What investors need to know about changes in regulation for disclosure and management of climate-related financial risks and opportunities

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CEC and CCLI webinar
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Canada Climate Law Initiative | L'Initiative canadienne de droit climatique

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A global baseline of sustainability disclosures

Image: Nairametrics

Canadian securities law

Canadian Securities Administrators (**CSA), Staff Notice 51-358 Reporting of Climate Change-related Risks,** 2019 – climate change is mainstream risk; boilerplate disclosure no longer acceptable; and issuer must disclose material climate related risks

CSA, Proposed **NI 51-107 Disclosure of Climate-related Matters** (and Companion Policy) October 2021

- governance and risk management of climate-related risks must be reported **regardless of materiality** (TCFD)- board's oversight and management's role in assessing and managing climate-related risks and opportunities
- strategy, targets, and metrics reporting, **only if material.**
- **disclosure of Scope 1, 2, and 3 emissions, on 'comply-or-explain' basis**– but not require 3rd party verification as to why not able to (TCFD Scope 1 and 2, irrespective of materiality)
- Two-year time-lag once comes in force

Image: CSA

Canadian Securities Administrators (CSA) October 2022

CSA still reviewing ISSB developments and SEC proposed rule and reviewing submissions.

Stan Magidson, Chair of CSA and Chair/CEO of the Alberta Securities Commission:

> "Climate-related disclosure standards that elicit consistent and comparable disclosure for investors and that **support a comprehensive global baseline of sustainability disclosures are a priority for the CSA**… we are working towards disclosure requirements that support the assessment of sustainability-related risks, reduce market fragmentation and contribute to efficient capital markets while considering the needs and capabilities of issuers of different sizes."

The ongoing assessment of key international climate-related rule proposals is intended to inform a CSA rule that serves the needs of Canadian capital markets, has considered international consensus, responds to Canadian investor needs, and reflects the realities of Canadian issuers.

CSA ACVM
Canadian Securities Administrators
Autorités canadiennes en valeurs mobilières

Image: CSA

Greenwashing

CSA, 2022:

Audit committees and external auditors must be diligent in fulfilling their responsibilities to ensure that investors receive accurate, transparent, and timely information that supports investment decisions.

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CSA SN 51-364 Continuous Disclosure Review Program Activities (3 November 2022) Overly Promotional Disclosure (Greenwashing)

- Disclosures pertaining to ESG or sustainability have grown rapidly
- ESG/sustainability used to refer to a wide variety of factors – e.g., biodiversity, climate risks, carbon and other GHG emissions, diversity and inclusion, human rights, Indigenous reconciliation
- Breadth can make using the terms misleading if there is not more specific disclosure about the particular factors being considered and how they are being measured and evaluated.
- CSA observes an increase in issuers making potentially misleading, unsubstantiated or otherwise incomplete claims about business operations or the sustainability of a product or service being offered, conveying a false impression commonly referred to as "greenwashing"
- CSA has identified greenwashing in continuous disclosure documents & voluntary documents (ESG reports)
- **When describing current and proposed ESG related activities, issuers should avoid misleading promotional language. All public disclosures, whether voluntary or required are factual and balanced.**

CSA Example of Deficient Disclosure – Greenwashing

Example:

• The company plans to be carbon neutral by 2023.

• Strategic relationship with high-quality partners attentive to environmental stewardship and performance enhance our long-term value. Our key partner exemplifies this by setting aggressive emissions reduction targets and investing in multiple environmental/economic-enhancing technologies.

• The Company is a global leader in environmental solutions.

CSA Example of Deficient Disclosure (cont'd)

CSA analysis:

- Issuer made an unsubstantiated claim stating that it would be carbon neutral in the very near term. Unless this statement can be supported by facts and corporate activities, it is misleading.

- This type of statement will typically constitute forward-looking information (FLI). An issuer must not disclose FLI unless the issuer has a reasonable basis for the FLI. **Any disclosure regarding material FLI should include any material risks factors that could cause actual results to differ materially, state the material factors or assumptions used to develop the FLI and describe its policies for updating the information.**

- Issuer included promotional language with respect to its partnerships, as there were no accompanying disclosures to support the issuer's claims about a key partner being "high-quality" or its "aggressive emissions reduction targets".

- Issuer described itself as being a global leader despite having generated only nominal revenue from its operating activities.

Canadian financial services law - OSFI, draft Guideline B-15 Climate Risk Management, 2022

Will apply to federally-regulated financial institutions – 81 banks, 221 insurers.
Consultation period completed

- Comprehensive guidelines governance, risk management, strategy, metrics and targets, with detailed guidance on what each of these requirements look like,.

- Mandate to protect safety and soundness of financial institutions and the financial system – so will also require embedded in **internal capital assessment** and **risk appetite framework**, with **stress testing using scenarios**; identify and measure the potential impact of climate-related risks on its portfolio of exposures (eg, credit, market, operational, insurance, and liquidity) over appropriate time horizons and relevance to risk management systems

- Will require transition plans in the path to low-carbon economy
- Larger FI scope 1 to 3 emissions, then smaller entities later
- Expected to be finalized in early 2023

Sustainable Finance Action Council (SFAC) Proposed Canadian Transition Taxonomy, 2022

SFAC has recommended a green and transition taxonomy to the federal government.

Proposed is:

- Phase 1 will be to publish a short-form taxonomy covering priority sectors and activities by mid-2023, and lay the foundation for the long term, including governance, funding, and strategic planning.
- Phase 2 will be to fully implement the Taxonomy initiative and publish a substantially more complete and detailed taxonomy by end-2025.

The taxonomy will address criteria to be eligible to issue green and/or transition financial instruments:

- company-level net-zero target setting, transition planning, and effective climate disclosure
- evaluation of project against framework criteria to determine whether ‘green’ or ‘transition’; and
- meet a “do no significant harm to other ESG objectives” threshold.

Expected to be public in next week or two.

Net zero capital allocation initiative

International Financial Reporting Standards International Sustainable Standards Board (ISSB)

Two exposure drafts, 2022

IFRS S2 Climate-related Disclosures

IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information

Aiming for early 2023

Exposure Draft IFRS Sustainability Disclosure Standard International Sustainability Standards Board [Draft] IFRS **S2 Climate-related Disclosures** (March 2022)

Objective is to require an entity to disclose information about its exposure to significant climate-related risks and opportunities, enabling users of an entity’s general purpose financial reporting to assess:

- the effects of significant climate-related physical and transition risks and opportunities on the entity’s enterprise value;
- to understand how entity’s use of resources, activities, outputs and outcomes support the entity’s response to and strategy for managing its significant climate-related risks and opportunities; and
- to evaluate the entity’s ability to adapt its planning, business model and operations to significant climate-related risks and opportunities.

ISSB/IFRS S2 - Governance

Disclose information about the governance body with oversight and management of climate-related risks and opportunities, and information about management's role:

- How board is ensuring that the appropriate skills and competencies are available to oversee and manage strategies to respond to climate-related risks and opportunities
- Frequency of assessing strategy and how embedded in decisions on major transactions
- Risk management policies, including any assessment of trade-offs and analysis of sensitivity to uncertainty that may be required
- How oversee the setting of targets related to significant climate-related risks and opportunities, and monitor progress towards them
- Whether and how related performance metrics are included in manager remuneration policies

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ISSB/IFRS S2 - Strategy

Disclosure must enable users of general-purpose financial reporting to understand an entity's strategy for addressing significant climate-related risks and opportunities.

Disclose information about:

- significant climate-related risks/opportunities that it reasonably expects could affect business model, value chain, strategy and cash flows, access to finance and cost of capital, over short, medium or long term
- effects of significant climate-related risks and opportunities on its strategy and decision-making, including its transition plans
- effects on financial position, financial performance and cash flows for the reporting period, and the anticipated effects over short, medium and long term (including financial planning)
- results of the analysis of climate resilience, to enable users to understand - implications for its strategy, including how it would need to respond to the effects and significant areas of uncertainty considered in the analysis of climate resilience; and entity's capacity to adjust or adapt its strategy and business model over different time horizons

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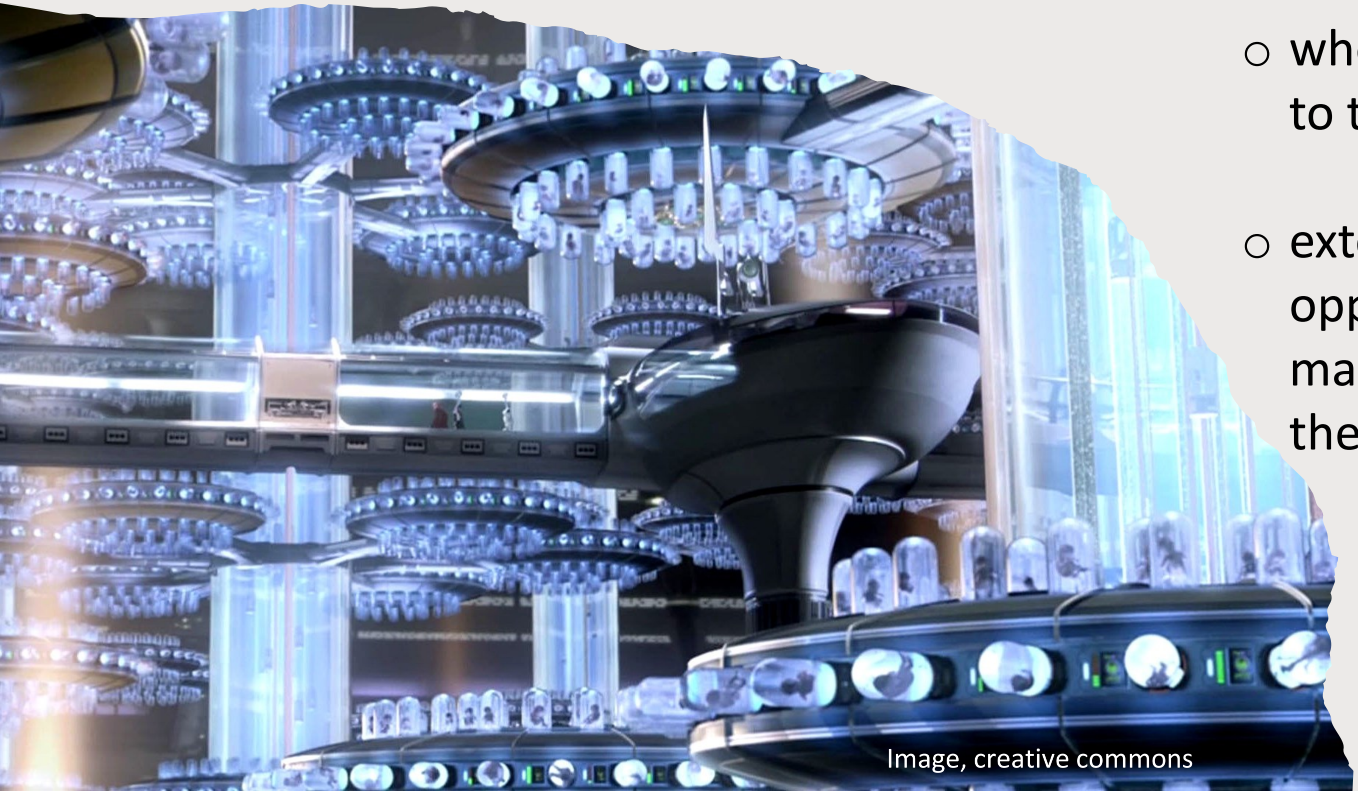
ISSB IFRS S2 – Risk Management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Must disclose:

- the process(es) use to identify climate-related risks, and opportunities for risk management purposes (such as the qualitative factors, quantitative thresholds and other criteria used)
- how prioritize climate-related risks relative to other types of risks, including its use of risk-assessment tools (for example, science-based, data sources)
- whether it has changed the processes used compared to the prior reporting period;
- extent to which and how the climate-related risk and opportunity identification, assessment and management process, or processes, are integrated into the entity's overall risk management process;

ISSB IFRS S2 – Targets and Metrics

- Must disclose targets set to mitigate or adapt to climate-related risks or maximize climate-related opportunities.
- Entity shall disclose information relevant to the cross-industry metric categories of absolute gross greenhouse gas (GHG) emissions generated during the reporting period, measured in accordance with the Greenhouse Gas Protocol Corporate Standard, expressed as metric tonnes of CO2 equivalent, classified as: (1) Scope 1 emissions; (2) Scope 2 emissions; (3) Scope 3 emissions; its greenhouse gas emissions intensity for each scope expressed as metric tonnes of CO2 equivalent per unit of physical or economic output;

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ISSB IFRS S2 – Targets and Metrics (cont'd)

- when the entity's measure of Scope 3 emissions includes information provided by entities in its value chain, it shall explain the basis for that measurement; and if entity excludes, state the reason for omitting them, for example, because it is unable to obtain a faithful measure

- transition risks—the amount and percentage of assets or business activities vulnerable to transition risks and physical risks

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ISSB IFRS S2 summary of tentative decisions 28 November 2022

One example:

Scalability-

- mechanisms should be identified to enable disclosure requirements to be scalable, when relevant (considering whether temporary, market guidance, and maturity of underlying methods as factors)

- amend the proposed disclosure requirements so that an entity, based on specific criterion related to scalability, would not be required to provide a particular disclosure (or would be required to provide an alternative disclosure that is simpler to apply);

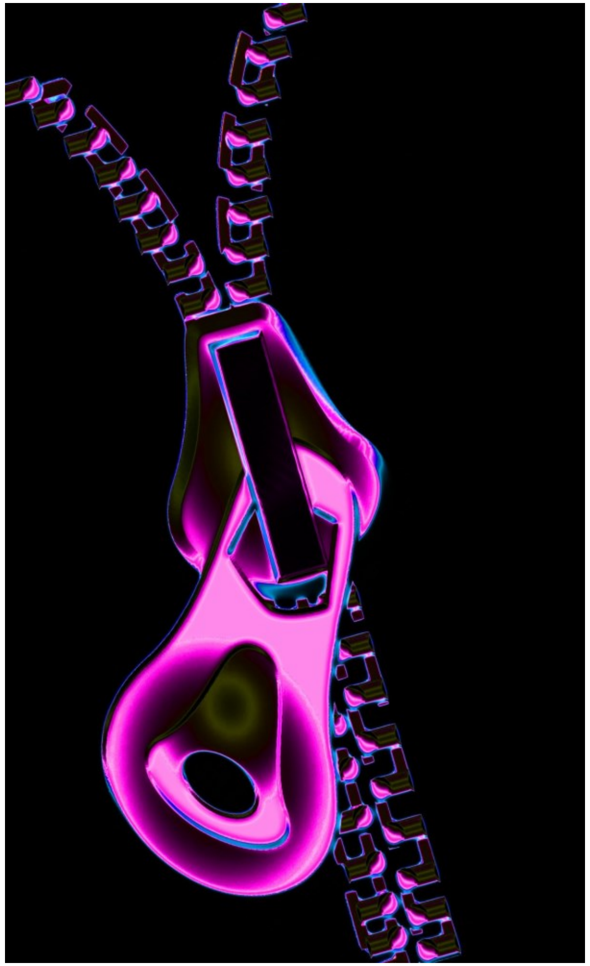
- amend the proposed disclosure requirements so that an entity that meets a criterion of being unable to provide a disclosure is required to explain how it meets the criterion;

Convergence commitment growing

- ISSB is working with the European Commission and EFRAG toward a shared objective to agree as soon as practicable a framework for maximizing interoperability of their standards and aligning on key climate disclosures. [2021 European Commission (EC) adopted legislative proposal for a Corporate Sustainability Reporting Directive (CSRD) that requires companies within its scope to report using a double materiality perspective in compliance with European Sustainability Reporting Standards (ESRS). EFRAG submitted first set of draft ESRS to the EC on 22 Nov 2022), including ESRS E1 Climate change.

- ISSB regularly consults with IOSCO in preparation for potential IOSCO endorsement of its proposed standards.

- CDP will incorporate the IFRS S2 Climate-related Disclosures requirements



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Where does the new Canadian Sustainability Standards Board (CSSB) fit in?

- Proposed CSSB will review ISSB standards and advise ISSB as IFRS/ISSB has said it will ask for input from jurisdictions re the standards.
- Supports global passport in financial reporting for multinational companies.
- Accounting standards have diverse entities beyond publicly-traded issuers, will extend and adopt standards, guidance or tools for other entities.
- Website states it will work in lock-step with ISSB
- Expected to be fully operational by April 2023

Canadian *Net-Zero Emissions Accountability Act*

Establishes a legally binding process to set five-year national emissions-reduction targets as well as develop credible, science-based emissions-reduction plans to achieve each target.

- It establishes the 2030 greenhouse gas emissions target as Canada's Nationally Determined Contribution (NDC) under the Paris Agreement emissions reductions of 40-45 percent below 2005 levels by 2030.

- Requirement to set national emissions reduction targets for 2035, 2040, and 2045, ten years in advance. Each target will require credible, science-based emissions reduction plans to achieve it.

2030 Emission Reduction Plan

$9.1 billion in new investments to cut pollution and grow the economy - EV charging infrastructure, national net-zero by 2050 buildings plan, regulated Clean Electricity Standard, approach to cap oil and gas sector emissions to achieve net-zero emissions by 2050, reduce oil and gas methane emissions by at least 75 per cent by 2030, and create good jobs, and greater incentives for clean technologies and fuels.

United States Securities and Exchange Commission (SEC) March 2022 proposed rule on climate-related disclosure (TCFD aligned)

Will require a domestic or foreign registrant to include climate-related information in its registration statements and periodic reports, such as on Form 10-K, including:

- climate-related risks and their actual or likely material impacts on the registrant's business, strategy, and outlook;
- governance of climate-related risks and relevant risk management processes;

1. registrant's GHG emissions, which, for accelerated and large accelerated filers and with respect to certain emissions, would be subject to assurance;

- certain climate-related financial statement metrics and related disclosures in a note to its audited financial statements; and
- information about climate-related targets and goals, and transition plan, if any.

Image: SEC

SEC Proposed Rule Requiring Enhanced Disclosure by Certain Investment Advisers and Investment Companies on ESG Investment Practices (25 May 2022)

Aimed at accuracy, reliability and comparability among various ESG asset management practices and products, and sufficiency of adviser/fund disclosures to investors requiring material information.

Require meaningful specific disclosure regarding ESG strategies in registration statements, the management discussion of fund performance in annual reports, and in adviser brochures.

For “ESG-focused” funds (employ one or more ESG factors as a significant component in their investment process or in engagement, or market themselves as such) – new disclosure requirements such as progress in achieving those impacts in both qualitative and quantitative terms.

For “ESG integration” funds or funds that consider one or more ESG factors among other factors in their investment process, rule will require disclosure around how the fund incorporates ESG factors into its investment selection process; and to extent that an integration fund considers GHG emissions of portfolio holdings, such fund must describe how it considers those emissions and what methodologies it employs in measuring those emissions.

Greenwashing regulatory action

Deutsche Bank and DWS (2021)
Supervisory authority BaFin and the German federal criminal police raided the offices of Deutsche Bank and DWS on suspicion of greenwashing at the asset manager. DWS has allegedly misled investors by overstating information on sustainability criteria in investments without making tangible progress on issues such as environmental and climate protection, according to reports. In a large number of investments, ESG factors "did not receive any attention", the prosecutor added in the statement, therefore leading to the allegation of fraud in the prospectuses (IPE. 2022).

SEC v BNY Mellon Investment Adviser Inc (2022)
US Securities and Exchange Commission (SEC) charged BNY Mellon Investment Adviser Inc for misstatements and omissions about ESG considerations in making investment decisions for certain mutual funds that it managed. BNY Mellon agreed to pay a US$1.5 million penalty to SEC as settlement.

SEC v. Trevor Milton (2021)
SEC filed in District Court Southern District of New York, alleging that Milton founded Nikola with the primary goal of manufacturing trucks that run on alternative fuels with low or zero emissions. Milton acted as Nikola's primary spokesperson. In December 2021, Nikola Corporation agreed to pay $125 million to settle charges that it defrauded investors by misleading them about its products, technical advancements, and commercial prospects. The order establishes a Fair Fund to return the penalty proceeds to victim investors.

SEC charged Goldman Sachs Asset Management, LP (GSAM) (22 November 2022)

- SEC charged GSAM for policies and procedures failures involving two mutual funds and one separately managed account strategy marketed as ESG investments.
- GSAM failed to have any written policies and procedures for ESG research in one product, and once policies and procedures were established, it failed to follow them consistently.
- E.g. GSAM's policies and procedures required its personnel to complete a questionnaire for every company it planned to include in each product's investment portfolio prior to the selection; however, personnel completed many of the ESG questionnaires after securities were already selected for inclusion, relied on previous ESG research not in compliance with its own policies and procedures.
- Investment advisers must develop and adhere to their policies and procedures over their investment processes, including ESG research, to ensure investors receive the advisory services they would expect to receive from an ESG investment,
- GSAM consented to the entry of the SEC's order finding that it violated Section 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-7, agreed to a cease-and-desist order, a censure, and a $4 million penalty.

Greenwashing

Competition Bureau of Canada defines greenwashing as making vague or misleading environmental claims of environmentally benefit products and processes to market to persuade consumers that company’s products and policies are environmentally sound. Consumer protection regulators are increasingly scrutinizing greenwash in advertising campaigns.

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HSBC UK Bank plc

UK Advertising Standards Authority (ASA) ruled HSBC UK can no longer run the ads that promoted its plans to reduce harmful emissions (19 October 2022)

ASA held that basis of environmental claims must be clear and that unqualified claims could mislead if they omit significant information.

Image: Adfree cities

Complaint re Royal Bank of Canada (RBC) greenwashing (2022)

Judy Wilson, Chief of the Skat'sin te Secwepemc-Neskonlith Indian Band and others filed application to Competition Bureau of Canada stating that until RBC stops financing fossil fuels, advertising itself as Paris Agreement-aligned is greenwashing.

Competition Bureau opened an investigation September 2022.

Image: Toronto Star 2022

Questions?

Thank you

Janis Sarra

Canada Climate Law Initiative Knowledge Hub: [Our Knowledge Hub - Canada Climate Law Initiative (ubc.ca)]

CCLI's Climate Governance Experts offer free of charge, confidential presentations to board directors and pension fiduciaries: [Confidential board presentations - Canada Climate Law Initiative (ubc.ca)]