that choice, the pension administrator should provide information on environmental, social and governance factors to the member, former member, survivor or former spouse or former common law partner of a member or former member for their consideration on each fund offered.*

The existing section 8(5.1) protection from liability, set out on page 37, would apply to these requirements regarding ESG factors.

The *Pension Benefits Standards Act, 1985* and the Pension Benefits Standards Regulations¹²⁹ (“PBSR”) currently require that the administrator of a federally-regulated pension plan establish a written Statement of Investment Policies and Procedures (“SIP&P”).¹³⁰ This SIP&P must be based on the “prudent person portfolio approach” that a reasonable and prudent person would apply to the investment portfolio of a pension fund.¹³¹ A well-developed SIP&P helps administrators optimize the members’ benefits under defined contribution pension plan provisions and meet the promised benefits under defined benefit pension plan provisions.¹³²

As prescribed in the PBSR, the SIP&P must specifically address the following elements:

- (a) categories of investments and loans, including derivatives, options and futures,
 - (b) diversification of the investment portfolio,
 - (c) asset mix and rate of return expectations,
 - (d) liquidity of investments,
 - (e) the lending of cash or securities,
 - (f) the retention or delegation of voting rights acquired through plan investments,
 - (g) the method of, and basis for, the valuation of investments that are not regularly traded at a marketplace; and categories of investments and loans, including derivatives, options and futures; and
 - (h) related party transactions
- having regard to all factors that may affect the funding and solvency of the plan and the ability of the plan to meet its financial obligations.¹³³

¹²⁹ Pension Benefits Standards Regulations, 1985, SOR/87-19, as amended (current to 8 November 2018), online: Government of Canada <<https://laws-lois.justice.gc.ca/PDF/SOR-87-19.pdf>> [PBSR].

¹³⁰ *Ibid.*

¹³¹ *Ibid.*

¹³² OSFI, *Guideline for the Development of Investment Policies and Procedures for Federally Regulated Pension Plans* (Ottawa: OSFI, April 2000), online: OSFI <<http://www.osfi-bsif.gc.ca/eng/pp-rr/ppa-rra/inv-plc/pages/penivst.aspx>> [OSFI, *Pension Plans*].

¹³³ PBSR, *supra* note 129, s 7.1 (1).

In addressing these elements, the plan administrator is currently required to determine the degree of risk and risk tolerance the plan is able to sustain.¹³⁴ The plan administrator must review the SIP&P at least annually.¹³⁵ These requirements would be enhanced by expressly amending the PBSR to incorporate ESG factors as one of the elements that the SIP&P must address.

Recommendation 5:

The Pension Benefits Standards Regulations should be amended to specify that ESG factors must be considered and incorporated in the SIP&P. The federal government should amend section 7.1 of the Pension Benefit Standards Regulation to require:

The Statement of Investment Policies and Procedures required under section 7.1 shall contain information as to how environmental, social and governance factors have been considered and have been incorporated into the plan's investment policies and procedures.

This amendment would align with developments in Ontario and internationally.

i. Other jurisdictions have already incorporated ESG factors in their statements of pension fund investment policy

The Ontario *Pension Benefits Act*¹³⁶ has been amended to require pension funds to disclose 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.¹³⁷ It is a "disclose and explain" approach.¹³⁸ Pursuant to Regulation 909 under the *Pension Benefits Act*, the administrator of a pension plan is required to establish a statement of investment policies and procedures ("SIPP").¹³⁹ Effective January 2016, plan administrators are required to file their SIPP and any amendments with the Financial Services Commission of Ontario ("FSCO").¹⁴⁰ FSCO observes that reporting that ESG factors are incorporated into the plan's broader investment policies and procedures requires action by the administrator beyond a broad delegation. Some examples of the actions that administrators should take include:

¹³⁴ OSFI, *Pension Plans*, *supra* note 132. In addressing these elements in an investment policy, the administrator should establish limits on the plan's exposure to credit risk (a single entity or group of associated entities), and to market risks (interest rate, currency and price). In setting these limits, the plan administrator should consider the plan's exposure under a variety of potential scenarios.

¹³⁵ PBSR, *supra* note 129, s 7.2.

¹³⁶ Ontario *Pension Benefits Act*, RSO 1990, c P 8, as amended [*Pension Benefits Act*].

¹³⁷ O Reg 235/14, made under the *Pension Benefits Act*, amending Reg 909 of RRO 1990 (General), s 8 [O Reg 235/14].

¹³⁸ Section 78(1) of General, RRO 1990, Reg 909 [*Pension Benefits Act*, Reg 909] under the *Pension Benefits Act*, *supra* note 136. The Statement of Investment Policies and Procedures (SIPP) must meet the requirements of the federal investment regulations (FIR), as modified in sections 47.8 and 79 of the Regulation: see Financial Services Commission for Ontario (FSCO), "FAQs – Statement of Investment Policies and Procedures (SIPP)", online: FSCO <<http://www.fSCO.gov.on.ca/en/pensions/legislative/Pages/sipp.aspx#ESG>> [SIPP].

¹³⁹ *Pension Benefits Act*, Reg 909, *ibid*.

¹⁴⁰ *Ibid*.

summarizing policies where the managers incorporate ESG factors into their investment policies; describing how the administrator incorporates ESG factors as part of the manager search, selection and review process; and describing how the administrator incorporates ESG in the choice of investment fund options.¹⁴¹

FSCO has observed that administrators have a fiduciary duty to supervise their investment managers, including ensuring that the managers are complying with the *Pension Benefits Act* and with the SIPP. This supervision requirement extends to the incorporation of ESG factors, where the SIPP contains them.¹⁴² There are also specific requirements as to what must be disclosed to beneficiaries and others that should provide guidance to how the federal government can amend the Canada Pension Benefits Standards Regulation.¹⁴³

One report suggests that the Ontario *Pension Benefits Act* amendments have been important in stimulating boards of trustees to explicitly discuss ESG issues and to seek advice on how responsible investment is consistent with their fiduciary obligation.¹⁴⁴ Investors have observed that the Ontario amendments have had an important catalytic effect on pension funds, in that they now consciously assess both risks and opportunities associated with ESG factors as they want to be in a position to give informed disclosure to beneficiaries.

¹⁴¹ SIPP, *supra* note 138.

¹⁴² *Ibid.*

¹⁴³ O Reg 235/14, *supra* note 137, s 8:

40 (1) A statement required under subsection 27 (1) of the Act shall contain, as recorded in the records of the administrator, at least,

(v) a statement that the administrator of the pension plan must establish a statement of investment policies and procedures for the plan that contains,

(ii) 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;

40.1 (1) A statement to a former member required under subsection 27 (2) of the Act shall contain, as recorded in the records of the administrator, at least,

(s) a statement that the administrator of the pension plan must establish a statement of investment policies and procedures for the plan that contains,

(ii) 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;

40.2 (1) A statement to a retired member required under subsection 27 (2) of the Act shall contain, as recorded in the records of the administrator, at least,

(r) a statement that the administrator of the pension plan must establish a statement of investment policies and procedures for the plan that contains,

(ii) 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;

78 (3) The statement of investment policies and procedures shall include information as to whether environmental, social and governance factors are incorporated into the plan's investment policies and procedures and, if so, how those factors are incorporated.

¹⁴⁴ UN PRI, "Fiduciary Duty in the 21st Century" (8 September 2018) at 15, online: UN PRI

<<https://www.unpri.org/fiduciary-duty/fiduciary-duty-in-the-21st-century/244.article>>. See also the Ontario Government, "The End of Coal" (published 15 December 2017), online: Government of Ontario <<https://www.ontario.ca/page/end-coal>> [archived], which reports that Ontario is saving approximately \$4.4 billion annually in health, environmental and financial costs since it eliminated coal-fired energy generation.

The UK has enacted similar legislation. Effective 1 January 2019, new regulations clarify trustees' fiduciary duties, including consideration of ESG factors.¹⁴⁵ The new regulations clarify that it is the duty of pension trustees to consider financially material risks and opportunities, including ESG topics like climate change, in addition to traditional financial metrics. All pension schemes that are required to produce a Statement of Investment Principles need to update the statement to set out financially material considerations over the appropriate time horizon of the investments, including how those considerations are taken into account in the selection, retention and realization of investments.¹⁴⁶ The UK Government has specified that "financially material considerations" include, but are not limited to, ESG considerations, including, but not limited to, climate change, which the trustees of the trust scheme consider financially material.¹⁴⁷ The appropriate time horizon for considering ESG factors is the length of time that trustees consider is needed for the funding of future benefits by the investments of the scheme.¹⁴⁸

The UK Sustainable Investment and Finance Association has observed:

Fiduciary duty means acting in the best interests of beneficiaries, who will have, given the nature of pensions, long-term investment horizons. The integration of financially material environmental, social and governance (ESG) issues into investment decisions and robust stewardship policies can help reduce investment risk and enhance returns.¹⁴⁹

One improvement from the current Ontario requirements would be to require federally-regulated pension plans across Canada to incorporate ESG factors, including climate change risk, into the plan's statement of investment policies and procedures, as opposed to a disclose or explain approach. Failure to do so would then give rise to liability for breach of fiduciary and prudential obligations. It would align with UK and EU developments and would enhance investment policies under the Canada *Pension Benefits Standards Act* and provide important signalling for provincial and territorial governments regarding pension legislation across the country. At the absolute minimum, the federal government should require a disclose or explain approach, as is required under Ontario law.

8. Require federal Crown corporations to consider ESG factors and address material ESG risks and opportunities

¹⁴⁵ UK Government, Department for Work and Pensions (DWP), "Pension trustees: clarifying and strengthening investment duties" (18 June 2018, last updated 11 September 2018), online: UK Government <<https://www.gov.uk/government/consultations/pension-trustees-clarifying-and-strengthening-investment-duties>>. See Impact Assessment.

¹⁴⁶ *Ibid.*

¹⁴⁷ By 1 October 2019 some schemes will have been required to update and publish their Statement of Investment Principles. Effective 1 October 2020 some schemes are required to produce and publish their implementation statement. *Ibid.*

¹⁴⁸ *Ibid.*

¹⁴⁹ UK House of Commons, *supra* note 83 at 7, citing UKSIF (GFI0002).

Federal Crown corporations operate in many sectors of the Canadian economy, each with a specified public policy interest.¹⁵⁰ There are currently 46 federal Crown corporations in Canada, varying in size, capitalization and reliance on government appropriations.¹⁵¹ There is a broad range of governance structures, although the majority are reporting corporations pursuant to International Financial Reporting Standards.¹⁵² The Expert Panel should recommend to the federal government that Crown corporations must consider ESG factors in their governance and oversight and that they address material risks and opportunities. It would demonstrate leadership in sustainability in terms of the activities funded in large part by Canadian taxpayers.

Recommendation 6:

The Expert Panel should recommend to the federal government to require federal Crown corporations to consider whether there are material ESG risks and opportunities, and where they exist, to take all reasonable care to address the material ESG factors.

Expert Panel Question 3.4(2):

What is the best way to incorporate ESG into rules or regulations that govern Canadian financial institutions?

1. The significance of Canadian financial institutions to the Canadian economy

Canadian financial institutions are a significant part of the Canadian economy. Federally-regulated financial institutions that are publicly-traded had \$597.6 billion in qualifying market value as at November 2018, and that figure does not include more than 200 financial institutions operating in Canada that are not listed on the TSX.¹⁵³ Canadian financial institutions earned a record total net income of \$44.7 billion CAD in 2017.¹⁵⁴ Insurance companies' business activities

¹⁵⁰ Government of Canada, "Crown Corporations Financial Data" (27 December 2018), online: Government of Canada <<https://www.canada.ca/en/treasury-board-secretariat/services/reporting-government-spending/inventory-government-organizations/crown-corporations-financial-data.html>>; Government of Canada, "Appendix A: List of Crown corporations and other reporting entities (9 October 2018), online: Government of Canada <<https://www.tpsgc-pwgsc.gc.ca/recgen/manuels-manuals/chap18/07-eng.html>>.

¹⁵¹ Government of Canada, "Consolidated Financial Information for Crown Corporations (Annual Report 2017-2018; in thousands of dollars)" (27 December 2018), online: Government of Canada <<https://www.canada.ca/en/treasury-board-secretariat/services/reporting-government-spending/inventory-government-organizations/consolidated-financial-information-crown-corporations-annual-report-2017-2018.html>>.

¹⁵² *Ibid.*

¹⁵³ They are listed on international exchanges or privately held. TSX, *supra* note 47; Bloomberg and OSFI, "Who We Regulate" (15 January 2019), online: OSFI <<http://www.osfi-bsif.gc.ca/Eng/wt-ow/Pages/wwr-er.aspx>> [OSFI, "Who We Regulate"].

¹⁵⁴ Canada Deposit Insurance Corporation, "Annual Report 2018" (2018) at 15, online (pdf): CDIC <<http://www.cdic.ca/en/newsroom/financial-reports/Documents/annual-report/2018-annual-report.pdf>>.

represent almost 2% of Canada's gross domestic product ("GDP") generated annually¹⁵⁵ and net income of insurance companies in Canada was \$9.8 billion in 2016, with 75% of the industry's net income attributable to three large conglomerate insurers.¹⁵⁶ There have been considerable amendments to financial institution legislation in recent years to enhance capital adequacy, liquidity and governance oversight.

Fairness suggests that amendments to incorporate ESG factors as part of fiduciary obligation should be made across the entirety of federally-regulated business entities, including federally-regulated banks, insurance companies and financial institutions. Given the size and market capitalization of many of these entities, it would result in a considerable shift in corporate activity towards sustainable governance.

Canada's financial institutions are regulated under a number of statutes. Given that directors are one of the key stakeholder groups to effect a shift to consideration of ESG factors, it makes sense to amend these statutes to mirror the provisions of the *CBCA*. The policy suggestions below specifically focus on fiduciary obligations under the *Bank Act*,¹⁵⁷ the *Insurance Companies Act*,¹⁵⁸ the federal *Trust and Loan Companies Act*,¹⁵⁹ statutes relating to federally-registered credit unions, and the *Bank of Canada Act*.¹⁶⁰

2. Amend the fiduciary obligation provisions under the Bank Act to incorporate ESG factors

The *Bank Act*¹⁶¹ applies to banks listed in Schedule I or II and to bank holding companies, which are body corporates incorporated or formed under Part XV of the *Bank Act*.¹⁶² The statute also applies to authorized foreign banks permitted to carry on business in Canada.¹⁶³ As of 31 December 2017, there were 32 banks,¹⁶⁴ 21 bank holding companies,¹⁶⁵ and 32 foreign banks authorized to carry on business in Canada pursuant to the *Bank Act*.¹⁶⁶ The six largest banks account for about 90% of total assets held by federally-regulated deposit-taking institutions.¹⁶⁷

¹⁵⁵ Canada, Statistics Canada, *Table 36-10-0434-05 Gross domestic product at basic prices, by industry, monthly, industry detail, growth rates (x1,000,000)* (Ottawa: Statistics Canada, 2018), online: Government of Canada <<https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3610043405>>.

¹⁵⁶ *Ibid.* 2016 are the statistics most recently available.

¹⁵⁷ *Canada Bank Act*, SC 1991, c 46, as amended [*Bank Act*].

¹⁵⁸ *Canada Insurance Companies Act*, SC 1991, c 47, as amended (*ICA*).

¹⁵⁹ *Trust and Loan Companies Act*, SC 1991, c 45, as amended.

¹⁶⁰ *Bank of Canada Act*, RSC, 1985, c B-2, as amended [*Bank of Canada Act*].

¹⁶¹ *Bank Act*, *supra* note 157.

¹⁶² *Bank Act*, *ibid.*, s 2.

¹⁶³ *Bank Act*, *ibid.*, s 14.1 (1) There shall be set out in Schedule III (a) the name of every authorized foreign bank and, where applicable, any other name under which it is permitted to carry on business in Canada; (b) the province in which the principal office of the authorized foreign bank is situated; and (c) whether the authorized foreign bank is subject to the restrictions and requirements referred to in subsection 524(2).

¹⁶⁴ Schedule I, *Bank Act*, *ibid.*

¹⁶⁵ Schedule II, *Bank Act*, *ibid.*

¹⁶⁶ Schedule III, *Bank Act*, *ibid.*

¹⁶⁷ OSFI, *Annual Report 2017-2018* (2018), online (pdf): OSFI <<http://www.osfi-bsif.gc.ca/Eng/Docs/ar1718.pdf>>. OSFI regulates: 35 domestic banks; 21 foreign banks; 28 full service foreign

The *Bank Act* also sets out the same fiduciary obligations for directors and officers of bank holding companies, as for Schedule I and II banks.

Recommendation 7:

For greater certainty, the *Bank Act* sections 158 and 748 on fiduciary obligations of banks and bank holding companies should be amended to read (in red italics):

158 (1) Every director and officer of a bank in exercising any of the powers of a director or an officer and discharging any of the duties of a director or an officer shall

- (a) act honestly and in good faith with a view to the best interests of the bank;
- (b) consider environmental, social and governance factors with a view to the best interests of the bank;*
- (c) take all reasonable care to address any material issues relating to environmental, social and governance factors with a view to the best interests of the bank;* and
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

158(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, depositors, deposit insurance protection funds, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

...

Duty of care

748 (1) Every director and officer of a bank holding company in exercising any of the powers of a director or an officer and discharging any of the duties of a director or an officer shall

- (a) act honestly and in good faith with a view to the best interests of the bank holding company;
- (b) consider environmental, social and governance factors with a view to the best interests of the bank;*
- (c) take all reasonable care to address any material issues relating to environmental, social and governance factors with a view to the best interests of the bank;* and
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

748(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, depositors, deposit insurance protection

bank branches; 4 lending foreign bank branches; 44 trust companies; and 18 loan companies. OSFI, “Who We Regulate”, *supra* note 153.

funds, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

The addition of sections 158(2) and section 748(2), which largely track the suggested CBCA amendments codifying Canadian common law, adds depositors and deposit insurance protection funds as stakeholders whose interests directors and officers may consider in acting with a view to the best interests of the bank. Depositors are significant stakeholders whose savings are protected under banking legislation. As the Office of the Superintendent of Financial Institutions (“OSFI”) has observed: “Relative to non-financial businesses, the failure of a financial institution can have a greater impact on members of the public who may have placed a substantial portion of their life savings with the institution and who may be relying on that institution for day-to-day financial needs.”¹⁶⁸ The deposit insurance protection fund¹⁶⁹ is essentially a significant contingent creditor that could have the largest claim on a deposit-taking bank’s assets if it were to fail. It is therefore another stakeholder that directors and officers may consider in acting in the best interests of the bank.

Strong defences are already available under sections 211 and 798 of the *Bank Act*, which would then apply to consideration of ESG factors and decisions to address material issues by banks and bank holding companies:

Defence – due diligence

211 (1) A director, officer or employee of a bank is not liable under section 207 or 210 or subsection 506(1) and has fulfilled their duty under subsection 158(2) if they exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances, including reliance in good faith on

- (a) financial statements of the bank that were represented to them by an officer of the bank or in a written report of the auditor or auditors of the bank fairly to reflect the financial condition of the bank; or
- (b) a report of a person whose profession lends credibility to a statement made by them.

Defence — good faith

211 (2) A director or officer of a bank has fulfilled their duty under subsection 158(1) if they relied in good faith on

- (a) financial statements of the bank that were represented to them by an officer of the bank or in a written report of the auditor or auditors of the bank fairly to reflect the financial condition of the bank; or
- (b) a report of a person whose profession lends credibility to a statement made by them.

¹⁶⁸ OSFI, *Corporate Governance Guideline* (September 2018), online: OSFI <http://www.osfi-bsif.gc.ca/Eng/finance/if/rg-ro/gdn-ort/gl-ld/Pages/CG_Guideline.aspx> [OSFI, *Corporate Governance Guideline*].

¹⁶⁹ Canada Deposit Insurance Corporation, “About deposit insurance” (2018), online: CDIC <<http://www.cdic.ca/en/about-di/Pages/default.aspx>>.

...

Defence — due diligence

798 (1) A director, officer or employee of a bank holding company is not liable under section 794 or 797 and has fulfilled their duty under subsection 748(2) if they exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances, including reliance in good faith on

(a) financial statements of the bank holding company that were represented to them by an officer of the bank holding company or in a written report of the auditor of the bank holding company fairly to reflect the financial condition of the bank holding company; or

(b) a report of a person whose profession lends credibility to a statement made by them.

Defence — good faith

798 (2) A director or officer of a bank holding company has fulfilled their duty under subsection 748(1) if they relied in good faith on

(a) financial statements of the bank holding company that were represented to them by an officer of the bank holding company or in a written report of the auditor of the bank holding company fairly to reflect the financial condition of the bank holding company; or

(b) a report of a person whose profession lends credibility to a statement made by them.

Thus, there is a strong defence that if directors and officers exercise the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances, including reliance in good faith on the assistance of professionals, they have nothing to be concerned about in terms of personal or corporate liability. Here again, an obligation to address material ESG factors would be counter-balanced by a strong defence for duly diligent directors and officers.

3. Include federally-regulated credit unions in the amended fiduciary obligation provisions under the Bank Act, and amend the fiduciary obligation provisions of the Canada Cooperatives Act and the Cooperative Credit Associations Act to align

The amendments to consider and address material ESG factors should also apply to federally-regulated credit unions.¹⁷⁰ There are currently three federal statutes that regulate credit unions, the *Bank Act*,¹⁷¹ the *Canada Cooperatives Act*¹⁷² and the *Cooperative Credit Associations Act*.¹⁷³

¹⁷⁰ *Bank Act*, *supra* note 157, s 183.01 Directors of federal credit union and s 216.01 Conversion into federal credit union.

¹⁷¹ *Ibid.*

¹⁷² *Canada Cooperatives Act*, SC 1998, c 1, as amended [*Canada Cooperatives Act*].

¹⁷³ *Cooperative Credit Associations Act*, SC 1991, c 48, as amended [*Cooperative Credit Associations Act*].

The *Bank Act* defines a federal credit union as “a bank that, within the meaning of section 12.1, is organized and carries on business on a cooperative basis.”¹⁷⁴ As with the issuing of letters patent to incorporate a bank, the Minister is to take into account all matters that the Minister considers relevant to the application, specifically, the nature and sufficiency of the financial resources, soundness, feasibility, integrity, competence and the best interests of the financial system in Canada, including the best interests of the cooperative financial system in Canada.¹⁷⁵ A credit union can be structured by common shares or membership shares pursuant to the *Bank Act*.¹⁷⁶ At least two-thirds of the directors of a federal credit union, or any greater proportion that is provided for by the by-laws, must be members of the federal credit union or representatives of members of the federal credit union.¹⁷⁷

A federal credit union may also apply, with the approval in writing of the Minister, under the *Canada Cooperatives Act*¹⁷⁸ for a certificate of continuance, or a certificate of continuance and a certificate of amalgamation, as a cooperative under that *Act*; or apply under the *Cooperative Credit Associations Act*¹⁷⁹ for letters patent continuing the federal credit union as an association under that *Act* or amalgamating and continuing the federal credit union as an association under that *Act*.¹⁸⁰

It therefore makes sense to amend the fiduciary duties under the *Canada Cooperatives Act* and the *Cooperative Credit Associations Act* to align with proposed changes to the *Bank Act*.

¹⁷⁴ Section 2, *Bank Act*, *supra* note 157. Section 12.1 specifies: 12.1 (1) For the purposes of this Act, a federal credit union is organized and carries on business on a cooperative basis if (a) a majority of its members are natural persons; (b) it provides financial services primarily to its members; (c) membership in the federal credit union is wholly or primarily open, in a non-discriminatory manner, to persons who can use the services of the federal credit union and who are willing and able to accept the responsibilities of membership; (d) each member has only one vote; (e) a delegate has only one vote even though the delegate is a member or represents more than one member; (f) dividends on any membership share are limited to the maximum percentage fixed in the federal credit union’s letters patent or by-laws; and (g) surplus funds arising from the federal credit union’s operations are used (i) to provide for the financial stability of the federal credit union, (ii) to develop its business, (iii) to provide or improve common services to members, (iv) to provide for reserves or dividends on membership shares and shares, (v) for community welfare or the propagation of cooperative enterprises, or (vi) as a distribution to its members as a patronage allocation. Section 22(2) specifies that (2) On the application of five or more persons, a majority of whom are natural persons, made in accordance with this Act, the Minister may, subject to this Part, issue letters patent incorporating a federal credit union.

¹⁷⁵ Section 27, *ibid.*

¹⁷⁶ Section 38(2), *ibid.*

¹⁷⁷ Section 159.1, *ibid.*

¹⁷⁸ *Canada Cooperatives Act*, *supra* note 172, s 11.1 specifies that: If a federal credit union, within the meaning of section 2 of the *Bank Act*, is continued as a cooperative under this Act, (a) its membership shares are deemed to be membership shares to which are attached the rights, privileges and restrictions set out in this Act and the articles; (b) the members of the federal credit union are deemed to be the members of the cooperative; and (c) any agreement made before continuance under which the members of the federal credit union have agreed to vote in a manner provided in the agreement is of no effect.

¹⁷⁹ *Cooperative Credit Associations Act*, *supra* note 173.

¹⁸⁰ Section 39.2 (1), *Bank Act*, *supra* note 157.

Recommendation 8:

Amend the fiduciary obligations of directors and officers under the *Canada Cooperatives Act* as follows (in red italics):

Duties

80 (1) Every director and officer must, in exercising the powers and performing the duties of office,

(a) act honestly and in good faith with a view to the best interests of the cooperative;

(b) consider environmental, social and governance factors with a view to the best interests of the corporation;

(c) take all reasonable care to address any material issues relating to environmental, social and governance factors with a view to the best interests of the corporation; and

(d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

80(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, depositors, deposit insurance protection funds, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

Directors would have the existing due diligence defence under section 111 of the *Canada Cooperatives Act*:

Defence Due diligence

111 A director is not liable under this Part if the director exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances, including reliance in good faith on

(a) financial statements of the cooperative represented to the director by an officer of the cooperative or in a written report of the auditor of the cooperative fairly to reflect the financial condition of the cooperative; or

(b) a report of a person whose profession lends credibility to a statement made by the professional person.

The *Cooperative Credit Associations Act* specifies similar duties of directors and officers and its provisions should be amended to align with the recommendations above.

Recommendation 9:

Amend the fiduciary obligation of directors and officers under section 168(1) of the *Cooperative Credit Associations Act* as follows (in red italics):

Duty of care

168 (1) Every director and officer of an association in exercising any of the powers of a director or an officer and discharging any of the duties of a director or an officer shall

- (a) act honestly and in good faith with a view to the best interests of the association;
- (b) consider environmental, social and governance factors with a view to the best interests of the corporation;*
- (c) take all reasonable care to address any material issues relating to environmental, social and governance factors with a view to the best interests of the corporation;* and
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

168(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, depositors, deposit insurance protection funds, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

Directors and officers under the *Cooperative Credit Associations Act* would have the due diligence and good faith defences that already exist under the statute:

Defence — due diligence

215 (1) A director, officer or employee of an association is not liable under section 211 or 214 or subsection 430(1) and has fulfilled their duty under subsection 168(2) if they exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances, including reliance in good faith on

- (a) financial statements of the association that were represented to them by an officer of the association or in a written report of the auditor of the association fairly to reflect the financial condition of the association; or
- (b) a report of a person whose profession lends credibility to a statement made by them.¹⁸¹

Defence — good faith

215 (2) A director or officer of an association has fulfilled their duty under subsection 168(1) if they relied in good faith on

- (a) financial statements of the association that were represented to them by an officer of the association or in a written report of the auditor of the association fairly to reflect the financial condition of the association; or
- (b) a report of a person whose profession lends credibility to a statement made by them.

¹⁸¹ Section 211 refers to a list of specified transactions for which a director may be liable in terms of consenting or voting; section 214 refers to liability for employee wages in specified circumstances; and section 430(1) refers to voidable contracts. *Cooperative Credit Associations Act*, *supra* note 173.

4. Amend the fiduciary obligation provisions under the Canada Trust and Loan Companies Act

In order to create fairness and consistency, the federal government should amend the federal *Trust and Loan Companies Act*,¹⁸² which currently has the same fiduciary obligation provisions as the *Bank Act*. The rationale for the change is the same.

Recommendation 10:

Amend the fiduciary obligations under the federal *Trust and Loan Companies Act* as follows (in red italics):

Duty of care

162 (1) Every director and officer of a company in exercising any of the powers of a director or an officer and discharging any of the duties of a director or an officer shall

- (a) act honestly and in good faith with a view to the best interests of the company;
- (b) consider environmental, social and governance factors with a view to the best interests of the bank;*
- (c) take all reasonable care to address any material issues relating to environmental, social and governance factors with a view to the best interests of the bank;* and
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

162(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, depositors, deposit insurance protection funds, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

The defences under sections 216(1) and (2) of the *Trust and Loan Companies Act*¹⁸³ are the same as the liability protection pursuant to the *Bank Act*, discussed above.

5. Federally-regulated insurance companies and fiduciary duty

Several major Canadian insurance companies are signatories to the UN “Principles for Sustainable Insurance”, which provides a framework for the global insurance industry to address ESG risks

¹⁸² *Trust and Loan Companies Act*, SC 1991, c 45, as amended.

¹⁸³ *Ibid*, s 216: *Defence — good faith* (2) A director or officer of a company has fulfilled their duty under subsection 162 (1) if they relied in good faith on (a) financial statements of the company that were represented to them by an officer of the company or in a written report of the auditor of the company fairly to reflect the financial condition of the company; or (b) a report of a person whose profession lends credibility to a statement made by them.

and opportunities.¹⁸⁴ The four principles are a commitment to: embedding ESG issues relevant to the insurance business in decision-making; work with clients and business partners to raise awareness of ESG issues, manage risk and develop solutions; work with governments, regulators and other key stakeholders to promote widespread action on ESG issues; and demonstrate accountability and transparency in regularly disclosing publicly progress in implementing the Principles.¹⁸⁵

There are a number of insurance companies that are federally regulated and thus amendment of the fiduciary obligation should significantly assist in embedding sustainable governance strategies. OSFI reports that it currently supervises 67 federally-regulated life insurance companies, 13 federally-regulated fraternal benefit societies and 152 federally-regulated property & casualty insurance companies.¹⁸⁶ Many of these insurance companies are already at the forefront of advocating or adopting climate-related or ESG factors in their decision-making.

The *Insurance Companies Act*¹⁸⁷ specifies that directors of a company shall manage or supervise the management of the business and affairs of the company.¹⁸⁸ There are a series of specified duties, as well as exceptions to those duties in some circumstances.¹⁸⁹ The fiduciary obligation in

¹⁸⁴ United Nations Environment Finance Initiative, “Principles for Sustainable Insurance” (2018), online: UNEP <www.unepfi.org/psi>.

¹⁸⁵ *Ibid.*

¹⁸⁶ OSFI, “Who We Regulate”, *supra* note 153.

¹⁸⁷ Canada *Insurance Companies Act*, SC 1991, c 47, as amended [ICA].

¹⁸⁸ *Ibid.*, s 165 (1) Duty to manage.

¹⁸⁹ *Ibid.*, s 165 (1) Duty to manage; and s 165 Specific duties (2) Without limiting the generality of subsection (1), the directors of a company shall

- (a) establish an audit committee to perform the duties referred to in subsections 203(3) and (4);
- (b) establish a conduct review committee to perform the duties referred to in subsection 204(3);
- (c) establish procedures to resolve conflicts of interest, including techniques for the identification of potential conflict situations and for restricting the use of confidential information;
- (d) designate a committee of the board of directors to monitor the procedures referred to in paragraph (c);
- (e) in the case of a company that issues participating policies, establish, before issuing any participating policies or, in the case of a former-Act company, within six months after the coming into force of this Part, a policy for determining the dividends and bonuses to be paid to the participating policyholders;
- (e.1) establish a policy respecting the management of each of the participating accounts maintained under section 456,
 - (i) if the company has participating policyholders on the day on which this paragraph comes into force, within six months after that day, and
 - (ii) in any other case, before issuing a participating policy;
- (e.2) establish criteria for changes made by the company to the premium or charge for insurance, amount of insurance or surrender value in respect of its adjustable policies,
 - (i) if the company has adjustable policyholders on the day on which this paragraph comes into force, within six months after that day, and
 - (ii) in any other case, before issuing an adjustable policy;
- (f) establish procedures to provide disclosure of information to customers of the company that is required to be disclosed by this Act and for dealing with complaints as required by section 486;
- (g) designate a committee of the board of directors to monitor the procedures referred to in paragraph (f) and satisfy itself that they are being adhered to by the company;
- (h) establish investment and lending policies, standards and procedures in accordance with section 492; and

section 166(1) of the *Insurance Companies Act* mirrors the *CBCA* provisions. Therefore, it makes sense to amend the fiduciary obligation in the *Insurance Companies Act* to align with the proposed changes to the *CBCA*. In terms of stakeholder groups to consider, insurance policyholders and the insurance protection funds should be included.¹⁹⁰ As with deposit insurance, the policyholder insurance protection funds are the largest contingent creditors and their interests should be included in the enumerated list. The same duties are mirrored for insurance holding companies in the *Insurance Companies Act*, and that language would also need amending.

Recommendation 11:

Amend the fiduciary obligations of directors and officers of insurance companies and insurance holding companies in the *Insurance Companies Act* as follows (in red italics):

166 (1) Every director and officer of a company in exercising any of the powers of a director or an officer and discharging any of the duties of a director or an officer shall

- (a) act honestly and in good faith with a view to the best interests of the company;
- (b) consider environmental, social and governance factors with a view to the best interests of the corporation;*
- (c) take all reasonable care to address any material issues relating to concerns environmental, social and governance factors with a view to the best interests of the corporation;* and
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.*

166(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, policyholders, insurance protection funds, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

...

Duty of care

795 (1) Every director and officer of an insurance holding company in exercising any of the powers of a director or an officer and discharging any of the duties of a director or an officer shall

- (a) act honestly and in good faith with a view to the best interests of the insurance holding company;

(i) in the case of a former-Act company, appoint the actuary of the company forthwith after the coming into force of this Part.

¹⁹⁰ Assuris, "Home Page" (2018), online: Assuris <www.assuris.ca/>, and the Property and Casualty Insurance Compensation Corporation, "Home Page" (2018), online: PACICC <<http://www.pacicc.ca/>>.

- (b) consider environmental, social and governance factors with a view to the best interests of the corporation;*
- (c) take all reasonable care to address any material issues relating to concerns environmental, social and governance factors with a view to the best interests of the corporation and*
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.*

795(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, policyholders, insurance protection funds, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

The existing good faith defences would then be available to the directors and officers:

Defence — good faith

220(2) A director or officer of a company has fulfilled their duty under subsection 166(1) if they relied in good faith on

- (a) financial statements of the company that were represented to them by an officer of the company or in a written report of the auditor of the company fairly to reflect the financial condition of the company; or
- (b) a report of a person whose profession lends credibility to a statement made by them.

Defence — good faith

845 (2) A director or officer of an insurance holding company has fulfilled their duty under subsection 795(1) if they relied in good faith on

- (a) financial statements of the insurance holding company that were represented to them by an officer of the insurance holding company or in a written report of the auditor of the insurance holding company fairly to reflect the financial condition of the insurance holding company; or
- (b) a report of a person whose profession lends credibility to a statement made by them.

...

Reliance on information

960 An insurance holding company and any person who is a director or an officer, employee or agent of the insurance holding company may rely on any information contained in a declaration required by the directors pursuant to section 959 or on any information otherwise acquired in respect of any matter that might be the subject of such a declaration, and no action lies against the insurance holding company or any such person for anything done or omitted to be done in good faith in reliance on any such information.

6. The Office of the Superintendent of Financial Institutions should assist in shifting governance practices

OSFI should assist boards that come under OSFI's supervisory authority to shift their governance practices to take account of ESG factors. OSFI has said that the quality of corporate governance practices of federally-regulated financial institutions is an important factor in maintaining the confidence of depositors and policyholders, as well as overall market confidence.¹⁹¹ In September 2018, it issued a corporate governance guideline that "draws attention to specific areas of corporate governance that are especially important for financial institutions (eg, risk governance), owing to the unique nature and circumstances of financial institutions and risks assumed relative to other corporations."¹⁹² While its guideline has a number of important recommendations regarding board diversity, independence, and risk management, it makes no mention of ESG factors, other than to specify that: "On an on-going basis, the FRFI (federally-regulated financial institutions) should be satisfied that the Risk Appetite Framework remains appropriate relative to the risk profile of the FRFI, its long-term strategic plan and its operating environment."¹⁹³

Importantly, the new corporate governance guideline requires federally-regulated financial institutions to develop a "Risk Appetite Framework", OSFI noting that "Risk governance is a distinct and crucial element of the FRFI's corporate governance".¹⁹⁴ The Risk Appetite Framework should set the basic goals, benchmarks, parameters and limits as to the amount of risk the federally-regulated financial institution is willing to accept, taking into account various financial, operational and macroeconomic factors. It should consider the material risks to the federally-regulated financial institution, as well as the institution's reputation vis-à-vis policyholders, depositors, investors and customers.¹⁹⁵ Thus it does recognize the need to take account of risks to diverse stakeholders, although makes no mention beyond direct financial claimants. Arguably, the scope of the Risk Appetite Framework includes consideration of material ESG risks; however, for greater certainty, OSFI should make clear the need to consider these risks.

OSFI's role is to supervise federally-regulated financial institutions to assess their financial condition and monitor compliance with the applicable federal legislation, which it carries out within a risk-focused framework".¹⁹⁶ OSFI has developed a comprehensive set of assessment criteria, key among which is the quality of oversight and control provided by the board and senior officers, monitoring their activities to assess safety and soundness, the quality of control and governance.¹⁹⁷ Its general approach is "trust but verify" in terms of governance, capital adequacy

¹⁹¹ OSFI, *Corporate Governance Guideline*, *supra* note 168.

¹⁹² *Ibid.*

¹⁹³ *Ibid* at 11.

¹⁹⁴ *Ibid* at 7.

¹⁹⁵ *Ibid* at 8.

¹⁹⁶ OSFI, *Supervisory Framework* (revised December 2010), online: OSFI <<http://www.osfi-bsif.gc.ca/Eng/financial/rai-eri/sp-ps/Pages/sff.aspx>>.

¹⁹⁷ *Ibid.*

and risk management.¹⁹⁸ Within these activities, OSFI should contribute meaningfully to enhanced governance through consideration of ESG factors by embedding them in its corporate governance guideline and in its oversight practice. As the World Bank and the OECD have observed, it is important to support financial supervisory authorities to better assess and oversee climate-related risks that could threaten the financial stability of the financial system in the short and long term.¹⁹⁹

The Bank of England is integrating the financial risks from climate change into its supervisory activities, including through its Prudential Regulatory Authority, to embed climate change risk in its assessment and intervention practices in support of the safety and soundness of its financial institutions and also in actively supporting an orderly transition to a low-carbon economy.²⁰⁰

The Expert Panel's Interim Report noted that this year OSFI will include questions on climate risk oversight in its supervisory process.²⁰¹ No information is yet available on this development, but it is an important factor to consider. OSFI advises that it will publish a short statement on climate-risk and the insurance industry in the coming weeks.²⁰² OSFI should be encouraged to expand that supervisory oversight to include material ESG factors that pose a risk to capital adequacy and liquidity of the financial institutions over which it exercises supervisory oversight.

Recommendation 12:

The Expert Panel should recommend that the Office of the Superintendent of Financial Institutions include in its supervisory oversight of federally-regulated financial institutions material ESG factors that pose a risk to capital adequacy and liquidity of these institutions. This requirement would provide greater certainty and transparency of management of ESG risks and opportunities.

7. Amend the Bank of Canada Act to include ESG factors

Canada's central bank is created pursuant to the *Bank of Canada Act*.²⁰³ The purpose of the bank is to: regulate credit and currency in the best interests of the economic life of the nation, control and protect the external value of the national monetary unit and mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be

¹⁹⁸ Janis Sarra, "Flotsam, Financing and Flotation: Is Canada 'Resolution Ready' for Insurance Company Insolvency?" / «Épaves, financement et flottage : Le Canada est-il prêt pour la résolution des sociétés d'assurance insolubles?» in Janis Sarra, Barbara Romaine, Blair Nixon and Jill Corraini, eds, *Annual Review of Insolvency Law 2018* (Toronto: Carswell, 2019) 793 at 1006.

¹⁹⁹ OECD, "Financing Climate Futures: Rethinking Infrastructure" (28 November 2018) at 30, 84, online: OECD <<http://www.oecd.org/environment/cc/climate-futures/>> [OECD, "Financing Climate Futures"].

²⁰⁰ Bank of England, "The Bank of England's response to climate change" (2017), online: Bank of England <<https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2017/the-banks-response-to-climate-change.pdf?la=en&hash=7DF676C781E5FAEE994C2A210A6B9EEE44879387>>.

²⁰¹ Expert Panel, *supra* note 16 at 17.

²⁰² OFSI, telephone conversation, 25 January 2019.

²⁰³ *Bank of Canada Act*, *supra* note 160.

possible within the scope of monetary action, and generally promote the economic and financial welfare of Canada.²⁰⁴ The business and powers of the bank include: buying and selling gold, silver, or any other coin and gold and silver bullion; buying and selling foreign currencies and maintaining deposit accounts with banks or foreign banks, either in or outside Canada; making short-term loans or advances to members of the Canadian Payments Association; and a host of other duties in buying and selling securities issued by or guaranteed by governments for the purposes of conducting monetary policy or promoting the stability of the Canadian financial system.²⁰⁵

While the Bank of Canada has a somewhat unique status as the nation's central bank, it is nonetheless worth considering legislative change to encourage the bank, in carrying out its statutory purposes, to consider ESG factors where they are material. The Bank of Canada is a body corporate with a board of 12 directors in addition to the Governor and a Deputy Governor of the bank.²⁰⁶ There is no express statutory duty of care or loyalty set out in the statute, although there is authority for the Minister, with the approval of the Governor in Council, to "appoint directors to hold office, during good behaviour, subject to removal by the Governor in Council at any time for cause."²⁰⁷ There are express restrictions on serving in respect of conflicts of interest, such as being a shareholder of a clearing house designated under the *Payment Clearing and Settlement Act*²⁰⁸ or an investment dealer that acts as a distributor of new federal government securities.²⁰⁹ There is a provision providing protection for directors specifying that no action lies against the directors and other listed persons "for anything done or omitted to be done in good faith in the administration or discharge of any powers or duties that under this *Act* are intended or authorized to be executed or performed."²¹⁰

Creating an express statutory fiduciary obligation that includes taking account of ESG factors in the *Bank of Canada Act* would codify director and officer responsibilities, creating greater transparency. It will enhance activities the Bank is already engaged in. Bank of Canada Deputy Governor Timothy Lane recently observed that the Bank of Canada needs to consider the effects of climate change as it delivers on its mandate to promote the economic and financial well-being of Canadians.²¹¹ He notes that the Bank has a broad "set of responsibilities to support financial stability, including identifying, analyzing and assessing both imminent and emerging systemic risks."²¹² He notes that climate change ultimately has implications for monetary policy and that

²⁰⁴ *Ibid*, preamble.

²⁰⁵ *Ibid*, s 18.

²⁰⁶ *Ibid*, ss 3(2), 5(1).

²⁰⁷ *Ibid*, s 9(1). Section 10 (1) specifies that "The directors shall be selected from various occupations."

²⁰⁸ *Payment Clearing and Settlement Act*, SC 1996, c 6.

²⁰⁹ *Bank of Canada Act*, *supra* note 160, s 10(1).

²¹⁰ *Ibid*, s 30.1.

²¹¹ Bank of Canada Deputy Governor Timothy Lane, "Thermometer Rising—Climate Change and Canada's Economic Future" (Remarks delivered at the Finance and Sustainability Initiative, 2 March 2017), online: Bank of Canada <<https://www.bankofcanada.ca/2017/03/thermometer-rising-climate-change-canada-economic-future/>> [Lane, "Thermometer Rising"]. He observed that "In Canada alone, it has been estimated that, in the absence of action to address global warming, we would face annual costs of between \$21 billion and \$43 billion by the 2050s."

²¹² *Ibid*.

the Bank will continue to pursue low, stable and predictable inflation amid the structural shift to a lower-carbon economy; monitor the transitory effect of carbon pricing on inflation, and take account of structural changes that are likely to have important consequences for both aggregate supply and demand. Lane observes that these changes may be difficult to incorporate directly into our economic models, but the Bank has a role, particularly in bringing green finance ideas to the table and envisaging a lower-carbon future.²¹³

Thus it merits consideration of enacting an express duty of care in the *Bank of Canada Act*, the federal government aligning requirements it asks of federally-regulated corporations and financial institutions with the duty of directors and officers of its central bank. The language would be different than the other statutes because the duties of directors of the Bank of Canada differ, but it should specify statutory language such as the following:

Recommendation 13:

Amend the *Bank of Canada Act* to add the following language (in red italics):

1. *The directors and officers, in carrying out their duties under this Act, shall in good faith consider any material environmental, social and governance factors that may affect the Bank fulfilling its statutory mandate.*
2. *In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, members of the public, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.*

The provision limiting liability should be amended to account for ESG factors in the following way (in red italics):

No liability if in good faith

30.1 No action lies against Her Majesty, the Minister, any officer, employee or director of the Bank or any person acting under the direction of the Governor for anything done or omitted to be done in good faith in the administration or discharge of any powers or duties that under this Act are intended or authorized to be executed or performed, *including their consideration of environmental, social and governance factors in carrying out their duties under this Act.*

The proposed amendments would bring transparency to the obligations of directors and officers and would encourage directors and officers of the Bank of Canada to take account of ESG factors in their governance decisions.

²¹³ *Ibid.*

Expert Panel Question 3.4(4):

What is the most effective method for delivering board education on climate risk and ESG/sustainability issues? Does education need to include guidance on effective governance and committee modeling for ESG oversight?

1. Board education is critically important

There needs to be a multi-faceted approach to education of boards of directors on ESG and sustainability issues. In this respect, there are a number of organizations well equipped to conduct board education. Chartered Professional Accountants Canada (“CPA Canada”) is working with the federal Ministry of Natural Resources to develop and conduct board education on climate-related financial risk, a project the co-authors are involved in. The Institute for Corporate Directors, while it has not yet taken on this issue, could be very effective, given its national reach. However, there also needs to be access for small- and medium-sized enterprises to gain information and expertise.

The CCGG has observed that Board orientation and continuing education should include building awareness and understanding of complex and emerging environmental and social issues, where relevant.²¹⁴ In this respect, boards should consider the use of independent advisors and/or external speakers to provide exposure to different viewpoints, and that education should be disclosed in committee updates.²¹⁵ The CCGG, whose members are Canadian institutional investors that together manage approximately \$4 trillion in assets, has issued a guidebook on effective board oversight of environmental and social matters.²¹⁶ The guidebook has 29 governance recommendations under eight key governance topics that are relevant for boards.²¹⁷ It notes that the materiality of other environmental and social factors will largely depend on the specific circumstances of a company, including sector, geography, or corporate structure, for example, relations with Indigenous communities for extractive sector companies or contamination of water in agribusiness.²¹⁸ The CCGG also suggests that an effective enterprise risk management framework can provide a process for identifying and managing material risks that includes environmental and social factors, and provide appropriate information to the board so that it can discuss the company’s management approach and priorities to environmental and social factors in its corporate reporting through its Management’s Discussion and Analysis (“MD&A”), annual report, and/or proxy circular.²¹⁹

²¹⁴ CCGG Guidebook, *supra* note 42 at 16.

²¹⁵ *Ibid* at 16.

²¹⁶ *Ibid.*

²¹⁷ *Ibid.*

²¹⁸ *Ibid* at 2.

²¹⁹ *Ibid* at 10. The OECD and World Bank have urged using blockchain to support board education, help overcome knowledge gaps in measuring and reporting on risks, and share knowledge on developing low-emissions and sustainable strategies; OECD, “Financing Climate Futures”, *supra* note 199 at 91.

In 2014, the TSX and CPA Canada issued a “Primer for Environmental and Social Disclosure” aimed at educating senior management, particularly chief financial officers, in-house counsel and members of audit committees of TSX issuers and TSX Venture Exchange issuers.²²⁰ It discusses what principles boards need to consider for their business operations and financial reporting.²²¹ This kind of primer should be expanded based on new knowledge and become part of education available to corporate boards of TSX-listed and TSX-V-listed companies.

The recent US National Climate Assessment Report highlights the need for board education in terms of directors and officers understanding the breadth of climate-related risks.²²² It observes that many terms are used, but not fully explained. For example, the “social cost of carbon” includes the economic costs of climate change that will be felt in market sectors such as agriculture, energy services, and coastal resources, as well as nonmarket impacts on human health and ecosystems.²²³

A taxonomy of terms could be incorporated into board education. Canada can benefit from efforts internationally to develop consistent terms and metrics. Many impacts of climate change are expected to have negative effects on economic productivity, such as increased prices of goods and services,²²⁴ and board education needs to draw fiduciaries’ attention to the type and scope of such risks. Equally, board education can alert boards to consider opportunities to move to more sustainable practices.

Thus, some initiatives for board education have made important contributions to date, but such education on ESG factors, including climate-related financial risk, needs to be widely expanded to reach boards of all sizes so that they fully understand their fiduciary obligations. Our recommendation regarding a Sustainable Finance Institute (recommendation 25 in Part VII) should serve an important role in dissemination of educational materials to boards as that information becomes available.

²²⁰ TSX and CPA Canada issued “A Primer for Environmental and Social Disclosure” (March 2014), online (pdf): TSX <<https://www.tsx.com/resource/en/73>>.

²²¹ *Ibid.*

²²² NCA, “Fourth National Climate Assessment”, *supra* note 11, Appendix 5 at 40. The Global Change Research Act of 1990 mandates that the U.S. Global Change Research Program (USGCRP) deliver a report to Congress and the President no less than every four years.

²²³ *Ibid.* It contains extensive discussion, including, that high temperatures and storm intensity, which are both linked to more deaths and illness, are projected to increase due to climate change, which would in turn increase health care costs for medical treatment. At the same time, these health effects directly impact labour markets. Workers in industries with the greatest exposure to weather extremes may decrease the amount of time they spend at work, while workers across a wide range of sectors may find their productivity impaired while on the job, which translate into lower earnings for workers and firms; *ibid.*, Chapter 14 at 28-29.

²²⁴ *Ibid.*

III. FINANCIAL SERVICES ADVISORS AND ESG CONSULTATIONS

Expert Panel Question 3.4 (3):

What are the responsibilities of investment agents and advisers for identifying and acting in accordance with the preferences of clients regarding sustainability issues? What is the most effective manner for these preferences to be identified and communicated?

1. Require financial services advice to include information on material ESG factors and work towards a “best interests of the client” standard of financial advice in the future

Canadian investment firms and their financial services representatives serve millions of retail investors.²²⁵ There are a growing number of reports on the inadequacy of financial advice in Canada, and it is well beyond the scope of this submission to discuss the myriad issues.²²⁶ However, in the context of the Expert Panel’s work on sustainable finance, two issues have been directly relevant. One is to consider requiring a “best interest standard” for financial advice to consumer or retail investors and the second is to embed ESG considerations in giving advice on financial services and products.

The Canadian Securities Administrators (“CSA”) have recently consulted on incorporating an explicit best interest of the client standard into financial services advice, and unfortunately, its new recommendations in September 2018 on embedded commissions as an investor protection measure do not propose reforms regarding the client best interest standard, which appears to mean that there is not yet sufficient support across Canadian securities regulators.²²⁷ The Expert

²²⁵ A significant majority of investors use an intermediary to complete their trades in securities. Such intermediaries have various titles, and can fulfill a number of roles. Sometimes the intermediary functions largely as an order-taker and simply executes orders. In many cases the intermediary provides advice and/or recommendations. In some cases the intermediary manages the portfolio and has discretion as to what specific investments the client will hold and is not required to obtain client consent to purchase or sell a specific investment. Often the relationship between the investor and the intermediary is long-term. The investor comes to rely on the intermediary’s advice in deciding how to invest his or her money. For ease of reference, we refer here to individuals who act as intermediaries in any of these capacities as “financial service representatives” or “representatives” for short. These individuals include all those individuals, known as “registrants” who are overseen by the Mutual Fund Dealers Association of Canada (“MFDA”), the Investment Industry Regulatory Organization of Canada (“IIROC”) and those directly regulated by the various securities commissions.” Canadian Centre for Elder Law and the Canadian Foundation for the Advancement of Investor Rights, “Report On Vulnerable Investors: Elder Abuse, Financial Exploitation, Undue Influence And Diminished Mental Capacity” (2018), online (pdf): British Columbia Law Institute <<https://www.bcli.org/wordpress/wp-content/uploads/2017/11/171115-Vulnerable-Investor-Paper-FINAL.pdf>> at 14 [Report on Vulnerable Investors].

²²⁶ See for example, Report on Vulnerable Investors, *ibid*.

²²⁷ Ontario Securities Commission, “Canadian securities regulators propose rules to prohibit certain embedded commissions” (13 September 2018), online: OSC <http://www.osc.gov.on.ca/en/NewsEvents_nr_20180913_csa-propose-rules-to-prohibit-certain-embedded-commissions.htm>. Barbara Shecter, “OSC drops push for ‘best interest’ standard as regulators propose narrower reforms” *Financial Post* (21 June 2018), online: <

Panel should recommend that financial services advice should include offering advice on options for investment that incorporate material ESG factors; which we submit would be a step towards advising in the best interest of the client, although not denominated as such. In the longer term, the best interest of the client standard, as adopted in the UK, US and other countries, is a standard that is more responsive to the modern challenges of retail investing and should be considered further.

In the interim, it is timely for the federal government to act to align with other OECD countries and at least implicitly embed “best interests of the client” in the standard for giving financial advice in Canada, by expressly requiring financial advisors to proactively ask investors if they wish to invest in socially responsible investments or funds that explicitly incorporate ESG factors. As Canada shifts from defined benefit pension plans and defined contribution pension plans to individually directed pension savings,²²⁸ the professionals advising individuals should be acting in their best interests and should be providing them with investment options that incorporate ESG factors and options that reflect socially responsible investment. At a minimum, they should be providing information on whether ESG factors are being included in the governance of financial services and products being recommended, in a form that allows consumers to assess their options.

One report has observed that: “In addition to low financial literacy, the increasing degree of product complexity and product proliferation makes it difficult for the average Canadian to be adequately informed about the different investment product options that are available. Canada has not been immune to the proliferation of complex products including complex exchange traded funds and structured products.”²²⁹

Provincial securities commissions, under the auspices of the Canadian Securities Administrators, the Investment Industry Regulatory Organization of Canada (“IIROC”), and the Mutual Fund Dealers Association of Canada (“MFDA”) are responsible for regulating investment firms and their representatives in Canada. They impose “suitability obligations” on representatives, which require representatives to ensure investment decisions are suitable for their clients based on their clients’ personal characteristics, investment objectives, time horizon, and risk tolerance.²³⁰

street/osc-drops-push-for-best-interest-standard-as-regulators-propose-narrower-reforms>, discussing CSA consultations on the best interest of the client standard and its replacement with specific reforms to reduce conflicts of interest.

²²⁸ Between 1977 and 2011, the proportion of the overall employed population covered by registered pension plans declined from 52% to 37% for men, mainly due to a drop in defined benefit coverage. Report on Vulnerable Investors, *supra* note 225 at 20-21.

²²⁹ *Ibid* at 21.

²³⁰ CSA Staff Notice 31-336, *Guidance for Portfolio Managers, Exempt Market Dealers and Other Registrants on the Know-Your-Client, Know-Your-Product and Suitability Obligations* (2014) and NI 31-103, *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (12 June 2018), s 13.3; IIROC, “Notice 12-0109 Know your client and suitability – Guidance” (26 March 2012), online (pdf): IIROC <http://www.iiroc.ca/Documents/2012/d21b2822-bcc3-4b2f-8c7f-422c3b3c1de1_en.pdf> and IIROC, “Rule 1300 Supervision of Accounts” (31 October 2018), online (pdf): IIROC <http://www.iiroc.ca/RuleBook/MemberRules/RulesCollated_en.pdf>; MFDA, “Bulletin 0713 Suitability – Research Paper on Canadian Securities Regulatory Authority Decisions” (24 January 2017), online: MFDA

The key components of the suitability obligation are: “know your client (“KYC”) and “know your product”, which means the “representative should be able to explain to the client the investment’s risks, key features, and initial and ongoing costs and fees”, and disclose all material negative factors about an investment product, ensuring the client comprehends the information.²³¹ The representative should be able to clearly explain the reasons that a specific investment product is or is not suitable for the client based on the client’s KYC profile.”²³²

The Canadian Foundation for the Advancement of Investor Rights (“FAIR Canada”)²³³ has observed that consumers are confused by different titles and functions of financial advisors.²³⁴ It observes that a key reform needed to help protect financial consumers and lead to improved outcomes for retail investors is the implementation of a meaningful statutory best interest standard. It observes:

While many consumers suffer harm as a result of non-compliance with existing rules (such as suitability), they also suffer significant and profound harms when they are dealing with registrants and licensees who are complying with the existing rules. These harms are costing Canadian financial consumers millions of dollars and impacting their ability to save adequately for their retirement, help put their children through university or for their other financial (and life) goals. Harms from product sales that are focused more on compensation to the advisor rather than the consumer’s best interest are much more widespread than harms from deficient financial plans.²³⁵

Implementation of a “best practices” standard to provide information on alternatives incorporating material ESG factors would align well with global efforts to develop good ESG information to be able to offer advice on retirement investments. One study found that employees, particularly younger employees, tend to save more for retirement when offered investment options that reflect their values.²³⁶ The World Business Council on Sustainable

<<http://mfda.ca/bulletin/0713-p/>>, MFDA, “Rule 2.2.1 ‘Know-Your-Client’” (4 January 2018), online: MFDA <http://mfda.ca/policy-and-regulation/rules/mfda-rules/#r2_2_1> [MFDA, “Rule 2.2.1”], and MFDA, “Notice 0069 Suitability” (22 February 2013), online: MFDA <<http://mfda.ca/notice/msn-0069/>>.

²³¹ Report on Vulnerable Investors, *supra* note 225 at 24.

²³² *Ibid.*

²³³ FAIR Canada, “Home Page” (2019), online: FAIR <www.faircanada.ca>.

²³⁴ FAIR Canada, “Comment on the Regulation of Financial Planners” (17 April 2018) at para 1.4, online: FAIR <<https://faircanada.ca/submissions/fair-canada-comments-on-regulation-of-financial-planners/>>. FAIR Canada therefore recommends that the use of business titles be restricted to the following categories: “financial planner” for those who have the necessary proficiency and who provide services on a fee-for-service basis and who do not receive any compensation for product sales or referrals; “investment or financial advisor or planner” with appropriate financial planning credential to be subject to a fiduciary duty and a statutory best interest standard; “portfolio manager” for those licensed to exercise discretionary authority while operating within business models that allow them to comply with the fiduciary duty already required of such registrants; and “salesperson” for the remaining financial services representatives who do not meet the above restricted categories.

²³⁵ *Ibid* at 2.3.

²³⁶ As You Sow, “Aligning Defined Contribution Plans with Sustainability Goals” (2017), online: As You Sow <<https://www.asyousow.org/reports/aligning-defined-contribution-plans-with-corporate-sustainability-goals>>. Meaghan Kilroy, “Millennials embrace ESG option in Bloomberg’s 401(k) plan” *Pensions & Investments* (7 February 2018), online: <<https://www.pionline.com/article/20180207/ONLINE/180209884/millennials->

Development (“WBCSD”) is a CEO-led organization of over 200 leading businesses working together to accelerate the transition to a sustainable world, targeting the realization of the Sustainable Development Goals (“SDG”) through six work programs to achieve systems transformation.²³⁷ One of its major projects is aimed at enabling companies to better align retirement assets, including defined benefit and defined contribution plans, with their overall sustainability goals by integrating ESG considerations, creating more demand for sustainable investments.²³⁸ WBCSD’s initial data indicate it may be possible to create total portfolio solutions that enhance risk-adjusted returns in the long run without compromising short-term return goals, matching well with the long duration of retirement investments. It suggests that companies that have high ESG characteristics are likely to be more resilient through a downturn. Top asset management and investment consulting firms, including BlackRock and Mercer, are developing best practices and innovative thinking on how to incorporate ESG sustainable strategies into advice regarding corporate retirement plans.²³⁹ As an aspirational goal, the WBCSD project envisions that 1% (\$10 billion US) of WBCSD member companies’ total retirement assets (estimated at \$1 trillion US) will be invested in ESG-themed funds by 2020.²⁴⁰

In December 2018, WBCSD published a toolkit, to help companies understand how retirement plans are governed and operated, as well as how ESG responsibility may be considered in different plan structures and contexts.²⁴¹ It specifies that, traditionally, investment “advisors have provided plan sponsors with advice on their portfolio asset allocation (defined benefit plans), lineup construction (defined contribution plans) and manager selection/monitoring (both) and plan sponsors have maintained the responsibility for implementation of investment portfolios and managing other third-party relationships such as recordkeepers. The nature and extent of this advice can vary substantially, up to and including a fully outsourced model.”²⁴²

Recommendation 14:

The Expert Panel should recommend that financial advisers be required to include information on material ESG factors in giving financial advice to consumer or retail investors.

embrace-esg-option-in-bloombergs-401k-plan>, cited in World Business Council on Sustainable Development (WBCSD), “Aligning Retirement Assets Toolkit #1: The Responsible Retirement Plan Opportunity” (4 December 2018), online: WBCSD <<https://www.wbcd.org/Programs/Redefining-Value/Investor-decision-making/Aligning-Retirement-Assets/Resources/The-responsible-retirement-plan-opportunity>> [WBCSD, “Aligning Retirement Investment Assets”]. WBCSD, “Aligning Retirement Assets develops new resource to help companies meet the growing demand for responsible investing” (4 December 2018), online: WBCSD <<https://www.wbcd.org/Programs/Redefining-Value/Investor-decision-making/Aligning-Retirement-Assets/News/new-resource-to-help-companies-meet-the-growing-demand-for-responsible-investing>>.

²³⁷ WBCSD, “How we drive sustainable development” (2019), online: WBCSD <<https://www.wbcd.org/>>.

²³⁸ WBCSD, “Aligning Retirement Assets” (2018), online: WBCSD

<<https://www.wbcd.org/Programs/Redefining-Value/Investor-decision-making/Aligning-Retirement-Assets>>.

²³⁹ *Ibid.* The project is developing the toolkits to help understand: (1) What is sustainable retirement? (2) How to develop a sustainable retirement plan?

²⁴⁰ *Ibid.*

²⁴¹ WBCSD, “Aligning Retirement Investment Assets”, *supra* note 236.

²⁴² *Ibid* at 14.

2. Investment agents and advisors should be responsive to client preferences regarding ESG

Investment advisors, brokers, dealers, and mutual fund dealers are regulated by the IIROC or the MFDA, both of which are self-regulatory organizations. Both have standards of conduct for their licensed members that generally require fairness, honesty, actions in good faith and observing high standards of ethics when dealing with clients' business.²⁴³ As noted above, investment advisors also have obligations to know their clients, including their clients' investment goals, risk tolerance, and investment horizon.²⁴⁴

Implicitly, these standards of conduct suggest that investment advisors and agents would be expected to suggest investments, or invest clients' money, where given discretionary authority, consistent with clients' statements of investment principles or sustainability concerns, and consistent with any contractual obligations defining the relationship between an investor and an asset manager.

The European Union is requiring a more proactive approach among financial advisors. Part of the European Commission's Action Plan on Financing Sustainable Growth is to incorporate sustainability when providing financial advice.²⁴⁵ The Markets in Financial Instruments Directive ("MiFID II") and the Insurance Distribution Directive ("IDD") require investment firms and insurance distributors to offer 'suitable' products to meet their clients' needs, when offering advice, requiring advisors to ask about their clients' preferences such as ESG factors and take them into account when assessing the range of financial instruments and insurance products to be recommended, *ie*, in the product selection process and suitability assessment.²⁴⁶ We recommend that the government encourage that approach in Canada.

Recommendation 15:

The federal government should work with IIROC, MFDA and investment firms to develop new requirements that investment advisers and distributors ask about their clients' preferences regarding ESG factors and take them into account when assessing the range of financial instruments and insurance products being recommended.

²⁴³ IIROC, "Rule 1402 Standards of Conduct", online (pdf): IIROC

<<http://www.iiroc.ca/industry/rulebook/Documents/rule-1400.pdf>>; MFDA, "Rule 2.2.1", *supra* note 230.

²⁴⁴ IIROC, "Rule 2500 Minimum Standards for Retail Customer Account Supervision", online (pdf): IIROC

<http://www.iiroc.ca/Rulebook/MemberRules/Rule02500_en.pdf>; MFDA, "Rule 2.2.1", *ibid*.

²⁴⁵ European Commission, "Commission Action Plan on Financing Sustainable Growth" (March 2018), online: Europa <https://ec.europa.eu/info/publications/180308-action-plan-sustainable-growth_en> [EC, "Commission Action Plan"]. The Commission will amend the MiFID II and IDD delegated acts in Q2 2018 to ensure that sustainability preferences are taken into account in the suitability assessment. Based on these delegated acts, the Commission will invite the European Securities Markets Authority (ESMA) to include provisions on sustainability preferences in its guidelines on the suitability assessment to be updated by Q4 2018.

²⁴⁶ *Ibid* at 2.4.

IV. EFFECTIVE FINANCIAL DISCLOSURES THAT WILL ADVANCE THE PATH TO SUSTAINABILITY

The Expert Panel has posed a series of questions on climate-related disclosure, and more specifically, questions relating to the Financial Stability Board (“FSB”) Taskforce on Climate-Related Financial Disclosures (“TCFD”) disclosure framework. We have reordered the questions slightly in our response in the belief that an important public policy decision is whether to broaden the sustainability disclosure to ESG factors, given that trend internationally. In our view, incorporating ESG into financial reporting is an important step in the transition to sustainable finance. It also aligns with our recommendations above in respect of codifying and enhancing the common law of director and officer fiduciary obligation.

Thus, we commence with the third question, 3.3(3), on including climate-related disclosures in financial statements, broadening the response to discuss why material ESG factors should be included in financial statements. We then address the remaining seven questions posed by the Expert Panel, directly responsive to the specific climate-related and TCFD-related questions.

Our discussion includes two possible routes to enhancing disclosure on the path to sustainability. One is through amendments to corporate law, as has been done in the UK. The second is through federal capital markets stability law. In answering the Expert Panel’s questions in this part, we clearly delineate the two possible avenues, both of which can be accomplished effectively within the Canadian law and policy framework. In addition, the Expert Panel should encourage the provincial and territorial governments to enhance disclosure under securities law in respect of ESG risks and opportunities, including climate-related risks and opportunities.

Expert Panel Question 3.3(3):

Is there a need for climate-related disclosures to be included in mainstream financial statements, or is that not necessary so long as other conditions are met (i.e. robust oversight and governance of the reporting process and quality)?

1. Include material ESG risks, costs and assets in financial statements

Realistically, the only way that corporations will fully take account of climate-related financial costs and benefits is to include them in the financial statements. Financial statements are a fundamental component of continuous disclosure. Financial statements provide both equity and debt investors with the information to make informed choices whether to buy, sell or hold their investment.²⁴⁷ Financial statements are, by their nature, mainly historical, in that they are the

²⁴⁷ NI 51-102, *Continuous Disclosure Obligations* (12 June 2018), s 4.1 [NI 51-102]: Generally, annual and quarterly reporting includes a statement of comprehensive income, a statement of changes in equity, a statement of cash flows, a statement of financial position at the end of the most recently completed financial year and the financial year immediately preceding the most recently completed financial year. NI 51-102 specifies that the audited annual financial statements must be filed, for a reporting issuer other than a venture issuer, within 90 days after the end of its most recently completed financial year; and the date of filing, in a foreign jurisdiction, annual financial statements for its most recently completed financial year. Venture issuers

record of past transactions and their impact on the issuer's financial position.²⁴⁸ Critically important is that the information is comparable from one year to the next. One issue that has been identified as problematic with separate "non-financial corporate social responsibility" ("CSR") reports is that companies can change the metrics from one year to the next if they do not like the results and there is nothing that requires them to explain the changes, thus there is no comparability or consistency in reporting year over year. The CCGG notes that siloed, non-integrated, CSR and environmental reporting can be viewed as "greenwashing".²⁴⁹ A second issue is that when CSR reports are not part of financial statements, they tend to be ignored by corporate boards, as they are not viewed as issues core to the corporation. They are often not up to date as a result, and there is not a corporate-wide commitment to accuracy or strategic planning in respect of material ESG issues.

Embedding disclosure of material ESG risks and opportunities in financial statements would allow directors and officers to report how they view ESG as material in the reporting period and how they have addressed it to date. It would embed sustainability thinking in core financial reporting. It would allow investors to measure progress year over year, as the data will be comparable or changes explained as the metrics reporting improves. Requiring ESG to be included in financial statements also levels the playing field for corporations, in terms of their ability to attract debt and equity investment. It avoids "greenwashing" of ESG results. It will encourage directors' and officers' best thinking in respect of material ESG risks and opportunities. Requiring ESG disclosure in financial statements would require corporate officers to explain changes in methodology of measuring material ESG risks and opportunities, and would provide transparency and comparability in the market across corporations. Changes in metrics because of developing information on ESG factors, such as climate-related financial risk, would be explained in the notes to the financial statement, leading to increasingly better transparency.

The TCFD recommends that organizations should provide information specific to the potential impact of climate-related risks and opportunities in their financial statements and future cash flows.²⁵⁰ The TCFD recommends that climate-related financial disclosures should be included in annual financial filings.²⁵¹ The TCFD observed that:

the Task Force's disclosure recommendations should result in more quantitative financial disclosures, particularly disclosure of metrics, about the financial impact that climate-related risks have or could have on an organization. Specifically, asset impairments may result from assets adversely impacted by the effects of

have 120 days. Deadlines for filing interim financial reports are 45 days for non-venture issuers and 60 days for venture issuers after the end of the interim period or the date of filing, in a foreign jurisdiction, interim financial reports: NI 51-102, ss 4.2, 4.4.

²⁴⁸ Mary Condon, Anita Anand, Janis Sarra and Sarah Bradley, *Securities Law in Canada: Cases and Commentary*, 3rd ed (Toronto: Emond Montgomery, 2017) at 401 [Condon, Anand, Sarra and Bradley, *Securities Law in Canada*].

²⁴⁹ *Ibid.*

²⁵⁰ Task Force on Climate-related Financial Disclosures (TCFD), "Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures – Appendix 3" (June 2017) at 50, online (pdf): FSB <<https://www.fsb-tcf.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf>> [TCFD, "Final Report"].

²⁵¹ *Ibid* at 18.

climate change and/or additional liabilities may need to be recorded to account for regulatory fines and penalties resulting from enhanced regulatory standards. Additionally, cash flows from operations, net income, and access to capital could all be impacted by the effects of climate-related risks (and opportunities).²⁵²

Arguably, the same case can be made for ESG factors more generally, as recognized by the International Organization of Securities Commissions (IOSCO), in a 2019 Statement on Disclosure of ESG Matters by Issuers.²⁵³ The IOSCO Statement is premised on the view that:

IOSCO Principle 16 states that issuers should provide “*full, accurate, and timely disclosure of financial results, risk, and other information which is material to investors’ decisions.*” With regard to this Principle, IOSCO emphasizes that ESG matters, though sometimes characterized as non-financial, may have a material short-term and long-term impact on the business operations of the issuers as well as on risks and returns for investors and their investment and voting decisions.²⁵⁴

As a result, the IOSCO Statement counsels that “IOSCO encourages issuers to consider the materiality of ESG matters to their business and to assess risks and opportunities in light of their business strategy and risk assessment methodology. When ESG matters are considered to be material, issuers should disclose the impact or potential impact on their financial performance and value creation. In doing so, issuers also are encouraged to give insight into the governance and oversight of ESG-related material risks.”²⁵⁵

The CCGG has observed that financial reporting should convey key considerations related to governance, strategy, and risk management with the right level of detail, context, supporting information, and metrics, so that investors can make better informed decisions; and boards should have the necessary controls in place, whether internal or external, to provide reasonable verification and assurance of the disclosure.²⁵⁶ One survey of asset and portfolio managers using ESG in their investments reported that the biggest challenge to using ESG information for investment decision making relates to the lack of comparability of reported information across firms.²⁵⁷ Another study examined how CSR disclosure in a stand-alone report, disconnected from a firm’s financial disclosure, is problematic, as it may lead to asymmetric anchoring, where financial professionals and investors may underreact to CSR information when it is disclosed in a

²⁵² *Ibid* at 37-38.

²⁵³ International Organization of Securities Commissions, “Statement on Disclosure of ESG Matters by Issuers” (18 January 2019), online (pdf): IOSCO <<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD619.pdf>>. This Statement was not voted on by the US Securities and Exchange Commission.

²⁵⁴ *Ibid* at 1 (emphasis in original).

²⁵⁵ *Ibid* at 3.

²⁵⁶ CCGG Guidebook, *supra* note 42 at 4.

²⁵⁷ Amir Amel-Zadeh and George Serafeim, “Why and How Investors Use ESG Information: Evidence from a Global Survey”, (2018) 74:3 *Financial Analysts Journal* 87 at 88.

stand-alone report compared to when CSR information is provided in an integrated financial report.²⁵⁸

As noted above, ESG factors are currently frequently reported as part of a CSR report, which the CCGG observes can result in metrics that do not link to strategy or are not relevant to a corporation's operations or risk.²⁵⁹ It observes that CSR reports usually are not subject to board oversight or approval and do not give investors or other corporate stakeholders the assurance processes that support financial reporting.²⁶⁰ As a result, boards of directors are often not paying attention to ESG factors. Incorporating either climate-related financial disclosures or ESG disclosures into financial statements would address this deficiency in current reporting.

Integrating ESG matters in corporate financial statements would allow greater transparency and accountability. Where accounting methods are developing, the notes to the financial statements can make clear the basis on which any metrics are being reported or which metrics have changed year over year. It would also allow for reporting of currently known ESG risks and opportunities as well as forward-looking ESG information. The scope of a potential safe harbour that recognizes that understanding of and information on these risks and opportunities are still evolving is discussed in response to the Expert Panel's Question 3.3(6) below.

The goal of financial reporting is to allow corporate stakeholders, including equity investors, debt investors, regulators and other corporate stakeholders, to understand the financial performance of the corporation. Accounting for ESG factors (including climate-related financial risk and return) in financial reporting must allow corporate stakeholders to understand the corporation's economic performance in respect of these issues. Metrics need to be clear and measurable. Financial reporting metrics continue to be refined by a number of organizations in Canada and internationally. The reporting framework a company chooses to follow, and its rationale, should be described in the company's MD&A, allowing investors and others to assess how the financials have been measured and verified.

i. Canada can look to international standards

The work of incorporating climate-related and ESG factors into financial reporting is already well underway. The US-based independent Sustainability Accounting Standards Board was created to develop standards for disclosure of material ESG matters.²⁶¹ The recommendations are not

²⁵⁸ Markus Arnold, Alexander Bassen and Ralf Frank, "Timing effects of corporate social responsibility disclosure: an experimental study with investment professionals" (2018) 8:1 *Journal of Sustainable Finance & Investment* 45-71, DOI: <<https://doi.org/10.1080/20430795.2017.1368229>>. See also George Apostolakis, Gert Van Dijk, Robert Blomme, Frido Kraanen & Athanasios Papadopoulos "Predicting pension beneficiaries' behaviour when offered a socially responsible and impact investment portfolio" (2018) 8:3 *Journal of Sustainable Finance & Investment* 213-241, DOI: <<https://doi.org/10.1080/20430795.2018.1429148>>.

²⁵⁹ CCGG Guidebook, *supra* note 42 at 18.

²⁶⁰ *Ibid.*

²⁶¹ Sustainability Accounting Standards Board (SASB), "Home Page" (2018), online: SASB <<https://www.sasb.org/>>, originally aimed at what SEC registrants should provide in 10K filings, but now developing global standards.

mandatory, but they serve as guidance on determining what is material. “SASB’s mission is to help businesses around the world identify, manage and report on the sustainability topics that matter most to their investors.”²⁶² The SASB has a Materiality Map that offers companies a risk management framework that contains a risk identification and prioritization process.²⁶³

In November 2018, SASB published a complete set of 77 globally applicable industry-specific codified standards that identify the minimal set of financially material sustainability topics and their associated metrics for the typical company in an industry.²⁶⁴ It sets out a minimum set of industry-specific disclosure topics reasonably likely to constitute material information, and a brief description of how management or mismanagement of each topic may affect value creation. It also recommends, for each sector, a set of quantitative and/or qualitative accounting metrics intended to measure performance on each topic. Each accounting metric is accompanied by a technical protocol that provides guidance on definitions, scope, implementation, compilation, and presentation, all of which are intended to constitute suitable criteria for third-party assurance. It also sets out a set of metrics that quantify the scale of a company’s business and are intended for use in conjunction with accounting metrics to normalize data and facilitate comparison.²⁶⁵ The accounting metrics for each industry and sector include how to financially report GHG emissions, biodiversity impacts, human rights and rights of Indigenous peoples, community relations, business ethics and transparency and a host of other metrics.²⁶⁶ Each standard has an accompanying document explaining the reasons for recommending the accounting standards proposed.²⁶⁷

Thus the federal government need not devise its own accounting standards regarding sustainability financing where there are increasingly widely accepted standards internationally. The federal government should deem companies to have complied with their reporting requirements if their financial statements incorporate the SASB sustainability metrics in their current accounting standards. The federal government should ask the Canadian Accounting Standards Board to assess the SASB standards and discern if any changes should be required to account for unique issues in Canada. However, with the move internationally to International

²⁶² *Ibid.*

²⁶³ SASB, “Materiality Map” (2018), online: SASB <<https://materiality.sasb.org/>>.

²⁶⁴ SASB, “Standards Overview” (November 2018), online: SASB <<https://www.sasb.org/standards-overview/>>. “SASB standards enable businesses around the world to identify, manage and communicate financially-material sustainability information to their investors.” SASB has also developed “an Engagement Guide for investors to consider questions to discuss with companies regarding financially material issues as well as an Implementation Guide . . . for companies which explains issues and approaches to consider when implementing SASB standards.”

²⁶⁵ See for example, SASB, “Oil & Gas – Exploration & Production: Sustainability Accounting Standard” (November 2018), online (pdf): SASB <https://www.sasb.org/wp-content/uploads/2018/11/Oil_Gas_Exploration_Production_Standard_2018.pdf>.

²⁶⁶ *Ibid.*

²⁶⁷ See for example, SASB, “Oil & Gas – Exploration & Production: Basis for Conclusions” (October 2018), online (pdf): SASB <https://www.sasb.org/wp-content/uploads/2018/11/Oil_Gas_Exploration_Production_BFC_2018.pdf>.

Financial Reporting Standards (“IFRS”),²⁶⁸ there has been an international move towards transparency, accountability and comparability in financial reporting, a shift that has been endorsed by Canadian governments and accounting standards-setting authorities. Discussions regarding how to integrate the SASB standards in IFRS are occurring and Canada should be part of that public policy discussion.

CPA Canada has issued a publication that outlines 20 questions for boards of directors to ask in overseeing organizational risk management, business strategy and performance in the context of climate change.²⁶⁹ In respect of financial statements, CPA Canada suggests that boards ask: How has the current and potential future impact of climate change issues, including carbon pricing, on revenues, expenditures and cash flows been determined?²⁷⁰ How has the impact that climate change issues have and could have on the company’s financial condition, liquidity and long-term value creation been determined?²⁷¹ How is materiality of climate change issues assessed, and are disclosures made in the financial statements, the MD&A and, if applicable, the Annual Information Form (“AIF”) consistent with this assessment?²⁷²

CPA Canada outlines a number of potential impacts on revenues and costs that could be reported, including sales or licenses of innovative low-carbon technologies, sales of emissions allowances or credits and proceeds from issuing green bonds, the possibility that assets such as oil and gas reserves may no longer generate revenue, the need to retrofit property, plant and equipment to reduce GHG emissions, and investments in productive capacity that embody new energy-efficient technologies.²⁷³ The CPA Canada report offers guidance to directors in their consideration of which procedures and controls to adopt to gather and record reliable and timely climate change-related financial information for management analysis and internal decision-making, disclosure filings with regulatory authorities, and external disclosure to investors, governments and other stakeholders.²⁷⁴

CPA Canada also published *Building a Better MD&A: Climate Change Disclosures*,²⁷⁵ which discusses how companies can account for and disclose carbon taxes, regulatory emissions reduction targets/caps, and emissions trading transactions and obligations. It notes that: “Under the second type of mandatory reporting, certain Canadian businesses must file GHG emissions information with Canadian provincial and/or federal governments”; and directors should assess

²⁶⁸ International Financial Reporting Standards, “Home Page” (January 2019), online: IFRS <<https://www.ifrs.org/>>.

²⁶⁹ Alan Willis and Sarah Keyes, “Climate change briefing: Questions directors should ask”, 2nd ed (Toronto: CPA Canada, 2017), online: CPA Canada <<https://www.cpacanada.ca/en/business-and-accounting-resources/strategy-risk-and-governance/corporate-governance/publications/climate-change-questions-directors-should-ask>>.

²⁷⁰ Question 13, *ibid*.

²⁷¹ Question 14, *ibid*.

²⁷² Question 17, *ibid*.

²⁷³ *Ibid* at 29.

²⁷⁴ *Ibid* at 31.

²⁷⁵ Legacy Body, “Building a Better MD&A: Climate Change Disclosures” (2008), online: CPA Canada <www.cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/Mdanda-and-other-financial-reporting/publications/climate-change-disclosures-in-the-md>.

whether adequate systems, processes and controls are in place to deliver timely and reliable information for these filings.²⁷⁶ In these situations, boards or audit committees may need to ask about legal and regulatory requirements related to climate change reporting to determine the appropriate degree of oversight.

While the CSA has been less active than one would have hoped, in 2010 the CSA did publish guidance for reporting issuers on the environmental disclosure requirements for financial statements, MD&A and AIF.²⁷⁷ The CSA's environmental guidance explains the roles and responsibilities of audit committees for oversight of continuous disclosure filings, including climate-related disclosures, and underlying controls and procedures.

The TCFD reports that to be sufficiently comprehensive, financial disclosures should contain historical and future-oriented information in order to allow users to evaluate their previous expectations relative to actual performance and assess possible future financial implications.²⁷⁸ Future-oriented data should include clarification of the key assumptions used and forward-looking quantitative disclosure should align with data used by the organization for investment decision making and risk management.²⁷⁹ It recommends that disclosures should be written with the objective of communicating financial information that serves the needs of a range of financial sector users and should be sufficiently granular to inform sophisticated users, but should also provide concise information for less specialized readers.²⁸⁰ The TCFD further recommends that disclosures should show an appropriate balance between qualitative and quantitative information and use text, numbers, and graphical presentations as appropriate; and that "fair and balanced narrative explanations should provide insight into the meaning of quantitative disclosures, including the changes or developments they portray over time."²⁸¹ Financial disclosures should be timely and consistent over time. The TCFD recommendations on financial statements should be adopted.

²⁷⁶ *Ibid.*, noting also that companies with subsidiaries or operations in the UK may be subject to mandatory GHG emissions or other climate change disclosure requirements.

²⁷⁷ CSA Staff Notice 51-333, *Environmental Reporting Guidance* (27 October 2010) [CSA Staff Notice 51-333]. Staff Notice 51-333 cites several securities law requirements under which companies may need to make disclosure: Form 51-102F2, *Annual Information Form* (30 June 2015) [Form 51-102F2]; NI 51-102, *supra* note 247; Form 51-102F1, *Management's Discussion & Analysis ("MD&A")* (30 June 2015) [Form 51-102F1]; NI 58-101, *Disclosure of Corporate Governance Practices* (31 March 2017); NI 52-110, *Audit Committees* (17 November 2015).

²⁷⁸ TCFD, "Annex: Implementing the Recommendations of the TCFD" (June 2017) at 68, online (pdf): FSB <<https://www.fsb-tcf.org/wp-content/uploads/2017/12/FINAL-TCFD-Annex-Amended-121517.pdf>> [TCFD, "Annex"].

²⁷⁹ *Ibid.* "Any scenario analyses should be based on data or other information used by the organization for investment decision making and risk management. Where appropriate, the organization should also demonstrate the effect on selected risk metrics or exposures to changes in the key underlying methodologies and assumptions, both in qualitative and quantitative terms."

²⁸⁰ *Ibid.*

²⁸¹ *Ibid.*

The European Commission has launched a broad Action Plan on Financing Sustainable Growth, which will require sustainability disclosure in accounting rule-making and create measurable standards for green financial products.²⁸²

Recommendation 16:

- i. Require material ESG factors, including climate-related financial disclosures, to be reported in annual financial filings.
- ii. Ask the Canadian Accounting Standards Board to review the industry specific standards promulgated by the Sustainability Accounting Standards Board for purposes of adoption in Canada.
- iii. The federal government should work with Canadian accounting standards authorities and securities regulators to provide tools to assist companies to embed ESG disclosure in publicly-listed corporations' financial statements and notes to financial statements.

2. Require disclosure of management's approach to material ESG risks and opportunities in management's proxy circular in conjunction with the annual meeting

The Annual Meeting for every company incorporated pursuant to the *CBCA*, both privately-held and publicly-issuing, includes, as important matters of business, the election of directors, consideration of the financial statements, consideration of the auditor's report, and re-appointment of the incumbent auditor.²⁸³ With respect to the election of directors, for companies required to distribute a proxy circular, biographical information is required to be disclosed concerning every proposed director, including those directors being re-elected, to permit an evaluation of that director's professional experience, likely competence, and integrity.²⁸⁴ In conjunction with review of the required financial statements,²⁸⁵ the proxy circular information allows shareholders to evaluate how the company has been managed, generally speaking, and whether it is prudent to continue the directors in office.

Publicly-listed companies that are reporting issuers under provincial and territorial securities legislation must distribute more extensive proxy information in the proxy circular to all shareholders entitled to vote in conjunction with the annual meeting and any special meetings

²⁸² EC, "Commission Action Plan", *supra* note 245: creating a road map of ten main actions that will be required on member states.

²⁸³ *CBCA*, *supra* note 41, s 135(5).

²⁸⁴ NI 51-102F5, *Information Circular* (30 June 2015), parts 7.1 and 7.2 [NI 51-102F5]. Regarding integrity, the proxy circular must state the facts concerning any judicial order within the prior 10 years, including a cease trade order, levied against any company where a proposed director was a director, CEO, or CFO: part 7.2.

²⁸⁵ *CBCA*, *supra* note 41, s 155(1).

that management calls.²⁸⁶ These requirements to distribute a proxy circular are pursuant to the *CBCA* and implementing Regulations, with the specific information to be disclosed primarily being defined by National Instruments pursuant to provincial and territorial securities law.²⁸⁷ Thus, this requirement is an area of law where federal and provincial powers interact regarding the scope of required disclosure. The purpose of the proxy circular is to provide the information that regulators have deemed necessary for shareholders or their representatives to be able to exercise their voting rights in an informed manner. Thus the information required depends on the specific issue on which shareholders are being asked to vote.

While most of the specific disclosure requirements for publicly-listed companies are promulgated based on National Instruments, the federal government does have the power to add to those disclosure requirements for corporations incorporated pursuant to the *CBCA*, and has done so in at least a few occasions.²⁸⁸ Thus, we recommend that the *CBCA* be amended to not only require incorporating material ESG risks disclosure into the financial statements and notes thereto, as above, but also amend the *CBCA* to require the board to discuss how it is evaluating and incorporating material ESG risks and opportunities into its strategy, governance, and risk management.

Proxy circular disclosure of how the board as a whole is analyzing material ESG risks and opportunities would give shareholders valuable qualitative information about how proactive management is, and how the board and management are positioning the company for future success. There are a number of approaches the federal government could take in amending the *CBCA* to require such annual proxy disclosure. As discussed immediately above, guidance for how directors should evaluate climate change and ESG risks and opportunities, including how to connect those topics to strategy and risk management generally, has been developed by a number of private initiatives, such as the SASB, the TCFD, and CPA Canada. The *CBCA* should be amended to ask companies to discuss governance, risk management, and strategy of ESG risks and opportunities using the parameters, or questions boards should ask, identified in one of those three frameworks.

Another approach is that recently suggested by Professor Jill Fisch, who proposed that the US Securities and Exchange Commission (“SEC”) require an annual Sustainability Discussion and Analysis (“SD&A”) modelled on MD&A (Management Discussion and Analysis).²⁸⁹ In MD&A, in both the United States and Canada, companies are required to discuss known trends, events, or uncertainties that may have a significant effect on the company’s financial results going forward. Fisch suggests that reporting companies should be required to “identify and explain the three sustainability issues most significant to their operations,” and include “a discussion of the potential impacts of the issues and the basis for the company’s determination” that these issues

²⁸⁶ *CBCA*, *ibid*, s 149 (2016) and Canada Business Corporations Regulations, 2001 (SOR/2001-512), part 7, Proxies and Proxy Solicitation [Can Reg 2001-512].

²⁸⁷ *Ibid*, and NI 51-102F5, *supra* note 284.

²⁸⁸ See, *eg*, Can Reg 2001-512, *supra* note 286, ss 2, 55(2), setting out disclosure requirements additional to those defined in Form 51-102F5, *supra* note 284.

²⁸⁹ Jill E Fisch, “Making Sustainability Disclosure Sustainable” (2018) *Georgetown L J* (forthcoming), online: SSRN <<http://www.ssrn.com/abstract=3233053>>.

are the three most significant for the company’s sustainability.²⁹⁰ Like MD&A, this requirement would give investors insight into management’s views of known or reasonably knowable sustainability issues that are likely to have a material effect on the company’s operations. Also like MD&A, this requirement would serve to focus board attention on sustainability issues, but with the flexibility for the board to determine what is significant among the panoply of potential sustainability issues. Professor Fisch emphasizes the importance of board responsibility for the proposed SD&A if the proposal is to have the intended effect of providing investors with insights into boards’ deliberations and understanding of sustainability risks and opportunities.²⁹¹

Any of these approaches would give shareholders and their advisors deeper insight into how the board is positioning the company for long-term success, and thus would add appreciably to the information available as shareholders exercise their voting rights regarding the composition of the board.

Recommendation 17:

- i. Require disclosure of management’s approach to material ESG risks and opportunities in management’s proxy circular in conjunction with the annual meeting.
- ii. Create a consultation process to evaluate using a “sustainability disclosure and analysis” (“SD&A”) reporting tool for the proxy circular ESG disclosure.

3. *The Supreme Court of Canada judgment in Reference re Pan-Canadian Securities Regulation offers another avenue for dealing with systemic risk*

Approval by the Supreme Court of Canada in November 2018 of the constitutionality of the draft federal “Capital Markets Stability Act”²⁹² presents an important and timely opportunity to embed systemic risk factors in financial statements and other disclosures. However, it is important to realize that it will take time for federal and provincial governments to sort out the transition towards the infrastructure and policies underpinning the new capital markets stability structure. Nonetheless, it offers yet another avenue to address systemic risk and the need for a shift to a sustainable economy.

The federal government and the governments of Ontario, British Columbia, Saskatchewan, New Brunswick, Prince Edward Island and Yukon have agreed to implement a national Cooperative System for the regulation of capital markets in Canada.²⁹³ All the reasoning in the SCC judgment points to climate-related financial risk falling squarely within the types of systemic risk that the SCC found was within the jurisdiction of the new national regulatory Authority.

²⁹⁰ *Ibid* at 42.

²⁹¹ *Ibid* at 43.

²⁹² *Reference re Pan-Canadian Securities Regulation*, 2018 SCC 48 (9 November 2018) at paras 81, 132 [*Reference re Pan-Canadian Securities Regulation*].

²⁹³ *Ibid*.

The SCC held that the *Constitution Act* of Canada authorizes the implementation of pan-Canadian securities regulation under the authority of a single regulator, according to the model established by the most recent publication of the “Memorandum of Agreement regarding the Cooperative Capital Markets Regulatory System”.²⁹⁴ The SCC held that the draft federal Capital Markets Stability Act does not exceed the authority of the Parliament of Canada over the general branch of the trade and commerce power under ss 91(2) of the *Constitution Act*.²⁹⁵ The main components of the Cooperative System include a model provincial and territorial statute that deals primarily with the day-to-day aspects of the securities trade,²⁹⁶ a proposed draft federal act, the Capital Markets Stability Act, which is aimed at preventing and managing systemic risk and which establishes criminal offences relating to financial markets, and a national securities regulator (the “Authority”) charged with administering this coordinated regime.²⁹⁷ The Authority and its board of directors are to operate under the supervision of a Council of Ministers, which will comprise the ministers responsible for capital markets regulation in each participating province and the federal Minister of Finance.²⁹⁸

The Supreme Court held that the pith and substance of the draft Capital Markets Stability Act is to control systemic risk having the potential to create material adverse effects on the Canadian economy.²⁹⁹ The concept of systemic risk is specifically invoked throughout the draft federal Act as a means of limiting the scope of federal regulatory powers. The SCC held at para 90:

[90] The cornerstone of the Draft Federal Act is the prevention and control of “systemic risk related to capital markets”, which is defined in s. 3 as follows:

3. In this Act, systemic risk related to capital markets means a threat to the stability of Canada’s financial system that originates in, is transmitted through or impairs capital markets and that has the potential to have a material adverse effect on the Canadian economy.

²⁹⁴ Department of Finance, *Memorandum of Agreement regarding the Cooperative Capital Markets Regulatory System* (Ottawa: Department of Finance, 26 August 2014), online (pdf): Government of Canada <<https://www.fin.gc.ca/n14/docs/moa-pda-eng.pdf>> [Memorandum of Agreement].

²⁹⁵ *Reference re Pan-Canadian Securities Regulation*, *supra* note 292 at paras 81, 132.

²⁹⁶ The Supreme Court held that the Model Provincial Act is expressly subject to legislative approval, and thus lacks the force of law within a province unless and until it is enacted by that province’s legislature. These provisions of the Memorandum do not contemplate that the Council of Ministers will have any formal involvement in the amendment of securities laws that have already been enacted by provincial legislatures. The terms of the Memorandum do not even require that the provisions of the Model Provincial Act themselves be enacted into law by the legislatures of the participating provinces. Accordingly, the legislatures remain free to reject the proposed statutes, and any amendments made to them, if they so choose. *Ibid.*

²⁹⁷ *Ibid.* The SCC at para 70 observed that “the participating provinces will be required to effectively dissolve their existing securities commissions, and to merge the administration of those commissions into the Authority’s organizational structure (as contemplated in ss 9.2 and 9.3 of the Memorandum)”.

²⁹⁸ *Ibid.* at para 25. With respect to the Model Provincial Act, s. 5.5 of the Memorandum provides that any proposals to amend the Model Provincial Act are subject to a vote and must be approved by at least 50 percent of the members of the Council of Ministers, as well as by the members representing the “Major Capital Markets Jurisdictions” — which at present, are Ontario and British Columbia.

²⁹⁹ *Ibid.* at para 90.

For the purposes of this definition, **systemic risk can be understood as having three constituent elements: (a) it must represent a threat to the stability of the country's financial system as a whole; (b) it must be connected to the capital markets; and (c) it must have the potential to have a material adverse effect on the Canadian economy.** It is noteworthy that this definition does not encompass every economic risk that may relate to capital markets, but is limited to those that pose a sufficiently significant threat to the Canadian economy.

[emphasis added]

The intention is not that the draft Act will displace provincial and territorial securities legislation, rather, it is designed to complement these statutes by addressing economic objectives that are considered to be national in character.³⁰⁰

With respect to the classification, the SCC held that the ultimate question is whether the draft Act, viewed in its entirety, addresses a matter of genuine national importance and scope going to trade as a whole, in a way that is distinct and different from provincial concerns. The SCC held that the dual purposes of the draft federal Act, set out in section 4: “The purposes of this Act are, as part of the Canadian capital markets regulatory framework, (a) to promote and protect the stability of Canada’s financial system through the management of systemic risk related to capital markets; and (b) to protect capital markets, investors and others from financial crimes”, when read together with the Authority’s statutory mandate (section 6), suggests that the federal government’s role in regulating capital markets is limited to the detection, prevention and management of risk to the stability of the Canadian economy, as well as to the protection against financial crimes.³⁰¹ The SCC held that draft federal Act does address a matter of genuine national importance and scope relating to trade as a whole, and it therefore falls within Parliament’s general trade and commerce power under section 91(2) of the *Constitution Act*. The preservation of the integrity and stability of the Canadian economy quite clearly has a national dimension, and one that lies beyond provincial competence.³⁰² The Court further held that “The regulatory powers authorized by the Draft Federal Act are engaged solely when such threats *may foreseeably affect national economic interests.*”³⁰³

The SCC further held that: “the regulation of systemic risk in capital markets goes to promoting the stability of the economy generally, not the stability of one economic sector in particular”,³⁰⁴ and engages trade as a whole under the federal trade and commerce power. “Put simply, the management of systemic risk across Canadian capital markets must be regulated federally, if at all.”³⁰⁵

³⁰⁰ *Ibid* at para 95. The SCC held that the Draft Federal Act does not contain provisions that go to the day-to-day regulation of all aspects of securities trading.

³⁰¹ *Ibid* at para 88.

³⁰² The Court held the fact that the federal government’s foray into securities regulation under the Draft Federal Act is limited to achieving these objectives supports the validity of this proposed statute: *ibid* at para 116.

³⁰³ *Ibid* at para 89.

³⁰⁴ *Ibid* at paras 111, 112.

³⁰⁵ *Ibid* at para 115.

The SCC findings that capital market stability comes under national authority is bolstered by the recent US federal government report on the systemic risks to the US national economy from climate change that was published in late November 2018.³⁰⁶ It reports that:

the continued warming that is projected to occur without substantial and sustained reductions in global greenhouse gas emissions is expected to cause substantial net damage to the US economy throughout this century, especially in the absence of increased adaptation efforts. With continued growth in emissions at historic rates, annual losses in some economic sectors are projected to reach hundreds of billions of dollars by the end of the century—more than the current gross domestic product (GDP) of many US states.

. . .

While these adaptation and mitigation measures can help reduce damages in a number of sectors, this assessment shows that more immediate and substantial global greenhouse gas emissions reductions, as well as regional adaptation efforts, would be needed to avoid the most severe consequences in the long term. Mitigation and adaptation actions also present opportunities for additional benefits that are often more immediate and localized, such as improving local air quality and economies through investments in infrastructure.³⁰⁷

The framework of the Cooperative System is set out in the memorandum between the federal government and the governments of Ontario, British Columbia, Saskatchewan, New Brunswick, Prince Edward Island and Yukon (“participating jurisdictions”).³⁰⁸ This cooperative system has four primary components: uniform provincial and territorial legislation, whereby each participating province is to enact a statute that mirrors the “Model Provincial Act” addressing all matters respecting capital markets that fall within provincial or territorial jurisdiction;³⁰⁹ complementary federal legislation that addresses matters relating to systemic risk in Canada’s capital markets, national data collection and criminal matters;³¹⁰ contemplates a national regulator;³¹¹ and the new national Authority, which is to operate under the supervision of a Council of Ministers.³¹² The duties of the Council of Ministers include proposing amendments to the draft federal Act and the Model Provincial Act.³¹³ Both statutes will provide that any

³⁰⁶ NCA, “Fourth National Climate Assessment”, *supra* note 11 at Volume II: Impacts, Risks, and Adaptation in the United States.

³⁰⁷ *Ibid.*

³⁰⁸ Memorandum of Agreement, *supra* note 294.

³⁰⁹ *Ibid.*

³¹⁰ *Ibid.*, s 3(a)(ii).

³¹¹ The national authority will become the sole entity responsible for administering both the federal and provincial cooperative system legislation, and will fulfill all relevant regulatory, enforcement and adjudicative functions relating to the trade in securities under these statutes as enacted; *ibid.*, s 3(a)(iii).

³¹² The Council of Ministers will comprise the ministers responsible for capital markets regulation in each participating province and the federal Minister of Finance; *ibid.*, s 3(a)(iv).

³¹³ *Ibid.*, s 4.2. The voting rules applicable to approval by the Council of Ministers of a proposal to amend the Model Provincial Act are set out in s 5.5.

regulations proposed by the Authority must be approved by the Council of Ministers before they come into force.³¹⁴

The draft Capital Markets Stability Act sets out the fundamental provisions of capital markets statutory law while leaving detailed requirements, including some requirements that are currently contained in provincial and territorial securities legislation, to be addressed in regulations.³¹⁵ Part 7, which deals with disclosure, does not contain any reference to ESG factors, although the fact that the requirements of the legislation will be set out in regulations³¹⁶ means that there is considerable scope for requiring ESG factors to be included in disclosure requirements.

The draft Capital Markets Stability Act specifies:

19. The regulations may, in order to address a systemic risk related to capital markets, prescribe requirements, prohibitions and restrictions respecting systemically important benchmarks, including in relation to

- (a) submissions of information for the purpose of determining those benchmarks;
- (b) their design, determination and dissemination;
- (c) plans for continuity, recovery and cessation;
- (d) governance, compliance and accountability; and
- (e) any other aspects of benchmark administration.

...

23. The regulations may, in order to address a systemic risk related to capital markets, prescribe requirements, prohibitions and restrictions respecting practices that are prescribed to be systemically risky, including in relation to

- (a) policies and procedures for risk management and internal controls;
- (b) disclosure to the public of information whose disclosure is not otherwise required;
- (c) transparency;
- (d) aspects of governance and organizational and ownership structure that are related to risk management;
- (e) capital, leverage and financial resources;
- (f) margin, collateral, credit protection and position limits;
- (g) the use of credit ratings, including how investment policies govern that use;

and

³¹⁴ Model Provincial Act, s 206; Draft Federal Act, s 76. The SCC noted that it was key that nowhere does the Memorandum imply that the legislatures of the participating provinces are required to implement any amendments made to the Model Provincial Act that have been approved by the Council of Ministers, or that they are precluded from making any other amendments to their securities laws; *Reference re Pan-Canadian Securities Regulation*, *supra* note 292 at paras 50, 68.

³¹⁵ Cooperative Capital Markets Regulatory System, “Capital Markets Stability Act – A Revised Consultation Draft” (2016), online: CCMR <<http://ccmr-ocrmc.ca/publications/legislation/>> [Draft Capital Markets Stability Act].

³¹⁶ *Ibid*, s 43 provides that the regulations will contain the periodic and material change disclosure obligations.

(h) conflicts of interest related to the determination of credit ratings.

It appears that there is ample potential for the new national regulatory Authority to work with provincial and territorial governments to develop regulations requiring disclosure of ESG factors that pose a systemic risk to Canada's securities law or capital markets, as we discuss at pages 81-84.

4. *Can the federal government relieve some of the regulatory burden of requiring climate-related or ESG factors to be included in financial statements?*

The federal government, pursuant to its new federal capital markets draft legislation, is already committed to being nimble in respect of approaches to capital markets and securities regulation, moving away from overly codified securities requirements. As the legislation and regulations are being finalized, the new Authority could relieve some of the regulatory burden on publicly-listed companies by moving to bi-annual financial statements rather than quarterly financial statements. Such a move would need to be with consent of the co-operating parties, which includes Ontario, in which case, approximately more than 95% of market disclosure would be covered. For smaller issuers, the requirement should be for only annual financial statements. Material changes would still be subject to the continuous disclosure regime, but the cost and resources of currently providing quarterly reports should be redirected towards effecting financial reporting on ESG risks and benefits. Moreover, moving away from quarterly financial statements assists with focusing time horizons on longer periods, much needed, particularly in respect of climate-related financial risk and opportunity.

While there would need to be national instruments agreed to by all regulators, the fact that six securities regulators, including Ontario and British Columbia, will be part of the new federal regulatory body, creates an opening to incorporate either climate-related or ESG factors in financial statements. There were also many recommendations in previous studies conducted by the Task Force to Modernize Securities Legislation and similar national efforts to conceptualize a national system that would relieve the regulatory burden while moving financial statement and other disclosure towards modern and responsive disclosure, including use of financial technology to allow full access to financial statements and material information.³¹⁷ These recommendations and many others made over the years should be considered in terms of how they might relieve the regulatory burden with the approval, finally, of a national capital markets stability framework.

Recommendation 18:

The Expert Panel should consider recommending a move to bi-annual and annual financial statements for larger issuers and only annual financial statements for venture

³¹⁷ See for example, Janis Sarra, "Modernizing Disclosure in Canadian Securities Law: An Assessment of Recent Developments in Canada and Selected Jurisdictions" (October 2006) Research Report for the National Task Force to Modernize Securities Legislation in Canada, Vol 2, 1-180. In 2006, more than 90% of TSX listed companies already maintained web-based disclosures, it is most likely much higher now.

and smaller issuers (by market cap) as one means to focus on longer-term sustainability and relieve some of the resource pressures in shifting to an ESG governance framework.

Expert Panel Question 3.3(1):

What would accelerate adoption of the TCFD disclosure framework? Are there any critical enablers or barriers to adoption that have not been discussed?

The most effective way for the Government to accelerate adoption of the TCFD disclosure framework is to require publicly-listed companies to disclose information pursuant to the TCFD recommendations.³¹⁸ In this section, we discuss the rationale for requiring TCFD disclosure; the mechanisms the federal government should use to require that disclosure, given Canada's cooperative federalism; and the rationale for taking a tiered approach. We then discuss a number of barriers to adoption of TCFD disclosure.

1. The rationale for requiring disclosure pursuant to the TCFD framework

As recognized by the Expert Panel's Interim Report, the recommendations of the TCFD merit careful consideration within the Canadian context for a number of reasons. These reasons include that the TCFD's recommendations (a) are specific to climate-change risk, which is understood to be a systemic risk; (b) have been developed by extremely influential, international participants in business and government; (c) have been endorsed by Canada's five largest banks and six of its eight largest pension funds,³¹⁹ indicating that core Canadian financial actors understand the importance of the information TCFD suggests needs to be disclosed; and (d) have been endorsed by hundreds of businesses and investors around the world, including 457 companies with over \$5.7 trillion US of market capitalization and financial firms with close to \$100 trillion US of assets under management.³²⁰ As Governor of the Bank of England Mark Carney stated in November of 2018: "TCFD is now supported by three-quarters of the world's globally systemic banks, eight of the top ten asset managers, the world's leading pension funds and insurers, major credit rating agencies, the Big Four accounting firms, the two dominant shareholder advisory firms, and the two dominant shareholder advisory services," all together representing a fifth of global GDP.³²¹

i. Overview of recommendations

³¹⁸ TCFD, "Final Report", *supra* note 250.

³¹⁹ See Expert Panel, *supra* note 16 at 6.

³²⁰ See TCFD, "2018 Status Report" (September 2018), online: FSB <<https://www.fsb-tcfd.org/publications/tcfd-2018-status-report>>. See also Emily Farnworth, "Global CEOs call for greater disclosure of climate risks and opportunities" (Switzerland: World Economic Forum, 21 April 2017), online: WEF <<https://www.weforum.org/agenda/2017/04/global-ceos-call-for-greater-disclosure-of-climate-risks-and-opportunities/>>: CEOs representing companies with \$4.9 trillion in assets and \$700 billion in revenue form Alliance of CEO Climate Leaders to advocate for adoption of TCFD Framework.

³²¹ Terry Slavin, "'Tragedy of the horizon' still holding back action on climate change, Carney says" *Ethical Corporation* (26 November 2018), online: <<http://ethicalcorp.com/tragedy-horizon-still-holding-back-action-climate-change-carney-says>> [*Ethical Corporation*, "Tragedy of the Horizon"]. In the same speech Governor Carney argued against requiring TCFD disclosure, which view will be discussed in Section IV, below.

The TCFD identified four features of its recommendations that it considers “key features”: (1) that they could be adopted by all organizations, including financial institutions and investors as well as operating companies; (2) that climate-related financial disclosures should be included in required financial filings; (3) that the disclosure be decision-relevant, forward-looking information; and (4) that there should be a strong focus on risks and opportunities from the transition to a lower-carbon economy.³²² It also emphasized, as a key recommendation, the importance of using and disclosing the results of scenario analysis to determine the resilience of an organization and its strategies under different climate change and adaptation scenarios,³²³ issuing a Technical Supplement to guide issuers and financial institutions in preparing scenario disclosure.³²⁴

The Final Report identifies four areas for climate-related disclosure that represent the core elements of how organizations operate: Governance, Strategy, Risk Management, and Metrics & Targets.³²⁵ It conceptualized these recommendations as follows:



TCFD Final Report³²⁶

In discussing these categories of information, the Task Force stated:

³²² See TCFD, “Final Report”, *supra* note 250 at iii.

³²³ See *ibid* at v.

³²⁴ See TCFD, “Technical Supplement: The Use of Scenario Analysis in Disclosure of Climate-Related Risks and Opportunities” (June 2017), online (pdf): FSB <<https://www.fsb-tcf.org/wp-content/uploads/2017/06/FINAL-TCFD-Technical-Supplement-062917.pdf>> [Technical Supplement].

³²⁵ TCFD, “Annex”, *supra* note 278 at 11.

³²⁶ *Ibid*.

The Task Force recommends that organizations provide climate-related financial disclosures in their mainstream (i.e., public) annual financial filings and recognizes that most information included in financial filings is subject to a materiality assessment. However, because climate-related risk is a non-diversifiable risk that affects nearly all industries, many investors believe it requires special attention. . . .³²⁷

The Task Force concluded that information about a company’s governance and risk management should be included in financial filings irrespective of materiality, while disclosures related to company strategy, metrics and targets should be provided in annual financial filings only when material.³²⁸ Even there, the TCFD recommended that non-financial firms in energy, transportation materials, and agriculture, food and forest products with \$ 1 billion US equivalent or more of annual revenue should provide disclosures on strategy and metrics and targets in “other reports,” such as sustainability or CSR reports.³²⁹

What is notable about the TCFD’s disclosure categories is that they do not call on issuers to make speculative determinations about how large-scale, systemic disruptions such as climate change might affect their business at a far future date. Rather, they call upon individual companies to discuss how that company is approaching the identification, quantification, and management of climate change risks and opportunities today, and what strategic risks and opportunities the company perceives in the transition to a low-carbon economy. In other words, what are companies’ managements doing *now* to respond to the challenges of the Paris Agreement and their country’s Nationally Determined Contributions to meet the goals of that agreement? Far from requiring speculative or boiler-plate disclosure, then, the TCFD has focused on specific information that managers can provide (how are they evaluating and managing these risks to their company in their industry and geographic regions), and specific information that investors and lenders can use to direct their capital to companies with smart, proactive management. Presumably it is because the information is perceived by investors to be decision-useful that financial institutions with close to \$100 trillion US have endorsed TCFD, including Canada’s largest banks and pension funds.

ii. Implementing the TCFD’s disclosure framework

The TCFD’s recommendations are widely viewed as the foundation for improved reporting of climate-related issues in mainstream financial filings. The TCFD believes that the reporting of climate-related risks and opportunities will evolve over time as companies, investors and others contribute to the quality and consistency of the information disclosed. Thus, eventually, TCFD disclosure is expected to allow investors, lenders, insurers, and credit ratings agencies’ access to better information about specific companies’ climate-related risks and opportunities, and how managers and boards are thinking about those issues. As such, the information disclosed should

³²⁷ *Ibid.* Some of the challenges associated with the concept of materiality, both generally, in mainstream financial filings, and with respect to climate-related risk, are discussed below at 83-88.

³²⁸ *Ibid.*

³²⁹ *Ibid.*

provide an important impetus to sustainable finance in Canada, allowing the capital markets to more effectively play a role in allocating capital to those companies with the most proactive insights into the transition to a low-carbon economy and how to position their company in light of that transition. The key question for the Expert Panel, then, is how to suggest that the federal government implement required TCFD disclosure consistent with the *Constitution Act*, if the Panel is persuaded that is the best policy recommendation to make to the federal government in order to accelerate TCFD disclosure.

As indicated above, a key consideration for the SCC in upholding the constitutional validity of the Cooperative Capital Markets Regulatory Scheme was that the federal government's role in regulating capital markets independent of the cooperating provinces and territory is limited to the detection, prevention and management of systemic risks to the stability of the Canadian economy.³³⁰ Systemic risk is defined in the draft Capital Markets Stability Act as "a threat to the stability of Canada's financial system that originates in, is transmitted through or impairs capital markets and that has the potential to have a material adverse effect on the Canadian economy."³³¹

Both climate change itself and the transition risks inherent in Canada meeting its obligations pursuant to the Paris Agreement to limit the warming of the Earth to "well under" 2° C, compared to the pre-industrial era, and "pursuing efforts" to limit to 1.5° C³³² are systemic risks with the potential to have a material adverse effect on the Canadian economy. As such, the federal government would likely have jurisdiction to act independently of the cooperating provinces in enacting new regulations to require disclosure consistent with TCFD. As the new framework negotiated between the federal government and the cooperating provinces specifies,³³³ the federal government's new Authority would work with the cooperating provinces and territory—Ontario, British Columbia, Saskatchewan, New Brunswick, Prince Edward Island, and the Yukon—

³³⁰ See text accompanying notes 292-300, *supra*.

³³¹ See Draft Capital Markets Stability Act, *supra* note 315, s 3.

³³² UN Framework Convention on Climate Change (UN FCCC), "Paris Agreement" (12 December 2015), article 2(1)(a), online (pdf): UN FCCC

<http://unfccc.int/files/essential_background/convention/application/pdf/english_paris_agreement.pdf>

("Article 2 (a): Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change".) The Paris Agreement entered into force as of 4 November 2016, when countries representing 55% of global GHG emissions had ratified the Agreement. By August 2017, 160 countries have ratified the Agreement. UN FCCC, "Paris Agreement – Status of Ratification" (2019), online: UN FCCC <http://unfccc.int/paris_agreement/items/9444.php>.

³³³ Draft Capital Markets Stability Act, *supra* note 315 at s 4: "The purposes of this Act are, as part of the Canadian capital markets regulatory framework,

(a) to promote and protect the stability of Canada's financial system through the management of systemic risk related to capital markets; and

(b) to protect capital markets, investors and others from financial crimes. The Act is to be administered by the Capital Markets Regulatory Authority (b) detect, identify and mitigate systemic risk related to capital markets;

(c) contribute, as part of the Canadian financial regulatory framework, to the stability of the financial system;

(d) provide leadership and coordination in enforcing criminal law related to capital markets; and

(e) coordinate Canada's international involvement in regulating capital markets, including developing policy and representing Canada in international forums related to that regulation."

to develop new climate-specific disclosure based on TCFD.³³⁴ Each of these approaches will be discussed in turn.

2. *Federal jurisdiction under the draft Capital Markets Stability Act: Climate change as a systemic risk*

The underlying premise of TCFD is that climate change poses systemic risks to the global financial system. The impetus for the TCFD was discussed in a September 2015 speech to Lloyd’s of London delivered by Mark Carney, Governor of the Bank of England and Chair of the FSB at the time of the speech, and former Governor of the Bank of Canada. The speech, entitled *Breaking the Tragedy of the Horizon – climate change and financial stability*, identified climate change as one of the greatest extant threats to the resilience and prosperity of global financial markets.³³⁵

Governor Carney identified three broad channels through which climate change can affect financial stability:

First, **physical risks**: the impacts today on insurance liabilities and the value of financial assets that arise from climate- and weather-related events, such as floods and storms that damage property or disrupt trade;

Second, **liability risks**: the impacts that could arise tomorrow if parties who have suffered loss or damage from the effects of climate change seek compensation from those they hold responsible. Such claims could come decades in the future, but have the potential to hit carbon extractors and emitters –and, if they have liability cover, their insurers–the hardest;

Finally, **transition risks**: the financial risks that could result from the process of adjustment towards a lower-carbon economy. Changes in policy, technology and physical risks could prompt a reassessment of the value of a large range of assets as costs and opportunities become apparent. The speed at which such re-pricing occurs is uncertain and could be decisive for financial stability.³³⁶

Each of these potential risks can be observed in Canada today, given such events as the Fort McMurray fire in 2016, with approximately \$8.9 billion Cdn of direct and indirect costs, or the recently-filed claim for liability against the federal government for failing to address climate change.³³⁷ The clearest risks to the Canadian economy are transition risks, however.

³³⁴ *Ibid*, s 6 specifies: (2) In fulfilling that mandate, the Authority must coordinate, to the extent practicable, its regulatory activities with those of other federal, provincial and foreign financial authorities so as to promote efficient capital markets, to achieve effective regulation and to avoid imposing an undue regulatory burden.

³³⁵ Mark Carney, “Breaking the Tragedy of the Horizon – climate change and financial stability” (Speech delivered at the Lloyd’s of London, 29 September 2015) [Carney].

³³⁶ *Ibid* at 5-6.

³³⁷ Staff, The Canadian Press, “Fort McMurray Wildfire: Study pegs cost of last buildings, income and environmental damage at \$8.9 billion” *Global News* (17 January 2017), online:

In December 2016, the Pan-Canadian Framework on Clean Growth and Climate Change was agreed to by the federal government and all of the provinces and territories, with the exception of Saskatchewan, to meet Canada's commitment to the Paris Agreement.³³⁸ That commitment is to reduce Canada's GHG emissions by 30% below 2005 levels by 2030.³³⁹ While the Ontario government has recently pulled out of the Pan-Canadian Framework's core policy instrument of a tax on carbon,³⁴⁰ it maintains it will still meet the commitment to reduce GHG emissions by 30%.³⁴¹ The federal government has indicated it will impose a back-stop tax on carbon in any province that has not implemented one by 2019, which now includes Ontario and Saskatchewan.³⁴²

The Pan-Canadian Framework estimates that 80% of Canada's GHG emissions are caused by the production and use of energy: to power homes, offices, and industrial facilities; to fuel the transportation of people and goods; to build and heat homes and other types of facilities; to grow food and transport that food; to fish, manage forests, cut trees, and generally to fuel the economy.³⁴³ But Canada faces a number of particularized challenges in its transition to a low-carbon economy. It is a large, cold country, with people primarily clustered along its southern border, but also living at great distances to the North.³⁴⁴ These geographic aspects require extensive systems of transportation, and intensive amounts of energy for heating, including the use of carbon-intensive and polluting diesel generators in the North. Moreover, 14.4% of the

<<https://globalnews.ca/news/3187254/fort-mcmurray-wildfire-study-pegs-cost-of-lost-buildings-income-and-environmental-damage-at-9-5b>> (revised from nearly \$10 billion). Of this, \$3.7 billion were insurable losses, making it the most expensive disaster for insurers in Canadian history. Statistics Canada, *Infographic: Fort McMurray 2016 Wildfire – Economic Impact* (16 March 2017), online: Government of Canada <<https://www150.statcan.gc.ca/n1/pub/11-627-m/11-627-m2017007-eng.htm>>. Regarding liability risk, see “Young Quebecers sue Canada for climate negligence” *Montreal Gazette* (26 November 2018), online: <<https://montrealgazette.com/news/quebec/young-quebecers-sue-canada-for-climate-negligence>>.

³³⁸ Canada, Environment and natural resources, *Pan-Canadian Framework on Clean Growth and Climate Change* (Gatineau, QC: Environment and Climate Change Canada, 2016), online: Government of Canada <<https://www.canada.ca/en/services/environment/weather/climatechange/pan-canadian-framework.html>> [*Pan-Canadian Framework*].

³³⁹ *Ibid.*

³⁴⁰ Mike Godfrey, “Ontario Withdraws Support for Canadian Carbon Taxes” *Tax-news.com* (16 July 2018), online: <https://www.tax-news.com/news/Ontario_Withdraws_Support_For_Canadian_Carbon_Taxes____86868.html>.

³⁴¹ Fatima Syed, “Ontario unveils climate plan with scant details” *Canada's National Observer* (29 November 2018), online: <<https://www.nationalobserver.com/2018/11/29/news/ontario-unveils-climate-plan-scant-details>>.

³⁴² Prime Minister, *Price on Pollution*, *supra* note 5.

³⁴³ See *Pan-Canadian Framework*, *supra* note 338, Forward. Canada's GHG emissions are coming from the following sources: 37% industry, the majority of which is coming from oil and gas production; 23% transportation; 12% buildings; 11% electricity production; 10% agriculture; and 7% waste and other. *Pan-Canadian Framework* at 8; oil and gas emissions constitute the majority of industrial emissions: *Pan-Canadian Framework* at 16. Electricity production is a small part of Canada's overall GHG emissions because 80% of its electricity comes from low-emitting sources, presumably hydro and nuclear power. *Pan-Canadian Framework* at 9.

³⁴⁴ Natural Resources Canada, *Infographic: Ten Key Facts on Canada's Natural Resources* (14 August 2018), online: Government of Canada <<https://www.nrcan.gc.ca/publications/key-facts/16013>>.

Canadian economy is tied to the extraction, refining, transport and sale of oil, gas, coal, and minerals.³⁴⁵ Transitioning away from these GHG-intensive sources of energy and economic inputs to the Canadian economy over the next decades will have effects on both producers and consumers; and could disproportionately affect particular provinces in Canada, notably Alberta, and particular people, such as those individuals who work in the oil, gas, and coal industries.

Given the systemic nature of climate change as a non-diversifiable economic challenge, and the particularized transition risks in Canada, we submit that the federal government has clear authority under the draft Capital Markets Stability Act to implement TCFD disclosure.

3. The federal government should also work with provincial securities regulators to encourage provincial securities law to require TCFD disclosure

Notwithstanding its likely jurisdiction under the new Capital Markets Stability Act, the federal government should also work cooperatively with the provinces, territories and exchanges now to encourage implementation of TCFD disclosure on a provincial and territorial level, since it is likely to be some time before the new cooperative Authority is fully operational, and its priorities established.

The CSA, an umbrella organization of provincial and territorial securities regulators, whose mission is to “improve, coordinate, and harmonize” securities regulation across Canada, would be the logical place to begin to develop a collaborative approach to this issue. CSA has already studied the potential for requiring TCFD disclosure, and has put the matter on a watching brief. The CSA was engaged in consultations with investors, regulators, and issuers throughout much of 2017, and on 5 April 2018, the CSA published Staff Notice 51-354 *Report on Climate Change-related Disclosure Project*.³⁴⁶ In the report, regulators stated that they intend to “consider new disclosure requirements regarding non-venture issuers’ corporate governance practices in relation to material business risks including emerging or evolving risks and opportunities arising from climate change.”³⁴⁷ Thus, there would seem to be some receptivity to policy consideration of at least part of TCFD-type disclosure, perhaps an approach like the SD&A discussed above.³⁴⁸

4. Concerns and barriers to requiring TCFD disclosure

³⁴⁵ *Ibid.*

³⁴⁶ CSA Staff Notice 51-354, *Report on Climate change-related Disclosure Project* (5 April 2018), online (pdf): OSC <http://www.osc.gov.on.ca/documents/en/Securities-Category5/csa_20180405_climate-change-related-disclosure-project.pdf> [CSA Staff Notice 51-354]. In the report CSA Staff noted widespread dissatisfaction by investors in the quality of climate change disclosure by reporting issuers. It found that just over half of issuers examined provide specific climate change-related disclosure in their MD&A and/or Annual Information Form, but the other half used boilerplate disclosure, or no disclosure at all. *Ibid* at 13. Almost none of the issuers reviewed disclosed their governance and risk management practices respecting climate change. *Ibid.*

³⁴⁷ *Ibid.*

³⁴⁸ See text accompanying notes 289-291, *supra*.

Mark Carney has expressed the view recently that it is too early to require TCFD disclosure, that the framework needs further iteration based on the experiences of early adopters.³⁴⁹ This point of view needs to be taken seriously, particularly because it is the expression of the person who initiated the TCFD process. Moreover, the academic literature supports the view that one of the advantages of voluntary, private self-regulation is that the “regulatory” framework can adapt more readily to changing circumstances, can evolve relatively quickly over time, and can more obviously incorporate the experiences of companies using it, versus traditional public laws, which can become ossified and are difficult to amend.³⁵⁰ Another advantage of voluntary self-regulation may be that participants become more engaged in meeting the spirit as well as the letter, of its requirements, and so there may be lower levels of psychological resistance to the requirements.³⁵¹

Given the broad support for TCFD disclosure by Canadian banks and investors, it could be that proceeding along the lines of (a) encouraging strong federal endorsement of TCFD; (b) energizing banks and investors to pressure their clients to disclose climate-change risks and opportunities using the TCFD framework; and (c) industry peer-pressure will lead to significant voluntary uptake of the disclosure framework while the federal Capital Markets Stability Act is being implemented, and while the CSA continues to study the issue of climate-related financial disclosure.

When the federal government is in a position to require this disclosure, it should take the approach indicated in our Recommendation 19, to require disclosure according to the “at-the-time current” version of TCFD. This approach would allow the framework for disclosure to evolve with the experience of companies using it, allowing some of the advantages of self-regulation, while still employing a mandatory approach. Sweden and Denmark have taken a similar approach to their sustainability reporting requirements, basing the structure of required sustainability reporting on voluntary reporting frameworks. Since 2008 public reporting companies in Sweden must issue an annual sustainability report using the Global Reporting Initiative (GRI) framework.³⁵² Since January 2009, approximately 1,100 large companies in Denmark, as well as institutional investors and loan providers, have been required to publish an annual corporate responsibility report, following a 2008 government Action Plan on Corporate Responsibility.³⁵³ Companies may use their annual reporting to the UN Global Compact as the framework for their

³⁴⁹ Carney, quoted in *Ethical Corporation*, “Tragedy of the Horizon”, *supra* note 321.

³⁵⁰ See, *eg*, John Braithwaite, “The Essence of Responsive Regulation” (January 2011) 44 *UBC L Rev* 475 (summary of the literature) [Braithwaite].

³⁵¹ See, *eg*, Deborah E Rupp and Cynthia A Williams, “The Efficacy of Regulation as a Function of Psychological Fit” (2011) 12 *Theoretical Inquiries in Law* 581.

³⁵² See Jan Bertil Anderson and Frida Segenmark, “Sustainable Companies: Barriers and Possibilities in Swedish Company Law” (11 April 2013), Univ of Oslo Res Paper No 2013-09, online: SSRN <<http://www.ssrn.com/abstract=2248584>>. For further information on the Global Reporting Initiative, see GRI, “Home Page” (2019), online: GRI <<http://www.globalreporting.org>>.

³⁵³ See Karin Buhmann, “Company Law as an Agent for Migration of CR-Related International Law into Company Self-Regulation? The Case of the CR Reporting Requirement” (2011) 8:2-3 *European Company Law* 65 at 68.

public disclosure, and institutional investors may report on their incorporation of the Principles of Responsible Investment (PRI) developed by the UN Environment Program.³⁵⁴

The safe harbour, discussed in response to Expert Panel Question 3.3(6): below, would protect corporations as the standards develop.

Recommendation 19:

- i. The new national Authority under the draft Capital Markets Stability Act should require companies to disclose and address material climate-related financial risk in its initial regulations, and should peg requirements to international standards as they develop.
- ii. The new national Authority under the draft Capital Markets Stability Act should assess whether there is a need to address material environmental, social and governance systemic risk more generally, in terms of risk to the stability of the country's financial system as a whole and the potential to have a material adverse effect on the Canadian economy.
- iii. The new national Authority under the draft Capital Markets Stability Act should negotiate with securities administrators across Canada to embed a staged approach to TCFD disclosure within provincial securities regulation, where applicable and as standards develop.

Expert Panel Question 3.3(2):

Should the Government of Canada become an official supporter of the TCFD?

- 1. The extensive process underpinning the TCFD framework is one that the Government of Canada should recognize***

In considering this question, we submit that members of the Expert Panel should consider the broad, global indications of support from companies and investors, set out above, but also the derivation of the idea for the TCFD, and the careful way the TCFD recommendations were developed. TCFD is a project of the FSB, under the leadership of Canada's former Governor of the Bank of Canada Mark Carney. Founded in 2009 in reaction to the global financial crisis, the FSB is an international organization of central bank governors and financial regulators established by the Heads of State and Government of the Group of Twenty (G-20) as a successor to the

³⁵⁴ See *ibid.* For more information on the PRI, see UN PRI, "About" (2019), online: UN PRI <<http://www.unpri.org/about-pri/>>.

Financial Stability Forum.³⁵⁵ Its remit is to enhance the stability of global financial markets by monitoring and making recommendations regarding financial regulations and policies.³⁵⁶

As discussed above, the impetus for the TCFD was Governor Carney, who, in a 2015 speech entitled *Breaking the Tragedy of the Horizon – climate change and financial stability*,³⁵⁷ identified climate change as one of the greatest threats to the resilience and prosperity of global financial markets. Carney promoted the establishment of a climate disclosure task force to assess the effectiveness of various environmental disclosure regimes and develop an authoritative, voluntary disclosure framework so that markets could allocate capital properly to promote the necessary transition to a low-carbon economy.³⁵⁸ In December 2015, the TCFD was established by the FSB, with Michael Bloomberg as its Chair, and with 32 global industry participants as members, including people from operating companies, banks, insurance companies, asset managers, and credit rating agencies.³⁵⁹ Canadians Jane Ambachtsheer (then at Mercer, now based in Paris) and Stephanie Leaist, CPPIB, were part of the Task Force.

The TCFD was created to develop voluntary climate-related disclosures that “could promote more informed investment, credit [or lending], and insurance underwriting decisions” that would, in turn, “enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system’s exposures to climate-related risks.”³⁶⁰ In keeping with its mandate, the TCFD released a scoping project in which it invited comments in April 2016; a consultation draft of recommended climate-related financial disclosures in December 2016; and then a Final Report setting out the TCFD’s recommendations on 29 June 2017.³⁶¹ Accompanying the Final Report, the TCFD published an Annex providing further specific guidance on how to report pursuant to its framework,³⁶² and a Technical Supplement providing further detail on how to develop climate-related scenario analyses.³⁶³

The extensive process to develop the TCFD recommendations and disclosure framework is a reason why so many governments, corporations, financial institutions and investors have endorsed it as a framework. The federal government’s endorsement of the framework would provide an important signal to Canada’s capital markets participants that Canada intends to closely align its capital markets disclosure framework with developments internationally. Then the new Authority can carefully work through the specifics with other securities regulators.

³⁵⁵ See FSB, “About” (2019), online: FSB <<http://www.fsb.org/about/>>.

³⁵⁶ *Ibid.*

³⁵⁷ Carney, *supra* note 335 at 16.

³⁵⁸ *Ibid* at 13-15.

³⁵⁹ See TCFD, “Final Report”, *supra* note 250.

³⁶⁰ FSB, *Proposal for a Disclosure Task Force on Climate-Related Risks* (9 November 2015), online: FSB <www.fsb.org/wp-content/uploads/Disclosure-task-force-on-climate-related-risks.pdf>.

³⁶¹ See TCFD, “Final Report”, *supra* note 250 at iv.

³⁶² See TCFD, “Annex”, *supra* note 278.

³⁶³ See TCFD, “Technical Supplement”, *supra* note 324.

Recommendation 20:

The federal government should endorse the TCFD disclosure framework, recognizing that it is continuing to develop.

Expert Panel Question 3.3(4):

Should larger firms be looked upon to demonstrate leadership to small- and medium sized enterprises with respect to TCFD disclosure?

1. Cultivate leadership by size of enterprise

Rather than looking to larger firms to demonstrate leadership to small- and medium-sized enterprises, we suggest that leaders be identified in each category—small, medium, large, and national enterprise champions. The challenges facing companies of different sizes are distinct, and the resources available to meet those challenges vary widely according to size. Thus the approaches taken by a larger firm to various TCFD disclosure issues—identifying, quantifying where possible, and analyzing risks and opportunities; developing targets for GHG emissions reductions and metrics; engaging in scenario analyses—may not be relevant to a small firm with few employees and informal governance systems at best.

The federal government may be able to encourage companies to pursue sustainability disclosure goals by rewarding leading companies in each size category. Leading companies could be asked by the federal government to constitute a Council of Sustainability Leaders. Companies could be permitted to advertise their membership in the Council by a certification mark, which would permit concerned consumers to direct their purchases to sustainability leaders. Empirical evidence is starting to show that consumers are willing to pay up to 20% more for fair trade goods and other goods with known sustainability certifications, and that demand for these goods is higher than for comparably priced, or even lower priced, non-fair trade goods.³⁶⁴ At least where companies are consumer-facing, being a recognized sustainability leader would presumably have economic value.

Moreover, by recognizing leaders and celebrating innovation, the government challenges laggards to improve performance. Japan has used techniques of celebrating leaders and supporting sector dialogues to improve technological performance. One study suggests that the greater success of Japanese car companies in reducing emissions versus US companies was based on the government's praise of technological innovations and clear expectations that other Japanese automakers "would have to innovate to reach or exceed a new ceiling as soon as another Japanese manufacturer took environmental engineering of motor vehicles up through an old ceiling."³⁶⁵ A similar technique could be used with respect to sustainability disclosure: celebrating leaders and implicitly expecting laggards to improve.

³⁶⁴ R Dragusanu, D Giovannucci, and N Nunn, "The Economics of Fair Trade" (2014) 28:3 *J of Econ Perspectives* 217-236.

³⁶⁵ John Mikler, *Greening the Car Industry: Varieties of Capitalism and Climate Change* (Cheltenham: Edward Elgar, 2009), cited in Braithwaite, *supra* note 350 at 501.

Still, it must be recognized that many small and medium enterprises will not have the resources to invest in new disclosure regimes of unproven benefit to them. Even larger companies express concerns about how sustainability disclosure may—or may not—be valued by investors. Natural Resources Canada recently gave support to CPA Canada to do an in-depth study of investors’ expectations of disclosure generally and sustainability disclosure specifically, and how the information is being used in investment, insurance and underwriting decisions. This avenue of study is promising. The government should be asked to support in-depth dialogues between investors and companies in key sectors to develop support for further engagement with TCFD across sectors and sizes of companies.

Finally, TCFD or other sustainability disclosure should not be understood only as a mechanism to better inform investors, insurers and underwriters, although it is important in that regard. Focusing on the underlying facts to be disclosed about governance of climate change risks and opportunities, risk management, strategy, targets, and metrics is understood to focus attention on those matters and lead to improvements in processes, cost savings, new products, innovations, and so forth. As Carney has observed, “you manage what you measure.”³⁶⁶ So if the government were to establish a Council of Sustainability Leaders recognizing excellent disclosure, and were to bring participants together annually, or semi-annually, it might help to establish networks of peers for sharing learning and innovation, much as innovation hubs such as the Centres for Social Innovation or Green Economy Canada do.

Recommendation 21:

- i. The government should establish criteria to recognize leaders in sustainability disclosure in each size category (small, medium, large, national champions) and constitute a Council of Sustainability Leaders.
- ii. The government should facilitate dialogues between investors and companies to develop mutual understandings of what types of sustainability disclosure is most valuable to investors.

Expert Panel Question 3.3(5):

Is there a need for further guidance on the relationship between climate-related risks and materiality? How can the understanding of what is material be improved?

World business leaders, members of civil society, and governments recognize that climate change presents material economic risks. In the World Economic Forum’s *Global Risks Report 2019*, published on 15 January 2019, climate change and climate change–related risks dominate the list, accounting for six of the top ten global risks, identified by both likelihood of occurrence and

³⁶⁶ Carney, *supra* note 335 at 11.

magnitude of impact.³⁶⁷ “Extreme weather events” was identified as the number one likely risk, and the failure of climate-change mitigation and adaptation was number two, both in terms of likelihood of occurrence and magnitude of negative impact.³⁶⁸ Biodiversity loss, water crises, food insecurity and large-scale involuntary migration also ranked within the top ten risks facing the world, each of which is related to climate change.³⁶⁹

The Canadian government has similarly understood that climate change represents material, economic risks. As just one example, Deputy Governor of the Bank of Canada Mark Lane has stated that the Bank recognizes that “climate change is one of the biggest challenges facing Canada and the world in the 21st Century. Climate change itself and actions to address it will have material and pervasive effects on Canada’s economy and financial system.”³⁷⁰ One difficulty has been translating these macro-economic and systemic environmental and social risks posed by climate change into specific, material information individual companies need to discuss and disclose. It is there that the TCFD process has advanced policy in a fundamental way.

The premise of the TCFD recommendations is that much of the climate-related financial disclosures they recommend, particularly regarding risk management and governance of climate change, are already required to be disclosed by existing securities law requirements in the G20 countries, where material.³⁷¹ As discussed above, however, the quality of both required (material) and voluntary climate change and ESG disclosure now in Canada is poor.³⁷² This poor quality of information suggests that there is a need for further guidance on the relationship between climate-related risks and materiality. In this section we summarize the guidance that has been provided by Canadian securities regulators to date on the materiality of environmental information generally, and then discuss recommendations on how to improve that guidance.

It is important to note in this context that what is “material” under securities law is a narrower concept than under corporate law. Under corporate law, materiality is one lens through which directors and officers assess risk and opportunity and act with a view to the best interests of the company. Under securities law, it is aimed at protecting investors, as discussed in this part.

³⁶⁷ World Economic Forum, *Global Risks Report 2019* (2019) at 5, online (pdf): WEF <http://www3.weforum.org/docs/WEF_Global_Risks_Report_2019.pdf>.

³⁶⁸ *Ibid.*

³⁶⁹ *Ibid.*

³⁷⁰ Lane, “Thermometer Rising”, *supra* note 211.

³⁷¹ See TCFD, “Final Report”, *supra* note 250, stating that “The Task force also reviewed financial filing requirements applicable to public companies across G20 countries and found that in most G20 countries, issuers have a legal obligation to disclose material information in their financial reports—which includes material, climate-related information.”

³⁷² See footnote 346. It should be noted that both the CPA Canada and the CSA have recently evaluated climate-related disclosures, primarily focussed on disclosure required under provincial securities laws and regulations, and found the quality of such disclosures to be poor. CSA Staff Notice 51-354, *supra* note 346; CPA Canada, “State of Play: Study of Climate-Related Disclosures by Canadian Public Companies” (2017), online: CPA <<https://www.cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/sustainability-environmental-and-social-reporting/publications/climate-related-disclosure-study>>.

1. *Guidance on the materiality of environmental information to date*

As discussed above, the requirements set out in provincial and territorial securities legislation are the primary source of disclosure obligations for publicly-listed corporations in Canada, but they are based on nationally harmonized standards agreed to by regulators.³⁷³ General disclosure obligations are primarily provided by National Instrument 41-101 *General Prospectus Standards* (“NI 41-101”) for primary market transactions, and National Instrument 51-102 *Continuous Disclosure Obligations* (“NI 51-102”) for secondary market transactions and continuing disclosure.³⁷⁴ According to those instruments, issuers’ disclosures must generally provide “full, true, and plain disclosure of all material facts”; issuers must also notify security holders of any material changes to their business and operations.³⁷⁵

Three changes in the market motivated the CSA in 2010 to issue specific guidance on environmental reporting in CSA Staff Notice 51-533: “increasing impacts on issuers of environmental matters; the changing environmental regulatory landscape; and increasing investor interest in environmental matters.”³⁷⁶ A staff notice is a less formal communication from the CSA than a National Instrument, often, as here, to provide guidance on “emerging regulatory problems that have not yet become the subject of a policy or a rule.”³⁷⁷ Staff Notice 51-533 was published in an effort to “assist issuers in assessing which information must be disclosed on material environmental matters, such as risks related to weather patterns or environmental legislation”.³⁷⁸ In specific, CSA Notice 51-333 was drafted to provide guidance on definitions and principles concerning the following areas of disclosure:³⁷⁹

- Material Information (that is, the materiality of environmental information)
- Environmental risks and related matters
- Environmental risk oversight and management
- Forward-looking information requirements as they relate to environmental goals and targets
- Impact of adoption of International Financial Reporting Standards on disclosure of environmental liabilities.³⁸⁰

It is important to point out that Canadian environmental disclosure requirements are part of disclosure obligations generally, as established in NI 51-102 *Continuous Disclosure Obligations*. In other words, environmental disclosure obligations are not housed in a distinct instrument or

³⁷³ See, for instance, *Ontario Securities Act*, RSO 1990, c S5 [OSA]; *Alberta Securities Act*, SA 2000, c S4 [ASA]; *British Columbia Securities Act*, RSBC 1996, c 418 [BCSA]; *Nova Scotia Securities Act*, RSNS 1989, c 418 [NSSA].

³⁷⁴ NI 41-101, *General Prospectus Standards* and NI 51-102, *Continuous Disclosure Obligations*, both agreed within the auspices of the Canadian Securities Administrators and then promulgated in each province and territory.

³⁷⁵ See, eg, *Kerr v Danier Leather Inc*, [2007] 3 SCR 331, 2007 SCC 44; OSA, *supra* note 373, §57(1) definition of material change.

³⁷⁶ CSA Staff Notice 51-333, *supra* note 277.

³⁷⁷ Condon, Anand, Sarra and Bradley, *Securities Law in Canada*, *supra* note 248 at 29.

³⁷⁸ *News Release: Canadian Securities Regulators Publish Additional Guidance on Environmental Disclosure* (27 October 2010), online: CSA <<http://www.securities-administrators.ca/aboutcsa.aspx?id=928>>.

³⁷⁹ CSA Staff Notice 51-333, *supra* note 277 at 6.

³⁸⁰ *Ibid.*

piece of legislation, but rather, are an application of the general disclosure obligations of NI 51-102. Staff Notice 51-333 states that environmental matters comprise a “broad range of issues, including air, land, water and waste”, which can affect issuers in several ways, “including interrupting operations, resulting in material unplanned costs, providing new business opportunities, and potentially affecting reputation, capital expenditures, and a license to operate”.³⁸¹ Bearing in mind the source and scope of environmental disclosure in Canada, what follows is an overview of the purpose of Staff Notice 51-333 and the guidance it sets out for issuers on the topic of materiality.

i. Purpose of Staff Notice 51-333

The purpose of CSA Notice 51-333 “is to provide guidance to reporting issuers (other than investment funds) on existing continuous disclosure requirements relating to environmental matters under securities legislation”.³⁸² The Notice is intended to assist issuers with: (1) determining what information about environmental matters needs to be disclosed, and (2) enhancing or supplementing their disclosure regarding environmental matters, as necessary.³⁸³

ii. Materiality of environmental information

The determining factor in considering whether information should be disclosed under securities disclosure laws generally is materiality. The test for materiality is objective: “information . . . is likely material if a reasonable investor’s decision whether or not to buy, sell or hold securities of the issuer would likely be influenced or changed if the information was omitted or misstated”.³⁸⁴ Where the information is deemed to be material, it must be disclosed. In order to assist issuers with determinations of the materiality of environmental information, the Notice sets out several guiding principles for determining the materiality of information generally.

One caveat to note here is that CSA Staff Notice 51-333 states that it reviewed many “discussions of materiality in the environmental context” in arriving at its guiding principles for determining the materiality of environmental information, including reviewing five specific documents on climate change disclosure.³⁸⁵ There is nothing specific to climate change disclosure in its discussion of material information, nor in its Staff Notice generally, although there are a number of examples of climate-related disclosures set out in the Appendix. Certainly there is no guidance

³⁸¹ *Ibid* at 3.

³⁸² *Ibid*.

³⁸³ *Ibid*.

³⁸⁴ *Ibid* at 5. See also Part 1(f) of Form 51-102F1 and Part 1(e) of Form 51-102F2, *supra* note 277.

³⁸⁵ CSA stated that it reviewed: “ • the CICA publication, Executive Briefing – Climate Change and Related Disclosures (March 2008) • the CICA publication, Building A Better MD&A: Climate Change Disclosures (November 2008) • the CICA publication, Climate Change Briefing (July 2009) • the CICA publication, Environmental, Social and Governance (ESG) Issues in Institutional Investor Decision Making (August 2010) • the May 2009 exposure draft of the Climate Disclosure Standards Board Reporting Framework, and • the U.S. Securities and Exchange Commission’s guidance, Commission Guidance Regarding Disclosure Related to Climate Change (effective 2 February 2010).” (CICA is the Canadian Institute of Chartered Accountants, which became CPA Canada in 2014.) CSA Staff Notice 51-333, *supra* note 277 at 6.

on climate-related financial disclosure of the kind now provided by the TCFD Final Report and supplemental materials.

The first guiding principle stated by the CSA is that *there is no-bright line test for materiality*.³⁸⁶ In order to make it clear that there is *no* quantitative threshold for materiality, the CSA states that issuers should consider both qualitative and quantitative environmental factors when deciding whether environmental matters are material and require disclosure.³⁸⁷ As such, materiality is a flexible concept that varies between issuers and industries according to the circumstance.³⁸⁸ In other words, an event that may warrant disclosure by one issuer, such as perhaps a small issuer, may not be material to another, larger issuer.

The second guiding principle is that *determinations of materiality depend on the context*.³⁸⁹ Though certain facts and events may not be material on their own, they may be material if considered “in light of all the facts available”.³⁹⁰ Conversely, some facts and events are material on their own. In any case, issuers should not assess the materiality of individual facts, but rather holistically consider the total mix of facts.³⁹¹

The next two guiding principles are closely related with an issuer’s projected lifecycle. The third guiding principle, being the *timing of disclosures*, is driven by the circumstances of the issuer.³⁹² For instance, an issuer that is expected to have a long investment cycle, or develop and implement new technologies throughout its projected investment cycle, may be more susceptible to the impacts of gradual environmental change.³⁹³ As such, an issuer should consider whether the impact of an environmental matter “might reasonably be expected to grow over time, in which case the matter may be considered material and warrant early disclosure on the basis that it might be important to reasonable investors”.³⁹⁴ Similarly, issuers should also understand how their business will intersect with known trends, demands, commitments, events and uncertainties. Accordingly, the next principle states that, *when an issuer’s affairs are (or will be) affected by a trend, demand, commitment, event or uncertainty, such information should be disclosed*.³⁹⁵ Issuers should consider their operational time horizon and assess the probability and the magnitude of the effects imposed by a trend, demand, commitment, event or uncertainty

³⁸⁶ See CSA Staff Notice 51-333, *ibid* at 7.

³⁸⁷ *Ibid*. See also NI 51-102, *Continuous Disclosure Obligations* [NI 51-102]; OSC NP 51-102, (2002) 25 OSCB 4492, (12 July 2002), s 4.2 [NP 51-201]; OSC Notice 51-716, *Environmental Reporting*, (29 February 2008) 31 OSCB 2223 [OSC Notice 51-716]; Form 41-101F1 *Information Required in a Prospectus*, General Instruction 3.

³⁸⁸ See CSA Staff Notice 51-333, *ibid* at 7.

³⁸⁹ *Ibid*.

³⁹⁰ *Ibid*.

³⁹¹ *Ibid*. See also *Re YBM Magnex International Inc* (2003), 26 OSCB 5285 at paras 94 and 101.

³⁹² See CSA Staff Notice 51-333, *supra* note 277 at 7.

³⁹³ *Ibid*.

³⁹⁴ *Ibid*. The CSA recognized that this guiding principle was “derived from sources such as the CICA publication, *Building A Better MD&A: Climate Change Disclosures* (November 2008) and the May 2009 exposure draft of the *Climate Disclosure Standards Board Reporting Framework*.

³⁹⁵ *Ibid*.

– such that environmental matters that are likely to come to fruition within the projected investment cycle of an issuer and materially affect its business and operations are disclosed.³⁹⁶

The last principle articulates the CSA’s general pro-disclosure approach. As it states, “if there is any doubt about whether particular information is material”, the CSA “encourages issuers to *err on the side of materiality* and disclose the information”.³⁹⁷

2. *Improving the understanding of what is material*

The CSA’s discussion of materiality in Staff Notice 51-333 shows that well-meaning and well-counseled issuers have good, general, principles-based guidance on the disclosure of environmental issues in securities documents and financial statements. Yet this guidance does not provide specific, clear, and comprehensive guidance on the disclosure of specific climate-related information, since “materiality” as the screen for what is to be disclosed is a principles-based concept. In our view, therefore, using the TCFD Framework to structure companies’ disclosure would give investors a clearer, more consistent, and more easily comparable picture of how companies are thinking about, and managing, their current and future challenges from the changing climate and regulatory efforts to mitigate and adapt to those climatic changes.

In the Annex accompanying its recommendations, the TCFD provided further details on its recommended disclosures, using a structure comparable to other voluntary disclosure initiatives (eg, GRI, the Carbon Disclosure Project’s (CDP) climate surveys, SASB): disclosure guidance for all sectors, including financial institutions; and then sector-specific disclosures. For all sectors, specific disclosures are identified relating to each of the four thematic areas: governance, strategy, risk management, and metrics and targets.³⁹⁸ For all sectors, there is no materiality screen for disclosures related to governance and risk management, since these are matters assumed to be of importance to investors across the board; but for strategy, metrics and targets materiality judgments are still relevant.³⁹⁹ Thus, some of the difficulties that the concept of materiality presents will still need to be addressed, particularly how company by company materiality determinations should be evaluated in light of systemic risks where each company’s contribution to the problem matters, but may not be independently “material” in the total economic output of that individual company. For asset managers, the “Task Force recommends including carbon foot-printing information in reports to clients and beneficiaries independent of a materiality assessment.”⁴⁰⁰

Sector-specific disclosures are identified for financial institutions, including banks, insurance companies, asset managers and asset owners (investors); and then for sectors particularly vulnerable to material financial implications from the physical effects of climate change and the transition to a low-carbon economy. The Task Force identifies those vulnerable sectors as energy;

³⁹⁶ *Ibid.*

³⁹⁷ *Ibid* at 8. See also NI 51-102, *supra* note 387.

³⁹⁸ See TCFD, “Final Report”, *supra* note 50 and TCFD, “Annex”, *supra* note 278 at 14-20.

³⁹⁹ See TCFD, “Annex”, *ibid* at 3.

⁴⁰⁰ *Ibid.*

transportation; materials and buildings; and agriculture, food and forestry.⁴⁰¹ Again, sector-specific, detailed guidance is provided for disclosure across the four thematic areas of governance, strategy, risk management, and metrics and targets.

It is clear from the TCFD analysis that few significant sectors are understood *not* to be particularly vulnerable to climate change effects and transition efforts. That analysis is consistent with the conclusion of the US-based SASB that 72 of 79 industries, representing 93% of capital market valuations, are vulnerable to material financial implications from climate change, although the implications are obviously different for different sectors.⁴⁰²

The TCFD guidance would encourage corporations to disclose more climate-related information, and give investors insight into the company’s process of considering ESG factors and asking questions regarding materiality. This guidance thus clarifies reporting responsibilities for issuers in a quite useful way. In every case, what is material is a fact-specific evaluation, based on the company; its industry and physical locations; its financial assets, liabilities, and exposure to climate risk and transition risk; its preparations for climate-related challenges, and so forth. In other words, further materiality guidance of a general nature is unlikely to be possible. Rather, the specific, sector-specific guidance of TCFD will be beneficial.

Recommendation 22:

The federal government should encourage securities regulators and the CSA to direct companies to use the TCFD sector guidance and SASB guidance when determining the materiality of climate-related disclosures and when disclosing information about governance, risk management, company strategy, and targets and metrics within the construct of their continuous disclosure.

Expert Panel Question 3.3(6):

Are there mechanisms that would help overcome the hesitation to make appropriate disclosures with uncertain information in good faith, such as some form of regulatory safe harbour?

1. A safe harbour for ESG disclosure

In addition to the protections from liability discussed above for the codified fiduciary duties of all directors and officers, it makes sense to also consider a regulatory “safe harbour” for disclosure by publicly-listed companies of either climate-related financial risk or ESG risk. While the corporate law provisions specify the obligation to consider ESG factors and to address them if they are material, securities law disclosure requirements are aimed at providing information to

⁴⁰¹ See *ibid* at 46.

⁴⁰² Sustainability Accounting Standards Board, *Climate Risk—Technical Bulletin* (SASB Library 2017), <<https://library.sasb.org/climate-risk-technical-bulletin/>>.

the capital markets so that investors can make informed decisions as to buy, hold or sell their securities. Thus securities disclosure engages a narrower set of stakeholders than corporate law.

NI 51-102 *Continuous Disclosure*⁴⁰³ already provides a safe harbour for a reporting issuer regarding material forward-looking information, as well as “forward looking financial information” (“FOFI”).⁴⁰⁴ The disclosure cautions users that actual results may vary from the forward-looking information and identifies material risk factors that could cause material variation.⁴⁰⁵ NI-51-102 defines FOFI as forward-looking information about prospective financial performance, financial position or cash flows, based on assumptions about future economic conditions and courses of action, and presented in the format of a historical statement of financial position, statement of comprehensive income or statement of cash flows.⁴⁰⁶ “Forward-looking information” means disclosure regarding possible events, conditions or financial performance that is based on assumptions about future economic conditions and courses of action and includes future-oriented financial information with respect to prospective financial performance, financial position or cash flows that is presented as a forecast or a projection.⁴⁰⁷ NI 51-102 contains provisions to avoid duplication with existing mineral and oil and gas disclosure requirements.⁴⁰⁸

Pursuant to NI 51-102, a reporting issuer must disclose the material factors or assumptions used to develop material forward-looking information.⁴⁰⁹ The factors or assumptions should be relevant to the forward-looking information. The CSA has stated that disclosure of material factors or assumptions does not require an exhaustive statement of every factor or assumption applied – a materiality standard applies.⁴¹⁰

⁴⁰³ NI 51-102, *supra* note 387.

⁴⁰⁴ NI 51-102, (New FLI Requirements), effective 21 December 2007. See also CSA Staff Notice 51-330 Guidance Regarding the Application of Forward-looking Information Requirements under National Instrument 51-102, *Continuous Disclosure Obligations* [CSA Staff Notice], online: BCSC <https://www.bsc.bc.ca/Securities_Law/Policies/Policy5/51-330_Guidance_Regarding_the_Application_of_Forward-looking_Information_Requirements_under_National_Instrument_51-102_Continuous_Disclosure_Obligations__CSA_Staff_Notice_/>.

⁴⁰⁵ NI 51-102, *ibid* at para 4A.3(b). See also CSA, Companion Policy 51-102CP, *Continuous Disclosure Obligations*, as amended 2018, online: BCSC <https://www.bsc.bc.ca/Securities_Law/Policies/Policy5/PDF/51-102CP__CP__June_30__2015/> [51-102CP].

⁴⁰⁶ Section 1.1, NI 51-102, *ibid*. It specifies that “financial outlook” means forward-looking information about prospective financial performance, financial position or cash flows that is based on assumptions about future economic conditions and courses of action and that is not presented in the format of a historical statement of financial position, statement of comprehensive income or statement of cash flows.

⁴⁰⁷ Section 1.1, NI 51-102, *ibid*.

⁴⁰⁸ Part 4B.1 (2), NI 51-102 states: “This Part does not apply to disclosure that is (a) subject to requirements in National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities or National Instrument 43-101 Standards of Disclosure for Mineral Projects; (b) made to comply with the conditions of any exemption from the requirements referred to in paragraph (a) that a reporting issuer received from a regulator or securities regulatory authority unless the regulator or securities regulatory authority orders that this Part applies to disclosure made under the exemption; or (c) contained in an oral statement.” *Ibid*.

⁴⁰⁹ Para 4A.6, Disclosure of Material Factors or Assumptions, 51-102CP, *supra* note 405.

⁴¹⁰ 51-102CP, *ibid*, continued at 4A.3.

Conceptually and practically, in the initial period requiring disclosure of ESG in financial statements, it makes sense to create a safe harbour in respect of disclosure of risks that may appear material now but later are determined not to be material or that turn out to be even more material than originally disclosed. While the metrics and accounting standards are being developed and implemented, there is likely to be a period over the next several years in which the standards will be refined. Thus, safe harbour language for disclosure of ESG information and ESG financial information makes sense. The FOFI provisions offer a good starting point as a model.

The reality is that amendments to NI-51-102 will have to be negotiated by the CSA, and in this respect, the federal government will not be able to unilaterally act as it is not responsible for day to day securities regulation over continuing disclosure. There are some aspects of ESG disclosure, such as climate-related financial risk, which may be so systematically important that the government should require disclosure in a regulation under the new Capital Markets Stability Act, as discussed above. Otherwise, the implementation of a safe harbour will be subject to provincial and territorial regulatory oversight, for some provinces, now under the umbrella of the new national Authority.

Clearly securities regulators are best equipped with the skill and knowledge to draft ESG disclosure safe harbour language, but the point of the draft text below is to show that ESG disclosure under securities law can be limited to material information, and it can provide a safe harbour by cautioning readers of the disclosures that results may vary as new information develops.

Importantly, the ESG disclosure safe harbour would not be confined only to forward looking information, but all ESG reporting. The point is to have directors and officers determine which ESG factors are material, what the risks and opportunities are, and how they are acting on these risks and opportunities. The safe harbour recognizes that as ESG disclosure evolves, readers of the information should understand that it *is* evolving and that the disclosure may change as understandings of risks, opportunities and how to measure them improve. Here again, such a safe harbour will encourage longer-term sustainability planning and provide protection against short-termism pressure by “impatient capital”. The safe harbour is a method under securities law to protect directors and officers in their duly diligent efforts to disclose material ESG factors to investors, regulators and the broader public.

Recommendation 23:

The Expert Panel should recommend an ESG disclosure “safe harbour” to protect duly diligent directors and officers (possible draft language in red italics):

DISCLOSURE OF ENVIROMENTAL, SOCIAL AND GOVERNANCE INFORMATION

1. Environmental Social and Governance (ESG) Information

(1) This Part applies to ESG information that is disclosed by a reporting issuer other than ESG information contained in oral statements.

2. Disclosure

(1) A reporting issuer that discloses material ESG information must include disclosure that

(a) cautions users of the ESG information that actual results may vary in the future due to refinements in metrics to measure risks and opportunities and identifies material risk factors that could cause results to differ materially from the reported ESG information;

(c) states the material factors or assumptions used to develop the ESG information; and

(d) describes the reporting issuer's policy for updating ESG information.

(2) ESG outlook information that is based on assumptions that are reasonable in the circumstances must, without limitation,

(a) be limited to a period for which the information in the ESG outlook can be reasonably reported or be estimated; and

(b) use the accounting policies the reporting issuer expects to use to prepare its historical financial statements for the period covered.

(3) This Part does not apply to disclosure that is (a) subject to requirements in National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities or National Instrument 43-101 Standards of Disclosure for Mineral Projects; made to comply with the conditions of any exemption from the requirements that a reporting issuer received from a regulator or securities regulatory authority unless the regulator or securities regulatory authority orders that this Part applies to disclosure made under the exemption; or contained in an oral statement.

3. Reasonable Basis

A reporting issuer is not required to disclose ESG information unless the issuer has a reasonable basis for considering the information to be material.

4. A reporting issuer that discloses ESG information must include disclosure that states the date management approved the ESG information.

5. ESG Financial Information

(1) A reporting issuer must not disclose ESG financial information unless it is reasonable in the circumstances,

(a) is limited to a period for which the information in the ESG financial information or financial outlook can be reasonably measured or estimated; and

(b) uses the accounting policies the reporting issuer expects to use to prepare its historical financial statements for the period covered by the ESG information or the financial outlook.

- (2) *The issuer must explain the ESG financial information in the financial statements and the notes to the financial statements.*
- (3) *The issuer must disclose the date management approved the ESG financial information and explain the purpose of the ESG financial information and caution readers that the information may not be appropriate for other purposes.*
- (4) *The issuer must disclose any year to year change in reporting ESG metrics used.*

The idea is that an issuer must have a reasonable basis on which to consider material ESG information and ESG financial information disclosed in financial statements. As with FOFI disclosure, the ESG disclosure should not be “boilerplate in nature”.⁴¹¹ If a reasonable investor’s decision whether to buy, sell or hold securities of the reporting issuer would be influenced or changed if the information were omitted or misstated, then the information is material.⁴¹² Disclosure of material ESG information should be presented in a manner that allows an investor who reads the document or other material containing the ESG information to be able to readily understand the information and inform him/her or itself of the material assumptions underlying the ESG information and/or ESG financial information and the material risk factors associated with the information.⁴¹³

Of note is that developing appropriate disclosures, including ESG information, is an ongoing process. The record of existing disclosures under current securities regulation attests to this ongoing process. In fiscal 2018, of 840 securities reviews the CSA conducted, 51% of issuers reviewed were required to take action to improve and/or amend their financial statement disclosures or resulted in issuers being sanctioned for failing to meet disclosure requirements in their financial statements.⁴¹⁴ There are continuing issues relating to financial disclosures in compliance with the requirements of the IFRS, which include mining technical reports, climate change disclosure, incorrectly classifying cash flows as investing or financing activities on the statement of cash flows, and a number of other deficiencies.⁴¹⁵ The CSA notes that many issuers across a wide range of industries could be materially impacted by climate change and yet many of these issuers either provide boilerplate disclosure or fail to provide disclosures of climate

⁴¹¹ 51-102CP, *supra* note 405.

⁴¹² *Ibid.*

⁴¹³ *Ibid* re forward looking information.

⁴¹⁴ CSA Staff Notice 51-355 *Continuous Disclosure Review Program Activities for the fiscal years ended March 31, 2018 and March 31, 2017* (19 July 2018), online: OSC <http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20180719_51-355_continuous-disclosure-review-program.htm>.

⁴¹⁵ *Ibid.*

change-related financial risks and opportunities.⁴¹⁶ To date, most disclosure of climate risks has failed to be sufficiently specific to the issuer and its finances and operations.⁴¹⁷

It will therefore be no surprise that fully embedding ESG factors in financial statements will take some time, effort and resources. The safe harbour provision would protect the good faith efforts of directors and officers of publicly-listed companies with respect to their securities law disclosure requirements.

Expert Panel Question 3.3(7):

What is the role of a board - and specifically the audit committee - in overseeing climate-related financial disclosures?

1. Both the board and the audit committee are vitally important to effective oversight of ESG financial disclosures, including climate-related financial disclosures

The role of both the board and the audit committee is vitally important to the successful transition of Canadian corporations to a sustainable future, particularly important with respect to climate-related financial disclosures because the risks are rapidly becoming a reality and the capacity to move swiftly and effectively to address climate-related risk has become an imperative.

The TCFD recommends that financial reporting of climate-related financial risk should be subject to the same requirements as other corporate reporting and thus involve review by the chief financial officer and audit committee, as appropriate.⁴¹⁸ As a core function, the board has a role in overseeing climate-related financial disclosures and risk management, as it has oversight of all significant risk factors, including ESG factors. Depending on the size of the company, it may be the board itself, an enterprise risk management committee or the audit committee. Whatever the designated structure in which ESG risks are being identified, reporting must be made directly to the full board; directors should be made aware of the risks and whether they are material, and how the risks are being managed, so that they can engage in proactive oversight.

If, as recommended above, ESG factors are required to be reported in financial statements, the national instrument on audit committees will be helpful. *National Instrument 52-110 Audit Committees*⁴¹⁹ (“NI 52-110”) establishes requirements for the responsibilities, composition, and

⁴¹⁶ *Ibid*, observing that the AIF must include disclosure of risk factors relating to the issuer and its business that would be likely to influence an investor's decision to purchase the issuer's securities. When assessing the materiality of climate change-related risks and impacts, issuers should consider a wide range of risks including physical (acute/chronic), regulatory, reputational and business model risks.

⁴¹⁷ *Ibid*, stating “In order to provide useful information to investors, material climate change-related risks should provide specificity and additional quantitative discussion (e.g. the financial impact). Reference: Item 5.2 of Form 51-102F2, Item 1.4(g) of Form 51-102F1, and CSA Staff Notice 51-333, *supra* note 277.

⁴¹⁸ TCFD, “Final Report”, *supra* note 250 at 18.

⁴¹⁹ NI 52-110, *Audit Committees* (effective 17 November 2015), online: BCSC <[https://www.bcsc.bc.ca/52-110_\[NI\]_11172015/](https://www.bcsc.bc.ca/52-110_[NI]_11172015/)> [NI 52-110].

authority of audit committees. An audit committee of the board of directors has responsibility for oversight of the financial reporting process, which includes helping directors meet their responsibilities, providing better communication between the directors and the external auditors, enhancing the independence of the external auditor, increasing the credibility and objectivity of financial reports, and strengthening the role of the directors by facilitating in-depth discussions among directors, management, and the external auditor.⁴²⁰ NI 52-110 also sets financial literacy requirements for audit committee members.⁴²¹ It means that ESG factors, if included in financial reporting, will be subject to the standards of review of the audit committee, providing greater assurance of the accuracy and reasonableness of the disclosures.

Also relevant to this question is National Instrument 52-109 *Certification Disclosure in Issuer's Annual and Interim Filings*⁴²² ("NI 52-109"), which was promulgated to improve the quality, reliability and transparency of annual filings, interim filings and other materials that issuers submit under securities legislation. NI 52-109 requires an issuer's chief executive officer ("CEO") and chief financial officer ("CFO"), or persons performing similar functions to a CEO or CFO (referred to as certifying officers), to personally certify: that the issuer's annual filings and interim filings do not contain any misrepresentations; that the financial statements and other financial information in the annual and interim filings fairly present in all material respects the financial condition, results of operations, and cash flows of the issuer; that they have designed or supervised design of disclosure controls and procedures ("DC&P") and internal control over financial reporting ("ICFR"); that they have caused the issuer to disclose in its MD&A any change in the issuer's ICFR that has materially affected the issuer's ICFR; and, on an annual basis, that they have evaluated the effectiveness of the issuer's DC&P and caused the issuer to disclose their conclusions about the effectiveness of DC&P in the issuer's MD&A.⁴²³

This certification requirement means that if federal corporate law or Canadian securities law is amended to require disclosure of ESG material information in financial statements, the certifying officers of publicly-issuing corporations will have to personally certify the accuracy and quality of the disclosures. They are required to certify that the financial statements fairly present the

⁴²⁰ Condon, Anand, Sarra and Bradley, *Securities Law in Canada*, supra note 248 at 539. Section 2.3(3), *ibid* specifies that an audit committee must be directly responsible for overseeing the work of the external auditor engaged for the purpose of preparing or issuing an auditor's report or performing other audit, review or attest services for the issuer, including the resolution of disagreements between management and the external auditor regarding financial reporting.

⁴²¹ An individual is financially literate if he or she has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the issuer's financial statements; NI 52-110, *ibid*, s 1.6.

⁴²² NI 52-109, *Certification of Disclosure in Issuer's Annual and Interim Filings* (15 December 2008, as amended effective 17 November 2015), online: BCSC <https://www.bsc.bc.ca/Securities_Law/Policies/Policy5/Group/?group=52%20109>.

⁴²³ Condon, Anand, Sarra, and Bradley, *supra* note 248 at 527. NI 52-109, *ibid*, does not define "financial condition," but its companion policy notes that the term "financial condition" in the annual certificates and interim certificates is to reflect the overall financial health of the issuer and includes the issuer's financial position, as shown on the balance sheet, and other factors that may affect the issuer's liquidity, capital resources, and solvency; see 52-109CP (1 January 2011), s 4.2.

financial condition of the issuer, that there are internal controls to ensure that material information is conveyed to decision-makers, and that they have disclosed to the auditor and audit committee any significant deficiencies in internal control and any fraud, material or not, that involved managers or other employees who have a significant role in the company's internal controls.⁴²⁴ This degree of scrutiny will play a pivotal role in the disclosure of ESG financial information, including climate-related financial risk.

Expert Panel Question 3.3(8):

Are there any other standards that could be combined with the TCFD to reduce reporting burden?

1. Canada can benefit from international reporting standards already developed

The TCFD sector-specific disclosure guidance referenced above (see discussion of Expert Panel Question 3.3(5)) has been prepared with a view to aligning TCFD's disclosure recommendations for energy; transportation; materials and buildings; and agriculture, food and forestry with the other leading disclosure standards: the GRI framework; the Carbon Disclosure Project Standards Board; and the SASB standards. As a result, requiring disclosure according with TCFD's proposals, as recommended above, obviates the need to canvass other reporting standards for synergies, as that alignment is already occurring.

Along with an expansion of materiality standards, the Climate Disclosure Standards Board (CDSB) has a framework for identifying material environmental information that should assist organizations in disclosing material climate risks.⁴²⁵ The framework involves an organization's activities that will likely give rise to environmental impacts and affect the organization's operation of its business model and its strategy. The CDSB includes activities such as changes in resource availability, supply, pricing, degradation, and policy constraints that could impact resources and relationships the organization is dependent on.⁴²⁶ For instance, an organization's activity may

⁴²⁴ Condon, Anand, Sarra, and Bradley, *ibid* at 528.

⁴²⁵ Climate Disclosure Standards Board (CDSB), "Position paper: Materiality and Climate-Related Financial Disclosures" (UK: CDSB, 2018) at 6-7, online (pdf): CDSB <https://www.cdsb.net/sites/default/files/materiality_and_tcf_paper.pdf> [CDSB]. Australia, Australian Securities and Investments Commission (ASIC), "Regulatory Guide 228 – Prospectuses: Effective Disclosure for Retail Investors" (November 2016) at 32-34, online (pdf): Government of Australia <<https://download.asic.gov.au/media/4062323/rg228-published-3-november-2016.pdf>>. Nancy Meyer, "Best Practices and Challenges: Using Scenarios to Assess and Report Climate-Related Financial Risk" (August 2018) Center for Climate and Energy Solutions at 2, online (pdf): <<https://www.c2es.org/site/assets/uploads/2018/08/using-scenarios-assess-climate-risk-08-18.pdf>>. Alexia Staker, Alice Garton & Sarah Barker, "Concerns misplaced: Will compliance with the TCFD recommendations really expose companies and directors to liability risk?" (2017) Commonwealth Climate and Law Initiative at 8-9 [Staker et al].

⁴²⁶ CDSB, *ibid*.

cause stakeholders to act against the company in order to protect environmental resources they are negatively impacting.⁴²⁷

V. AN ENHANCED ROLE FOR LENDERS AND INSTITUTIONAL INVESTORS IN THE TRANSITION TO A SUSTAINABLE ECONOMY

Both debt and equity investors have an important role in promoting Canada's transition to a low carbon economy. As noted above, many institutional investors in Canada have already recognized the importance of this role. Internationally, there is considerable leadership whereby institutional investors are committed to identifying and managing portfolio risks in order to facilitate the transition to low emissions, and to accelerate the integration of climate change analysis into the management of large, long-term and diversified asset pools.⁴²⁸ 415 investors with more than \$30 trillion US in assets under management have called on the G7 countries to act now to address climate-related financial risk, including accelerating private sector investment into the low carbon transition and committing to improve climate-related financial reporting.⁴²⁹

In Canada, financial institutions are extremely well-positioned to help shift the trajectory of climate-related financial risk in both their debt and equity investment decisions. Currently, 16 financial institutions and their 51 subsidiaries have an aggregate qualifying market value of \$597.6 billion and comprise 71.2% of all financial services trading on the TSX.⁴³⁰ In addition, there are 71 privately-owned financial institutions, 27 domestic subsidiaries of foreign companies, publicly traded on foreign markets and 175 foreign-owned institutions operating in Canada.⁴³¹ The investment power of these institutions could be effectively deployed in the shift to a sustainable economy. More importantly, absent their active support of the transition, Canada is unlikely to be able to effectively address the impending transition risks to its economy or meet its international commitments under the Paris Agreement.

Yet despite the leadership of some institutional investors,⁴³² there are counter-pressures to moving towards sustainable finance. On the debt side, our significant financial institutions are well resourced to foster the move towards sustainable finance. However, amending fiduciary

⁴²⁷ CDSB, *ibid* at 21. The framework also includes activities that impact the organization's capacity to innovate, its ability to influence natural capital, and brand and reputational consequences. The CDSB additionally emphasizes that GHG emissions should be treated as material and reported in all cases.

⁴²⁸ Sovereign Wealth Funds, "The One Planet Sovereign Wealth Fund Framework" (2018), online (pdf): International Forum of Sovereign Wealth Funds <http://www.ifswf.org/sites/default/files/One_Planet_Sovereign_Wealth_Fund_Framework.pdf>.

⁴²⁹ The Investor Agenda, "Investors call on world leaders to address climate change 'ambition gap'" (10 December 2018), online (pdf): The Investor Agenda <<http://theinvestoragenda.org/wp-content/uploads/2018/12/Investor-Agenda-COP24-press-release-final-06.12.18-1.pdf>>.

⁴³⁰ TSX, *supra* note 47, on file with authors.

⁴³¹ *Ibid*.

⁴³² An example would be Caisse de dépôt et placement du Québec, "CDPQ announces investment strategy to address climate change" (18 October 2017), online: CDPQ <<https://www.cdpq.com/en/news/pressreleases/cdpq-announces-investment-strategy-to-address-climate-change>> [Caisse de dépôt et placement du Québec].

obligation alone will not shift the trajectory. Capital markets have changed significantly in the past two decades in nature and size, in the maturing of Canadian securities regulation that has allowed access to international capital pools, and in the shift from bank lending to public and private market non-bank lending.⁴³³ The ease of capital movement and the accompanying exponential increase in pressure for short-term investor returns has led many companies to pay out dividends in preference to investing in the longer-term sustainability of firms.⁴³⁴ Intercompany credit arrangements have become common, where assets of Canadian companies are encumbered to finance operations of related entities in foreign jurisdictions.⁴³⁵ New products and strategies in the structure of finance, including syndication, securitization and collateralization, have profoundly altered the nature of debt.⁴³⁶ The result has been a fundamental shift in credit relationships from the many years of relational lending to a situation where both domestic and foreign creditors have little interest or direct connection with Canadian domestic corporations and their stakeholders, other than an interest in short-term returns on their investment.

The result of these developments is that directors and officers of financial institutions can fully act in the best interests of their institution and continue their lending practices of financing carbon-intensive sectors. If the risk is fully hedged through securitization of the loan, or the risk substantially reduced through syndicated lending, they will meet the best interests threshold test as currently construed. What is needed, therefore, is more: some action that will ensure lenders shift credit patterns to actually address climate-related financial risk. A first step is disclosure: how are they taking steps in their portfolio construction, oversight of debt compliance and engagement activities to ensure Canada is moving towards a lower carbon economy? Combined with pricing ESG in financial statements, as recommended above, it will encourage financial institutions to move towards more sustainable finance.

The same obligations should be placed on debt and equity institutional investors and asset managers, given the increased market share of private equity funds, mutual funds and pension plan investment firms. It will shift the minds, and hopefully the capital, of institutional investors and asset managers towards potential investments in green infrastructure and technologies.

The federal government should adopt legislation similar to that enacted in France to require institutional investors, including mutual funds and pension funds, to disclose annually the financial risks related to the effects of climate change and the company's measures to reduce them, including how they are implementing a low-carbon strategy in every component of their activities, and how their corporate and investment decision-making is contributing to the energy and ecological transition to limit global warming. Relevant for this report are the requirements

⁴³³ Janis Sarra, "The Oscillating Pendulum: Canada's Sesquicentennial and Finding the Equilibrium for Insolvency Law" in J Sarra and BE Romaine, *Annual Review of Insolvency Law, 2016* (Toronto: Carswell, 2017).

⁴³⁴ *Ibid* at 9. The structure of corporate groups has resulted in the uploading of cash on a frequent basis to the parent company to finance non-domestic related entities, leaving fewer assets in the Canadian debtor to satisfy claims on insolvency, a trend occurring globally.

⁴³⁵ *Ibid*.

⁴³⁶ *Ibid* at 10; with the globalization of business, many cross-border enterprises have grown, both originating in Canada and as subsidiaries of large multinational enterprises.

that institutional investors publish commitments on responsible investment regarding climate change risk, including explanations of how these commitments align with their fiduciary duties.

In 2015, the French National Assembly enacted *La Loi de transition énergétique pour la croissance verte* (the *Law for Energy Transition and Green Growth*), aimed at reducing GHG emissions, capping fossil fuel production and increasing renewable energy usage.⁴³⁷ Article 173 of the *Law* introduces the first mandatory requirements for institutional investors, including mutual funds and pension funds.⁴³⁸ Institutional investors must disclose how their investment decision-making takes ESG criteria into consideration, and disclose how they are contributing to the energy and ecological transition to limit global warming.⁴³⁹ The law is an important step forward in addressing climate financial risk, both in the transparent and accountable reporting required and the obligation to disclose the specific manner in which climate change issues are being addressed.

The European Commission has proposed that institutional investors and money managers demonstrate how their investments align with ESG factors under proposed regulations pursuant to its action plan for financing sustainable growth.⁴⁴⁰ Among the proposals are regulations to introduce consistency and clarity on how institutional investors, including pension funds and insurance companies, should integrate ESG in investment decision-making processes. In November 2018, the European Commission adopted a strategic long-term vision for a prosperous, modern, competitive and climate neutral economy by 2050, “A Clean Planet for

⁴³⁷ French National Assembly, *Law for Energy Transition and Green Growth* (22 July 2015). On 18 November 2015, modifications were made to the *Code de l’environnement* – L222-1 in response to Article 173 of the *Law for Energy Transition and Green Growth* (“*Transition énergétique*”). The amendments address carbon budgets and national low-carbon strategy, regulating the quantity of greenhouse gases of certain types of large-scale operation, converting energy consumed or waste processed into corresponding emission factors. Emissions are recorded annually, excluding international air and sea links, under France’s carbon budgets as set out by the European Commission and the UN Convention on Climate Change, UN FCCC, *supra* note 332. On 19 August 2016, modifications were made to the *Code de commerce* – Art R225-105-1(M) in response to Articles 70 and 173 of the *Transition énergétique*. The *Commercial Code* now includes a section on Environment information:

- A. General policy on the environment, including that environmental assessment must be made where appropriate, employees trained to protect the environment, and steps be taken to prevent environmental risks and pollution;
- B. Pollution, including measures to reduce or repair damage;
- C. Economical waste management, including recycling, reuse, use of sustainable resources, and the minimization of energy consumption;
- D. Climate change, particularly significant emissions from the use or development of the company’s product;
- E. Protection of biodiversity.

The amendment also added societal commitments to sustainable development, including a commitment to use resources sustainably and to adapt to the consequences of climate change, *ibid*.

⁴³⁸ As well as investment companies with variable share capital, *ibid*.

⁴³⁹ As well as how they exert the voting rights attached to the financial instruments resulting from those choices. “Environmental” includes the exposure to climate-related risks, including GHG emissions associated with assets owned, *ibid*.

⁴⁴⁰ European Commission, *A Clean Planet for all – A European strategic long-term vision for a prosperous, modern, competitive and climate neutral economy*, COM(2018) 773 final (28 November 2018), online (pdf): Europa <https://ec.europa.eu/clima/sites/clima/files/docs/pages/com_2018_773_en.pdf>.

All".⁴⁴¹ The strategy focuses on investing in realistic technological solutions, empowering citizens, and aligning action in key areas such as industrial policy, finance and research, while ensuring social fairness for a just transition.⁴⁴² The Action Plan on Sustainable Finance is aimed at connecting finance with the EU's agenda for sustainable development, while the European Commission's proposal for a unified classification system or taxonomy on sustainable economic activities and proposed rules for low-carbon benchmarks and improved disclosure requirements for investment products is aimed at enhancing transparency and helping investors with targeting the right investments.⁴⁴³

We have an excellent role model within Canada. The Caisse de dépôt et placement du Québec (CDPQ) has an impressive investment strategy to address climate change, which is built on four pillars:

1. CDPQ is factoring in climate change in every investment decision.
2. CDPQ is committed to increasing its low carbon investments by 50%, \$8 billion, by 2020.
3. CDPQ is committed to reducing its carbon footprint by 25% per dollar invested by 2025, setting a carbon target covering all its asset classes.
4. CDPQ is committed to exercising strong leadership in accounting for climate risk and will publish audited information on its portfolio's GHG emissions annually.⁴⁴⁴

CDPQ's strategy offers a frame of reference for what the federal government could mandate. Recommendation 24 on disclosure would be an important first step. While this report discusses ESG disclosure at length, the role of institutional debt and equity investors in addressing climate-related financial risk and opportunity is of such importance, it is deserving of its own targeted recommendation.

Recommendation 24:

The federal government should adopt requirements to require debt and equity institutional investors and asset managers, including mutual funds and pension funds, to disclose annually the financial risks related to the effects of climate change and the company's measures to reduce them, including how they are implementing a low-carbon strategy in each component of their activities, and how their corporate and investment decision-making is contributing to the energy and ecological transition to limit global warming.

⁴⁴¹ *Ibid.* See also European Commission – Press release, “The Commission calls for a climate neutral Europe by 2050” (28 November 2018), online (pdf): Europa <http://europa.eu/rapid/press-release_IP-18-6543_en.htm>.

⁴⁴² *Ibid.*

⁴⁴³ *Ibid.* at 18.

⁴⁴⁴ Caisse de dépôt et placement du Québec, *supra* note 432 at 3.

VI. INITIATING THE REFORM PROCESS

The recommendations that we have made are extensive, and both the Expert Panel and the federal government are likely to have priorities in what legislative reform is addressed first. We note that of the 72 questions posed by the Expert Panel, the majority will not require legislative change. However, our recommendations focus on areas of law that are already codified and require amendment to reflect developments in the common law and in international standards. The executive summary sets out our top four priorities.

If addressed on an individual statute basis, the process is clear: a bill proposing a new law or amendments to existing law is introduced in either the Senate or the House of Commons, often after a public consultation process on possible amendments to existing statutes or a new draft bill. The bill is tabled, then debated in the chamber of Parliament, and if approved for further consideration, it is sent to a parliamentary committee for study and amendments if needed. The bill is then brought for final reading and a vote; if it passes, it goes to the other chamber and the process is repeated. Once the bill has been passed by both Chambers in identical form, it goes to the Governor General for Royal Assent and is in force in Canadian law on a named date.

On a statute by statute basis, easiest to amend is the *CBCA* because it has a well-established consultation and legislative process, as evidenced by recent amendments on board diversity. One option would be to start with the *CBCA* and then work to amend the other federal incorporation statutes to align. If the approach is to be statute by statute, we recommend that the *Bank Act* and the *Insurance Companies Act* would also be the highest priorities, in terms of impact. We note, however, that the recent amendments to the corporate board diversity provisions simultaneously amended the *CBCA*, the *Canada Cooperatives Act*, the *Canada Not-for-profit Corporations Act* and the *Competition Act*,⁴⁴⁵ so there is recent precedent for amending a number of statutes on the same issue in one parliamentary bill.

The federal government should also implement a more overarching strategy on sustainable finance by having a “framework strategy”, which it has used recently in its process regarding a federal financial sector framework. In this framework strategy, the federal government examined, on a broader basis, how to advance a financial sector legislative and regulatory framework that supports stability, in terms of safety, soundness and resilience; efficiency, in terms of encouraging competitively priced products and services, including efficiency gains to customers, accommodating innovation, and effectively contributing to economic growth; and utility, in terms of meeting the needs of an array of consumers, including businesses, individuals and families.⁴⁴⁶ It commenced with a 2016 consultation paper and process, publishing responses and submissions.⁴⁴⁷ It then conducted a second consultation stage in 2017 that proposed specific

⁴⁴⁵ *An Act to amend the Canada Business Corporations Act, the Canada Cooperatives Act, the Canada Not-for-profit Corporations Act and the Competition Act*, SC 2018, c 8.

⁴⁴⁶ Government of Canada, “Department of Finance Canada Launches Consultations to Review the Federal Financial Sector Framework” [Archived] (26 August 2016), online: Government of Canada <<https://www.fin.gc.ca/n16/16-105-eng.asp>>.

⁴⁴⁷ *Ibid.*

policy measures.⁴⁴⁸ That process is in the final stages, the Department of Finance Canada now working on legislative reforms for consideration by Parliament prior to the statutory sunset date of 29 March 2019, as well as having the suggestions and recommendations inform the Department's longer-term approaches to the financial sector.⁴⁴⁹

In terms of the Expert Panel's recommendations, the recommendations for federally-regulated financial institutions, recommendations 7 to 13 of our report, should be included in the legislative proposals coming forward in early 2019. They meet the express goals of the financial framework process: stability, efficiency and utility; and are aimed at the protection of consumers, businesses and other stakeholders. It would result in treating the federally-regulated financial institutions on a level playing field in terms of ESG requirements being embedded in law.

The Expert Panel should also recommend a framework approach to the fiduciary obligations of all federally-regulated entities and ESG considerations such as we have proposed here. It should propose a series of legislative changes related to ESG across a variety of statutes as a framework approach to effective governance and risk management, seeking community responses to the express proposals and initiating the parliamentary process. That would assist in developing a broad-based policy approach to ESG, and assist in creating a level playing field, as all federally-registered companies would be subject to the new provisions at the same time.

Most of the recommendations in our report fall directly under federal jurisdiction and thus could be implemented using one of these strategies. A few call on federal-provincial cooperation, which, as noted in this report, will take more time and energy, but are nonetheless possible.

On climate-related financial risk more specifically, the Expert Panel should consider whether some of its recommendations fall within the current federal government process of climate action incentives, the public consultation process of which just closed.⁴⁵⁰ This process follows on enactment of the *Greenhouse Gas Pollution Pricing Act*,⁴⁵¹ but looks more systemically on creating pricing incentives to shift Canada to a lower carbon economy. Some of its recommendations may align with the federal government's efforts to address these issues in a timely manner.

VII. A MECHANISM FOR ONGOING DIALOGUE AND POLICY DEVELOPMENT

The Expert Panel should also consider making a recommendation to the federal government to establish a longer-term mechanism for ongoing dialogue and actions on aligning financial policies and regulations with low carbon sustainable economy transition, so that there is a mechanism in

⁴⁴⁸ Government of Canada, "Department of Finance Canada Launches Second Stage of Consultations on Federal Financial Sector Framework" (11 August 2017), online: Government of Canada <<https://www.fin.gc.ca/n17/17-074-eng.asp>>.

⁴⁴⁹ *Ibid.*

⁴⁵⁰ Government of Canada, "Department of Finance Announcing Climate Action Incentive Payments and Launch of Fuel Charge Consultations" (23 October 2018), online: Government of Canada <<https://www.fin.gc.ca/n18/18-097-eng.asp>>.

⁴⁵¹ *Greenhouse Gas Pollution Pricing Act*, SC 2018, c 12, s 186.

place for evolution of fiduciary obligation, disclosure and transition strategies, and a coordinated source for information on developments internationally as they occur. It is critically important that the government stay engaged with the financial sector regarding the shift to a low carbon economy, and that this engagement also includes other sectors of the economy, as well as Indigenous peoples, and both urban and rural communities across Canada. The transition is both challenging and exciting, and what is needed is a range of financial and other expert conversations, including how best to leverage Canada's natural and financial assets in this transition.

One possible option is an institute on sustainable finance. There are different models. The UK Government and the City of London have co-created and co-funded, in 2019 a new Green Finance Institute that will act as the focal point for future UK green finance activity, a "one-stop-shop for world-leading climate science, and for capital".⁴⁵² The Green Finance Institute is aimed at accelerating green finance across a range of thematic areas, including green fintech solutions, advancing international partnerships, supporting green finance policy and enhancing communications and branding.⁴⁵³ It is to advance an innovative, coordinated agenda to ensure London's green finance approach continues to represent the cutting edge; work with other Green Finance centres to shape international dialogues on green and sustainable finance; partner with the private sector to deliver recommendations and support the UK Government's Green Finance Strategy; collaborate with universities to promote innovation and data analytics; and work closely with the UK Government and regulators to ensure policy that supports the growth of green and sustainable finance.⁴⁵⁴

The UK Green Finance Institute has been created at the same time as a new venture capital fund, the Clean Growth Fund, in which the UK will invest £20 million, alongside at least £20 million from private investors, in an investment fund to support new clean technology at early stages, making direct investments in companies seeking to commercialize promising innovative green solutions.⁴⁵⁵ It has sought proposals from prospective fund managers that will be responsible for raising the private sector portion of fund investment of 50% or more.⁴⁵⁶

Other models include university-based models. The Smith School of Business Oxford Sustainable Finance Programme at Oxford University and its Global Sustainable Finance Advisory Council is researching environment-related risks, impacts, and opportunities across different sectors and

⁴⁵² UK Green Finance Initiative, "Green Finance Institute" (announced by the UK Chancellor on 21 June 2018), online: City of London <<http://greenfinanceinitiative.org/green-finance-institute/>>. UK Government, Department for Business, Energy & Industrial Strategy, "Clean Growth Fund: Request for Proposals" (2018), online (pdf): City of London <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/748943/CGF_RFP.pdf>.

⁴⁵³ UK Green Finance Initiative, "CEO Job Description" (2018), online (pdf): City of London <<http://greenfinanceinitiative.org/wp-content/uploads/2019/01/Job-Information-Pack-GFInstitute-CEO.pdf>>.

⁴⁵⁴ *Ibid.*

⁴⁵⁵ UK Government, Department for Business, Energy & Industrial Strategy, "Driving ambition in green finance" (17 October 2018), online (pdf): City of London <<https://www.gov.uk/government/news/driving-ambition-in-green-finance>>.

⁴⁵⁶ *Ibid.*

asset classes; how such factors are emerging and how they positively or negatively affect asset values; how they might be interrelated or correlated; their materiality (in terms of scale, impact, timing, and likelihood); who will be affected; and what affected groups can do to pre-emptively manage risk.⁴⁵⁷ Also in the UK, the Cambridge Centre for Sustainable Finance at Cambridge University is aimed at building a sustainable financial system through strong partnerships that bridge traditional academic and industry boundaries. It is developing research on the efficacy of regulatory standards and practices in promoting the movement of capital into sustainable business; the governance of the financial system with respect to the Sustainable Development Goals; the potential gains and losses in financial markets as a consequence of climate change, inequality and ecosystem degradation; whether responsible investment practices create more stable and profitable institutions; and the impact of active ownership and engagement on corporate sustainability performance.⁴⁵⁸

Similarly, Canada needs an independent research and policy body that can assist both public and private sectors to build capacity.

Recommendation 25:

The Expert Panel should recommend that the federal government create a Sustainable Finance Institute aimed at accelerating green finance and a sustainable Canadian economy, including working with the private sector, regulators, universities, non-governmental organizations, and green finance institutes internationally to further develop green finance policy, innovative strategies, data and metrics.

VIII. CONCLUSION

The interim report of the Expert Panel on Sustainable Finance was an important first step in the public policy discussion regarding how to ensure Canada is sustainable financially in the long term. All of the questions posed in the report need careful consideration and specific proposals need to be developed, but the policy recommendations generated must be timely and should be implemented expeditiously. For climate-related financial risk, there is an urgent time imperative that affects all Canadians in their daily economic and social lives. There is also the requirement to act in order to meet Canada's international commitments. For ESG more generally, it merits serious consideration of expanding the need to address climate-related risks and opportunities to these other important factors. It is hoped that our response to 12 of the 72 questions posed by the Expert Panel contributes to moving the federal government forward to take action now.

⁴⁵⁷ Smith School of Business Oxford, "Sustainable Finance Programme" (2019), online: University of Oxford <<https://www.smithschool.ox.ac.uk/research/sustainable-finance/>>. See also The Global Research Alliance for Sustainable Finance and Investment (the "Alliance"), which was founded in 2017 to promote multi-disciplinary academic research on sustainable finance and investment across more than 20 universities globally: Global Research Alliance, "Welcome" (2019), online: Sustainable Finance Alliance <<https://www.sustainablefinancealliance.org/>>.

⁴⁵⁸ Cambridge Institute for Sustainability Leadership, "About the Centre for Sustainable Finance" (2019), online: University of Cambridge <<https://www.cisl.cam.ac.uk/research/centre-for-sustainable-finance/about>>.

APPENDIX 1 Summary of Recommendations

Recommendation 1:

The current fiduciary obligation under the *CBCA* should be amended to incorporate ESG factors as follows (in red italics):

Duty of care of directors and officers

122 (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall

- (a) act honestly and in good faith with a view to the best interests of the corporation;
- (b) consider environmental, social and governance factors with a view to the best interests of the corporation;*
- (c) take all reasonable care to address any material issues relating to environmental, social and governance factors with a view to the best interests of the corporation;* and
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

122(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

Recommendation 2:

Amend section 148 of the *Canada Not-for-profit Corporations Act*⁴⁵⁹ to read (in red italics):

Duties of directors and officers

148 (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall

- (a) act honestly and in good faith with a view to the best interests of the corporation;
- (b) consider environmental, social and governance factors with a view to the best interests of the corporation;*
- (c) take all reasonable care to address any material issues relating to environmental, social and governance factors with a view to the best interests of the corporation;* and
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

⁴⁵⁹ *NFP Corporations Act*, supra note 81.

148(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, members, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

Recommendation 3:

The fiduciary obligation of the directors and officers pursuant to the *Canada Pension Plan Investment Board Act* is virtually the same as many other federal statutes and the *Act* should be amended to incorporate ESG as follows (in red italics)

Duty of care

14 (1) Every director and officer of the Board in exercising any of the powers of a director or an officer and in discharging any of the duties of a director or an officer shall

- (a) act honestly and in good faith with a view to the best interests of the Board;
- (b) consider environmental, social and governance factors with a view to the best interests of the corporation;*
- (c) take all reasonable care to address any material issues relating to environmental, social and governance factors with a view to the best interests of the corporation;* and
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

Special knowledge or skill

14(2) A director or officer of the Board who in fact possesses, or by reason of profession or business ought to possess, a particular level of knowledge or skill relevant to the director's or officer's powers or duties shall employ that particular level of knowledge or skill in the exercise of those powers or the discharge of those duties.

14(3) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

Recommendation 4:

Amend sections 8(4.1) and 8(4.2) of the *Canada Pension Benefits Standards Act* by adding the follow language (in red italics):

Manner of investing assets

8(4.1) The administrator shall invest the assets of a pension fund in accordance with the regulations and in a manner that a reasonable and prudent person would apply in respect of a portfolio of investments of a pension fund, *and in exercising this authority, will consider environmental, social and governance factors.*

Investment choices

8(4.2) A pension plan may permit a member, former member, survivor or former spouse or former common law partner of a member or former member to make investment choices with respect to their account maintained in respect of a defined contribution provision or with respect to their account maintained for additional voluntary contributions, *and to inform that choice, the pension administrator should provide information on environmental, social and governance factors to the member, former member, survivor or former spouse or former common law partner of a member or former member for their consideration on each fund offered.*

Recommendation 5:

The Pension Benefits Standards Regulations should be amended to specify that ESG factors must be considered and incorporated in the SIP&P. The federal government should amend section 7.1 of the Pension Benefit Standards Regulation to require:

The Statement of Investment Policies and Procedures required under section 7.1 shall contain information as to how environmental, social and governance factors have been considered and have been incorporated into the plan's investment policies and procedures.

Recommendation 6:

The Expert Panel should recommend to the federal government to require federal Crown corporations to consider whether there are material ESG risks and opportunities, and where they exist, to take all reasonable care to address the material ESG factors.

Recommendation 7:

For greater certainty, the *Bank Act* sections 158 and 748 on fiduciary obligations of banks and bank holding companies should be amended to read (in red italics):

158 (1) Every director and officer of a bank in exercising any of the powers of a director or an officer and discharging any of the duties of a director or an officer shall

- (a) act honestly and in good faith with a view to the best interests of the bank;
- (b) consider environmental, social and governance factors with a view to the best interests of the bank;*
- (c) take all reasonable care to address any material issues relating to environmental, social and governance factors with a view to the best interests of the bank;* and
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

158(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, depositors, deposit insurance protection funds, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

...

Duty of care

748 (1) Every director and officer of a bank holding company in exercising any of the powers of a director or an officer and discharging any of the duties of a director or an officer shall

- (a) act honestly and in good faith with a view to the best interests of the bank holding company;
- (b) consider environmental, social and governance factors with a view to the best interests of the bank;*
- (c) take all reasonable care to address any material issues relating to environmental, social and governance factors with a view to the best interests of the bank;* and
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

748(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, depositors, deposit insurance protection funds, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

Recommendation 8:

Amend the fiduciary obligations of directors and officers under the *Canada Cooperatives Act* as follows (in red italics):

Duties

80 (1) Every director and officer must, in exercising the powers and performing the duties of office,

- (a) act honestly and in good faith with a view to the best interests of the cooperative;

- (b) consider environmental, social and governance factors with a view to the best interests of the corporation;*
- (c) take all reasonable care to address any material issues relating to environmental, social and governance factors with a view to the best interests of the corporation;* and
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

80(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, depositors, deposit insurance protection funds, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

Recommendation 9:

Amend the fiduciary obligation of directors and officers under section 168(1) of the *Cooperative Credit Associations Act* as follows:

Duty of care

168 (1) Every director and officer of an association in exercising any of the powers of a director or an officer and discharging any of the duties of a director or an officer shall

- (a) act honestly and in good faith with a view to the best interests of the association;
- (b) consider environmental, social and governance factors with a view to the best interests of the corporation;*
- (c) take all reasonable care to address any material issues relating to environmental, social and governance factors with a view to the best interests of the corporation;* and
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

168(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, depositors, deposit insurance protection funds, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

Recommendation 10:

Amend the fiduciary obligations under the federal *Trust and Loan Companies Act* as follows (in red italics):

Duty of care

162 (1) Every director and officer of a company in exercising any of the powers of a director or an officer and discharging any of the duties of a director or an officer shall

- (a) act honestly and in good faith with a view to the best interests of the company;
- (b) consider environmental, social and governance factors with a view to the best interests of the bank;*
- (c) take all reasonable care to address any material issues relating to environmental, social and governance factors with a view to the best interests of the bank;* and
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

162(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, depositors, deposit insurance protection funds, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

Recommendation 11:

Amend the fiduciary obligations of directors and officers of insurance companies and insurance holding companies in the *Insurance Companies Act* as follows (in red italics):

166 (1) Every director and officer of a company in exercising any of the powers of a director or an officer and discharging any of the duties of a director or an officer shall

- (a) act honestly and in good faith with a view to the best interests of the company;
- (b) consider environmental, social and governance factors with a view to the best interests of the corporation;*
- (c) take all reasonable care to address any material issues relating to concerns environmental, social and governance factors with a view to the best interests of the corporation;* and
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

166(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, policyholders, insurance protection funds, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

...

Duty of care

795 (1) Every director and officer of an insurance holding company in exercising any of the powers of a director or an officer and discharging any of the duties of a director or an officer shall

- (a) act honestly and in good faith with a view to the best interests of the insurance holding company;
- (b) consider environmental, social and governance factors with a view to the best interests of the corporation;*
- (c) take all reasonable care to address any material issues relating to concerns environmental, social and governance factors with a view to the best interests of the corporation and*
- (d) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

795(2) In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, policyholders, insurance protection funds, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.

Recommendation 12:

The Expert Panel should recommend that the Office of the Superintendent of Financial Institutions include in its supervisory oversight of federally-regulated financial institutions material ESG factors that pose a risk to capital adequacy and liquidity of these institutions. This requirement would provide greater certainty and transparency of management of ESG risks and opportunities.

Recommendation 13:

Amend the *Bank of Canada Act* to add the following language (in red italics):

- 1. The directors and officers, in carrying out their duties under this Act, shall in good faith consider any material environmental, social and governance factors that may affect the Bank fulfilling its statutory mandate.*
- 2. In exercising their powers and duties under the Act, directors and officers may consider the interests of, inter alia, members of the public, shareholders, employees, retirees, creditors, consumers, governments and the environment to inform their decisions.*

The provision limiting liability should be amended to account for ESG factors in the following way (in red italics):

No liability if in good faith

30.1 No action lies against Her Majesty, the Minister, any officer, employee or director of the Bank or any person acting under the direction of the Governor for anything done or omitted to be done in good faith in the administration or discharge of any powers or duties that under this Act are intended or authorized to be executed or performed, *including their consideration of environmental, social and governance factors in carrying out their duties under this Act.*

Recommendation 14:

The Expert Panel should recommend that financial advisers be required to include information on material ESG factors in giving financial advice to consumer or retail investors.

Recommendation 15:

The federal government should work with IIROC, MFDA and investment firms to develop new requirements that investment advisers and distributors ask about their clients' preferences regarding ESG factors and take them into account when assessing the range of financial instruments and insurance products being recommended.

Recommendation 16:

- i. Require material ESG factors, including climate-related financial disclosures, to be reported in annual financial filings.
- ii. Ask the Canadian Accounting Standards Board to review the industry specific standards promulgated by the Sustainability Accounting Standards Board for purposes of adoption in Canada.
- iii. The federal government should work with Canadian accounting standards authorities and securities regulators to provide tools to assist companies to embed ESG disclosure in publicly-listed corporations' financial statements and notes to financial statements.

Recommendation 17:

- i. Require disclosure of management's approach to material ESG risks and opportunities in management's proxy circular in conjunction with the annual meeting.

- ii. Create a consultation process to evaluate using a “sustainability disclosure and analysis” (“SD&A”) reporting tool for the proxy circular ESG disclosure.

Recommendation 18:

The Expert Panel should consider recommending a move to bi-annual and annual financial statements for larger issuers and only annual financial statements for venture and smaller issuers (by market cap) as one means to focus on longer-term sustainability and relieve some of the resource pressures in shifting to an ESG governance framework.

Recommendation 19:

- i. The new national Authority under the draft Capital Markets Stability Act should require companies to disclose and address material climate-related financial risk in its initial regulations, and should peg requirements to international standards as they develop.
- ii. The new national Authority under the draft Capital Markets Stability Act should assess whether there is a need to address material environmental, social and governance systemic risk more generally, in terms of risk to the stability of the country’s financial system as a whole and the potential to have a material adverse effect on the Canadian economy.
- iii. The new national Authority under the draft Capital Markets Stability Act should negotiate with securities administrators across Canada to embed a staged approach to TCFD disclosure within provincial securities regulation, where applicable and as standards develop.

Recommendation 20:

The federal government should endorse the TCFD disclosure framework, recognizing that it is continuing to develop.

Recommendation 21:

- i. The government should establish criteria to recognize leaders in sustainability disclosure in each size category (small, medium, large, national champions) and constitute a Council of Sustainability Leaders.

- ii. The government should facilitate dialogues between investors and companies to develop mutual understandings of what types of sustainability disclosure is most valuable to investors.

Recommendation 22:

The federal government should encourage securities regulators and the CSA to direct companies to use the TCFD sector guidance and SASB guidance when determining the materiality of climate-related disclosures and when disclosing information about governance, risk management, company strategy, and targets and metrics within the construct of their continuous disclosure.

Recommendation 23:

The Expert Panel should recommend an ESG disclosure “safe harbour” to protect duly diligent directors and officers (possible draft language in red italics):

DISCLOSURE OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE INFORMATION

1. *Environmental Social and Governance (ESG) Information*
 - (1) *This Part applies to ESG information that is disclosed by a reporting issuer other than ESG information contained in oral statements.*
2. *Disclosure*
 - (1) *A reporting issuer that discloses material ESG information must include disclosure that*
 - (a) *cautions users of the ESG information that actual results may vary in the future due to refinements in metrics to measure risks and opportunities and identifies material risk factors that could cause results to differ materially from the reported ESG information;*
 - (c) *states the material factors or assumptions used to develop the ESG information; and*
 - (d) *describes the reporting issuer’s policy for updating ESG information.*
 - (2) *ESG outlook information that is based on assumptions that are reasonable in the circumstances must, without limitation,*
 - (a) *be limited to a period for which the information in the ESG outlook can be reasonably reported or be estimated; and*
 - (b) *use the accounting policies the reporting issuer expects to use to prepare its historical financial statements for the period covered.*
 - (3) *This Part does not apply to disclosure that is (a) subject to requirements in National Instrument 51-101 Standards of Disclosure for Oil and Gas*

Activities or National Instrument 43-101 Standards of Disclosure for Mineral Projects; made to comply with the conditions of any exemption from the requirements that a reporting issuer received from a regulator or securities regulatory authority unless the regulator or securities regulatory authority orders that this Part applies to disclosure made under the exemption; or contained in an oral statement.

3. Reasonable Basis

A reporting issuer is not required to disclose ESG information unless the issuer has a reasonable basis for considering the information to be material.

4. A reporting issuer that discloses ESG information must include disclosure that states the date management approved the ESG information.

5. ESG Financial Information

- (1) A reporting issuer must not disclose ESG financial information unless it is reasonable in the circumstances,

 - (a) is limited to a period for which the information in the ESG financial information or financial outlook can be reasonably measured or estimated; and*
 - (b) use the accounting policies the reporting issuer expects to use to prepare its historical financial statements for the period covered by the ESG information or the financial outlook.**
- (2) The issuer must explain the ESG financial information in the financial statements and the notes to the financial statements.*
- (3) The issuer must disclose the date management approved the ESG financial information and explain the purpose of the ESG financial information and caution readers that the information may not be appropriate for other purposes.*
- (4) The issuer must disclose any year to year change in reporting ESG metrics used.*

Recommendation 24:

The federal government should adopt requirements to require debt and equity institutional investors and asset managers, including mutual funds and pension funds, to disclose annually the financial risks related to the effects of climate change and the company's measures to reduce them, including how they are implementing a low-carbon strategy in each component of their activities, and how their corporate and investment decision-making is contributing to the energy and ecological transition to limit global warming.

Recommendation 25:

The Expert Panel should recommend that the federal government create a Sustainable Finance Institute aimed at accelerating green finance and a sustainable Canadian economy, including working with the private sector, regulators, universities, non-governmental organizations, and green finance institutes internationally to further develop green finance policy, innovative strategies, data and metrics.