

Investing in Transition – Exploring Canada’s new Transition Taxonomy Framework

Presentation to the
Net-Zero Asset Owner Alliance

Introducing the Sustainable Finance Action Council & Canada's Transition Taxonomy

Kathy Bardswick,
Chair
Sustainable Finance Action Council

Where it began...



June 2019

Chair: Tiff Macklem (Current Governor of the Bank of Canada)

Members: Andy Chisholm, Barb Zvan, Kim Thomassin

Recommendation 3

Establish a standing Canadian **Sustainable Finance Action Council (SFAC)**

Federal government established SFAC in May 2021 to help lead the Canadian financial sector towards integrating sustainable finance into standard industry practice.

Recommendation 9.1

...to develop Canadian **green and transition-orient fixed income taxonomies**

Responsible Ministers:

- Deputy Prime Minister & Minister of Finance
- Minister of Environment and Climate Change



Released March 2, 2023

Lays out an approach:

- ✓ For the development of the taxonomy (i.e. high level criteria)
- ✓ How to structure governance

Members of SFAC – Significant Portion of Canada’s Financial Industry and Regulators

Financial Industry Members:



Official Sector Coordinating Group:



Provincial Securities Commissions, and Provincial Prudential Supervisors.



Chair
Kathy Bardswick
 former CEO of Co-operators

Growing Canada's transition finance market



Green bond market in Canada and globally has grown significantly in recent years, supported by green taxonomies that have created investor confidence in the green label

Growth challenges

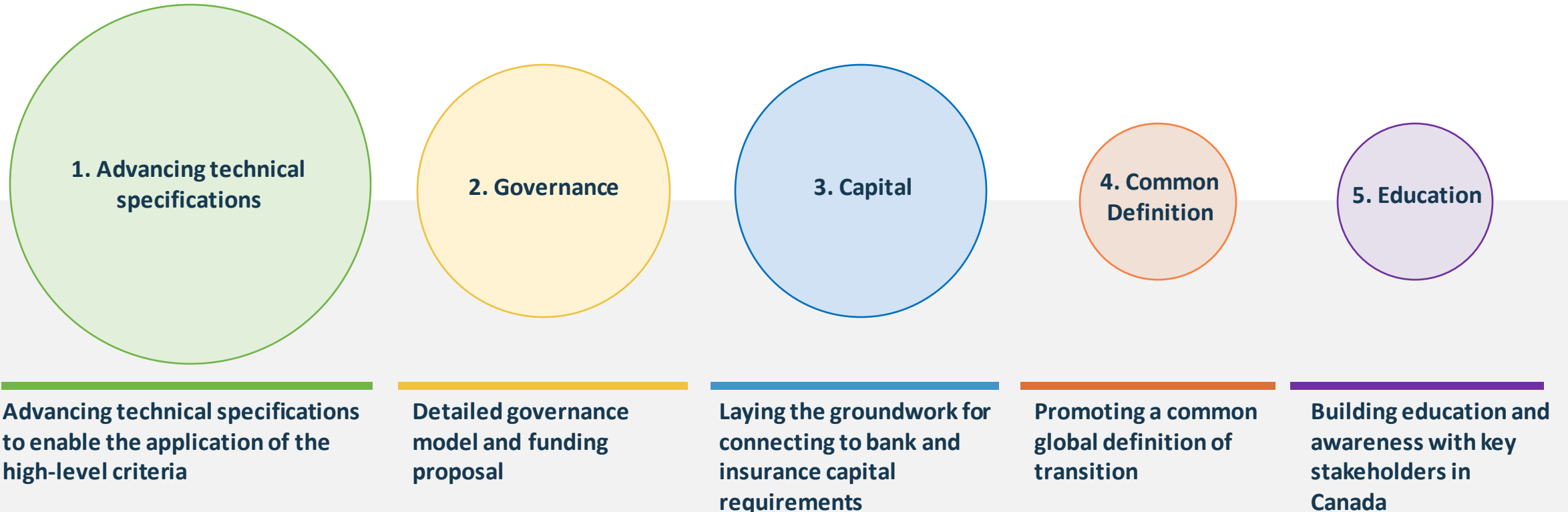
- The transition bond market is non-existent in Canada and represents a very small share of the global sustainable bond market
- Early transition bond issuances were criticized for greenwashing and no globally-accepted taxonomies dealing with 'transition' have emerged
- Transition capital-raising shifted from transition bonds to 'sustainability-linked' bonds/loans, which have grown significantly, but are now facing greenwashing criticisms

Growth opportunities

- **A science-based taxonomy** dealing with transition would help to promote investor confidence in the transition label and reduce greenwashing risks associated with sustainability-linked products
- Critical for Canada to develop a transition finance market that can provide a **reliable source of capital over time for Canadian companies (a natural resource based economy)** with credible transition plans – including interoperability with other taxonomies

It is also crucial the taxonomy is constructed to support multiple use cases in addition to labelling financial products: climate disclosure (incl. enhanced disclosure on aligned capex and opex), net-zero transition planning, stewardship, bank and insurance capital requirements and central bank activities

The work effort is organized by advancing the following key areas:



Working Canadian Climate Institute
Next paper “Operationalizing Oil and Gas Activities in the SFAC Green & Transition Taxonomy”



Working with Canadian Climate Law Initiative



Lead by the regulator, OSFI

CBI, ASEAN, ASFI (Australia)

Institute for Sustainable Finance, SFAC members



“We look forward to the Sustainable Finance Action Council’s work on behalf of the Ministers of Finance and Environment and Climate Change Canada; particularly the taxonomy framework which we intend to leverage in our continuing work to ensure our capital rules fully capture the opportunities as well as the risks of climate change.” - **Peter Routledge, OSFI Superintendent** (RBC Capital Markets Bank CEO conference, Jan 9, 2023)

Deep dive on the Transition Taxonomy Framework

Jonathan Arnold
Clean Growth Research Lead,
Canadian Climate Institute

What is (is not) a green and transition finance taxonomy?

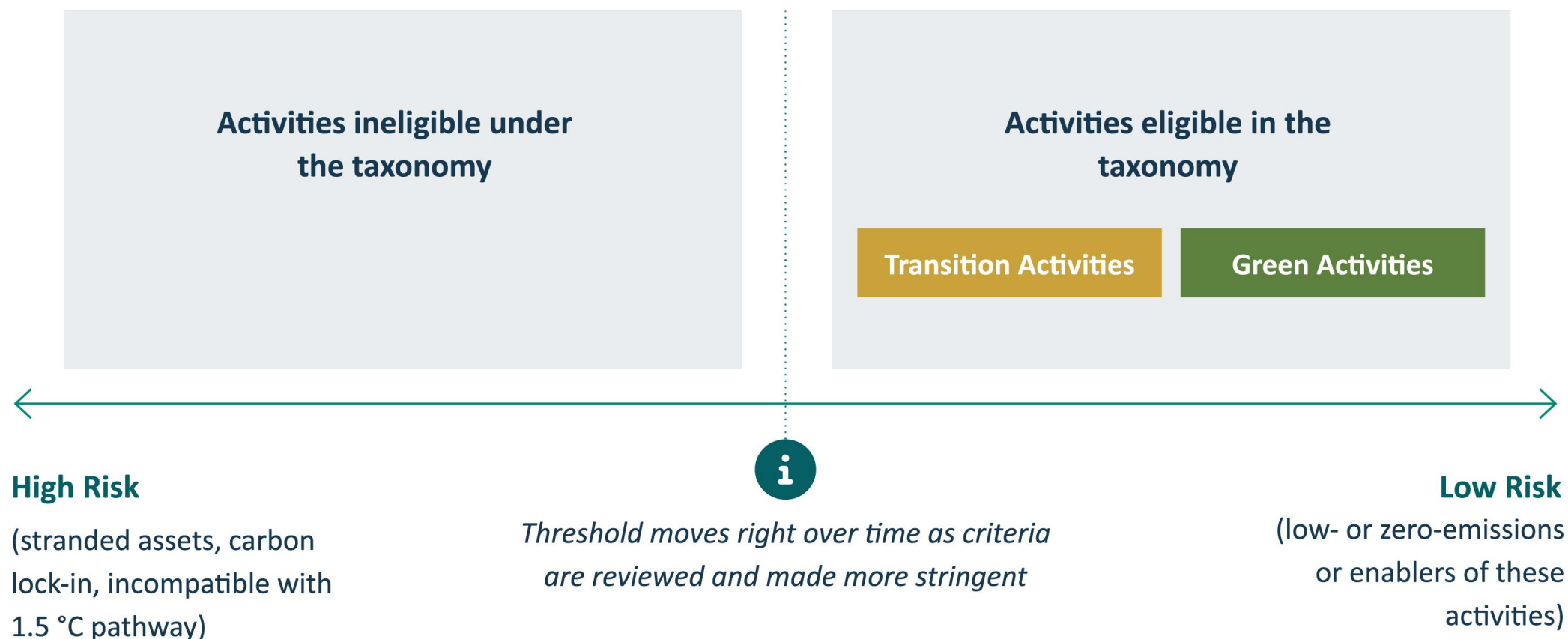
Two Categories of Activities

A green and transition finance taxonomy establishes screening criteria about which economic activities (assets, projects or revenue segments) have a higher or lower transition risk.

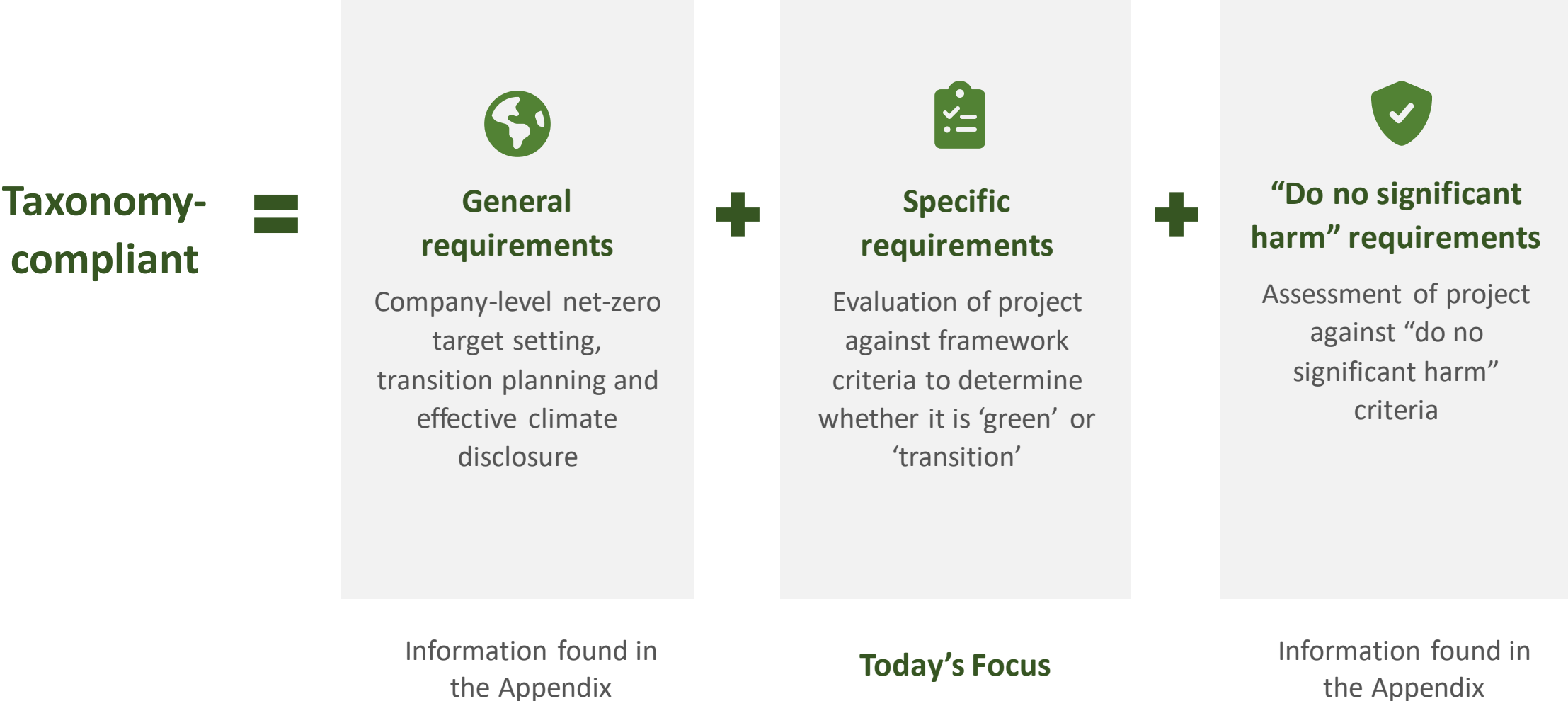
Transition activities	Green activities
Decarbonizing emission-intensive activities that are critical for sectoral transformation and consistent with a net-zero, 1.5 °C transition pathway	Low or zero-emitting activities (e.g., solar and wind) or those that enable them (e.g., hydrogen pipelines.)

The taxonomy's principal objective be to support the achievement of Canada's emissions reduction targets, consistent **with keeping global temperature rise to below 1.5 °C** (based on pre-industrial levels) across all emissions categories. Grounding the taxonomy with this ambitious climate objective can build and **maintain international credibility** and also help drive progress on other important economic, financial and social objectives.

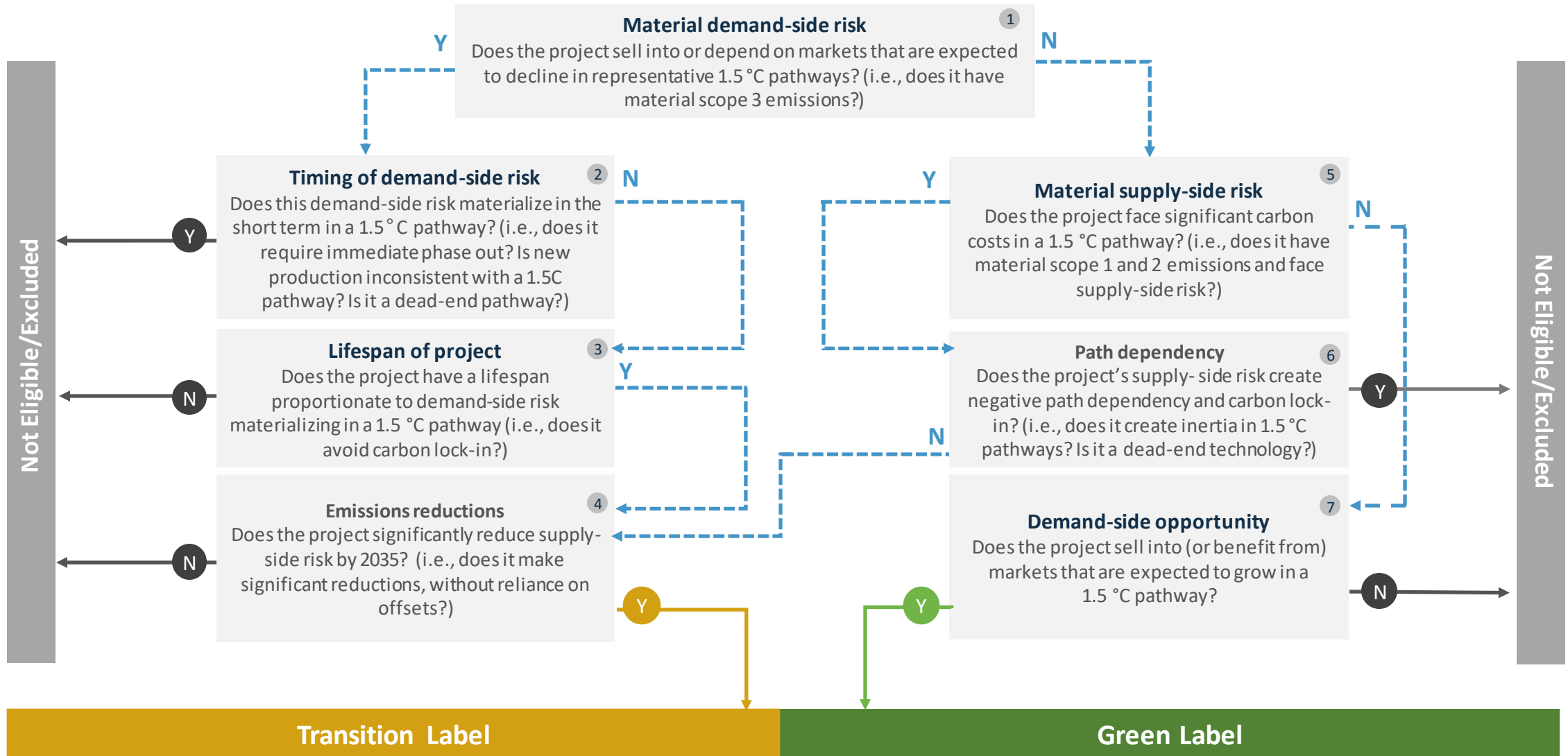
What is (is not) a green and transition finance taxonomy?



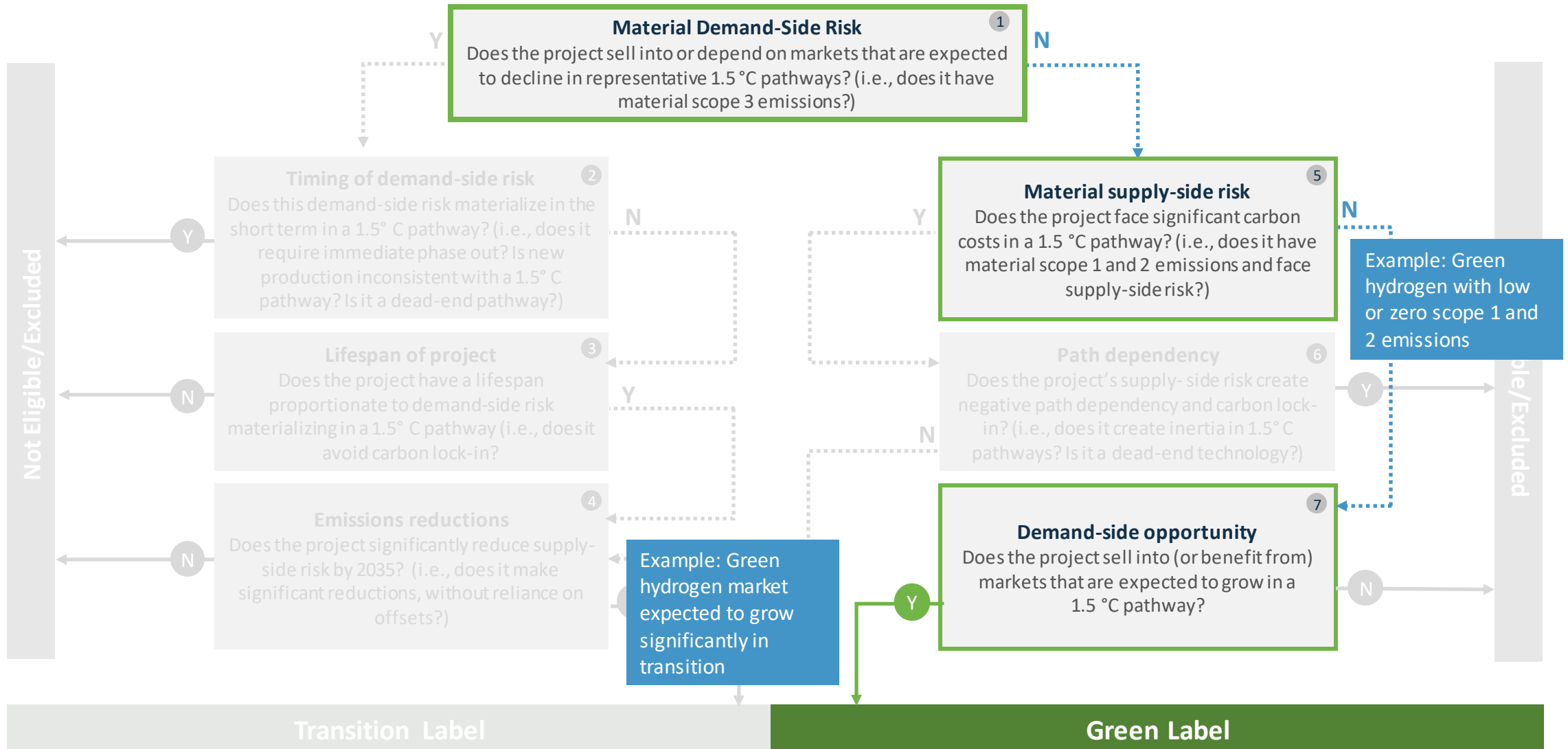
Taxonomy-compliant issuances must meet three requirements



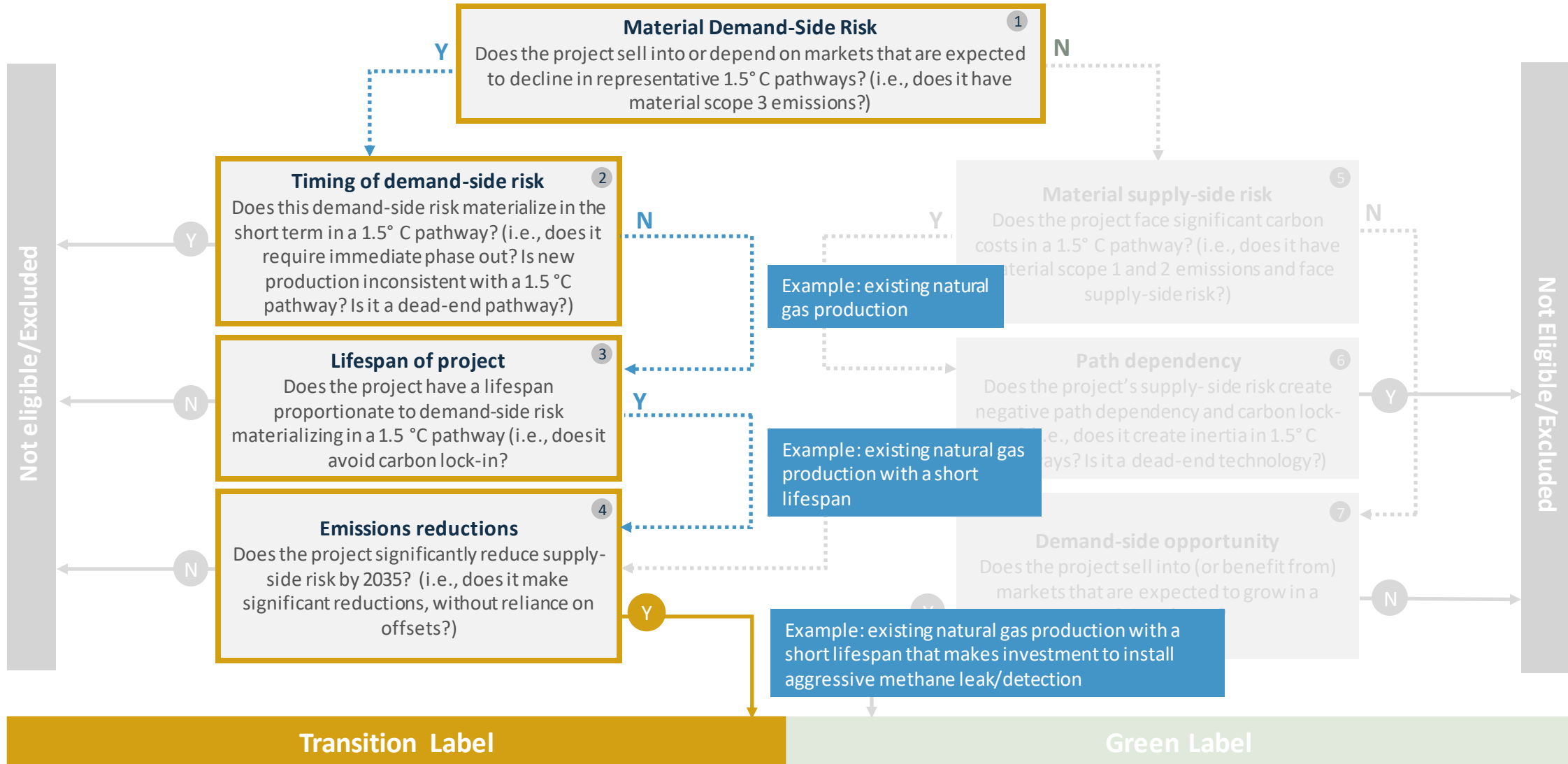
Categorization framework for specific requirements



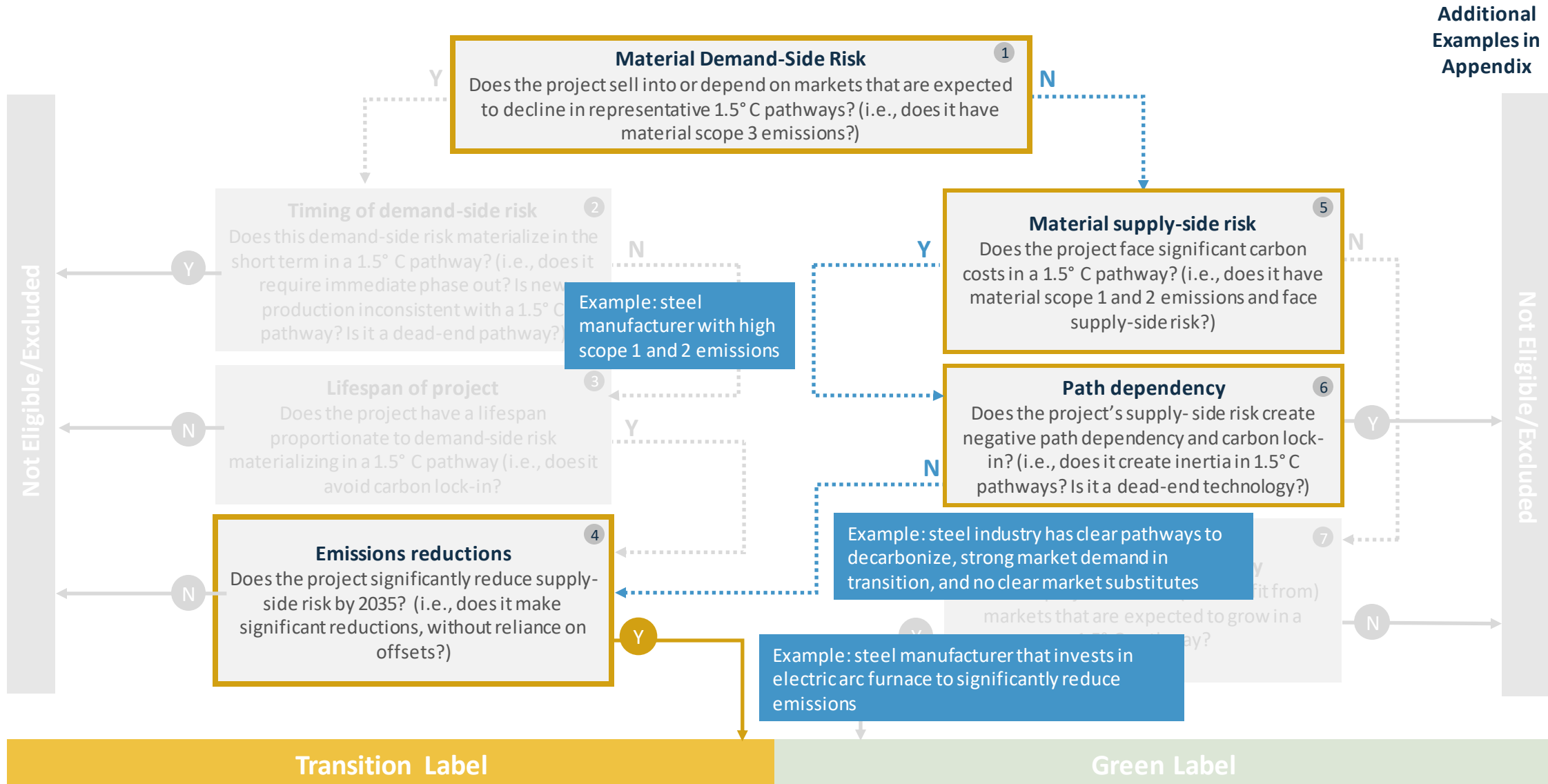
2. Categorization framework for specific requirements (Green Label)



Categorization framework for specific requirements (Transition Label)



2. Categorization framework for specific requirements (Transition Label)



Governance – A Critical Element for success

Joint federal government-financial sector leadership, with strong Indigenous and provincial participation, to maximize credibility and usability

Governance that is transparent and results-oriented and that safeguards scientific integrity

Well-resourced, with stable and predictable funding for the long term

All national taxonomies have government participation; OECD and World Bank note this is critical



Taxonomy development involves many stakeholders and much consultation



All taxonomies have significant involvement from the financial sector – key to deployment (practical & usable)



Industries are involved in sector-specific working groups

Recommended robust governance model

Recommendation based on learnings from an Institute for Sustainable Finance landscape review of taxonomy governance structures =>

<https://smith.queensu.ca/centres/isf/resources/taxonomies-resources.php>

Taxonomy Council (Accountable for Initiative)

- Governance, strategic direction and performance, approves the Custodian’s taxonomy proposals
- Cannot alter technical criteria or override the integrity of the science as determined by the Custodian
- Federal government and financial sector led with strong provincial participation (OSFI, Bank of Canada, Indigenous Rights Holder, Community, Financial Sector, others)

Net-Zero Advisory Body

- To be consulted periodically as an input to the Council’s priorities and planning activities

Taxonomy Custodian (Taxonomy Developer)

- Develops taxonomy proposals (framework/criteria) for Council approval
- Develops and executes critical path/work plans; convenes right expertise
- Housed within arms-length (research) organization – enables scientific integrity
- Extensive climate/environment expertise
- Accountable to perform broad outreach as they develop their recommendations

Other important stakeholders:

- Data Providers
- Second Opinion Providers

Technical Working Groups

- Groupings of the right mix of experts (industry, academics and subject matter experts) to advance detailed, sector-based technical taxonomy work

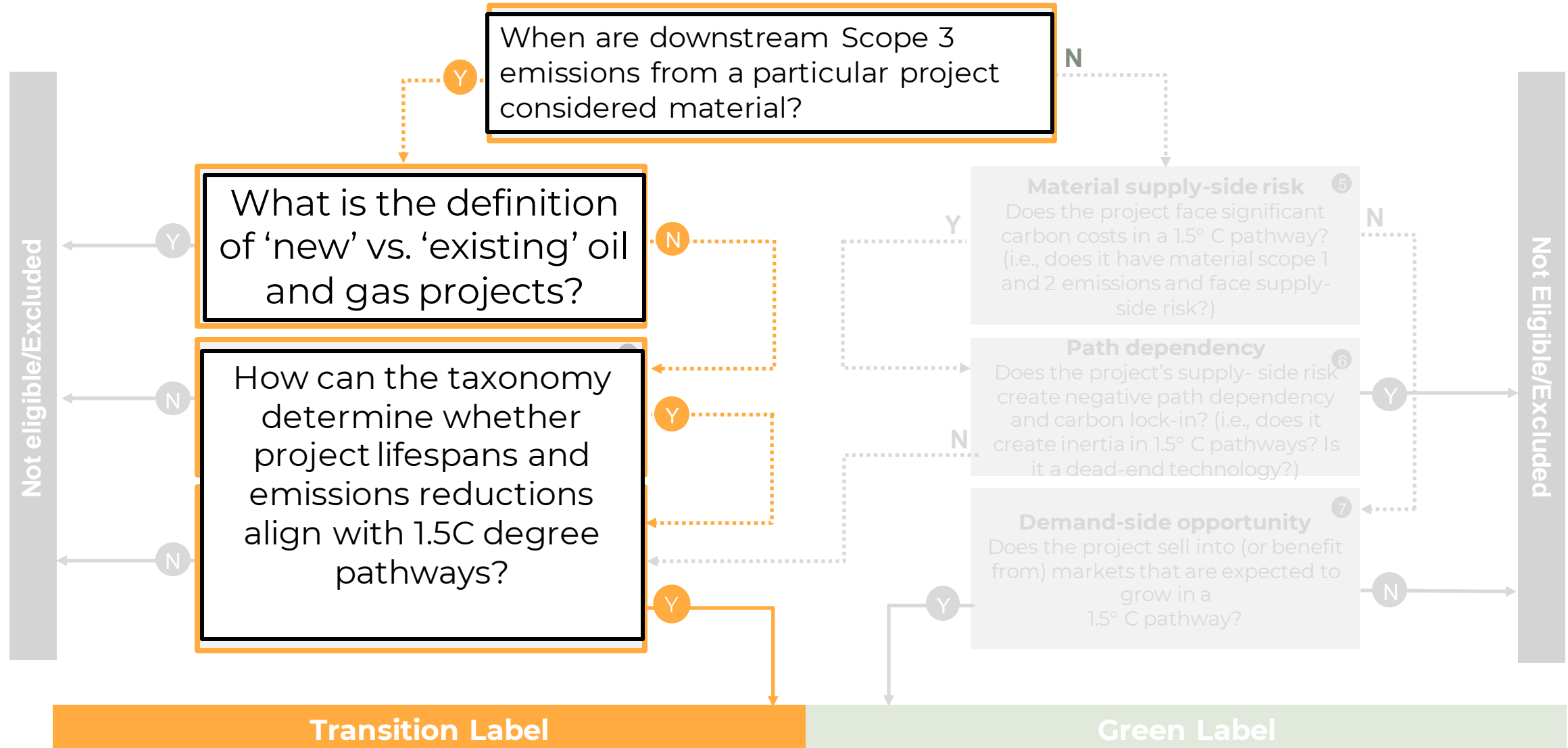
Stakeholder Advisory Forums

- Provincial, Territorial, Indigenous Rights Holder
- Community (e.g. Environmental Non-Government Organizations)
- Financial Sector

Operationalizing oil and gas activities in the taxonomy

- CCI was asked by SFAC to conduct early-stage research on how to operationalize parts of its Climate Investment Taxonomy
- Specifically, CCI was tasked with researching ways to operationalize the components of the taxonomy framework that are relevant to oil and gas sector activities
- The Roadmap Report prioritized O&G activities, recognizing that they will be among the hardest and most complex to operationalize
- Ultimately, the goal is to develop preliminary criteria and metrics for how—and under what conditions—oil and gas activities might be eligible for taxonomy financing

Three major research questions



Question #1: When are downstream Scope 3 emissions from a particular project considered material?

Proposed approach:

- Any project with over 50% of its total emissions generated downstream would be considered to have material downstream Scope 3 emissions
- Allows Taxonomy Custodian to create pre-certified categories of activities
 - E.g., fossil fuel projects answer 'yes' to having material downstream emissions
- Issuers that believe the pre-approved categories do not apply to the specific characteristics of its project would need to demonstrate through disclosure
 - E.g. blue hydrogen

Question #2: What is the definition of 'new' and 'existing' oil and gas assets?

Proposed approach:

Existing Oilsands Projects	Existing Conventional Oil and Gas Projects
<ul style="list-style-type: none">• A field where extraction and production are already taking place; AND,• Where capital funds have already been committed and implementation of the development project or mining operation is underway (where a final investment decision was made before a specified date); AND,• Where any project expansions (if relevant) do not require new major infrastructure (e.g., gathering lines, processing facilities, upgraders, etc.)	<ul style="list-style-type: none">• A field where extraction and production are already taking place; AND,• Where any new pads and wells do not require new major infrastructure (e.g., gathering lines, processing facilities, upgraders, etc.)

Question #3: How to determine whether project lifespans and GHG reductions align with 1.5°C pathways?

Proposed approach for Scope 1 and 2 emissions & lifespan:

- Use sectoral emissions-intensity curves in 1.5C degree scenarios as the benchmark
 - Sectoral emissions-intensity curves developed by the Transition Pathways Initiative can provide a starting point for developing these dynamic thresholds

Proposed approach for upstream Scope 3 emissions:

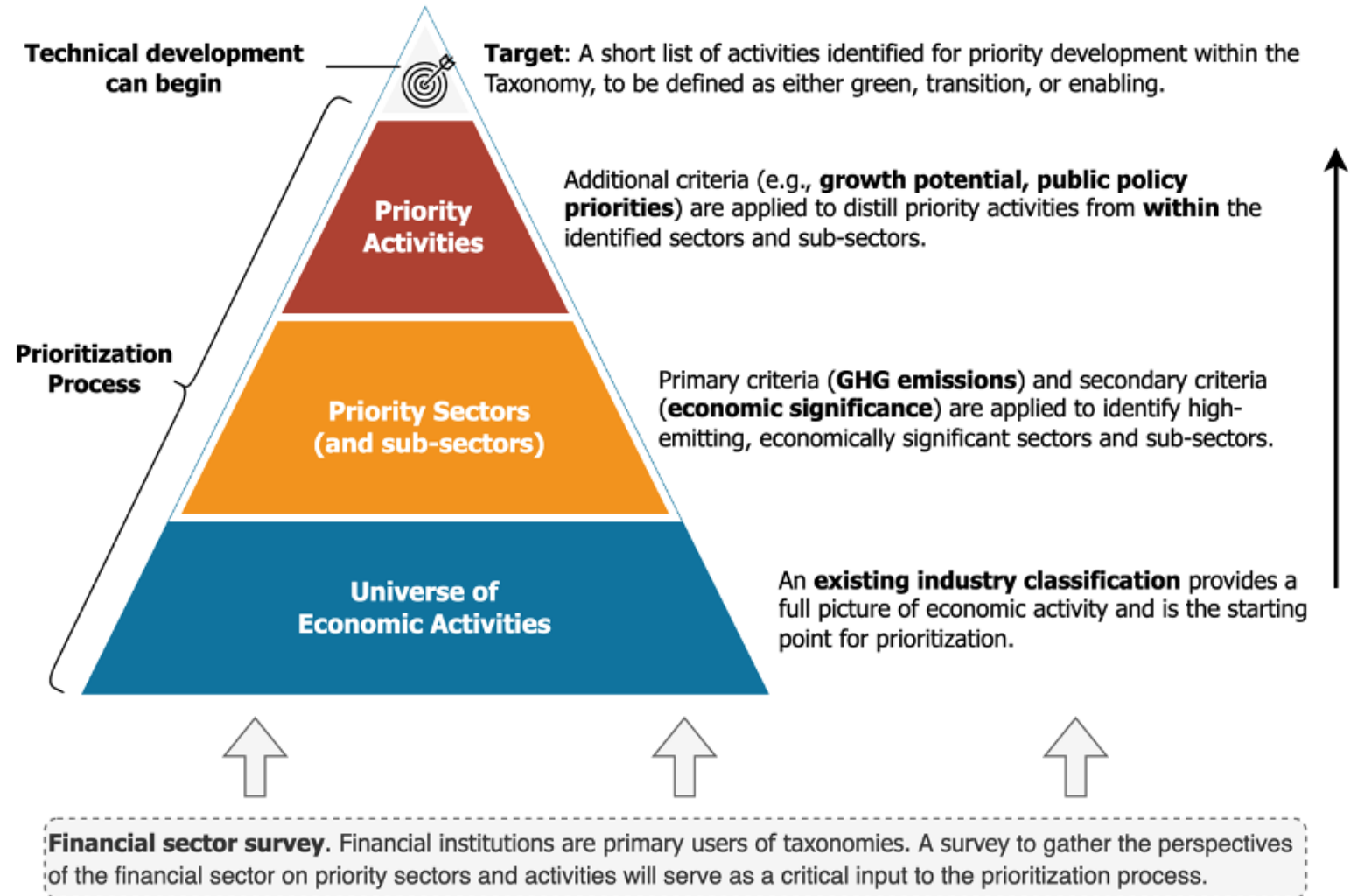
- Use sectoral emissions-intensity curves in 1.5C degree scenarios as benchmark for upstream suppliers

Expert analysis

Caelan Welch
Research Associate,
Smart Prosperity Institute

Sector and Activity Prioritization

- A prioritization framework will guide decision-making and ensure systematic assessment of sectors and activities for priority inclusion.
- Prioritization is a practical solution to balance timely taxonomy development with effectiveness & scientific credibility



EU and Canada: How the Taxonomies Compare

Taxonomy	European Union	Canada
Underlying approach	Impact-based (top-down)	Risk-based (bottom-up)
Covered Objectives	Climate change mitigation; climate change adaptation; sustainable use and protection of water and marine resources; transition to a circular economy; pollution prevention and control; protection and restoration of biodiversity and ecosystems	Climate change mitigation (additional objectives TBD)
Sector Classification	Statistical Classification of Economic Activities in the European Community (NACE)	TBD
Eligibility Approach	Quantitative thresholds and criteria. Alignment with 1.5°C Paris goal informs ambition level of activity criteria for climate change mitigation objective.	
DNSH?	Yes. Combination of activity-specific DNSH provisions and universal requirements applicable to all activities.	Yes. Approach TBD.
Social Safeguards?	Yes. Activities aligned with OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights.	Yes. Roadmap identifies EU minimum social safeguards approach for consideration + additional DNSH requirements relating to UNDRIP.

Comparison Continued

Taxonomy	European Union	Canada
Scope	Green w/ limited inclusion of transitional elements	Green and transition (as separate categories)
Activity Types Covered		
Near Zero	Yes (Green)	Yes (Green)
Pathway to Zero	Yes (Green)	Yes (Green/Transition)
No Pathway to Zero	No	Yes (Transition)*
Dead-end technology	No	No
Enabling	Yes	Yes

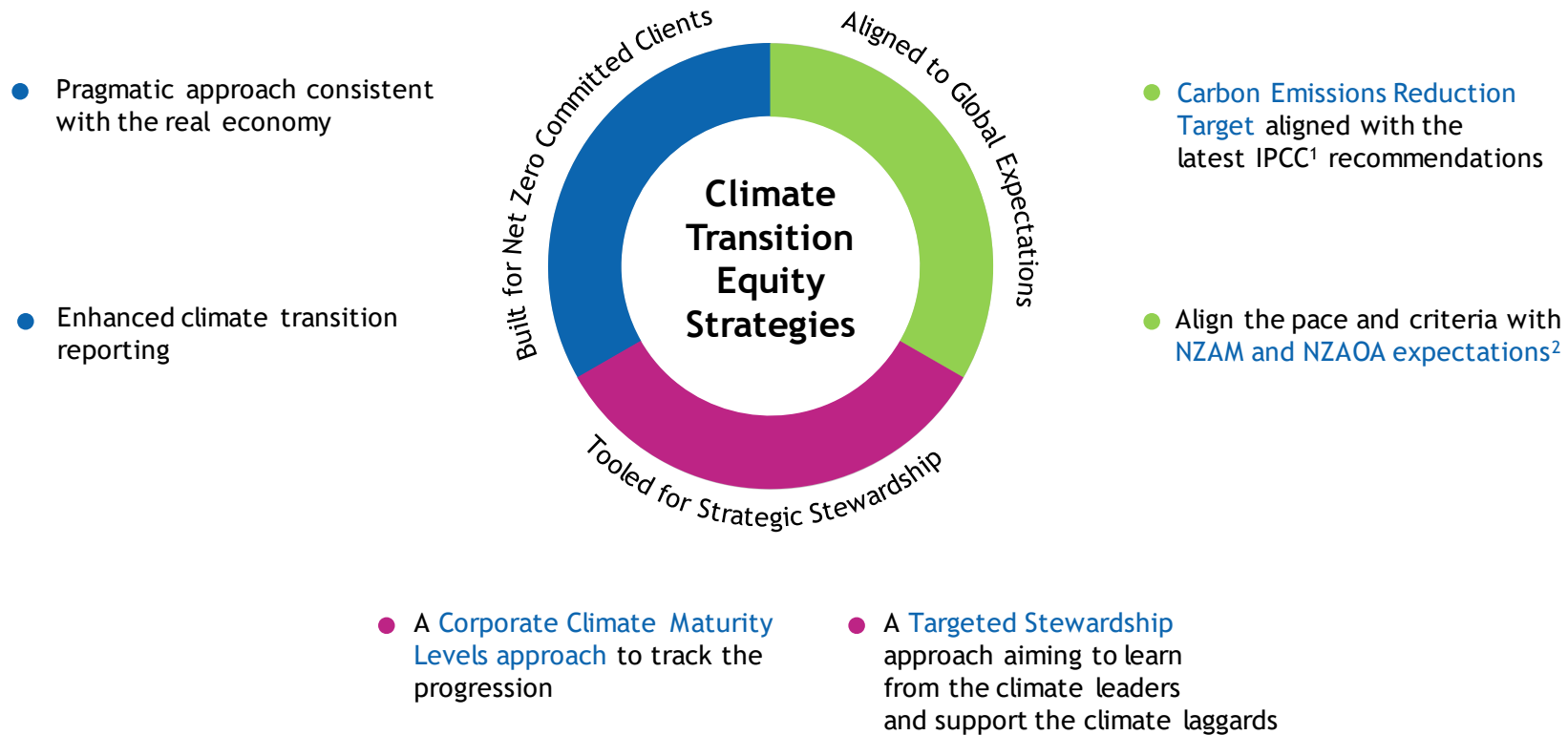


Applying the taxonomy

Andrea Moffat
Senior Director, Investment Stewardship
Addenda Capital
(Part of Co-operators group of companies)

Addenda Climate Transition Strategy

Generating Compelling Financial Returns With a Net Zero Aligned Portfolio



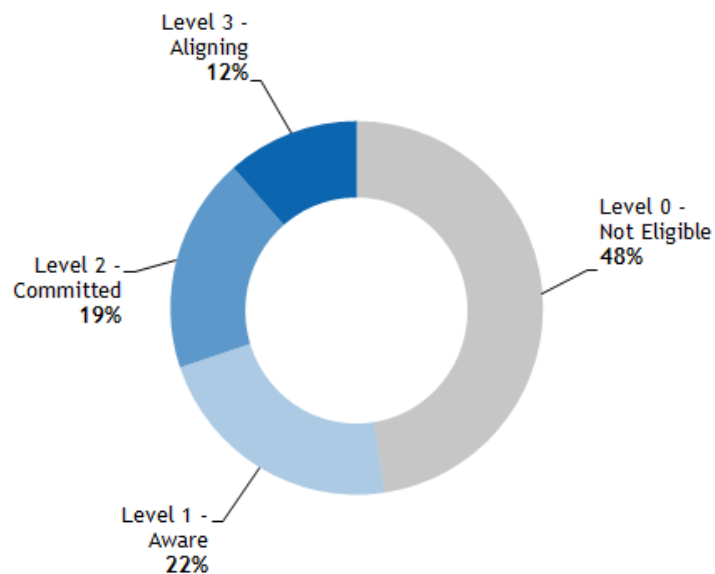
¹ IPCC: [Inter governmental Panel on Climate Change](#)

² NZAM: [Net Zero Asset Manager](#)

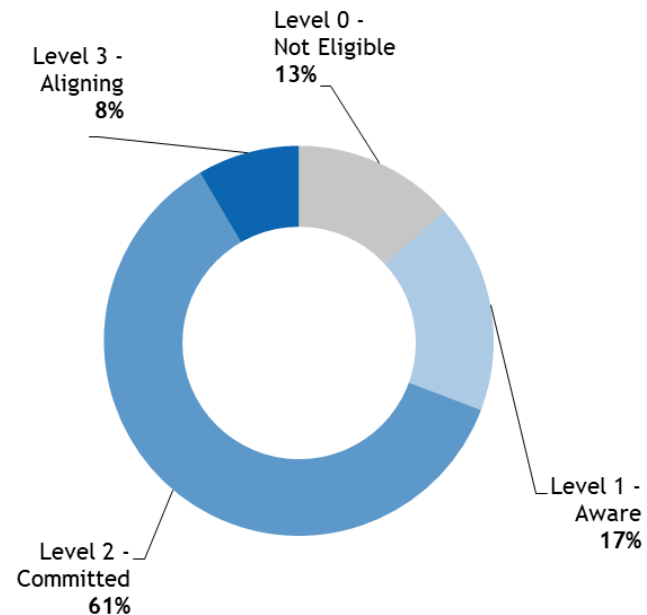
NZAOA: [Net Zero Asset Owner Alliance](#)

Investible Universe Comparison

Canadian Eligibility of Companies in the S&P TSX Composite Index



International Eligibility of Companies in the MSCI EAFE Index



As at March 17, 2023

Sources: S&P Dow Jones, Bloomberg, MSCI, Addenda Capital Inc.

Thank you for your participation.

If you have any additional feedback, or wish to further discuss, please contact NZAOA members involved with SFAC:

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Brian Minns

Senior Managing Director, Responsible Investing
University Pension Plan Ontario

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“The launch of Canada’s Climate Investment Taxonomy Framework is a milestone. It delivers a vital contribution to international efforts to mobilize investment flows to climate action. With a focus on both green and transition investments, Canada’s framework will help to scale the finance we need to change emissions intensive industries. It’s an example for other nations.” - Sean Kidney, CEO, Climate Bonds Initiative



Where to find key reports or information:



Expert Panel on Sustainable Finance Report (2019)

<https://www.canada.ca/en/environment-climate-change/services/climate-change/expert-panel-sustainable-finance.html>



<https://www.canada.ca/en/department-finance/programs/financial-sector-policy/sustainable-finance/sustainable-finance-action-council.html>

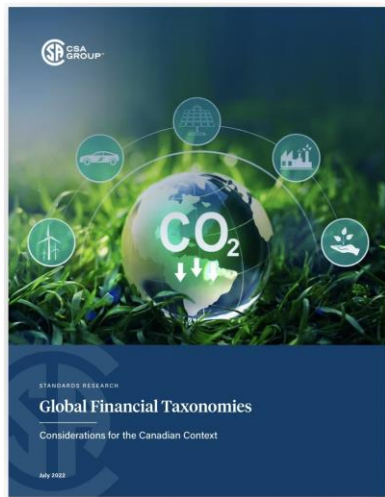


Taxonomy Roadmap Report (2023)

<https://www.canada.ca/en/department-finance/programs/financial-sector-policy/sustainable-finance/sustainable-finance-action-council/taxonomy-roadmap-report.html>

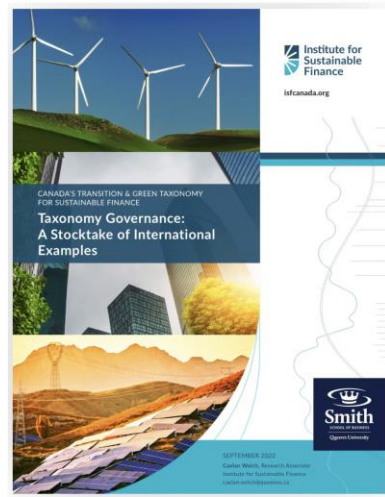
Press release & Quotes:

<https://smith.queensu.ca/centres/isf/news/SFAC-Taxonomy-Release-English.php>



Taxonomy Landscape Review (by CBI)

<https://www.csagroup.org/article/research/global-financial-taxonomies-considerations-for-the-canadian-context/>



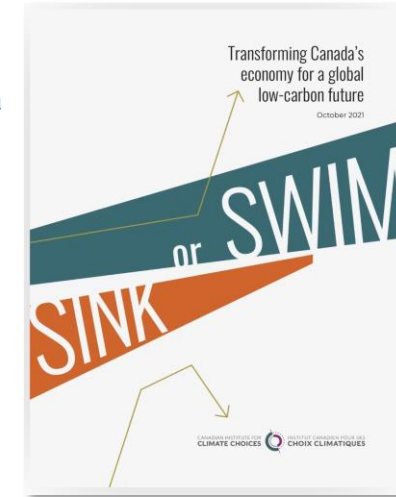
Taxonomy Governance Landscape Review (ISF)

<https://smith.queensu.ca/centres/isf/resources/taxonomies-resources.php>



Taxonomy Research Review (ISF)

<https://smith.queensu.ca/centres/isf/resources/taxonomies-resources.php>



Low Carbon Future Research For Canada (CCI)

<https://climateinstitute.ca/reports/sink-or-swim/>

Where to find key information about partners:



<https://smith.queensu.ca/centres/isf/index.php>



<https://climateinstitute.ca/>



<https://www.csagroup.org/>



<https://www.climatebonds.net/>



<https://ccli.ubc.ca/>