Greenwashing in the Financial Sector: Time for Transparency and Accountability

CQDE

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This publication is intended as a policy report on financial greenwashing only and is not intended to provide legal advice. Legal advice should be sought in respect of specific matters or projects. The laws, regulations and policies discussed in this report are stated as of September 15, 2024.

Presentation

OF THE CENTRE QUÉBÉCOIS DU DROIT DE L'ENVIRONNEMENT

The Centre québécois du droit de l'environnement (CQDE) is a charitable organization founded in 1989 by a group of jurists interested in the legal aspects of environmental issues. The CQDE has over 300 individual and corporate members active in all regions of Québec.

The CQDE's mission is to use its legal expertise to serve the people of Québec and to protect the environment.

The CQDE plays an active role in Québec society, participating in major environmental debates. It takes part in government consultations on various legislative and regulatory reforms and intervenes before the courts when necessary.

The CQDE provides legal information to the public and to environmental protection groups, enabling them to shed light on the legal dimensions of the environmental problems they face, with the aim of ensuring respect for the right to a healthy environment.

It is the only non-profit organization to offer independent expertise in environmental law in Québec, thereby giving the public access to information and justice in environmental matters. By helping to establish a body of law that responds to the environmental crises we face, the CQDE contributes to the development, dissemination, and enforcement of environmental law in order to protect the environment and living species.

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ACRONYM	DEFINITION
AIF	Annual Information Form
AMF	Autorité des marchés financiers (Québec)
AMF Act	*Act respecting the regulation of the financial sector*
APLMA	Asia Pacific Loan Market Association
ASC	Alberta Securities Commission
ASIC	Australian Securities & Investments Commission
BA	*Bank Act* (Canada)
Big Six	Canada's biggest six banks: RBC, TD, BMO, Scotia, CIBC and National Bank
Big Five	Canada's biggest five banks, excluding National Bank
BMO	Bank of Montréal
CAFA	Bill S-243 – *An Act to enact the Climate-Aligned Finance Act* (Canada)
CB	Competition Bureau of Canada
CBI	Climate Bonds Initiative
CBS	Climate Bonds Standard
CD Documents	Continuous disclosure documents, as prescribed by R 51-102
CDR Program	AMF's continuous disclosure review program
CFTC	United States Commodity Futures Trading Commission
CIBC	Canadian Imperial Bank of Commerce
CORSIA	Carbon Offsetting and Reduction Scheme for International Aviation
CQDE	Québec Environmental Law Center
CRA	Credit rating agency
CSA	Canadian Securities Administrators
CSDS 2	Canadian Sustainability Disclosure Standard 2: Climate-related Disclosures
CSF	Chambre de la sécurité financière
CSF Code	*Code of ethics of the Chambre de la sécurité financière* (Québec)
CSF Regulation	*Regulation respecting the rules of ethics in the securities sector* (Québec)
CSRD	*Corporate Sustainability Reporting Directive* (European Union)
CSSB	Canadian Sustainability Standards Board
Distribution Act	*Act respecting the distribution of financial products and services* (Québec)
DNSH	Do no significant harm
DR 51-107	*Draft Regulation 51-107 respecting Disclosure of Climate-related Matters* (Québec)
DRO	Designated rating organization
ESG	Environmental, social and governance
ESMA	European Securities and Markets Authority
ESRS	European Sustainability Reporting Standards
ETF	Exchange-traded fund
EU	European Union
EU GBS	European Union's Green Bond Standard

FCA	United Kingdom Financial Conduct Authority
FCAC	Financial Consumer Agency of Canada
FCAC Act	*Financial Consumer Agency of Canada Act* (Canada)
FinCoop Act	*Act respecting financial services cooperatives* (Québec)
FMAT	Financial Markets Administrative Tribunal
FRFI	Federally regulated financial institution
GBP	Green Bond Principles
GFANZ	Glasgow Financial Alliance for Net Zero
GHG	Greenhouse gas
Guideline B-15	OSFI's Guideline B-15 – Climate Risk Management
I4PC	Investors for Paris Compliance
ICMA	International Capital Market Association
ID	Investment dealer
IFM	Investment fund manager
IFRS S2	International Financial Reporting Standards' S2 Climate-related Disclosures standard
IIROC	Investment Industry Regulatory Organization of Canada
IIROC Rules	Rules established by the Investment Industry Regulatory Organization of Canada (now replaced by CIRO)
IVIC	Individual Variable Insurance Contract
ISSB	International Sustainability Standards Board
KYC	Know-your-client
KYP	Known-your-product
LD Guideline	Guideline on Individual Variable Insurance Contracts Relating to Segregated Funds
LMA	Loan Market Association
LSTA	Loan Syndicated and Trading Association
MCR	Material Change Report
MD&A	Management's Discussion and Analysis
MFD	Mutual fund dealer
MFDA	Mutual Funds Dealers Association of Canada
MRFP	Management Report of Fund Performance
OPC	Office de la protection du consommateur (Québec)
OSC	Ontario Securities Commission
OSFI	Office of the Superintendent of Financial Institutions (Canada)
OSFI Act	*Office of the Superintendent of Financial Institutions Act* (Canada)
PAS	*Public accountability statement as prescribed by the Bank Act*
PM	Portfolio manager
QSA	*Québec Securities Act* (Québec)
R 25-101	*Regulation 25-101 Respecting Designated Rating Organizations* (Québec)
R 31-103	*Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations* (Québec)
R 41-101	*Regulation 41-101 respecting Rights Offerings* (Québec)

R 45-106	*Regulation 45-106 respecting Prospectus Exemptions* (Québec)
R 51-102	*Regulation 51-102 respecting continuous disclosure obligations* (Québec)
R 81-101	*Regulation 81-101 Respecting Mutual Fund Prospectus Disclosure* (Québec)
R 81-102	*Regulation 81-102 respecting Investment Funds* (Québec)
R 81-106	*Regulation 81-106 Respecting Investment Fund Continuous Disclosure* (Québec)
RBC	Royal Bank of Canada
Scotia	Bank of Nova Scotia
SDR	United Kingdom's Sustainability Disclosure Requirements
SEC	United States Securities and Exchange Commission
SEC Rules	Rule amendments adopted by the SEC to enhance and standardize climate-related disclosures for investors
SFAC	Sustainable Finance Advisory Committee (Canada)
SFDR	*Sustainable Finance Disclosure Regulation* (European Union)
SFRI	Refers to the labels "ESG", "sustainable finance", and "responsible investment" on a collective basis
SLB	Sustainability-linked bond
SLBP	Sustainability Linked Bond Principles
SLL	Sustainability-linked loan
SLLP	Sustainability-Linked Loan Principles
SN	CSA Staff Notice
SN 51-333	Staff Notice 51-333 – Environmental Reporting Guidance
SN 51-358	Staff Notice 51-358 – Reporting of Climate Change-related Risks
SN 51-364	Staff Notice 51-364 Continuous Disclosure Review Program Activities
SN 81-334	Staff Notice 81-334 ESG-Related Investment Fund Disclosure
SRI	Socially Responsible Investment
SRO	Self-regulatory organization
TCFD	Task Force on Climate-Related Financial Disclosures
TD	Toronto-Dominion Bank
UK	United Kingdom
UN PRI	United Nations Principles for Responsible Investment
UNEP FI	United Nations Environment Program Finance Initiative
UoP	Use-of-proceeds
US	United States
VCMDA	*Voluntary Carbon Market Disclosures Act* (California)
VCO	Voluntary carbon offset, also known as verified carbon credit

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The CQDE benefitted from the invaluable comments and feedback from highly qualified reviewers for the preparation of this report. They are listed below in alphabetical order. We would like to warmly thank them for their time and contribution. The views expressed in this report may not reflect the reviewers' personal views. Any error is our own.

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To view the executive summary :
cqde.org/wp-content/uploads/2024/10/executivesummary_greenwashing_web.pdf

1. Foreword

In the fall of 2022, the Québec Environmental Law Center (**CQDE**) published a report titled "Climate-washing in Québec and Canada: How to Turn the Tide".[1] The report examined the provincial and federal laws applicable to firms' climate-related claims and formulated recommendations for policymakers on how to improve their effectiveness, notably through a reform of competition and consumer protection law.

The CQDE is now turning to the next phase of its work on greenwashing by focusing on three emerging forms of deceptive environmental claims: financial greenwashing, greenwashing relating to consumer goods and governmental greenwashing. This research will lead to the publication of three new research reports in the upcoming months. You are now reading the first of these reports. It examines how to improve the credibility and transparency of environmental claims in the financial sector.

The purpose of this report is to map the greenwashing risks prevailing in the Canadian financial sector, identify existing laws, regulations and guidelines that mitigate these risks, and propose policy measures to address regulatory gaps. This report formulates 26 recommendations to improve environmental transparency and accountability in the financial sector. The CQDE is hopeful that these recommendations will positively influence the ongoing discussions on the regulation of sustainable finance at both provincial and federal levels and help stakeholders better understand the gaps in the current regulatory landscape.

This report's recommendations are primarily targeted at federal and provincial policymakers focusing on financial sector policy and regulation, including Parliamentarians, department officials, regulatory agencies and self-regulatory authorities. In addition, this report aims to assist financial sector professionals, academic researchers and consumers in better understanding financial greenwashing risks and their regulation within the Canadian context.

This report is structured as follows:

- **Section 2** defines greenwashing and provides examples of alleged greenwashing cases in the financial sector.
- **Section 3** provides an overview of the sustainable finance and responsible investment landscape.
- **Section 4** reviews the legal frameworks applicable to environmental claims in the financial sector in Québec and Canada and identifies key international and regional developments around their regulation.
- **Section 5** formulates detailed recommendations on how to improve the effectiveness of existing federal and provincial laws and regulations to curb financial greenwashing.

This report focuses on Québec laws and federal laws applicable across Canada. However, given the relative uniformity of provincial securities laws across the country, most of this report's provincial recommendations are also relevant outside Québec. Additionally, while

[1] Beaulieu and Bishai (2022).

its focus is on environmental claims, this report often touches on human rights and social issues, which are crucial aspects of sustainability.

This report focuses on greenwashing risks, which result from information asymmetries and coordination failures in the financial sector. To address these risks, this report recommends implementing policy and regulatory measures aimed at improving the quality and quantity of sustainability information disclosed to investors, which ultimately will accelerate the shift towards a just, resilient and climate-oriented economy. However, as noted throughout the report, the effectiveness of informational measures often depends on the establishment of complementary command-and-control and market-based environmental measures, such as environmental regulations, taxes and subsidies. Even if informational policies are essential to ensure that stakeholders share accurate and comprehensive information about their sustainability impacts, they cannot replace the additional structural regulatory and policy measures needed to achieve other environmental policy goals.

This research project is funded by research grants from the Canadian Bar Association's Law for the Future Fund and the Ministère de l'Environnement, de la Lutte contre les changements climatiques, de la Faune et des Parcs du Québec. In addition, Julien O. Beaulieu, principal author of this report, has received the Laure-Waridel Grant jointly issued by the Caisse d'économie solidaire Desjardins and Équiterre to conduct this project. While this research has been conducted independently of any third-party influence, the author and the CQDE are thankful for these organizations' essential financial support.

Québec

CBA LAW FOR THE FUTURE FUND
FONDS POUR LE DROIT DE DEMAIN DE L'ABC

Desjardins
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Équiterre

2. Introduction: Mapping the issue

In a recent global survey conducted by the World Economic Forum, disinformation, extreme weather events and pollution were ranked as three of the most severe short-term risks threatening the world.[2] These risks are intrinsically interconnected.

Disinformation can have several negative consequences for the socio-ecological transition. For example, climate denial campaigns can reduce the support of voters for environmental policies by downplaying the causes or effects of the climate crisis. Deceptive advertisements for falsely "eco-friendly" products can convince consumers to continue purchasing polluting goods instead of switching to less damaging alternatives. Likewise, deceptive lobbying initiatives can persuade policymakers to delay the implementation of needed environmental policies by fostering the incorrect belief that voluntary actions by the industry will preempt the need for mandatory regulations.[3]

The repercussions of environmental disinformation can be particularly significant in the financial sector, which has a critical role in contributing to the climate and nature-related goals of the Paris and Kunming-Montréal Agreements.[4] Over the past twenty years, there has been a boom in the development of financial products and initiatives promoting distinctive environmental characteristics, which are often regrouped under the labels "Environmental, Social and Governance" (**ESG**), "sustainable finance", or "responsible investment" (collectively referred to as **SFRI**).

However, several studies and investigations have raised concerns about the real environmental credentials of SFRI products. For example, a 2021 global study of 723 equity funds marketed as ESG or climate-themed found that a majority of these funds' investment portfolios were not aligned with the goals of the Paris Agreement, and that many of these funds exhibited similar misalignment levels as regular (non-ESG) funds.[5] Similarly, in a 2023 study, researchers found that among 250 of the largest passive investments funds marketed as "socially responsible" or "environmentally friendly", only 5% were aligned with the goals of the Paris Agreement.[6]

Canadian regulatory authorities have also been scrutinizing financial institutions' SFRI claims. For example, in 2022, the Canadian Securities Administrators (**CSA**), the umbrella organization of Canada's provincial and territorial securities regulators, indicated that it had observed defective disclosure practices among Canadian ESG investment funds.[7] After reviewing the regulatory disclosures and sales communications of 32 of these funds, the CSA found that a third of them held investments in industries that should have been

[2] World Economic Forum (2024).
[3] Malhotra et al. (2019).
[4] United Nations Framework Convention on Climate Change (2015); Convention on Biological Diversity (2022).
[5] InfluenceMap (2021).
[6] Fichtner et al. (2023). Similarly, a study by Kim and Yoon (2023) of US active mutual funds that had signed the United Nations Principles for Responsible Investment, a voluntary initiative aimed at promoting ESG investing (UN PRI), showed that signatories did not improve their fund-level ESG scores after joining the initiative.
[7] Canadian Securities Administrators (2022a).

excluded based on the funds' investment strategies.[8] Moreover, one fifth of the ESG funds reviewed "had portfolio holdings that appeared to be inconsistent with the fund's name, investment objectives or investment strategies".[9]

Similarly, in its review of reporting issuers' continuous disclosures for 2021 and 2022, the CSA noted "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'."[10] According to the CSA, greenwashing appeared both in voluntary documents, such as an issuer's sustainability report, and mandatory documents, such as regulatory filings. The CSA also identified major gaps in reporting issuers' disclosure of climate risks: in 2021, more than 40% of public companies' climate risk disclosures were "boilerplate, vague or incomplete". Moreover, 25% failed to mention the financial impact of climate risks, and those that did discuss this impact failed to quantify it.[11]

Concerns around the accuracy of SFRI claims have triggered several complaints to consumer protection agencies and securities regulators for alleged greenwashing in Canada. For example:

- In April 2021, six citizens filed a complaint with the Competition Bureau of Canada (**CB**) against the Royal Bank of Canada (**RBC**), accusing the bank of misleadingly presenting itself as aligned with the Paris Agreement while engaging in substantial fossil fuel financing activities.[12]
- In February 2023, Investors for Paris Compliance (**I4PC**), an investor engagement organization, filed a complaint with the Alberta Securities Commission (**ASC**) against Enbridge, a fossil fuel transportation company, in relation to its issuance of sustainability-linked bonds (**SLBs**).[13] According to the complaint, which called for an investigation by the ASC and the publication of regulatory guidance on SLBs, Enbridge's SLB failed to include performance indicators based on the firm's absolute emissions, failed to properly measure its scope 3 emissions, and allowed the company to expand its fossil fuel activities.[14]
- In October 2023, Greenpeace Canada filed a complaint with the ASC against Suncor, alleging that the energy firm had inadequately disclosed its exposure to

[8] Idem.
[9] Idem.
[10] Canadian Securities Administrators (2022b).
[11] Canadian Securities Administrators (2021a).
[12] Ecojustice (2021). As of the last update, the CB's investigation remains ongoing. The CB has not publicly addressed the complaint or taken legal action against the Royal Bank of Canada regarding its climate claims at this point.
[13] Berkow, J. (2023). SLBs are discussed in more details in section 4.3.2.
[14] A similar complaint was filed in the US in respect of green bonds. As summarized by Setzer and Higham (2023): "A 'climate-washing' and fraud complaint was presented by the NGO Mighty Earth to the US Securities and Exchange Commission, calling for a full investigation into alleged misleading and fraudulent 'green bonds' issued by the Brazilian meat giant JBS. The complaint claims that JBS based the bond offerings on its commitment to achieve net zero emissions by 2040 – but that its emissions have in fact increased and the target excluded Scope 3 supply chain emissions that comprise 97% of its climate footprint."

climate-related risks.[15] According to the complaint, which called upon the ASC to investigate the matter, Suncor omitted to warn investors about potential stranded oil sands assets while increasing its financial exposure to such assets.

- In January 2024, I4PC filed a complaint with Québec's Autorité des marchés financiers (**AMF**) and the Ontario Securities Commission (**OSC**) against Canada's five biggest banks in respect of their sustainable finance activities.[16] According to the complaint, the banks engaged in so-called sustainable finance activities without adequately disclosing the climate impact of these activities.[17]

These Canadian controversies echo similar cases that have arisen in other jurisdictions. In the United States (**US**), allegations of deceptive environmental claims are being increasingly investigated and prosecuted by the Securities and Exchange Commission's (**SEC**) Climate and ESG Task Force. Similarly, the Australian Securities & Investments Commission (**ASIC**) has made a total of 47 enforcement interventions relating to greenwashing cases between April 2023 and June 2024.[18]

Box 1 – Defining greenwashing

Greenwashing takes place when an organization communicates false, misleading, or unsubstantiated information about its environmental credentials, leading stakeholders to form overly positive beliefs about the organization's environmental performance.[19] Greenwashing may include claims about various aspects of an organization, including the environmental performance of the entity itself, its products, practices, or relevant environmental facts, such as exaggerated statements regarding the environmental impact of specific business activities.[20]

Greenwashing encompasses the following communication practices:[21]

- Communicating purely false information
- Selectively disclosing information that does not reflect an organization, product, or activity's overall environmental performance (also known as "cherry picking")
- Exaggerating achievements
- Failing to deliver on past commitments
- Promoting irrelevant or legally mandatory accomplishments
- Using problematic certifications and labels or ambiguous symbols

[15] Greenpeace Canada (2023).
[16] Investors for Paris Compliance (2024a). The banks listed in the complaint are RBC, the Canadian Imperial Bank of Commerce (CIBC), the Toronto-Dominion Bank (TD), the Bank of Montréal (BMO) and the Bank of Nova Scotia (Scotia).
[17] Idem. As of the last update, the AMF and the OSC have not publicly addressed the complaint or taken legal action against the banks named in the complaint.
[18] Australian Securities & Investments Commissions (2023a, 2023b, 2023c, 2023d, 2023e, 2024a).
[19] Montgomery et al. (2023); de Freitas Netto et al. (2020).
[20] de Freitas Netto et al. (2020).
[21] Nemes et al. (2022).

- Making environmental claims that contradict one's individual or collective lobbying efforts
- Failing to substantiate claims with sufficient and easily accessible information
- Making vague and overly broad statements
- Making forward-looking statements that are unrealistic, unqualified or unsupported by credible action plans[22]

Numerous motivations drive private organizations to promote their environmental credentials, ranging from product differentiation and consumer and investor attraction to projecting the image of a socially responsible corporate entity. Stakeholders heavily rely on environmental information to compare the environmental performance of products and organizations and to make informed consumption, investment or democratic decisions. Yet, when such information is deceptive, it can distort stakeholders' decisions, leading:

- **Consumers** to purchase products that are more environmentally damaging than they appear
- **Investors** to invest in activities, products or organizations that have a higher environmental footprint, exposure to environmental risks, or potential for carbon lock-in
- **Voters and policymakers** to be less supportive of more ambitious environmental policies[23]

Greenwashing may also harm organizations making genuine environmental claims by breeding skepticism among stakeholders in respect of all environmentally-oriented communications. For instance, a 2023 survey reported that 57% of Canadian consumers have lost trust in brands' environmental assertions, and that 46% are reluctant to pay a green premium due to challenges in identifying authentically sustainable products.[24]

Similar trends were observed with respect to financial products and services. In a 2022 survey of Canadian retail investors, 75% of respondents indicated being concerned about greenwashing, and 78% showed support for more stringent and heightened regulation in the financial sector to address greenwashing.[25]

Financial greenwashing, which is greenwashing that takes place in the financial sector, may occur at the entity-level (e.g., a financial institution discussing the characteristics of its lending policy), during the provision of financial services (e.g., a financial advisor recommending a given investment product) or at the product-level (e.g., a claim on the characteristics of securities).[26]

Financial greenwashing results from the convergence of two different forms of information asymmetry: asymmetry in the observation of environmental characteristics; and asymmetry in the understanding of financial characteristics. On the one hand, financial

[22] This category is an addition to Nemes et al.'s (2022) list.
[23] Malhotra et al. (2019). See also: Werfel, S. (2017). For opposite findings, see Heeb et al. (2023).
[24] Deloitte (2023).
[25] Responsible Investment Association (2022).
[26] European Securities and Markets Authority (2023).

markets are inherently complex, and poor investment decisions can have major consequences on a person's life, making retail investors particularly vulnerable to financial intermediaries.[27] On the other hand, environmental claims are often difficult to verify and may rely on scientific principles that are difficult to understand for the layperson. Moreover, given the pivotal role that capital allocation plays in driving the environmental transition, financial greenwashing can be a major obstacle to achieving global environmental goals.

In addition to eroding investors' trust, financial greenwashing has the potential to result in financial risks that can harm the financial system's integrity.[28] For the organizations that greenwash, these risks include reputational, litigation, liability, strategic, business, liquidity, funding, credit and market risks.[29] These risks may spread to other organizations and threaten the stability of the entire financial system.

For example, in a recent report, the European Banking Authority indicated that there could be events "where green financial instruments, in their entirety or a substantial part of them, are no longer perceived as green, impacting negatively the sustainable financial markets' credibility and causing a widespread repricing and drop in liquidity, subsequently resulting in a risk to the entire financial system (e.g., fire-sales of green bonds)."[30] This risk can be amplified by contractual requirements that force asset managers to sell assets that do not comply with their SFRI investment mandates. These risks are likely to increase as SFRI financial products gain in popularity.[31]

In Canada, existing federal and provincial laws prohibit many forms of deceptive claims in the financial sector, including false, incomplete or misleading environmental claims.

For example, in Québec, the *Securities Act* (**QSA**) and *Regulation 51-102 respecting continuous disclosure obligations* **(R 51-102)** require publicly-traded firms to disclose their financially material environmental risks as part of their continuous disclosure obligations. Similarly, investment funds that are distributed to the public must disclose their investment objectives and strategies under *Regulation 41-101 respecting general prospectus requirements* (**R 41-101**) and *Regulation 81-102 respecting Investment Funds* (**R 81-102**), which may involve disclosing information about their integration of environmental risks and impacts.[32] Issuers and investment funds making incomplete, false or misleading disclosures may expose themselves to financial penalties as well as claims from investors that were negatively impacted by the deceptive disclosures.

Similar obligations exist at the federal level. For example, under the *Bank Act* (**BA**), banks are required to ensure that their advertisements in Canada, including those that relate to

[27] Duclos et al. (2024), section 1 of chapter 3.
[28] European Banking Authority (2023).
[29] Idem.
[30] Idem, p.38.
[31] Idem.
[32] The CSA's expectations about ESG-related funds' disclosures have been clarified in guidance document CSA Staff Notice 81-334 (Revised) – ESG-Related Investment Fund Disclosure. See Canadian Securities Administrators (2024a).

environmental performance, are "accurate, clear and not misleading".[33] A violation of this requirement can constitute a criminal offence punishable by a fine of up to $5 million.[34]

In addition to these sector-specific legal requirements, which are examined in more detail in Section 3, both federal and provincial consumer protection laws prohibit the making of false and misleading statements under some circumstances. As described in the CQDE's 2022 report on climate-washing, violations of these prohibitions can lead to investigations by the CB and Québec's Office de la protection du consommateur (**OPC**), criminal fines, administrative monetary penalties as well as lawsuits from private plaintiffs.[35] The provision of false or misleading information prior to the conclusion of a contract may also give rise to contract law remedies under the *Civil Code of Québec.*[36]

Upcoming regulatory developments could expand the stringency of federal and provincial laws applicable to SFRI-related claims. At the provincial level, in October 2021, the CSA issued *Draft Regulation 51-107 respecting Disclosure of Climate-related Matters* (**DR 51-107)**, which proposes to impose new climate-related disclosures to reporting issuers (see Box 4 for more details).[37] A revised version of this regulation is expected to be released by the CSA for consultation in the future, as further discussed in Box 4.[38]

At the federal level, the government announced in the 2023 Fall Economic Statement that it would explore options for "making climate disclosures mandatory for private companies".[39] Additionally, the government announced that it would build upon the Sustainable Finance Advisory Council (**SFAC**) Taxonomy Roadmap Report to develop a green and transition taxonomy aligned with achieving net-zero emissions by 2050.[40] If done in alignment with science and global climate and biodiversity commitments, the adoption of such a taxonomy, which is a classification system that sets common definitions and standards for sustainability labels, could facilitate the allocation of capital towards more sustainable activities and mitigate greenwashing risks.

Moreover, in March 2023, the Office of the Superintendent of Financial Institutions (**OSFI**), which supervises federally-regulated financial institutions such as banks (**FRFIs**), published a new guideline on climate-related risk management that will progressively require banks and insurance companies to make public climate-related financial

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[33] See s.627.14 of the BA.

[34] See s.985 of the BA.

[35] The role and enforcement powers of the CB and the OPC are extensively discussed in the CQDE's 2022 report on climate-washing. See Beaulieu and Bishai (2022). It should be noted that section 6 of the *Consumer Protection Act* indicates that business practices and contracts regarding transactions governed by the *Derivatives Act* or the *Securities Act* are exempt from the application of the *Consumer Protection Act.*

[36] See for example s.1401 and s.1407 of the *Civil Code of Québec*. Moreover, s.1375 of *Civil Code of Québec* requires the parties to a contract to act in good faith, which has been interpreted by case law as requiring the parties to share information with each other when information asymmetries exist between them. See Côté (2019). See also Banque de Montréal c. Bail ltée, [1992] R.C.S. 544, 586-587.

[37] Canadian Securities Administrators (2021a)

[38] Canadian Securities Administrators (2024b).

[39] Government of Canada (2023).

[40] Idem. This commitment was reiterated in the 2024 Budget. See: Government of Canada (2024a).

disclosures by end of fiscal year 2025 (**Guideline B-15**).[41] These requirements, which were announced by the federal government in the 2022 Budget, will complement the federal government's 2021 Budget request that federal Crown corporations publicly issue climate-related financial disclosures.[42]

These measures hold the potential to significantly increase the transparency and credibility of environment-related financial information in Canada by increasing the quantity, comparability and quality of the environmental information publicly disclosed by financial actors. As such, they can help mitigate greenwashing risks.

However, as we discuss throughout this report, even when taking into consideration upcoming developments, federal and provincial laws still fall short in implementing comprehensive rules to combat greenwashing. The CQDE's recommendations to address these issues and reform the regulatory framework applicable to the financial sector are provided in Section 5.

[41] Office of the Superintendent of Financial Institutions Canada (2023). As discussed further in Box 9, in July 2024, the AMF published, as Québec's provincial prudential regulator, a Climate Risk Management Guideline that is similar to Guideline B-15. See: Autorité des marchés financiers (2024a).

[42] Government of Canada (2021a).

3. The rise of ESG, sustainable finance and responsible investment

Over the past two decades[43], the financial sector has emerged as a potential driving force for stronger environmental action.[44] Several voluntary industry initiatives were developed, and the financial sector is increasingly acknowledging the need to align financial flows with planetary constraints:

- In 2003, a group of 10 international financial institutions adopted the Equator Principles, a voluntary risk management framework, establishing minimum environmental and social criteria for signatories to finance projects.[45] Since then, more than 100 financial institutions have adopted the principles.
- In 2005, a group of 20 investors including the Caisse de dépôt et placement du Québec, the Canada Pension Plan Investment Board and Bâtirente joined the United Nations Principles for Responsible Investment (**UN PRI**), a voluntary framework promoting the integration of ESG factors in investment decisions.[46] There are now more than 5,300 UN PRI signatories as of July 2024.
- At the 2021 COP in Glasgow, over 160 firms from the financial sector representing more than US$70 trillion in assets committed to reach net-zero emissions by 2050 as part of the Glasgow Financial Alliance for Net Zero (**GFANZ**), including Canada's six biggest banks.[47]

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[43] Fichtner et al. (2023) describe the evolution of the SFRI segment in three phases. First, SFRI investing relied on the exclusion of specific firms or industries – often on moral grounds. As the authors explain, the "origin of ESG investing can be seen in the anti-apartheid movement when investors from Europe and North America sought to avoid investment in companies active in South Africa. Even earlier attempts to do "socially responsible investing" focused on excluding so-called "sin stocks" (alcohol, tobacco, etc.) from investment portfolios and have been mainly pursued by religious groups". Second, in the early 2000s, the SFRI segment transitioned from a niche to a more mainstream investing approach, leading to the development of privately-governed ESG ratings, data, and indices. During this period, which saw the launch of the first passive investment funds tracking financial indices, the focus of investors was less on achieving moral objectives, and more on managing ESG-related financial risks. Third, since 2015, there has been a greater focus on achieving real-world impact and increasing involvement from policymakers and regulators. This period has also seen a rise in passive asset management, where "benchmark indices and major index providers increasingly shape the capital allocation of many investors". See Fichtner et al. (2023) for more details. The regulation of ESG data services is discussed at section 4.2.2

[44] Eric Usher, head of the United Nations Environment Program Finance Initiative (UNEP FI), explains this shift as follows: "In earlier days of the environmental movement, the relationship between public and private actors was simpler, somewhat idealistic, with environmental externalities expected to be simply priced in by government. Of course, we've learned [...] that getting pricing right and even getting the political ambition to do so is not easy. (...) Clearly the model that the private sector should wait to be regulated into action is somewhat flawed. And, of course, expecting that voluntary action on its own is enough is also often wishful thinking. (...) With this, the private finance community can [...] help catalyze governments to join the dance and create the conditions where the laggards have no choice but to also join the fray. Public and private action, both credible and ambitious – this is what the world needs today, both in Glasgow and beyond." See: Usher (2021).

[45] ING (undated).

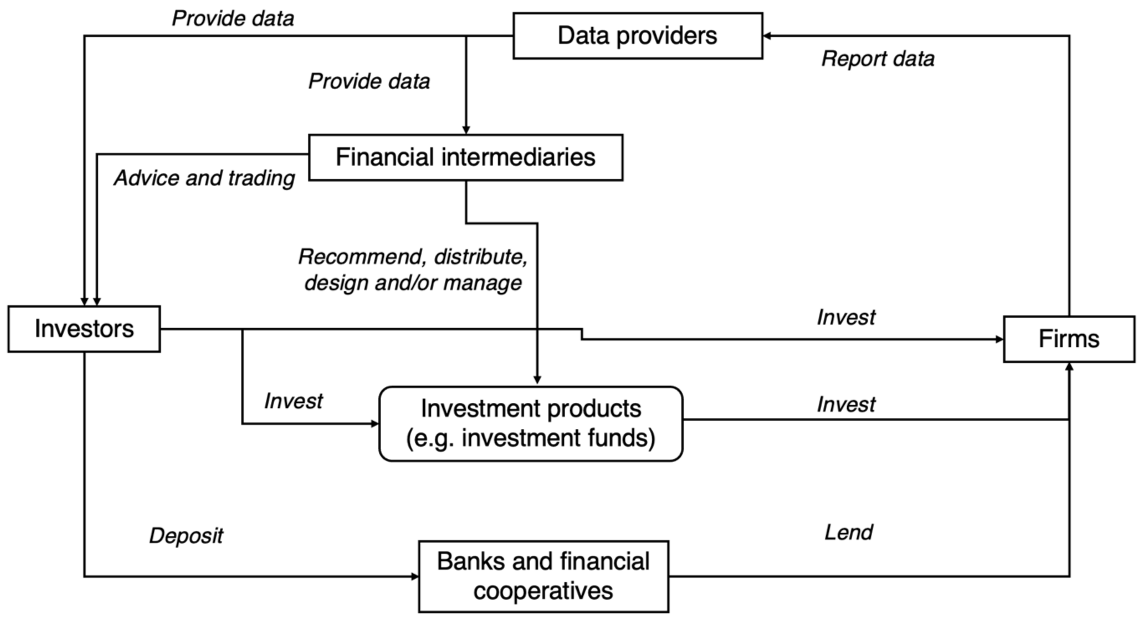
[46] Principles for Responsible Investment (undated).

[47] BMO Financial Group (2021).

The financial sector's role in addressing the environmental crisis has also been acknowledged in international environmental agreements. For example, in 2015, the Paris Agreement called for an alignment of financial flows with "a pathway towards low greenhouse gas emissions and climate-resilient development".[48] Similarly, in the fall of 2023, the Kunming-Montréal Agreement set the target of aligning all financial flows with the agreement's goals, which include the protection of at least 30% of the world's ecosystems.[49]

The financial sector plays an important role in allocating resources across the economy, which can have significant environmental implications.[50] By lending, investing, and providing insurance coverage to firms, financial actors can contribute to limiting the expansion of environmental harmful activities and support the development of a low-carbon, resilient and inclusive society.

Figure 1 – Relationships between the main private actors of the financial sector



Voluntary environmental initiatives may also be aligned with the interests of financial actors, who may rely on them to:

- **Mitigate their exposure to financial risks.** Financial actors may want to mitigate their exposure to environmental risks and ensure the long-term sustainability of their financial assets. For example, an increase in the frequency and size of floods and wildfires can increase insurance payouts for insurers; more stringent environmental regulations can result in asset value drops for pension funds and asset managers; and

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[48] United Nations Framework Convention on Climate Change (2015). These commitments aim at addressing the global climate and biodiversity financing gaps, which are respectively estimated at $2.4 trillion and $US 700 billion per year. See: United Nations Environment Program (2023); Kaplan (2023).
[49] Convention on Biological Diversity (2022).
[50] Without financial services, firms cannot obtain insurance coverage for their factories, pay their workers and suppliers, borrow funds and raise capital to expand their business.

changes in consumer preferences towards more sustainable products can lead to liquidity issues for firms and their lenders.

- **Benefit from financial opportunities.** Financial actors may want to seize financial opportunities arising from the environmental transition. For instance, investors may want to invest in renewable energy assets in anticipation that their value will increase as the world decarbonizes. Similarly, issuers of "green" financial products may seek to benefit from the potential interest rate premium, or "greenium", at which these products can sometimes be issued.
- **Signal their positive environmental record to stakeholders**. Financial actors may want to signal their good environmental performance to their stakeholders, such as employees, regulators and civil society. For example, a bank may expect that environmentally conscious employees are more likely to perform at work if they believe that their employer contributes to solving environmental issues.[51] Similarly, an investment manager may proactively set voluntary climate targets to pre-empt the imposition of mandatory environmental policies by regulators.
- **Differentiate their offering.** Financial actors may want to offer differentiated financial products that are tailored to the evolving needs of environmentally conscious investors. For instance, an investment fund manager may develop an investment fund dedicated to clean technology to attract investors wishing to achieve climate impact through their investment choices.

As a result of the mobilization of financial actors for the achievement of environmental goals and the development of SFRI products, environmental claims in the financial sector have proliferated.

Some of these claims relate to the environmental performance of **entities**, such as a reporting issuer's net-zero emissions commitment or the sustainability report of a bank that describes its sustainable finance activities. Other claims relate to the environmental performance of **products**, such as the contents of a "green" or "ESG" investment fund's prospectus. Finally, some claims are made in the context of investment **services**, such as the provision of advice on SFRI products by a financial advisor, or the aggregation of SFRI data into ratings by financial information providers.

While many of these claims are made voluntarily, some fall under mandatory disclosure regimes (see Box 4 and Box 6) and must follow particular content and format requirements. For example, from Budget 2021, federal Crown corporations are expected to issue climate-related disclosures that meet the requirements of the Task Force on Climate-Related Financial Disclosures (**TCFD**).[52]

The next section examines how federal and provincial laws apply to each of these three categories of environmental claims.

Box 2 – The ABCs of ESG

[51] On this topic, see: Robertson et al. (2023).

[52] Government of Canada (2021a).

The acronym ESG refers to environmental, social, and governance factors that may be used to measure an organization or an asset's environmental, social and governance performance. For illustrative purposes, the CSA provides the following non-exhaustive list of ESG criteria in its *Staff Notice (Revised) 81-334 ESG-Related Investment Fund Disclosure*[53] (**SN 81-334**).

Table 1: CSA's non-exhaustive list of ESG factors

Environmental	Social	Governance
Air and water pollution	Community relations	Audit committee structure
Biodiversity	Data protection / privacy	Board diversity
Climate change and carbon emissions	Diversity	Bribery and corruption
Deforestation	Employee engagement	Executive compensation
Energy efficiency	Human rights	Lobbying
Waste management	Indigenous inclusion and reconciliation	Political contributions
Water scarcity	Labour standards	Whistleblower schemes

There is no finite or official list of relevant ESG factors in Canada, as investors are free to decide which criteria matter for their needs and how to measure them. For example, an investor may consider that a firm's carbon footprint is a relevant and material financial metric to assess its exposure to ESG risks, but only consider the firm's scope 1 emissions as financially material, even if it represents a small portion of the firm's total carbon footprint.[54]

The lack of common definition of ESG has led to investor confusion and several controversies around the use of the acronym.[55] For example, one common misconception about the integration of ESG factors in the investment process is that it constitutes an indicator of "greenness". In fact, the labelling of an asset as "ESG" may only mean that ESG factors have been used to evaluate its risk profile, without providing any indication of the asset's environmental and social impacts.[56] For example, an asset considered "ESG" may cause significant harm to the environment, such as the construction of an electric vehicle battery plant in a fragile ecosystem, or the development of a renewable energy project that contravenes the rights of affected Indigenous people. Similarly, an asset that is associated with positive environmental impact may still be exposed to significant ESG risks, such as a solar farm exposed to flood risk. ESG ratings are discussed in more detail in subsection 4.2.2.

Table 2: When do stakeholders refer to an asset as being "ESG"?

	Low exposure to environmental risks	High exposure to environmental risks

[53] Canadian Securities Administrators (2024a).

[54] For a definition of scope 1, 2 and 3 emissions, we refer the reader to the CQDE's 2022 climate-washing report. See Beaulieu and Bishai (2022).

[55] Fichtner et al. (2023). See also Autorité des marchés financiers (2022) at page 13.

[56] Kishan (2020), cited by Fichtner et al. (2023).

Positive environmental impact	Could be labelled as "ESG" based on its impact	Could be labelled as "ESG" based on both impact and risk profile
Negative environmental impact	Could be labelled as "ESG" based on its risk profile	Unlikely to be labelled as "ESG"

In 2023, an "anti-ESG" political movement emerged in the United States, resulting in threats of antitrust prosecution, anti-boycott legislation and anti-ESG legislation.[57] Proponents of this movement argue, among other things, that financial institutions are illegally collaborating with each other to set sustainability standards (which can lead to the exclusion of certain assets from their portfolios) and breaching their fiduciary duties to maximize risk-adjusted financial returns.[58] Some of the measures introduced as part of this movement include legislation preventing public investors, such as state pension funds, from doing business with ESG investments funds that boycott certain industries, like fossil fuel producers.[59] So far, the anti-ESG movement has been limited to the United States.

On another front, some stakeholders have proposed to expand the ESG acronym into ESGI, the "I" letter standing for "Indigenous". For example, in a 2021 letter to the CSA, a group of Canadian Indigenous organizations criticized the fact that some of the main draft ESG standards being developed internationally failed to include Indigenous Reconciliation Principles. In their letter, they asked that future Canadian ESG standards be developed in consultation with Indigenous people.[60] Since then, some international sustainability reporting frameworks, like the Taskforce on Nature-related Financial Disclosures, have started to integrate Indigenous considerations in their disclosure guidelines.[61]

Box 3 – Size of the Canadian SFRI market segment

Given the lack of universal definitions about categories like "sustainable finance" or "responsible investment", estimates of the size of the SFRI market segment vary. According to estimates from the Responsible Investment Association, Canadian responsible investment assets under management have grown sharply between 2006 ($460 billion) and 2019 ($3,166 billion) but experienced a small decline between 2020 and 2022 ($2,931 billion).[62] In 2022, the market share of such assets as a percentage of all Canadian professionally managed assets was estimated at 49% by the Responsible Investment Association.[63]

[57] Goodlett et al. (2023). On anti-ESG threats against proxy advisors, see Hallez (2023).
[58] Idem.
[59] Idem.
[60] First Nations Financial Management Board et al. (2021).
[61] Taskforce on Nature-related Financial Disclosures (2023).
[62] Responsible Investment Association (2023). Ellmen (2023) explains this decline by the global tightening of the definitions ESG investment frameworks and a change in the reporting practices of certain asset managers.
[63] Idem.

4. Environmental claims in the financial sector

4.1. Entity-level claims

Entity-level claims are environmental claims by financial institutions and publicly-traded firms about their own environmental performance. This may include claims about the following sustainability topics:[64]

- **Metrics, actions, results and risks:** Entities may report on their environmental performance using environmental metrics, like greenhouse gas (**GHG**) emissions, use of resources, biodiversity impact, etc. Organizations may also describe their ongoing actions and projects relating to the environment. Moreover, they may report on their exposure to environmental risks and opportunities using qualitative and quantitative metrics.
- **Strategy, targets and governance:** Entities may communicate on their strategy to improve their environmental performance and make forward-looking statements about their objectives, like publishing a climate transition plan and setting net-zero targets. They may also explain how they plan to engage with their stakeholders to incentivize the adoption of more sustainable practices, discuss their investment policies, and indicate their participation in industry initiatives, like the UN PRI. Moreover, organizations may explain which governance mechanisms are in place to implement their environmental strategy, such as the attribution of specific responsibilities to board members or senior management.
- **Resources and expertise:** Entities may communicate on their ability to offer certain services with an environmental component, such as expertise in providing ESG investment advice.

Entity-level claims may be found in:

- **Mandatory communications**, such as a bank's annual report or a reporting issuer's Annual Information Form. As described further below, some of these mandatory communications are legally required to include specific environmental information. However, entities may also include additional, voluntary environmental claims in their mandatory communications.
- **Voluntary communications**, such as a web page dedicated to sustainability, an annual responsible investment or sustainability report, a presentation to investors or promotional materials like ads and marketing leaflets.

The following subsections discuss the legal frameworks applicable to environmental claims by specific actors of the financial sector.

[64] European Securities and Markets Authority (2023).

4.1.1 *Reporting issuers*

a) Description of the segment

As defined in the QSA, a reporting issuer is an entity which has "made a distribution of securities to the public", such as the listing of securities on a stock exchange (QSA s.68). Securities are financial assets that can be traded on financial markets, such as shares, bonds, subscription rights or receipts, options and warrants (QSA s. 1). There are approximately 1,200 reporting issuers in Québec (excluding investment funds), many of which are active in the natural resources sector.[65] Most Canadian reporting issuers are relatively small, emerging entities, and several of them are cross-listed on US stock markets.

b) Legal framework

i. Pre-issuance prospectus disclosures

Under the QSA, issuers wishing to distribute securities to the public must, unless an exemption applies, prepare a prospectus that provides detailed information about its financial situation, activities and governance to allow prospective investors to make informed investment decisions (QSA s.11).[66] Prospectuses are subject to review and approval by the AMF, which may issue a "receipt" to the issuer (QSA s.11, s.14). The QSA requires issuers to provide in their prospectus a "full, true and plain disclosure of all material facts relating to the securities issued or proposed to be distributed" (QSA s.13). As indicated in *Form 41-101F1 – Information Required in a Prospectus*, materiality is a matter of circumstances, and it must be determined based on an item's significance for information users.[67]

R 41-101 and the corresponding form[68] explicitly identify material information that a prospectus must minimally include, such as a description of the issuer's business; a description of the issuer's projected use of the proceeds generated by the securities distribution; a Management's Discussion and Analysis[69] (**MD&A**); and the risk factors facing the issuer, including environmental risks and regulatory constraints.

These requirements may lead issuers to disclose material financial information related to their environmental performance. For example, *Form 41-101F1 – Information Required in a Prospectus* adopted in connection with R 41-101 expressly indicates that an issuer shall disclose any "environmental policies that are fundamental to the issuer's operations" and the steps taken to implement them.

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[65] Autorité des marchés financiers (2024b).

[66] Unless an exemption applies. For information on prospectus exemptions, see Kravitz and Roy (2010).

[67] As indicated in the form, an item should be "considered material if it is probable that its omission or misstatement would influence or change an investment decision with respect to the issuer's securities. In determining whether information is material, [reporting issuers must] take into account both quantitative and qualitative factors. The potential significance of items must be considered individually rather than on a net basis if the items have an offsetting effect."

[68] See Form 41-101F1 – Information Required in a Prospectus.

[69] As described in Form 51-102F1 – Management's Discussion & Analysis, the MD&A is "a narrative explanation, through the eyes of management, of how [the] company performed during the period covered by the financial statements, and of [the] company's financial condition and future prospects."

ii. Post-issuance regulatory disclosures

Once they start distributing their securities to the public, reporting issuers are required to periodically disclose information to the AMF about their business and internal affairs (QSA, s.68 and s.73). As prescribed by R 51-102, these continuous disclosure documents (**CD Documents**) include the reporting issuer's annual and interim financial statements, Annual Information Form[70] (**AIF**), MD&A and Material Change Reports[71] (**MCRs**).[72] As for the prospectus, the purpose of these documents is to provide investors with material information that is likely to influence their decision to invest in an asset, such as information on a firm's business, products and exposure to certain risks. Non-material information may still be disclosed by reporting issuers on a voluntary basis.

To determine whether information is material, *Form 51-102F2 Annual Information Form* indicates at Part 1, paragraph (f), that reporting issuers may ask themselves the following questions: "Would a reasonable investor's decision whether or not to buy, sell or hold securities in your company likely be influenced or changed if the information in question was omitted or misstated? If so, the information is likely material."

Like R 41-101, R 51-102 expressly mentions the requirement for reporting issuers to disclose information on certain environmental issues.[73] For example, an issuer's AIF must include a description of the "financial and operational effects of environmental protection requirements on the capital expenditures, profit or loss and competitive position of [the] company in the current financial year and the expected effect in future years."[74] Similar

[70] As described in Form 51-102F2 – Annual Information Form, the AIF is a "disclosure document intended to provide material information about [the] company and its business at a point in time in the context of its historical and possible future development. [The] AIF describes [the] company, its operations and prospects, risks and other external factors that impact [the] company specifically. This disclosure is supplemented throughout the year by subsequent continuous disclosure filings including news releases, material change reports, business acquisition reports, financial statements and management discussion and analysis." The AIF is only required for firms wishing to use a short-form prospectus.

[71] As noted in R 51-102 at s.7.1(1), "If a material change occurs in the affairs of a reporting issuer, the reporting issuer must (a) immediately issue and file a news release authorized by an executive officer disclosing the nature and substance of the change; and (b) as soon as practicable, and in any event within 10 days of the date on which the change occurs, file a Form 51-102F3 Material Change Report with respect to the material change." Material change is defined as R 51-102, s.1.1 as meaning "(a) a change in the business, operations or capital of the reporting issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the reporting issuer; or (b) a decision to implement a change referred to in paragraph (a) made by the board of directors or other persons acting in a similar capacity or by senior management of the reporting issuer who believe that confirmation of the decision by the board of directors or any other persons acting in a similar capacity is probable".

[72] In addition to those listed, R 51-102 also mentions the Business Acquisition Reports, which must be filed in connection with significant acquisitions by reporting issuers, as well as the Statement of Executive Compensation. R 51-102 s.11.1 and ss.12.1-12.2 also provide for additional disclosure requirements, such as the filing of material contracts.

[73] However, the QSA does not require the reporting issuer to disclose how its activities impact the environment – an approach commonly referred to as "single materiality", as opposed to a "double materiality" approach, which involves disclosing both how the environment impacts the firm's activities and how the firm's activities impact the environment.

[74] See Form 51-102F2 Annual Information Form. Moreover, if the issuer "has implemented social or environmental policies that are fundamental to [its] operations, such as policies regarding [the] company's relationship with the environment or with the communities in which it does business, or human rights policies", these policies shall

requirements apply to the MD&A.[75]

As in the prospectus, CD Documents may need to include material environmental information, even if it is not specifically identified as such in the regulation.[76] For example, Form 41-102F2 requires reporting issuers to disclose, in their AIF, material risk factors that the issuer and its business are facing. This could include, for example, material information on the issuer's exposure to changing climate patterns, or the impact of more stringent carbon pricing regulations on its business.[77] Similarly, Form 51-102F1 requires reporting issuers to include information in their MD&A on their overall performance, such as information on "changes in customer buying patterns" or "progress in achieving previously announced milestones". This could include, for example, information on the increase in consumer demand for low-carbon goods or on the issuer's progress with respect to its climate targets.[78]

The CSA has issued two staff notices (**SN**) on reporting issuers' obligations to disclose material information on environmental matters in their CD Documents. These SNs complete *National Policy 51-201 – Disclosure Standards*, which provides generic guidance on best disclosure practices for reporting issuers. They also complete *SN 51-330 – Guidance Regarding the Application of Forward-looking Information Requirements under NI 51-102 Continuous Disclosure Obligations*, which provides specific guidance on the disclosure of forward-looking information.[79] While these SNs do not introduce new legal obligations, they provide a useful overview of the CSA's expectations about reporting issuers' environmental disclosures.

- **SN 51-333 – Environmental Reporting Guidance[80]:** Published in 2010, this notice provides guidance on the application of the QSA's existing continuous disclosure obligations to environmental matters, such as air quality, land use, water management and waste disposal. SN 51-333 identifies five categories of environmental matters that may be subject to disclosure: (i) environmental risks[81], (ii) trends and uncertainties, (iii) environmental liabilities, (iv) asset retirement obligations, and (v) financial and operational effects of environmental protection requirements. The guidance provides examples of questions that may help issuers

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be described together with the steps taken to implement them. Similarly, the issuer must identify in the AIF any environmental risks, regulatory constraints, economic or political conditions that are likely to "influence an investor's decision" to invest in its business. Material legal proceedings and regulatory actions – which may relate to environmental issues – must also be disclosed. See item 12 of the Form 51-102F2 Annual Information Form. Moreover, companies with mineral projects are subject to additional disclosures with respect to environmental liabilities and permitting, as well as "reasonably available information" on environmental and social factors related to the project. See Form 51-102F2 Annual Information Form, at item 5.4.

[75] For example, "for issuers that have significant projects that have not yet generated revenue", the MD&A must discuss "any factors that have affected the value of the project(s) such as change in commodity prices, land use or political or environmental issues." See item 1.4 of Form 51-102F1 – Management's Discussion & Analysis.

[76] Canadian Securities Administrators (2018) at page 5.

[77] Idem.

[78] See item 1.5 of Form 51-102F1 – Management's Discussion & Analysis.

[79] CSA (2002; 2009).

[80] Canadian Securities Administrators (2010).

[81] Risks include litigation risks, physical risks, regulatory risks, reputational risks and risks relating to the business model. See: Canadian Securities Administrators (2010).

identify what to include in their CD Documents[82]. It also includes guidance on risk oversight and management disclosures and examples of environmental disclosure wording.

- **SN 51-358 – Reporting of Climate Change-related Risks[83]:** Published in 2019, this notice follows a 2018 study in which the CSA observed that the climate-related information disclosed by issuers lacked comprehensiveness, consistency, and comparability.[84] Building upon SN 51-333, SN 51-358 describes (i) the responsibilities of the issuer's board and management for the preparation, review and approval of climate-related disclosures; (ii) best practices for climate-related disclosures, such as avoiding vague or boilerplate statements; (iii) how to determine whether a particular climate-related risk is material and requires disclosure; (iv) where to disclose such risks (i.e., in the AIF and the MD&A); and (v) the main categories of physical[85] and transition[86] climate-related risks, together with questions to assess their materiality.[87] The guidance also notes that voluntary disclosures included in CD Documents or other voluntary publications (like a sustainability report published on the issuer's website) shall not "obscure material information" or "contain any misrepresentations".

iii. Sanctions for inadequate disclosures[88]

A reporting issuer's communication of false, misleading or incomplete information in a prospectus or CD Documents can have severe consequences for the issuer, its officers,

[82] For example, with respect to physical risks, a reporting issuer may consider the following questions: "How is the issuer likely to be affected by physical risks of environmental matters, such as the impacts of industrial contamination, changing weather patterns and water availability?" and "What risk management, adaptation and mitigation strategies has the issuer adopted, or is the issuer planning to adopt in the near future? What are the expected costs of those strategies?". See: Canadian Securities Administrators (2010) at page 9.

[83] Canadian Securities Administrators (2019).

[84] Canadian Securities Administrators (2018). The study also found that issuers disclosed limited quantitative information on climate-related risks, and were free to make selective disclosures under voluntary reporting frameworks. The study included a review of 78 issuers' CD Documents and voluntary disclosures; a survey of all TSX-listed issuers; and 50 consultations with stakeholders. The study did not lead the CSA to request re-filings, restations or corrective actions from issuers. However, the CSA "noted variations in disclosure practices and room for improvement in the disclosure of several issuers". For instance, the CSA found that 44% of the issuers reviewed either provided "boilerplate [climate-related] disclosure or no disclosure at all" in their CD Documents. When the CSA asked issuers to explain why they omitted such information from their disclosures, "their principal explanation was that they only disclosed such information to the extent it had been determined to be material, and that other information was omitted because they concluded it was not material." Many respondents to the CSA's survey also noted that the uncertainty associated with the timing and measurement of climate-related risks were making their materiality assessments challenging. The vast majority of the users of climate-related disclosures consulted by the CSA indicated that the quality of issuers' climate-related disclosures had to be improved.

[85] For example, the exposure to extreme weather events.

[86] As indicated in SN 51-358, these include reputational, market, regulatory, policy, legal and technology risks. See: Canadian Securities Administrators (2019).

[87] For example: "What is the issuer's exposure to emissions-limiting regulations? How does the geography of the issuer's operations factor into this analysis?" See Canadian Securities Administrators (2019) at page 14.

[88] A comprehensive description of these sanctions is beyond the scope of this report. For an insightful review of the QSA's information disclosure obligations and potential sanctions in case of non-compliance in connection with climate-related disclosures, see Coiteux et al. (2023).

directors and employees.[89] For instance, it can lead to:

- **Rejection of prospectus:** The AMF shall refuse to issue a receipt if it considers that a prospectus contains a "statement, promise, estimate or forward-looking information that is misleading, including through plain and simple omission, or contains a misrepresentation" (QSA s.15).[90]
- **Requests to restate and refile:** In 2002, the AMF established a continuous disclosure review program (**CDR Program**) to monitor reporting issuers' compliance with the QSA's continuous disclosure requirements.[91] As part of the CDR Program, the AMF may communicate recommendations and observations to issuers about disclosure deficiencies, and follow up to ensure timely and appropriate resolution by the issuers.[92] If the AMF detects material deficiencies or errors, it may require issuers to (i) restate and refile their CD Documents and (ii) issue a press release explaining the correction.[93]
- **Order to cease any activities, injunctions and other public interest measures:** Section 265 of the QSA allows the AMF, in cases where a reporting issuer fails to meet its regulatory disclosure obligations, to "order a person to cease any activity in respect of a transaction in securities". The AMF may also apply for an injunction before the Superior Court in respect of any matter relating to the QSA (QSA s.268). Moreover, the AMF may apply for an order by the Financial Markets Administrative Tribunal (**FMAT**), an administrative court, against a person who failed to comply with securities law requirements (QSA s.262.1). The order may require the person to comply with the law or decisions of the AMF, rescind any transaction relating to trading in securities and repay to a security holder the money paid for securities.
- **Administrative sanctions**: The QSA allows the FMAT to impose an administrative monetary penalty of up to $2 million for each contravention (directly or by aiding, either by an act or omission) to the QSA or to related regulations (QSA s.273.1), in addition to the payment of the AMF's inspection or investigation costs (QSA s.273.2).
- **Penal sanctions:** The QSA contains several penal provisions that prohibit issuers' deceptive communications practices. For example, under the QSA, it is an offence to:
    - Fail to furnish mandatory information or documents within the prescribed time (QSA ss.195(3)).
    - Provide false documents or information to the AMF (QSA ss.195(6)).
    - Influence or attempt to influence "the market price or the value of securities by means of unfair, improper or fraudulent practices" (QSA s.195.2).

[89] Section 208 of the QSA also establishes a liability regime for persons who aid the person committing an offence, or who, by incitation, counsel, order or incite a person to commit an offence.
[90] In the course of a securities distribution, in addition to their prospectus, issuers may use certain advertising documents. However, they shall not distort the information contained in the prospectus "by selective presentation or by adding misleading statements" in their marketing materials (QSA s.16(3)).
[91] Autorité des marchés financiers (undated a).
[92] Idem.
[93] Idem.

- Make a misrepresentation in a prospectus or CD Documents (QSA s.196 and par.197(5)).[94] The QSA defines the term "misrepresentation" as "any misleading information on a material fact as well as any pure and simple omission of a material fact" (QSA s.5), i.e., a "fact that may reasonably be expected to have a significant effect on the market price or value of securities issued or securities proposed to be issued." (QSA s.5).
- Make a misrepresentation, other than in a way described at s.196, in respect of a transaction in a security.[95]

A violation of s.195 by a legal person can lead to a fine that can reach up to $200,000 or four times the profit realized from the contravention, whichever is the greater amount (QSA s.202). Similarly, a violation of s.195.2 and s.196 by a legal person can lead to a fine that can reach up to $5 million, four times the profit realized or one fifth of the funds invested, whichever is the greatest amount (QSA s.204.1).[96]

Violations of the QSA may be identified following an investigation by the AMF, which may result from observations made as part of the agency's CDR Program. Investigations may also be triggered by private complaints from investors or other stakeholders. The QSA grants the AMF with large investigation powers to ensure compliance with the statute (QSA s.239-248). Moreover, the AMF has the power to directly institute penal proceedings for offences under a provision of the QSA (QSA s.210) and may even apply for compensatory and punitive damages on behalf of other persons (QSA s.269.2).

- **Civil claims – primary market[97]:** Investors who have "subscribed for or acquired securities in a distribution effected with a prospectus containing a misrepresentation may apply to have the contract rescinded or the price revised" (QSA, s.217). Investors may also seek compensatory damages from the issuer if they have incurred damages as a result of a reporting issuer's prospectus misrepresentations (QSA s.217 and s.218).[98]

[94] A similar definition is included in s.197.

[95] Section 197 also applies in respect of misrepresentations "in the course of soliciting proxies or sending a circular to security holders" (par.197(2)) and "in any document forwarded or record kept by any person pursuant to" the QSA (par.197(5)). Section 197 includes a definition of "misrepresentation" that is similar to the one provided at s.5 of the QSA. See also Coiteux et al. (2023).

[96] Moreover, section 205 of the QSA states that "[e]very officer, director or employee of the principal offender, including a person remunerated on commission, who authorizes or permits an offence under this Act is liable to the same penalties as the principal offender". Similarly, section 208 extends penal liability to any person "who, by act or omission, aids a person in the commission of an offence". These provisions are subject to the same enforcement mechanisms as those listed above. As stated in the QSA, "In determining the penalty, the court shall take particular account of the harm done to the investors and the advantages derived from the offence."

[97] Additional remedies may be sought in respect of misrepresentations in forward-looking information. See QSA s.225.0.1.

[98] The QSA also provides for compensation claims against the issuer's officers or directors, the securities dealer and the expert whose opinion contained a misrepresentation that was included in the prospectus. See QSA ss.218-219.

- **Civil claims – secondary market[99]:** Investors who have acquired or disposed of a security in the secondary market and have incurred damages as a result of misrepresentations in a "document" or a "public oral statement" by the issuer or an influential person[100] may seek compensatory damages under the QSA (QSA s.225.2-225.33). Plaintiffs are not required to prove that they relied on the misrepresentation to obtain compensation (QSA s.225.12). The term "document" is defined broadly to include (i) any writing filed with the AMF, a government, a government agency or a stock exchange, whether voluntarily or not, and (ii) any document "which would reasonably be expected to affect the market price or value of a security of the issuer", which could include a large number of documents like webpages, press releases and marketing materials (QSA s.225.3).[101] Different liability regimes will apply depending on whether a claim is filed against the issuer, its directors, its officers, influential people or experts that have contributed to the misrepresentation; whether the misrepresentation was included in CD Documents or other types of documents; and whether the misrepresentation relates to a failure to disclose a material change.

  While the QSA's secondary market liability regime can theoretically apply to a wide range of misrepresentations, bringing forward secondary market claims can be a complex task. As for class actions under the Québec *Code of Civil Procedure*, applications may only be brought if they are authorized by a court. Moreover, in some situations, plaintiffs will be required to prove that the defendant committed a gross fault. In addition, defendants will be able to defeat an action if they can prove that they acted diligently (QSA s.225.17-225.18) or, with respect to forward-looking statements, if they can prove that the statements included "reasonable cautionary language", that "material factors or assumptions that were applied" and that the "defendant had a reasonable basis" for making these statements" (QSA s.225.22). For claims that end up being successful, the QSA establishes methods to evaluate damages and apportion them between defendants.

Box 4 – Climate-related disclosure requirements for reporting issuers[102]
In October 2021, the CSA issued DR 51-107, a draft regulation aimed at standardizing issuers' disclosure of climate-related information to provide consistent, comparable and decision-useful information to investors and ensure alignment with international standards.[103] Under the regulation, reporting issuers would be required to disclose their

[99] Another potential source of legal liability is the breach of fiduciary duty. For additional information on this source of liability, see: Commonwealth Climate and Law Initiative and Climate Governance Initiative (2021).

[100] Defined in QSA s.225.3 as referring, in the case of a reporting issuer, to a "control person, a promoter, an insider who is not a director or officer".

[101] Stikeman Elliot LLP (2012). See also: Rousseau (2010), item 3, paragraph 40.

[102] On the effectiveness of mandatory carbon reporting to limit unrepresentative environmental disclosures, see Grewal et al. (2022).

[103] Climate-related disclosure requirements aim at addressing two different market failures: the lack of standardized disclosure practices across issuers, which decreases the comparability and consistency of information available to investors; and the information asymmetry that exists between investors and reporting issuers, which prevents investors from properly assessing the risk profile of the firms in which they invest.

scope 1, 2, and 3 GHG emissions[104] using the GHG Protocol methodology or an equivalent approach.[105] Reporting issuers would also be obligated to disclose material information pertaining to climate-related risks and opportunities, including the issuers' processes to manage these risks and the targets utilized for such management. These obligations would complement existing environmental disclosure requirements for reporting issuers under R 51-102. DR 51-107 is closely aligned with the TCFD's climate disclosure recommendations.[106]

The members of the CSA were among the world's first securities agencies to propose to regulate climate disclosures. However, as of September 15, 2024**,** the new requirements have not yet been adopted, resulting in growing pressure from stakeholders to accelerate their implementation.[107]

This delay may have been partly influenced by two significant international developments.[108]

First, in March 2022, the SEC released a draft proposal to require domestic and foreign issuers to incorporate specific climate-related information in their securities filings.[109] A final version of these climate-related disclosure rules (the **SEC Rules**) was adopted on March 6, 2024.[110] Under the SEC Rules, registrants would be required to disclose their exposure to climate-related risks and their governance and management processes to deal with these risks.[111] Moreover, with the exception of certain exempted registrants, issuers would be required to disclose their scope 1 and 2 GHG emissions if they are material.[112] Registrants would also be required to provide information on their climate-related targets if they are material to their business, results of operations, or financial condition.[113] Shortly after the adoption of the final version of the SEC Rules, several businesses and business interest groups filed lawsuits to challenge their validity, and the SEC decided to suspend their

[104] During the consultation on the content of DR 51-107, the CSA sought public input on two potential disclosure approaches. Under the first approach, issuers would have the ability to choose to either disclose their emissions for each scope or provide explanations for not disclosing all their emission scopes (i.e., comply or explain why they are not complying). Under the second approach, issuers would be required to disclose their scope 1 emissions and avoid disclosing their scope 2 and 3 emissions by explaining why they are not complying. While most respondents were supportive of scope 1 and 2 disclosure, respondents had mixed views on scope 3 disclosure. See Sarra et al. (2022). See also Canadian Securities Administrators (2018) at page 21 for a summary table of users' views about the pros and cons of GHG emissions disclosure.
[105] More information is provided on the GHG Protocol in the CQDE's climate-washing report at page 18 and following. See Beaulieu and Bishai (2022).
[106] With the exception of the requirement to use climate-related scenarios and the requirement to disclose scope 1 and scope 2 emissions, and, if appropriate, scope 3 emissions.
[107] Sarra, J. (2024).
[108] Canadian Securities Administrators (2022c).
[109] U.S. Securities and Exchange Commission (2022c; 2024).
[110] U.S. Securities and Exchange Commission (2024). In April 2024, the implementation of the rules was voluntarily stayed by the SEC after the filing of several lawsuits challenging its validity. As of September 15, 2024, these challenges were still pending. For an overview of these challenges, see Balsanek et al. (2024).
[111] Idem.
[112] Idem.
[113] Idem.

implementation for the duration of the judicial review process.[114] The future of the SEC Rules is therefore uncertain as of September 15, 2024.

Second, in June 2023, after two years of public consultations, the International Sustainability Standards Board (**ISSB**), a global organization responsible for setting standards for sustainability-related financial disclosures, released its first two standards, including the *IFRS S2 Climate-related Disclosures* standard (**IFRS S2**).[115] This standard establishes requirements for the disclosure of climate-related risks and opportunities in the context of financial reporting. IFRS S2 compliant disclosures shall include, among other things, the reporting entity's scope 1, 2 and 3 GHG emissions and its climate-related targets. Financial institutions engaged in asset management, commercial banking and insurance activities are subject to specific disclosure requirements.

Following the publication of these standards, the Canadian Sustainability Standards Board (**CSSB**) was established with the mission to adapt the ISSB's standards to the Canadian context. On March 13, 2024, the CSSB issued for consultation its draft *Canadian Sustainability Disclosure Standard 2: Climate-related Disclosures* (**CSDS 2**).[116] The CSSB sought views on three main deviations from IFRS S2: an extension of disclosure timelines, the requirement to conduct climate-related scenario analysis, and the disclosure of scope 3 GHG emissions.[117] The CSSB closed the consultation on CSDS 2 on June 10, 2024, and expects to adopt its standard by Q4 2024.[118]

Compliance with the ISSB standards is currently voluntary[119] and compliance with the SEC Rules will only be required for US-listed issuers (assuming that they are upheld by the courts). However, the publication and implementation of these standards is likely to accelerate the finalization of DR 51-107. Following the publication of CSDS 2, the CSA declared that the agencies "will consider the final CSSB standards and may include modifications appropriate for the Canadian capital markets".[120] The group also indicated that it would continue to evaluate international developments regarding climate disclosures, including the US SEC Rules.[121]

Compliance costs and the risks of regulatory arbitrage are two constraints that are likely to be raised as the CSA finalizes the new rules:

- **Compliance costs**: There has been a notable decline in the number of firms choosing to distribute securities to the public in Canada over the past years. These firms have

[114] U.S. Securities and Exchange Commission (2024b). For an overview of these challenges, see Balsanek et al. (2024).
[115] International Sustainability Standards Board (2023).
[116] Canadian Sustainability Standards Board (2024).
[117] Idem.
[118] Idem.
[119] As noted by the CSA, ""In order to become mandatory under Canadian securities legislation, the CSSB standards must first be incorporated into a CSA rule. Once the CSSB consultation is complete and its standards are finalized, the CSA anticipates seeking comment on a revised rule setting out climate-related disclosure requirements." See: Canadian Securities Administrators (2023a; 2024b).
[120] Idem.
[121] Idem.

preferred to seek financing through private capital markets — a trend that some observers attribute to the administrative burden facing reporting issuers.

- **Arbitrage**: North American securities markets are highly integrated, and under the current framework, Canadian firms may choose to only list in the U.S., bypassing Canadian markets entirely if they find the domestic requirements too onerous. Similar arbitrage concerns exist at the provincial level: firms may avoid a province's securities market if its regulations diverge significantly from those of other provinces.

These concerns will have to be weighed against the benefits of ambitious sustainability disclosure rules, notably the possibility for reporting issuers to attract sustainability-oriented investors and the prevention of deceptive claims about sustainability risks and impacts.

One potential solution to these concerns is to establish sustainability disclosure rules that apply to all firms of a certain size, not just reporting issuers. As described below in Box 5, this approach has been adopted by the European Union (**EU**) under the Corporate Sustainability Reporting Directive. The Canadian government may also be considering this approach in relation to climate-related disclosures (see Box 8).

Box 5 – European corporate sustainability disclosure requirements

Climate-related disclosures can help investors access standardized, high-quality corporate sustainability data. Together with standards, taxonomies, and labeling schemes aimed at setting common definitions in the marketplace, these disclosure requirements can help mitigate greenwashing risks by improving the availability, consistency, and quality of the climate-related data issued by companies.

However, these measures are not a panacea: they are typically risk-focused (i.e., excluding impact) and limited to climate-related indicators (as opposed to biodiversity, water and other environmental indicators). Moreover, some rules may be overly general (which can harm comparability), limited in scope (e.g., by allowing issuers to only disclose some of their GHG emissions) or silent on the use of important environmental performance indicators. Finally, these rules may not lead to the disclosure of accurate, substantiated and verified information unless adequate monitoring and enforcement mechanisms are put in place. The European corporate sustainability disclosure regime, which is described below, addresses some of these shortcomings.

In April 2021, the European Commission adopted the Corporate Sustainability Reporting Directive (**CSRD**), which establishes new sustainability reporting requirements for large private and public European firms, non-European firms with significant operations in the EU and certain public SMEs.[122] The CSRD's reporting obligations started to apply to certain

[122] To be considered large, EU companies must meet at least two of the following three criteria: have more than 250 employees, have a turnover of at least €50 million and have total assets of at least €25 million. Non-EU companies are subject to the directive if they have an aggregated revenue of over €150 million within the EU, provided they have at least one branch in the EU generating more than €40 million in revenue or a large EU subsidiary. See: KMPG (2024).

categories of entities on January 1, 2024 and will progressively be phased in until 2028 to apply to almost 50,000 companies.[123]

The CSRD requires organizations to report under the European Sustainability Reporting Standards (**ESRS**).[124] The ESRS are designed to cover the entire value chain of an organization, including its suppliers and customers. Moreover, these standards follow a double materiality approach, which means that covered entities are required to disclose information on both:

- the material sustainability risks and opportunities facing their organization [125]; and
- the material sustainability impacts resulting from their activities.[126]

As of September 15, 2024, the ESRS includes two cross-cutting standards, which set disclosure obligations for all covered organizations, and 10 thematic standards, for which disclosure is only required when information is material from an impact or financial perspective.[127] The thematic standards cover three aspects of sustainability performance: environmental issues (such as climate change, pollution, water and marine resources, biodiversity and ecosystems and resources use), social issues (workforce, workers in the value chain, affected communities, consumers and end users) and governance issues.

Each of the thematic ESRS set disclosure requirements across four reporting areas: (i) governance (e.g., roles and responsibilities of the board of directors); (ii) strategy (e.g., aspects of the organization's strategy that relate to sustainability); (iii) the management of impacts, risks and opportunities (e.g., which process is in place to identify sustainability risks), and (iv) metrics and targets.[128]

For example, under the ESRS E1 standard, which focuses on climate issues, organizations facing material climate risks and/or generating material climate impacts must report the physical risks facing the organization, the organization's scope 1, 2 and 3 GHG emissions, the organization's transition plan, etc. Organizations are also required to report on metrics that reflect their alignment with the EU Taxonomy, such as the proportion of taxonomy-aligned capital expenditures and the turnover derived from taxonomy-aligned activities.[129]

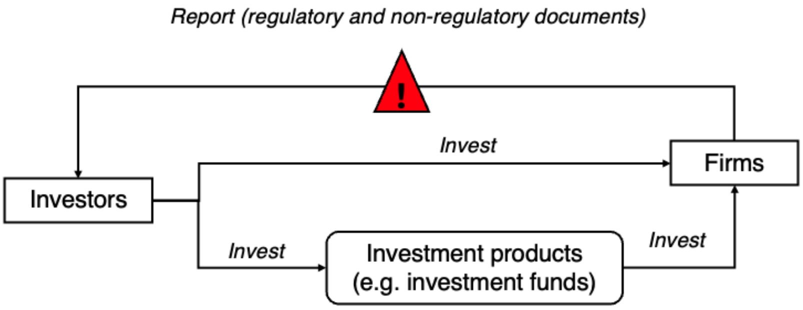
The CSRD's reporting requirements will be complemented by those of the *Corporate Sustainability Due Diligence Directive,* which was adopted in April 2024.[130] Once incorporated into national law by EU Member States, this directive will require certain large EU entities to establish policies and mechanisms to address environmental and human rights impacts within their operations and supply chains.

[123] Idem.
[124] KMPG (2023a).
[125] Based on the severity and likelihood of the impact. See: KPMG (2023b).
[126] Based on the likelihood and potential size of the financial effect. See: KPMG (2023b).
[127] Carbone 4 (2023).
[128] KPMG (2023).
[129] EFRAG (2022).
[130] Tréfois (2024).

c) Greenwashing risks

As noted above, reporting issuers that communicate false, misleading or incomplete information in a prospectus, CD Documents or other documents may violate the QSA's information disclosure rules, which can lead to a wide range of sanctions, including penal and administrative sanctions and market compensation claims. This is also true for the communication of deceptive information (or lack thereof) about reporting issuers' environmental performance.

Figure 2 – Greenwashing risks in the reporting issuers segment



In 2022, the CSA issued *Staff Notice 51-364 Continuous Disclosure Review Program Activities* (**SN 51-364**) to summarize the results of its continuous disclosure review program for fiscal years 2022 and 2021.[131] In SN 51-364, the CSA noted having "observed 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 (…)."[132] The potential greenwashing cases were identified in both CD Documents and voluntary documents, including "sustainability or ESG reports and public surveys".[133] The CSA noted the following examples of overly promotional environmental disclosures:[134]

- Claiming to be achieving carbon neutrality in the near term without having facts or corporate activities to support this claim.
- Promoting the sustainability credentials of the issuer's partners without any accompanying disclosures to support this language.
- Describing the issuer as a sustainability leader without sufficient supporting evidence.

[131] CSA (2022b). The reviews relate to the fiscal years ended March 31, 2022 and March 31, 2021.
[132] Idem, page 16.
[133] Idem.
[134] The CSA also notes that a statement about achieving a particular goal in the future will typically constitute forward-looking information (FLI). As noted by the CSA, an issuer that communicates FLI "must have a reasonable basis for the FLI, identify the material risk 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." See CSA (2022), pp.16-17.

- Making generic and vague sustainability claims without providing details regarding the aspects of sustainability being pursued by the issuer and their measurement and evaluation.
- Mentioning the issuer's relationship with third-party organizations relating to sustainability without providing sufficient information on these organizations and their activities.
- Promoting sustainability ratings and rankings without disclosing their methodology (criteria, weights of the criteria, third-party certification).

As noted above, when the AMF identifies disclosure deficiencies as part of its CDR Program, it may communicate recommendations and observations to reporting issuers, and follow up to ensure resolution. [135] It is only for material deficiencies or errors that the agency may require an issuer to restate and refile CD Documents and issue corrective press releases.[136] Disclosure deficiencies will therefore not systematically result in penal or administrative penalties under the QSA. This may explain why there have been no publicly reported enforcement cases relating to reporting issuers' environmental performance claims under the QSA as of September 15, 2024 (see Box 6 for examples of cases in other jurisdictions).[137] As the AMF does not publicly disclose specific information on its private interactions with reporting issuers regarding sustainability disclosures, it is challenging to evaluate the intensity of the agency's efforts in this area.

The lack of public enforcement cases could also be explained by the fact that the QSA's disclosure obligations are based on the principle of financial materiality : issuers are only required to share information with investors if there is a reasonable expectation that it will have a significant effect on the market price or value of securities (QSA s.5).[138] However, as noted by Lee (2023), sustainability factors may not be "well captured by current market mechanisms", and their nature can make it "difficult for a more quantitative test like the market impact test to support a finding of materiality."[139] However, the assessment of materiality is currently a subjective and contextual exercise under the responsibility of the reporting issuer. As an external third party, the AMF may assume that it is not well positioned to judge whether issuers have failed to conduct their materiality assessment properly.[140] Moreover, even if the AMF decides to bring enforcement cases against issuers, it may be difficult for the regulator to prove that information relating to SFRI considerations

[135] Autorité des marchés financiers (undated a).
[136] Idem.
[137] Coiteux et al. (2023).
[138] For a detailed discussion of this issue, see Coiteux et al. (2023) at pp.23-25. As noted by the authors, "it is a question of examining to what extent there is a marked probability that the reasonable investor would have considered the information relating to an ESG factor important when making their decision, that is to say that they would have taken it into account. As part of the analysis, it is necessary to take into account all the information made available to investors (total mix of information) which can come both from the issuer and from external sources. Finally, as the Supreme Court notes, it is up to the AMF to establish through evidence the importance of the ESG information in relation to the rest of the information."
[139] Lee (2023).
[140] Idem.

constituted material information for the "reasonable investor" under the current materiality standard.[141]

In addition, contrary to plaintiffs in secondary market compensation claims, the AMF's enforcement powers are limited to information that must be included in a prospectus and CD Documents. Many reporting issuers provide the bulk of their environmental disclosures outside of their regulatory filings, such as in standalone sustainability reports or on their website. Assuming it is not financially material, and unless it contradicts the content of an issuer's regulatory filings, these documents will not be within the purview of the AMF.

The finalization of DR 51-107 could increase the likeliness of climate-related claims. First, it may clarify the materiality threshold associated with environmental disclosures, which could facilitate the proof of a breach in both enforcement and private compensation cases. Second, it would explicitly require reporting issuers to include certain climate-related information in their CD Documents (such as GHG emissions), ensuring that their content is subject to the AMF's oversight.

The regulator is also increasing in enforcement capacity in respect of climate-related claims. As announced in its annual statement of priorities for 2023-2024, the AMF recently created a specialized oversight and supervision unit responsible for sustainable finance-related activities, which could lead to heightened scrutiny of environmental claims in the near term.[142]

Box 6 – Examples of greenwashing controversies involving reporting issuers

A recent private complaint in Alberta, enforcement cases in Australia and class actions in the United States may offer insights into forthcoming developments under provincial securities law.

***Kinder Morgan* (Alberta)**: In 2018, Greenpeace Canada filed a complaint against pipeline operator Kinder Morgan, alleging that the company had inadequately disclosed its exposure to climate-related risks.[143] The complaint followed a 2017 letter that had been sent by Greenpeace to the ASC to request a halt to Kinder Morgan's IPO, alleging that the IPO prospectus had included outdated information about oil projections.[144] As of September 15, 2024, the ASC has not taken public enforcement action against Kinder Morgan or made public comments on the complaint. However, Greenpeace Canada indicated that Kinder Morgan has publicly changed its prospectus to disclose additional climate risks.[145]

***Black Mountain Energy Limited* (Australia):** In 2023, Black Mountain Energy, a publicly traded energy company, had to pay AU$40,000 to comply with three infringement notices from ASIC in connection with potentially false or misleading environmental statements to the Australian stock exchange.[146] According to ASIC, the company claimed to be developing a "net-zero carbon emissions" natural gas project that would result in net zero GHG emissions.

[141] Idem.
[142] Autorité des marchés financiers (2023a).
[143] Greenpeace Canada (2018).
[144] Vamburkar (2017).
[145] Greenpeace Canada (2021), p.16.
[146] Australian Securities & Investments Commission (2023f).

However, ASIC alleged that the firm did not have sufficient evidence to make these claims or that they were "factually incorrect".

In separate matters, ASIC also asked listed firms active in the chemicals, metals and mining, and energy sector to correct, clarify or retract problematic environmental statements, including the inappropriate use of the expressions "zero carbon", "negative carbon" and "carbon neutral"; and unsupported environmental claims.[147] ASIC has also issued an infringement notice to a listed firm regarding deceptive statements about the progress of a reforestation project.[148]

***Jochims v. Oatly Group AB* (United States):** In 2021, a class action was launched against beverage manufacturer Oatly and its directors and officers following allegations that the firm made misleading statements to investors about the environmental characteristics of its products.[149] According to the plaintiff's claim, Oatly made several statements about its environmental credentials and financial outlook in securities filings, press releases and other announcements ahead of its initial public offering.[150] Two months after Oatly's shares started to be publicly traded, a short seller published a report that shed doubts on the truthfulness of Oatly's environmental claims and criticized its accounting practices. The report was picked up in news stories, and Oatly's stock price declined by 8.8% over two days, leading the plaintiff and other class members to seek compensation for the resulting economic losses. The lawsuit was settled for US$9.3 million in February 2024.

Similar class actions filed in the US include *Fagen v. Enviva Inc.*[151] (2022 – statements about the sustainability of a wood pellet production plant), *Rosencrants v. Danimer Scientific Inc.*[152] (2021 – statements about a product's biodegradability), *Barnes v. Edison International*[153] (2018 – failure to disclose the organization's exposure to wildfire risk) and *Ramirez v. Exxon Mobil Corp.*[154] (2016 – failure to disclose the organization's exposure to climate risks).

Box 7 – Regulating sustainability impact disclosures

The mission of the AMF

The mission of the AMF, as outlined in the *Act respecting the regulation of the financial sector* (the **AMF Act,** s.4 and s.7), includes the following responsibilities:

- Assisting consumers of financial products and services;

[147] Australian Securities & Investments Commission (2024a); see also: Australian Securities & Investments Commission (2023g)
[148] Australian Securities & Investments Commission (2024a)
[149] The plaintiff also alleged that the company had improper accounting practices. See: Climate Case Chart (2021a).
[150] An initial public offering takes place when a private company makes its first distribution of shares to the public and becomes a publicly traded company.
[151] Climate Case Chart (2022).
[152] Climate Case Chart (2021b).
[153] Climate Case Chart (2018).
[154] Climate Case Chart (2016).

- Ensuring that financial institutions and other regulated entities of the financial sector comply with solvency standards and other legal obligations;
- Supervising activities connected with the distribution of financial products and services;
- Supervising securities and derivatives markets;
- Implementing and administering protection and compensation programs for consumers of financial products and services; and
- Serving as an information and reference center across all fields of the financial sector.

Although these responsibilities do not explicitly mention sustainability, as noted before, environmental issues may indirectly fall within the AMF's current mandate due to their relevance to investor protection and market integrity. The QSA's current sustainability disclosure requirements are aligned with this approach, ensuring that investors have access to adequate information for making informed investment decisions.

Challenges in requiring the disclosure of sustainability impacts

This raises questions about the AMF's ability, under the current framework, to regulate the disclosure of sustainability information beyond financial risks and opportunities. For example, could the AMF require reporting issuers to disclose the significant negative environmental impacts of their activities, even when these impacts are unlikely to translate into financial risks or opportunities?

Section 13 of the QSA only mandates the disclosure of "material facts", defined as information "that may reasonably be expected to have a significant effect on the market price or value of securities issued or securities proposed to be issued".[155] If there is no reasonable expectation that information will have a significant effect on the market price or value of a security, reporting issuers are not required to disclose it. Form 51-102F2, which details the regulator's disclosure expectations, indicates that information is likely material if a "reasonable investor's decision whether or not to buy, sell or hold securities in [the] company [would] likely be influenced or changed if the information in question was omitted or misstated".[156] This form, however, does not specify who the "reasonable investor" is.

On one hand, sustainability-conscious investors are likely to consider information about sustainability impact to be material. For these investors, who prioritize sustainability in their investment decisions, sustainability impact is likely to be a determining factor of their

[155] In a 2013 decision, the Ontario Superior Court ruled that the concept of price and value were distinct, suggesting that a change in value may be material even if price effects cannot be observed. See: Cornish v Ontario Securities Commission, 2013 ONSC 1310. As cited by Lee (2023). "One must also consider whether particular information would reasonably be expected to have a significant effect on the 'value' of securities even if that disclosure would not, for some reason, be expected to affect the market price of securities."

[156] While the concept of the "reasonable investor" does not appear in the QSA, court decisions from other provinces have recognized the use of this concept for the determination of materiality. As noted by Lee (2023), focussing on the perception of the reasonable investor instead of the impact on the price or value of a security may result in a slightly different materiality standard, as the "market impact test (…) can deem information immaterial when reasonable investors would deem it material". For a discussion of the differences between the concepts of "reasonable investor" and "market impact", see: Lee (2023).

decision to buy, sell or hold securities. The AMF's mission includes protecting all categories of investors, including those focused on sustainability impacts.

On the other hand, the preferences of sustainability-conscious investors may differ from the majority, limiting the effect of sustainability impact on the market value or price of a security, especially when such impact is not clearly linked to financial performance. Under this approach, sustainability standards based on a principle of double materiality might conflict with the current regulatory framework.

A similar debate has emerged in the US regarding the SEC Rules. Plaintiffs have argued that these rules exceed the SEC's mandate to "require disclosure of information important to investors' investment and voting decisions".[157] The SEC, however, maintains that the rules are consistent with its mission given their aim to protect investors by fostering "more detailed, consistent and comparable information".[158]

The AMF's potential role in sustainability impact disclosure

Despite these challenges, the frontier between environmental impact, risks and opportunities is not always clear-cut, and the AMF has some leeway to regulate impact disclosures, even under a narrow interpretation of its mandate. Empirical evidence suggests that investors increasingly value sustainability factors, making it arguably material.[159] In addition, several indicators of sustainability risks are also indicators of impact, such as GHG emissions. Similarly, news about an issuer's involvement in an environmental disaster – resulting in negative impacts – could translate into financial risks. Hence, a broad range of sustainability topics clearly fall within the AMF's mandate, even under a narrow interpretation.

Moreover, the AMF's mandate is not a static one, and the current framework could be modified to explicitly allow the agency to require the disclosure of information that is material to impact investors, notably by ensuring that the concept of materiality reflects the preferences of all categories of investors.

Another potential avenue of intervention for the AMF would be to establish standards for sustainability impact disclosures, without making them mandatory. For example, companies could be provided with guidelines on how to disclose sustainability impact information if they choose to, but they would not be obligated to do so. This would allow companies seeking to attract impact investors to disclose information in a consistent format while allowing others to avoid any additional regulatory burden. This approach would align with the AMF's role as an information center and could enhance the consistency of impact disclosures in the financial sector.

[157] Segal (2024).
[158] Idem.
[159] Lee (2023).

4.1.2 Banks

a) Description of the segment

Banks operating in Canada are regulated at the federal level under the BA, while non-bank lending institutions such as credit unions or trust and loan companies are covered by separate provincial legislation.[160] As of September 15, 2024, there are 80 banks doing business in Canada, including 35 Canadian banks, 15 subsidiaries of foreign banks and 30 foreign banks permitted to carry on business in Canada.[161] Canada's banking market is dominated by the country's biggest six banks, RBC, TD, BMO, Scotia, CIBC and National Bank (the **Big Six** – or, when excluding National Bank, the **Big Five**), which collectively hold almost 95% of total Canadian banking assets.[162]

b) Legal framework

Broadly speaking, two of the main categories of BA provisions that regulate the information that banks communicate to third parties are (i) the consumer protection provisions and (ii) the supervisory disclosure provisions. These categories are examined separately in the paragraphs below. Subsequently, we describe the penal sanctions that can be imposed by the courts for violations of the BA's provisions.

i. Consumer protection provisions

The BA sets forth minimum requirements that banks must follow in their interactions with consumers and the general public. Some of these requirements include:

- **Prohibition of false or misleading information and advertisements**: Banks shall not provide "false or misleading information to a customer, the public or the [Commissioner of the Financial Consumer Agency of Canada]" (the **FCAC**) (BA s.627.03). Moreover, their advertisements in Canada shall be "accurate, clear and not misleading" (BA s.627.14).
- **Provision of appropriate products or services**: Banks are required to establish and implement policies and procedures to ensure that the products or services that they offer to Canadian consumers are appropriate for their needs (BA s.627.06).
- **Mandatory training**: Banks shall ensure that their officers, employees, and any person commercializing their products or services in Canada are trained in accordance with the institution's policies and procedures on consumer protection, including those on appropriate products or services (BA s.627.02).
- **Governance**: Banks[163] shall establish a board committee responsible for their compliance with the BA's consumer protection provisions (s.157(2)(e)). The committee shall be responsible for the establishment and review of the institution's consumer

[160] As reporting issuers, federal banks are also subject to the requirements described at subsection 4.2.1. These requirements apply to Canadian banks in addition to the requirements of the BA.
[161] Office of the Superintendent of Financial Institutions (2024a).
[162] Bickis (2023).
[163] This requirement does not apply to other categories of FRFIs.

protection procedures (BA s.195.1(3)). The committee shall submit a report to the FCAC Commissioner regarding the performance of its duties on a yearly basis (s.195.1(5)).

- **Complaints handling**: Banks shall establish procedures for dealing with customer complaints regarding their products, services, and the manner in which they are offered by the institutions (BA s.627.43). Banks are also required to issue an annual report about the complaints received during the year, including the number and nature of the complaints (BA s.627.47). Consumers who are not satisfied by a bank's handling of a complaint or who have not received a resolution proposal within the prescribed delay may turn to an independent external complaints body to seek resolution.
- **Public accountability statement**: If a bank's[164] equity exceeds $1 billion, it shall issue a public accountability statement (**PAS**) (BA s.627.996).[165] The PAS must be filed with the FCAC Commissioner and include, among other things, "detailed examples [...] of [the bank and its affiliates'] goals in the area of community development and of their participation during the financial year in activities for the purpose of community development", which includes the "environmental enrichment of a community".[166] This requirement has led some banks to include information about their environmental initiatives in their PAS – but this information is typically limited and does not provide a comprehensive and standardized overview of the environmental impacts of the bank's activities.[167]

The BA's consumer protection provisions are enforced by the FCAC, which is headed by the FCAC Commissioner. As indicated in the *Financial Consumer Agency of Canada Act* (**FCAC Act**), the agency's mission is to protect the rights and interests of consumers of financial products and to ensure that banks and external complaints bodies comply with the BA's consumer provisions, including s.627.02 to 627.998 of the BA (FCAC Act, s.3). The FCAC is also responsible for monitoring and evaluating market trends and emerging issues that may impact consumers of financial products and promoting consumer awareness about FRFIs' legal obligations (FCAC Act, s.3). The FCAC's supervisory activities encompass promotion, monitoring and enforcement initiatives.[168]

As part of its promotion activities, the FCAC may issue guidance on its expectations and interpretations for the industry (including guidelines, bulletins and rulings), engage with stakeholders (e.g., by conducting surveys) and regulated entities and publish the FCAC

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[164] This requirement does not apply to other categories of FRFIs.

[165] Examples of Canadian banks' public accountability statements can be found in Canadian Bankers Association (2022).

[166] Financial Consumer Protection Framework Regulations, section 95.

[167] For example, in its 2022 PAS, RBC promoted its commitment to provide "$100 million by 2025 to support organizations that develop innovative solutions for a greener future." The bank also mentioned its partnerships and support for associations and research organizations, like the Ocean Wise Conservation Association and Queen's University Institute of Sustainable Finance and noted the number of "actions in support of the environment" completed by its employees on Earth Day. However, the PAS did not include any detailed information about the overall environmental impact of RBC's financing activities, such as its financing of fossil fuel projects, raising selective disclosure concerns. See: Royal Bank of Canada (2022).

[168] Financial Consumer Agency of Canada (2020).

Commissioner's enforcement decisions and proceeding summaries.[169]

In the course of its monitoring activities, the FCAC may conduct examinations[170] and industry reviews[171] and direct third parties to conduct special audits[172] to ensure that regulated entities comply with their legal obligations.

Furthermore, in the context of its enforcement actions, the FCAC may investigate the practices of a regulated entity to assess potential breaches of its market conduct obligations.[173] The FCAC Commissioner has large information gathering powers under the BA.[174] Following an investigation, the FCAC may, if it considers that there are reasonable grounds to believe that a breach has occurred, undertake one or a combination of the following actions:

- **Notice of Breach**: The FCAC may set out its expectations to an entity by issuing a Notice of Breach. Such notices can be of level 1 (low severity), 2 (elevated severity) or 3 (high severity). A Notice of Breach may be combined with other enforcement actions. A level 3 Notice of Breach is typically accompanied by a Compliance Report, as described below.[175]
- **Action Plan**: The FCAC may require an entity to enter into an Action Plan, which shall describe the "corrective measures required to address a breach of a market conduct obligation, to prevent recurrence, and/or to implement any measure designed to ensure compliance with market conduct obligations."
- **Compliance Agreement:** The FCAC may require an entity to enter into a Compliance Agreement, which may detail "the corrective measures required to address breaches of market conduct obligations, to prevent recurrence of breaches, and/or to implement any measures designed to further compliance with market conduct

[169] Idem.

[170] Examinations may include reviewing documents and interviewing employees to assess compliance. These can be conducted on-site or off-site. After an examination is completed, FCAC reports on its findings in an Examination Report, which may include recommendations for the regulated entity on how to improve its legal compliance. As noted in FCAC's Supervision Framework, "[u]nsatisfactory corrective actions or measures can lead to enforcement action" by FCAC. Financial Consumer Agency of Canada (2020).

[171] As noted in FCAC's Supervision Framework, such reviews are "designed to gather information from multiple regulated entities or stakeholders on specific market conduct matters or on matters related to the financial services sector generally." See: Financial Consumer Agency of Canada (2020). After an industry review is completed, FCAC may publish a summary or detailed findings. Compliance breaches identified during an industry review may lead to enforcement action by FCAC.

[172] For additional information on special audits, see: Financial Consumer Agency of Canada (2020).

[173] The FCAC confirmed via email that it may launch investigations based on information from complaints, monitoring activities, the media and from other regulatory organizations.

[174] Section 657 of the BA states that "A bank, authorized foreign bank or external complaints body must provide the Commissioner with the information at the times and in the form that he or she may require for the purposes of the administration of the Financial Consumer Agency of Canada Act and the consumer provisions." See also s.660 of the BA.

[175] As noted in Financial Consumer Agency of Canada (2020), "A Compliance Report captures the facts of the breach, an assessment of its severity, and recommendations for enforcement action. The regulated entity may be provided an opportunity to verify the facts of the breach. Any such comments received from the entity form part of the record for review by the Deputy Commissioner who will determine whether to issue a Notice of Violation."

obligations." The entity shall provide regular updates to the FCAC throughout the duration of the agreement and a full report once all actions have been completed in a satisfactory manner.

- **Notice of Violation:** The FCAC may require an entity to pay an administrative monetary penalty (**AMP**) by issuing a Notice of Violation.[176] This notice must indicate the nature of the violation and any AMP that shall be paid by the entity. Under the FCAC Act, AMPs imposed to entities may not exceed $10 million.
- **Commissioner's Direction or court order**: The FCAC may direct an entity to comply with its legal obligations under the BA's consumer provisions by issuing a Commissioner's Direction (BA s.661.1) or by applying for a court order (BA s.989(3)).[177]

The FCAC may also report a situation to the federal prosecution services if it considers that an offence may have been committed under the BA. Additional information on penal sanctions is provided in subsection iii.

Consumers of banking services may invoke the BA's provisions to file private actions before the courts. Moreover, in Québec, these provisions may be invoked in conjunction with the Québec *Consumer Protection Act* the general civil liability provisions of the *Civil Code of Québec* as the basis of legal actions, including claims for compensatory damages.[178]

ii. Supervisory disclosure provisions

Under the *Office of the Superintendent of Financial Institutions Act* (**OSFI Act**), OSFI supervises FRFIs to ensure that they are in good financial condition and comply with their governing statutes and the corresponding supervisory requirements (OSFI Act, s.4). OSFI is also responsible for promoting the adoption by FRFIs' boards and management of risk management policies and procedures. Moreover, OSFI monitors and evaluates "system-wide or sectoral events or issues that may have a negative impact on the financial condition of financial institutions" (OSFI Act, s.4(2)(d)).

OSFI is responsible for the administration of the BA, except the consumer protection provisions which are under the exclusive responsibility of the FCAC (OSFI Act, s.6). Under the BA, OSFI has the power to make guidelines relating to "the maintenance by banks of adequate capital and adequate and appropriate forms of liquidity and the maintenance by domestic systemically important banks of the minimum capacity to absorb losses" (BA s.485(2)). Moreover, under s.628(1), OSFI may require a bank to provide it with any information in the form and within the delay prescribed by OSFI (BA s.628(1); BA s.600).

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[176] Section 20 of the FCAC Act establishes the criteria that shall be used by the Commissioner to determine the amount of the AMP.

[177] Under section 989(3) of the BA, "[if] a bank or an authorized foreign bank or any director, officer, employee or agent of one does not comply with any applicable consumer provision, the Commissioner or any complainant may, in addition to any other right that that person has, apply to a court for an order directing the bank, authorized foreign bank, director, officer, employee or agent to comply with — or restraining the bank, authorized foreign bank, director, officer, employee or agent from acting in breach of — the consumer provision and, on the application, the court may so order and make any further order it thinks fit."

[178] See Moore (2023). See also s.1457 and following of the Civil Code of Québec.

In 2023, OSFI adopted Guideline B-15, a new guideline setting the regulator's expectations about FRFIs' management of climate-related risks. OSFI revised Guideline B-15 in March 2024 to align it with IFRS S2 and will continue updating it to incorporate evolving standards in this space.[179] While the first chapter of the document focuses on FRFIs' governance and risk management practices, the second chapter establishes mandatory, annual climate-related financial disclosures for FRFIs. Such disclosures shall be made publicly available and must include information on an FRFI's governance, strategy and risk management practices in respect of climate-related risks and opportunities, including its climate transition plan. The disclosures shall also include the FRFI's scope 1, 2 and 3 GHG emissions (including financed emissions), the reporting standard used to calculate them, the FRFI's climate-related targets, its performance against these targets, and any public climate-related commitments made by the FRFI. Guideline B-15's disclosure requirements are becoming progressively effective in 2024 and 2025.[180]

An institution's failure to comply with Guideline B-15's disclosure requirements constitutes a minor violation and can lead to a daily penalty ranging between $100 and $500 depending on the bank's total asset value.[181]

iii. Sanctions

In addition to enforcement action by FCAC and OSFI, a violation of the BA's requirements – including the consumer protection and supervisory disclosure provisions – can lead to criminal prosecution and sanctions. Under s.980, "Every person who, without reasonable cause, contravenes any provision of this Act or the regulations is guilty of an offence." (BA s.980). Moreover, s.980.1 of the statute establishes a specific offence relating to the provision of deceptive information by stating that "Every person who knowingly provides false or misleading information in relation to any matter under this Act or the regulations is guilty of an offence." (BA s.980.1).

Entities which are guilty of an offence under sections 980 and 980.1 of the BA can be liable to a criminal fine of up to $5 million (BA s.985 (1))[182]. Similarly, any "officer, director, agent or principal officer of the entity who directed, authorized, assented to, acquiesced in or participated in the commission of the offence is a party to and guilty of the offence and liable" to a fine that can reach up to $1 million and/or imprisonment for up to five years (BA s.986). Criminal cases are brought by the Public Prosecution Service of Canada.[183].

[179] Office of the Superintendent of Financial Institutions (2024b).

[180] Guideline B-15 will be effective at the end of fiscal year 2024 for domestic systemically important banks and internationally active insurance groups headquartered in Canada, and at the end of fiscal year 2025 for other in-scope FRFIs. See: Office of the Superintendent of Financial Institutions (2024b).

[181] Administrative Monetary Penalties (OSFI) Regulations. In case of violations that occur over several days, the penalty shall not exceed "shall be the lesser of the penalty fixed under that subsection and the amount determined by dividing $25,000 by the total number of those separate violations".

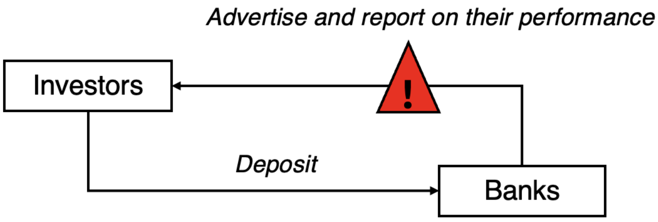
[182] The court may also impose compliance orders to convicted offenders (BA s.985 (2)).

[183] During the course of an investigation, if the FCAC finds evidence of a potential violation of sections 980 and 980.1 of the Bank Act, it may refer the case to the Public Prosecution Service of Canada to consider whether criminal proceedings should be initiated.

c) Greenwashing risks

Despite their numerous environmental commitments, Canadian banks' environmental record has been subject to intense criticism from non-governmental organizations, elected officials and the general public over the past few years.[184]

Figure 3 – Greenwashing risks in the banking segment



On the one hand, these institutions have voluntarily set emission reduction targets, formulated environmental pledges, set "green" or "sustainability-linked" bond frameworks and joined industry initiatives like GFANZ. On the other hand, Canadian banks have been criticized for lacking transparency regarding their environmental performance, failing to deliver on their climate commitments and increasing their exposure to carbon-intensive sectors. Table 3 identifies some of the Big Five's voluntary environmental actions and commitments as well as these commitments' alleged shortcomings.

Table 3: Big Five's environmental performance[185]

Criteria	Actions and commitments	Alleged shortcomings
Commitments	• Committed to achieving "sustainable financing"[186] goals ranging between US$300-500 billion.[187] • Adopted voluntary "green" or "sustainability-linked" bond frameworks to	• SFRI commitments may not translate into net environmental impact (e.g., no guarantee of absolute emission reductions) and may even result in additional environmental damage.[188] • Investments may be used to achieve intensity targets that exclude scope 3 emissions.[189]

[184] See for example: Greenpeace Canada (2023); McCarthy (2022).
[185] The content of this table is based on InfluenceMap (2024) and Investors for Paris Compliance (2023).
[186] As noted by I4PC, different terms are used by the Big Five to refer to their SFRI commitments, such as "sustainable finance", "sustainable and decarbonization financing" and "climate-related financing". See Investors for Paris Compliance (2023).
[187] As noted by I4PC, these commitments relate to the issuance of SFRI effects-based and performance-based products like green and sustainability-linked bonds and loans. Additional information on these instruments and their weaknesses is provided at subsection 4.3.2.
[188] For example, some of the banks' SFRI commitments are relying on the issuance of SLBs. However, these instruments have been criticized for failing to trigger additional emission reductions or for financing an expansion of carbon intensive activities. See: Berkow, J. (2023). Additional information on these instruments is provided at subsection 4.3.2.
[189] The intensity of GHG emissions corresponds to the quantity of GHGs per unit produced. A company that increases its production, even if it reduces its emissions intensity, may end up with higher absolute emissions than before. According to I4PC, the banks could address these shortcomings by establishing a quantitative emissions baseline against which the impact of their SFRI commitments could be measured. Moreover, I4PC recommends that banks strengthen their internal taxonomies to prevent greenwashing. An internal taxonomy is

	govern their sustainable financing activities.	
Emission reduction targets	• Committed to achieving net-zero financed emissions by 2050. • Set 2030 interim targets for certain carbon intensive sectors, like the oil and gas and power sectors.	• Most interim targets are intensity-based, allowing a rise in absolute emissions. • Some targets are limited to the banks' lending activities and fail to consider other financing activities like capital markets. • Some banks have failed to disclose important assumptions underlying their targets. • Some banks' oil and gas targets exclude downstream emissions. • None of the Big Five have restricted financing of fossil fuel expansion, and some of them are financing fossil fuel expansion projects, despite the International Energy Agency's conclusion that such projects are inconsistent with global climate targets.[190]
Reporting and transparency	• Disclose their financed emissions for some sectors and/or proportion of their loan portfolio. • Use scenario analysis to assess the impact of climate-related risks. • Incorporate ESG and climate factors into their compensation policies. • Measure their assets and/or business activities vulnerable to climate-related risks.	• Most banks do not indicate the proportion of their loan portfolio included in their financed emissions disclosure. • Some banks only disclose financed emissions from drawn loans (i.e., excluding committed but undrawn loans). • Big Five only disclose their financed emissions for a subset of sectors, and/or fail to disclose all scopes of emissions, leading to inconsistent emissions data. • Some banks fail to disclose details on the results of their scenario analyses. • Some banks do not indicate how ESG and climate factors are incorporated into their compensation policies.
Participation to industry initiatives	• Joined the Net Zero Banking Alliance.[191]	• Some banks are members of industry associations advocating for an expansion of oil and gas production.[192]

The implementation of Guideline B-15, which will take place progressively over the next two years, will address some of the issues identified in Table 3. For instance, it will standardize banks' climate-related disclosures, notably by requiring that all banks disclose a climate transition plan together with their scope 1, 2 and 3 GHG emissions

a classification system developed internally by an organization to categorize different activities and assets based on their sustainability credentials. See: Investors for Paris Compliance (2023).

[190] International Energy Agency (2023).

[191] To become signatories, the banks had to commit to "transition all operational and attributable GHG emissions from [their] lending and investment portfolios to net-zero by mid-century, or sooner, including CO2 emissions reaching net-zero at the latest by 2050, consistent with a maximum temperature rise of 1.5°C above pre-industrial levels by 2100." See: Net Zero Banking Alliance (undated).

[192] InfluenceMap (2024).

(including financed emissions). However, Guideline B-15's disclosure framework is flexible, high-level and climate risk-focused. For instance, the **guideline does not**:

- **Establish comprehensive target-setting rules.** As a "principles-based"[193] document, like other OSFI guidelines, Guideline B-15 provides a lot of flexibility to banks on how they should set their climate targets. For example, the guideline requires banks to describe their targets "to manage climate-related risks and opportunities and the FRFI's performance against these targets", without imposing minimum requirements for such targets, like an alignment with the goals of the Paris Agreement.
- **Provide guidance on transition planning.** The guideline requires banks to prepare a climate transition plan, but it does not impose minimum content requirements for such a plan.[194]
- **Provide specific disclosure guidance.** The guideline requires banks to disclose "specific and comprehensive information" about their exposure to physical and transition risk but does not provide a detailed description of the information and metrics that should be disclosed and used by the institutions. For example, specific information could include geographic location, categories of assets most likely to be impacted by climate change, etc.
- **Regulate environmental impact disclosures.** The guideline focuses on the disclosure of banks' exposure to climate-related risks and opportunities. However, it does not require banks to disclose how their financing activities impact the environment.
- **Address areas of environmental performance other than climate, like biodiversity.** The guideline focuses on the management and disclosure of climate-related risks. As such, it does not standardize banks' communications about other environmental aspects like biodiversity.
- **Set definitions of which assets and activities may be issued a sustainability label.** Most banks have adopted voluntary frameworks for the issuance of SFRI debt instruments, such as green bonds and SLBs. However, in the absence of a taxonomy that would provide official or legally binding definitions of which activities may be labelled as 'sustainable' or 'green,' banks have had the freedom to establish their own classification systems. The regulatory framework applicable to SFRI debt instruments is discussed in subsections 4.3.1 and 4.3.2.

That being said, Canadian banks are and will remain subject to the BA's general provisions on deceptive statements.[195] For example, a bank providing "false or misleading" information about its environmental performance to the public or communicating ads

[193] This flexible approach has been criticized by Weber (2023): "Finally, as demonstrated above, climate-related risks are still not seen as risks that should be regulated by the financial supervisor. The guideline describes these risks as unique and not useful for a one-size-fits-all approach. This is just a denial to accept sustainability risks as real for the financial industry. No regulator or supervisor would argue that, for instance, capital requirements are unique and that each bank should come up with its own strategy to manage them."

[194] Instead, the guideline refers to the Financial Stability Board's Task Force on Climate-Related Financial Disclosures Guidance on Metrics, Targets, and Transition Plans, which FRFIs may choose to ignore. See: Task Force on Climate-Related Financial Disclosures (2021).

[195] Moreover, as reporting issuers, banks are also subject to the QSA's provisions on deceptive statements.

that misleadingly promote the institution's environmental credentials could lead FCAC to launch an investigation and take enforcement action against the bank.

Similarly, a bank failing to establish sufficient policies and procedures to ensure that the SFRI products that it offers are appropriate for the needs of Canadian customers, and that its employees receive adequate training with respect to these products, could be found to violate the BA's consumer protection provisions.

As noted above, under the FCAC Act, the FCAC may require a bank to pay an AMP that shall not exceed $10 million following a violation of the BA's consumer protection provisions. A bank's violation of these provisions may also lead, in the most egregious cases, to the imposition of a fine of up to $5 million by the courts.

While the CB and the AMF have each received at least one complaint concerning banks' environmental claims, there have been no reported instances of greenwashing complaints to the FCAC and no enforcement actions for this type of matter by the agency thus far. Moreover, neither the FCAC's Business Plan for 2022-2023 to 2024-2025 nor the FCAC's 2021-2026 Strategic Plan list the prevention of greenwashing as a goal or priority.[196] Contrary to the AMF and OSFI, which have both issued climate-related guidelines and established teams dedicated to environmental considerations, the FCAC has not indicated clearly how it plans to integrate environmental considerations in its educational and enforcement activities.[197]

For instance, the FCAC has not issued any guidance on its expectations and interpretations in respect of FRFIs' environmental claims. Likewise, the FCAC's National Financial Literacy Strategy 2021-2026 does not refer to SFRI products and services – although it does list as cross-cutting priorities the need to "communicate in ways people understand" and the "strengthening of consumer protection measures".[198]

However, the agency has recognized that environmental issues are on its radar. While the FCAC does not make public comments on its monitoring and enforcement action, it confirmed via email that it "continues to examine environmental and climate-related issues in the financial landscape and their impact on consumers as they relate to potential areas of FCAC involvement".[199] The agency also confirmed that deceptive environmental claims to consumers would be addressed by its current oversight structure. Moreover, in its 2023 to 2027 Department Sustainable Strategy, the FCAC recognized that "climate change and the threat it poses could significantly impact the safety and soundness of Canada's financial system" and that the agency would continue to develop advice on this "emerging financial protection issue".[200]

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[196] Financial Consumer Agency of Canada (2021a); Financial Consumer Agency of Canada (2023a).

[197] FCAC's 2023 to 2027 Departmental Sustainable Development Strategy is particularly light on details in that respect. See: Financial Consumer Protection Agency (2023b).

[198] Financial Consumer Agency of Canada (2021b).

[199] Translated from French. Based on an email from the FCAC dated April 5, 2024.

[200] Financial Consumer Protection Agency (2023b). As described in the strategy, the FCAC also helped review the OECD High-Level Principles on Financial Consumer Protection, which identify sustainable finance as a cross-cutting theme.

As with reporting issuers, trends in other jurisdictions may provide valuable insights into what might be expected for Canada's banking sector regarding greenwashing litigation. For example, a 2024 analysis by Sustainalytics revealed a twelvefold increase in global litigation incidents related to the environmental and carbon impact of banking products globally between 2020 and 2023.[201]

Box 8 – Federal climate-related disclosure requirements
In addition to announcements relating to Guideline B-15, the federal government has made several announcements regarding climate-related disclosure requirements over the past years. • **In Budget 2021**, the Government of Canada announced that it would engage with provinces and territories on making climate-related disclosures part of "regular disclosure practices for a broad spectrum of the Canadian economy."[202] The government also requested certain federal Crown corporations to start preparing climate-related financial disclosures in line with the TCFD's requirements.[203] • **During the COVID-19 pandemic**, the Government of Canada required that large companies receiving financing from the Large Employer Emergency Financing Facility issue TCFD-aligned climate-related financial disclosures on an annual basis.[204] The requirement was introduced as a covenant in the program's loan agreements. • **In Budget 2022**, the federal government announced that it would be developing requirements for ESG disclosures, including climate-related risks, for federally regulated pension plans.[205]

[201] Batoudaki (2024). Most of these cases have not yet reached the litigation stage.
[202] Government of Canada (2021a).
[203] Government of Canada (2021a). Disclosure was mandatory for Crown corporations with over $1 billion in assets starting in calendar year 2022. Crown corporations with less than $1 billion in assets are expected to report on their climate-related financial risks starting in calendar year 2024, unless they choose to explain why these risks are not material to their operations. Prior to this announcement, the Commissioner of the Environment and Sustainable Development had identified irregular climate disclosure practices among federal Crown corporations: "As part of our research, we examined the 2019–20 annual reports and publicly available information of 14 of the largest federal Crown corporations. The quality and completeness of climate-related financial disclosures varied greatly among Crown corporations. Some reported according to TCFD guidelines or another global framework, while others appeared not to be following a globally recognized framework. Some Crown corporations were lacking a consistent set of climate-related financial disclosures but had a strategic plan in place to publish climate-related financial disclosures. Not all strategic plans had a clear timeline for their implementation. More problematic is that some entities did not appear to publish any climate-related financial disclosures or have any plans to do so. Mandatory climate-related financial disclosures should help bridge the inconsistencies in reporting among Crown corporations." See: Commissioner of the Environment and Sustainable Development (2022).
[204] Commissioner of the Environment and Sustainable Development (2022).
[205] Government of Canada (2022a). Similar requirements already exist at the provincial level in Ontario and Manitoba. See: Wolfe (2022).

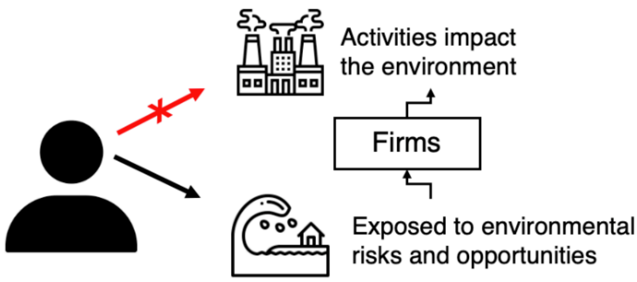
- **In the 2023 Fall Economic Statement**, the federal government announced that it would examine options to introduce mandatory climate disclosures for companies.[206] The government has not yet provided details on this potential requirement. However, the disclosures could be implemented in a similar way as the diversity disclosure requirements introduced by the federal government in 2019 to publicly-traded corporations governed by the *Canada Business Corporations Act*.[207]

Combined with Guideline B-15 and the finalization of DR 51-107, the implementation of federal climate disclosure rules for private corporations and federally-regulated pension funds would ensure that almost all entities in Canada are covered by a climate disclosure requirement – and those that are not will be indirectly caught by the rules through scope 3 and financed emissions disclosures.

That being said, these disclosure requirements focus on an entity's climate-related risks and opportunities, an approach commonly referred to as "single materiality".[208] As such, they do not directly regulate disclosures about the environmental impact of an issuer's activities, an approach usually referred to as a "double materiality" approach. For example, DR 51-107 would not require reporting issuers to disclose how their production processes may *impact* biodiversity or climate change. Similarly, Guideline B-15 does not require banks to indicate how their financing activities *impact* the environment.

Moreover, these rules only regulate information that must be disclosed to investors, without requiring reporting organizations to meet specific environmental performance goals, such as aligning their activities with the goals of the Paris Agreement or Canada's climate goals.

Figure 4 – Single materiality climate-related disclosure



[206] The 2023 Fall Economic Statement announcement follows the federal government's Budget 2021 commitment to "engage with provinces and territories, with the objective of making climate disclosures, consistent with the Task Force on Climate- related Financial Disclosures, part of regular disclosure practices for a broad spectrum of the Canadian economy." Government of Canada (2023).

[207] For information on the diversity disclosure requirements, see: Jeffery et al. (2019). The federal government could also draw inspiration from California, which recently introduced draft legislation that requires all firms meeting certain turnover thresholds to disclose their greenhouse gas emissions and climate-related financial risks. For information on these requirements, see: Roberts et al. (2023).

[208] As noted by the Commissioner of the Environment and Sustainable Development, climate-related financial disclosures must be complemented by other policy instruments in order to achieve the climate transition, such as green taxonomies, prudential measures to divert financial flows away from fossil fuel assets, and carbon pricing measures. See: Commissioner of the Environment and Sustainable Development (2022).

These limitations could be addressed by regulatory measures. For instance, the *Climate-Aligned Finance Act* (**CAFA**), a bill proposed in 2022 by independent senator Rosa Galvez would introduce additional climate obligations on FRFIs and federally-incorporated corporations in Canada.[209] If passed into law, this new piece of legislation would require over 400,000 organizations, including 83 banks, 219 insurance companies, and thousands of federally-incorporated companies to demonstrate their alignment with the Government of Canada's emission reduction targets every year. CAFA would require reporting entities to disclose their climate targets, their transition plans to achieve these targets, and the progress made by entities every year. CAFA would also establish carbon accounting requirements and minimum standards for the use of carbon offsets and carbon capture and storage technology. Additionally, the proposed legislation would amend the mandates of several federal institutions, including the Bank of Canada and OSFI, to ensure their actions align with Canada's climate commitments. As of September 15, 2024, the bill had reached the committee stage at the Senate.

Box 9 – Financial cooperatives

Financial cooperatives are important actors in the Québec financial ecosystem. For example, in 2023, approximately one third of all loans issued in Québec (by value) were issued by financial cooperatives affiliated with the Desjardins Group.[210]

Financial cooperatives are regulated at the provincial level under the *Act respecting financial services cooperatives* **(FinCoop Act)**. This statute requires financial cooperatives to issue an annual report that contains specific information established in legislation, although none of these requirements expressly refer to environmental matters (FinCoop Act, s.162). Under the FinCoop Act, it is an offence for a person to intentionally share with anyone information that is both (i) false or misleading and (ii) required to be provided under the FinCoop Act (FinCoop Act s.605). In addition, financial cooperatives' public communications are subject to the general deceptive marketing provisions of the *Competition Act* and the *Consumer Protection Act*.[211]

Despite the lack of specific environmental disclosure requirements in the FinCoop Act, several financial cooperatives have been voluntarily disclosing information on their environmental performance in their annual reports or standalone reports dedicated to sustainability, such as Desjardins' Annual Report on Responsible Investment.[212]

In July 2024, following a consultation that took place from November 2023 to February 2024, the AMF released the final version of its Climate Risk Management Guideline.[213] This non-binding guideline, published by the AMF in its capacity as Québec's provincial prudential regulator, sets the agency's expectations with respect to climate-related risk management. It applies to provincially regulated Québec insurers, financial services

[209] A summary of CAFA's disclosure and reporting requirements is provided at Appendix D of the CQDE's 2022 climate-washing report. See Beaulieu and Bishai (2022).
[210] Autorité des marchés financiers (2023b), p.36.
[211] Section 3 of the *Consumer Protection Act* specifies explicitly that cooperatives are subject to its requirements.
[212] Desjardins (2023).
[213] Autorité des marchés financiers (2024a).

cooperatives, credit unions, trust companies and deposit institutions. While it does not apply to financial intermediaries, the AMF indicates that financial institutions should establish business relationships with intermediaries that allow institutions to meet the expectations set in the guideline.

The guideline's content on climate-related risk disclosures and management is similar to Guideline B-15.[214]

In addition, the Climate Risk Management Guideline includes specific expectations regarding financial institutions' fair treatment of clients in the context of product design, underwriting, product marketing, product advertising and disclosure. For example, the guideline recommends that every financial institution "ensure that staff and any other persons acting on its behalf who are involved in offering its products receive appropriate training so that they understand the product features pertaining to climate change, extreme weather events and the target client groups."[215] Similarly, the guideline indicates that "the financial institution should take the necessary steps to ensure that [product advertisements] are accurate, clear and not misleading in relation to climate-related risks, including extreme weather events, and the needs of the target client groups."[216]

While this guideline has the potential to significantly improve the transparency and quality of the environmental information disclosed by financial cooperatives and other provincially regulated financial institutions, it has certain shortcomings. For example, it is solely focused on climate-related risks, such that it may not apply to communications about other aspects of environmental performance, such as climate-related impact or nature-related risks. Moreover, given its prudential nature, the guideline does not create binding obligations for institutions, and a breach of its provisions may not translate into legal sanctions.

[214] Canada Climate Law Initiative (2024).
[215] Idem, p.10.
[216] Idem, p.11.

4.2 Investment and data services

4.2.1 Investment services

a) Description of the segment

Financial products are often complex, and financial intermediaries[217] play a key role in helping investors make decisions aligned with their needs and preferences.[218] This is particularly true for SFRI products, which are relatively novel and are not well understood by all investors, especially retail investors. For instance, a 2024 survey of Canadian retail investors indicated that 70% of respondents knew "little or nothing" about responsible investment, and 21% had "never heard of it".[219]

In Canada, financial intermediaries are regulated and must be registered with the authorities in order to provide financial services. As identified in Figure 5, some of the main categories of financial intermediaries are:[220]

- **Investment dealers (IDs)** are firms that provide advice and assist investors with respect to the purchase and sale of any type of securities.[221]
- **Mutual fund dealers (MFDs)** offer similar services as those offered by IDs, but their offering is limited to mutual funds, a type of investment fund that regroups a diversified portfolio of securities.[222] As further described in subsection 4.3.3, mutual funds are typically managed by professional investment fund managers and portfolio managers.[223]
- **Portfolio managers (PMs)** are firms that provide advice on the purchase and sale of securities and the management of a securities portfolio. PMs may provide advice on specific transactions or be given a broad mandate to manage their clients' portfolios.[224]

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[217] Duclos et al. (2024) use this expression to refer to the natural and legal persons that provide investment advice, portfolio management and investment dealing services in the securities, personal insurance and financial planning sectors. For additional information, see the introduction of chapter 3 of their book.

[218] For a description of the nature of the relationship between investment services professionals and retail investors, see Duclos et al. (2024), chapter 3, section 1.

[219] Responsible Investment Association (2024).

[220] Other categories include financial security advisors, scholarship plan dealer representatives, group insurance advisers and group annuity plan advisors.

[221] IDs provide their services through ID representatives, who may only practice as part of a registered ID. See: Duclos et al., (2024), chapter 4.

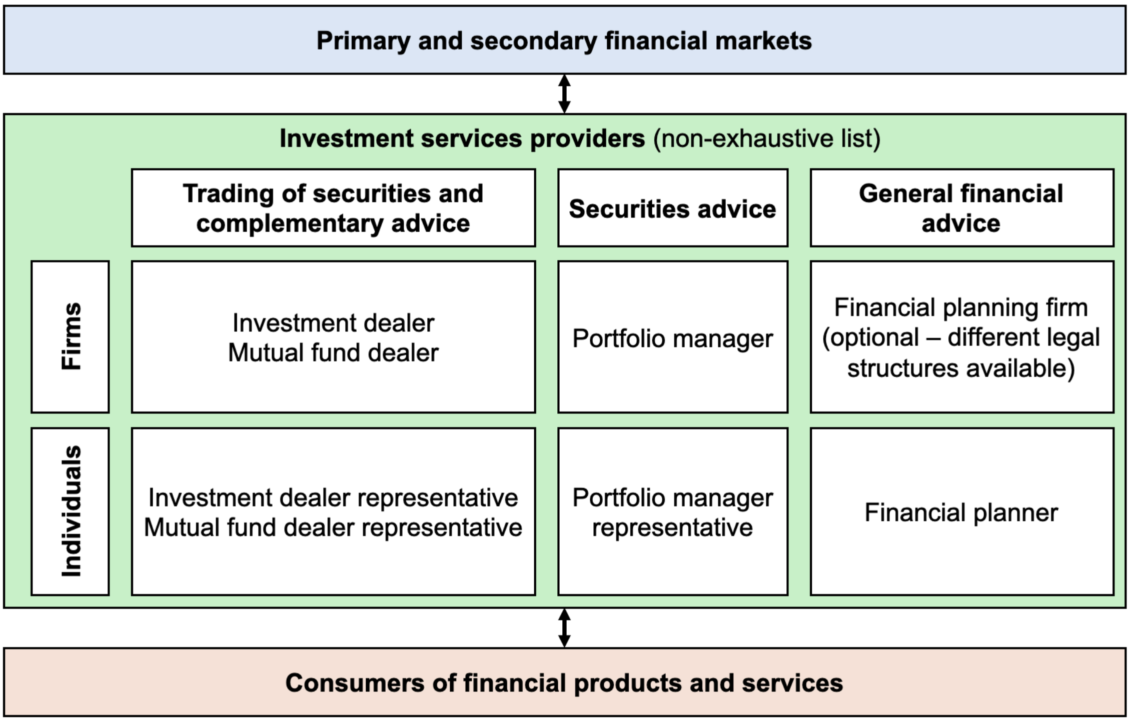
[222] MFDs provide their services through MFD representatives, who may only practice as part of a registered MFD. Unless they are registered as representatives of another category of dealers in addition. MFD representatives' advisory services are seen as complementary to their trading services. See Duclos et al., (2024).

[223] Investment fund managers are responsible for managing the daily operations of an investment fund, whereas portfolio managers are responsible for setting the fund's investment strategy. See Duclos et al., (2024).

[224] PMs provide their services through advising representatives of PMs, who may only practice as part of a registered PM. Different categories of representatives exist, such as advising representative of a PM and associate advising representative of a PM. For more information, see Duclos et al. (2024). As noted by the authors, PMs may offer their services in collaboration with IDs to execute trades and have a more complete offering.

- **Financial planners** are professionals who help individuals assess their personal financial situation, identify their financial goals and develop financial strategies to achieve them.[225] Financial planners are not authorized to provide advice about specific investment products and execute trades for their clients unless they are also practicing as ID or MFD representatives.[226]

Figure 5 – Selected categories of financial intermediaries[227]



IDs, MFDs, PMs and their respective representatives are product specialists: they are allowed to provide services in respect of specific investment products. Financial planners, on the other hand, are generalists: they provide advice covering a large range of financial services, including insurance, tax planning and retirement planning.[228]

b) Legal framework

Given the importance of their advisory role and the information asymmetry between them and their clients, financial intermediaries are subject to several legal obligations set in laws, regulations and rules adopted by self-regulatory organizations. These obligations can be found in the QSA, the *Act respecting the distribution of financial products and services* (**Distribution Act**), *Regulation 31-103 respecting Registration Requirements,*

[225] Institut de planification financière (2023). Financial planners may practice on their own or as part of a financial planning firm.
[226] Idem.
[227] This figure is adapted from Crête and Duclos (2011). One category of investment products that is not represented in this figure is the investment products tied to some form of insurance coverage. These products are distributed by financial intermediaries that are not represented in Figure 5. For additional information, see Chapter 1 of Duclos et al. (2024).
[228] Duclos et al., (2024).

Exemptions and Ongoing Registrant Obligations (**R 31-103**), the *Code of ethics of the Chambre de la sécurité financière* (**CSF Code**), the *Regulation respecting the rules of ethics in the securities sector* (**CSF Regulation**) and rules established by the Canadian Investment Regulatory Organization (**CIRO**) (the **IIROC Rules**).[229]

In this subsection, we provide a broad overview of certain obligations imposed on firms and representatives that may be triggered by greenwashing practices.[230]

IDs, MFDs, PMs and their representatives are regulated under the QSA, whereas financial planning firms and their representatives are regulated under the Distribution Act.[231] However, the AMF has delegated some of its powers to CIRO, a newly created self-regulatory organization (**SRO**).[232] The Chambre de la sécurité financière (**CSF**), another SRO, has been granted supervisory authority over certain categories of financial professionals under the Distribution Act, but not the firms that they represent.[233] The AMF supervises and monitors the CIRO and the CSF to ensure that they comply with their respective mandates.[234]

Financial intermediaries that are both (i) regulated under the QSA and (ii) not supervised by an SRO are subject to the requirements of R 31-103. This includes PMs[235], PM representatives and, until CIRO becomes fully operational, MFDs.

IDs and ID representatives, on the other hand, are subject to professional conduct rules established by CIRO.[236] Depending on the circumstances, however, the IIROC Rules may apply in addition or as an alternative to R 31-103.

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[229] For a discussion of the nature of the relationship between financial intermediaries and their clients, see Crête et al. (2014) at par.22 and following.

[230] We do not discuss the obligations imposed to the officers of financial intermediaries. Moreover, for a comprehensive exploration of the rules applicable to financial intermediaries in Québec, including the sanctions and remedies in case of non-compliance, we refer the reader to Duclos et al. (2024).

[231] Duclos et al., 2024, chapter 4.

[232] Despite the delegation, the AMF has retained its authority over disciplinary matters. CIRO was established in 2023 following the merger of the Investment Industry Regulatory Organization of Canada (IIROC), a national SRO responsible for adopting ethical rules and monitoring the conduct of investment dealers, their representatives and their officers, and the Mutual Funds Dealers Association (MFDA), another national SRO with similar responsibilities in respect of MFDs. In most Canadian provinces, the MFDA was also responsible for supervising MFD representatives, but not in Québec, where MFDs and their representatives were respectively supervised by the AMF and the CSF. In the context of the merger between the MFDA and IIROC into CIRO, the AMF announced that it would delegate the supervision of MFDs to CIRO and that the CSF would keep its powers over MFD representatives. As of September 15, 2024, the delegation of powers by the AMF to CIRO had not entirely been completed, such that the CIRO's rules were not yet applicable to MFDs. See: Canadian Investment Regulatory Organization (2023).

[233] Duclos et al., (2024), chapter 3.

[234] Idem.

[235] Both PMs and their representatives are subject to the AMF's oversight. There is no SRO that regulates PMs and their representatives.

[236] Once CIRO becomes fully operational, it will also be responsible for the registration and establishment of professional conduct rules for MFDs and their officers, while the CSF will remain in charge of disciplinary matters and ethical rules relating to MFD representatives. In the meantime, MFDs remain subject to the regulation established by the AMF. See: Duclos et al. (2024).

The professional conduct standards applicable to MFD representatives are set in the CSF Regulation, which is enforced by the CSF, whereas the professional conduct obligations of financial planners are established in the CSF Code adopted by the CSF. The CSF is responsible for monitoring the compliance of financial planners with these rules, while the AMF is responsible for the supervision of financial planning firms.

Beyond their general duties of loyalty and diligence towards clients, financial intermediaries are bound by specific legal obligations that can impact their capacity and willingness to communicate sustainability-related information and offer SFRI-related services to their clients. For example:

- **Training:** To be authorized to offer their services, investment professionals are required to be registered with the appropriate authority, which is only possible if they meet the educational requirements applicable to their title, as set out in legislation and regulation. [237] For example, the use of the financial planner title is restricted to professionals who hold a diploma in financial planning issued by the Institut de planification financière (**IPF**) and the corresponding certificate issued by the AMF (Distribution Act, ss.56-57). Similarly, MFD, ID and PM representatives all need to have passed specific exams to be able to register themselves with the AMF and CIRO.[238] These professionals are also subject to continuous education requirements, which guarantee that professionals remain relevant and proficient in their respective fields.[239]

  As of September 15, 2024, most of the mandatory training programs for financial professionals include little – if any – content on SFRI products and services.[240] Moreover, investment services professionals are not required to attend training sessions on SFRI products as part of their continuous education requirements, although they can voluntarily decide to do so.

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[237] Duclos et al. (2024), chapter 4, item 1.2.

[238] See R 31-103. The representative must have passed one of the following exams: the Canadian Investment Funds Course exam, the Canadian Securities Course exam or the Investment Funds in Canada Course exam. The representative may also qualify if they have met the education and experience requirements to be an advising representative PM. See s. 2600 of the IIROC Rules for a full list of the proficiency requirements applicable to different categories of professionals. As set out in R 31-103, to obtain a certificate, an advising representative of a PM must either: (i) have earned a CFA charter and has 12 months of relevant investment management experience in the 36-month period before applying for registration; or (ii) have received the Canadian Investment Manager (Chartered Investment Manager designation) designation and has 48 months of relevant investment management experience, including 12 months in the 36-month period before applying for registration.

[239] For example, see: IIROC Rules, s.2701(1); Distribution Act, s.200(5.1) and 202.1, cited by Duclos et al. (2024). As noted by Duclos et al. (2024) in chapter 4, the QSA does not provide for continuous training requirements. However, the policy statement issued in connection with R 31-103 indicates that "Registered individuals should update their knowledge and training to keep pace with new securities, services and developments in the industry that are relevant to their business. Firms are required to provide training on compliance with securities legislation to their registered individuals."

[240] The syllabus of the Canadian Securities Course and the Investment Funds in Canada Course do not include any SFRI-related content. See: Canadian Securities Institute (2024). One of the 40 learning outcomes of the portfolio management module of the CFA Level I course for 2024 was to "describe how environmental, social, and governance (ESG) considerations may be integrated into portfolio planning and construction". See: CFA Institute (2024a; 2024b).

- **Know-your-client (KYC):** Financial intermediaries are required to understand their clients' financial situation and needs before providing them with investment solutions. For example, s.13.2 of R 31-103 requires financial intermediaries to "take reasonable steps" to ensure that they have sufficient information on their clients' personal and financial situation, investment needs and objectives, investment knowledge, risk profile and investment time horizon. The IIROC Rules reiterate this requirement (IIROC Rules, s.3202).[241] Likewise, the CSF Regulation requires MFD representatives to "make a diligent and professional effort to get to know a client's financial and personal situation as well as his investment goals" (CSF Regulation s.3). Moreover, the MFD representative's advice "shall be based on an in-depth analysis of information obtained from the client and information concerning the trade." (CSF Regulation s.4). The CSF Code provides for a general obligation to have a comprehensive understanding of the applicable facts before providing advice (CSF Code, s.15).

  None of these KYC regulations and rules expressly refer to clients' sustainability preferences. However, professionals should seek information on their clients' environmental or social objectives and beliefs before recommending a particular product or service as part of a broad interpretation of their duties. Professionals should also take into consideration these preferences if and once expressed as part of their advisory services.

  In 2021, CIRO clarified its expectations in its guidelines on suitability determination for retail clients.[242] In the document, CIRO argued that the obligation to acquire "sufficient information" about clients' "investment needs and objectives" required providing "clients with the opportunity to express their investment needs and objectives in terms that are meaningful to them, such as (…) investing in accordance with environmental, social and governance criteria or other personal preferences."[243] However, it is unclear whether this clarification has led to any concrete changes to the KYC practices of financial intermediaries.

  During a public conference held in February 2024, CIRO's Chief Executive Officer acknowledged the need for anti-greenwashing rules to ensure that consumers have access to sufficient information to make informed decisions.[244] He also noted that CIRO was considering requiring professionals to ask specific questions about their ESG preferences.[245] However, these comments were not reflected in CIRO's 2025-2027 Strategic Plan and 2025 Annual Priorities.[246]

[241] Duclos et al. (2024), chapter 5.
[242] Canadian Investment Regulatory Organization (2021).
[243] Idem. However, it is uncertain whether financial intermediaries have integrated this requirement in their business practices, as one expert interviewed in the context of this report indicated that some firms are not following CIRO's guidance on this topic and are not documenting whether advisors comply with it.
[244] Poulin-Goyer (2024).
[245] Idem.
[246] Canadian Investment Regulatory Organization (2024a; 2024b).

- **Know-your-product (KYP):** Financial intermediaries[247] are required to have an adequate understanding of the investment solutions that they offer. For example, before offering securities, par.13.2.1(1) of R 31-103 requires registered firms to take reasonable steps to evaluate their relevant characteristics, including their structure, features, risks and costs. This requirement is reiterated in the IIROC Rules at s.3301. Likewise, par.13.2.1(2) of R 31-103 requires registered representatives to only trade or recommend securities if they have taken steps to understand the securities' characteristics, risks and structure. This requirement is reiterated in the IIROC Rules at s.3302.

  While these KYP requirements are not specific to SFRI products, they also apply to them, and financial intermediaries that purchase, sell or recommend financial products with an SFRI component shall understand their distinctive characteristics.

- **Suitability:** Financial intermediaries are required to offer investment solutions that are reasonably aligned with their clients' expectations, needs and situation. For example, before taking investment action for, or making a recommendation to a client, s.13.3 of R 31-103 requires financial intermediaries to ensure that the proposed action is "suitable for the client" and puts their "interest first" (R 31-103, s.13.3). To determine whether an action is suitable, the intermediary shall consider the information collected as part of the KYC and KYP processes, the impact on the client's account, the action's costs and the alternative actions available (R 31-103, s.13.3).[248] Similar obligations, albeit with more detailed specifications, also extend to intermediaries under CIRO's oversight.

  These requirements are not specific to SFRI products. However, an investment professional whose client expresses interest in such products (or signals preferences that match the characteristics of such products) during the KYC process should make recommendations that meet these needs. Moreover, investment professionals should have sufficient knowledge of products that they recommend to clients to ensure that they meet the clients' needs, including with respect to SFRI products' characteristics.

- **Information**: Financial intermediaries are required to provide specific information to their clients to allow them to make adequate investment decisions.[249] This obligation may be general, such as the CSF Code's requirement that every representative "fully and objectively explain to his client or any potential client the type, advantages and disadvantages of the product or service that he is proposing to him and must refrain from giving information that may be inaccurate or incomplete." (s.13). This obligation may also be specific, as can be seen in Part 14 of R 31-103 and in section 165 of the QSA.[250]

- **Deceptive representations:** The regulations applicable to financial intermediaries contain several provisions that prohibit financial intermediaries from making false or

[247] As financial planners are not authorized to offer specific products to their clients, this obligation is less relevant for this category of providers.
[248] See also IIROC Rules ss. 3402-3403. The IIROC Rules establish different suitability determination requirements for retail versus institutional clients.
[249] Duclos (2024) at Chapter V.
[250] Idem.

misleading representations to their clients. For example, financial planners are prohibited from making "statements that are incomplete, false, deceptive or liable to mislead" (CSF Code, s.16). Similarly, an MFD representative is required to "take reasonable steps to ensure the accuracy and sufficiency of information given to a client concerning his investments" (CSF Regulation s.7)[251] and "refrain from making false declarations as to his level of skill or as to the effectiveness of his services or those of the firm on behalf of which he is acting" (CSF Regulation s.18).[252] Section 13.18 of R-31-103 formulates similar requirements. Likewise, IDs may not issue advertisements, sales literature or correspondence that contains "false or misleading" statements, omits a "material fact", contains an "unjustified promise of specific results", "fails to fairly present the potential risks or the client" or is "detrimental to the interests of the public" (IIROC Rules, s.3603).

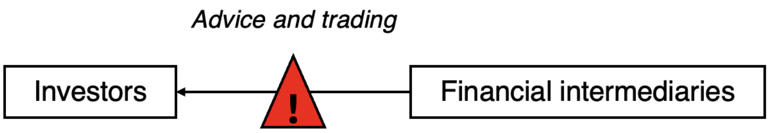
These rules may apply to claims by financial intermediaries about the environmental characteristics of financial products. For example, depending on the circumstances, an MFD representative's false claims about their expertise in ESG investment funds could constitute a violation of s.18 of the CSF Regulation. Similarly, a misleading claim about the use of a negative screening method by a PM could constitute a violation of s.3603 of the IIROC Rules.

A violation by investment services firms and the professionals that they employ of their KYC, KYP, suitability and information obligations can lead to a wide range of penal, disciplinary and administrative sanctions.[253]

c) Greenwashing risks

In a 2022 survey of Québec workers by ÉducÉpargne, 53% of respondents indicated being interested in responsible investment strategies and products.[254] Moreover, a majority of them indicated being interested in investing in thematic funds related to the production and distribution of renewables and clean technologies.

Figure 6 – Greenwashing risks in the financial intermediation segment



However, surveys have also suggested that the demand for SFRI products and advice is not met by investment services providers. According to ÉducÉpargne's survey, 65% of respondents who receive advice from a financial advisor or planner indicated that their

[251] Section 13 of the CSF Code establishes a similar requirement: "A representative must fully and objectively explain to his client or any potential client the type, advantages and disadvantages of the product or service that he is proposing to him and must refrain from giving information that may be inaccurate or incomplete."

[252] Section 10 of the CSF Code and par.13.18(1)(a) of R 31-103 establish a similar requirement.

[253] An exhaustive review of these sanctions is beyond the scope of this report. For additional information on the AMF, CIRO and CSF's monitoring and enforcement powers, see Duclos et al. (2024).

[254] ÉducÉpargne (2022).

advisor has never raised the topic of responsible investment with them.[255] Likewise, a 2024 survey by the Responsible Investment Association indicated that 67% of respondents would like their investment services provider to share information about responsible investment options – however, only 32% indicated that their providers had raised the topic with them.[256]

Similar conclusions were drawn in an investigation by Protégez-Vous magazine, which sent mystery shoppers to meet 14 financial advisors from seven major financial institutions to seek information on SFRI products.[257] During the meetings, many advisors had limited knowledge of ESG products, while some advisors did not even know about their existence. Some advisors were unable to provide advice on ESG funds, did not know the characteristics of the ESG funds that they offered and failed to provide details about these funds' investment methodology.

Many factors can explain why some financial intermediaries struggle to respond to the rising demand for SFRI products and advice. One of them is the **lack of mandatory training** with respect to this market segment, which can lead professionals to prioritize more traditional investment products. Due to their KYP requirements, professionals are prohibited from offering products they are not knowledgeable about. Consequently, if they do not have a good understanding of SFRI products, they are unlikely to mention them to clients.

In addition, the **lack of specific KYC requirements** relating to SFRI characteristics – such as a client's willingness to achieve environmental or social goals through their investments – may lead professionals to focus on other aspects of their clients' investment preferences. Often, investors are unaware of the existence of SFRI options, and without prompting, they are unlikely to raise the topic. Similarly, without information on their clients' sustainability preferences, providers are unlikely to provide options that suit their clients' needs. CIRO's 2021 update on its KYC and suitability expectations was a good first step to address this situation – but it could be expanded further via regulation to ensure compliance, as was done in the European Union (**EU**) (see Box 10).[258]

Nevertheless, investment services providers have legal obligations towards their clients. They need to inquire about their clients' needs and preferences – and that may include asking questions about their environmental and social goals. If clients communicate a desire to invest in SFRI products, it is the responsibility of professionals to ensure that they provide investment options aligned with their clients' needs. In cases where they lack sufficient expertise in the SFRI segment, professionals shall defer to more experienced colleagues and/or seek external knowledge and expertise. A failure to meet these requirements may lead to a wide range of sanctions for financial intermediaries.[259] Proactive professionals may already choose to voluntarily enroll in dedicated training

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[255] Idem.
[256] Responsible Investment Association (2024).
[257] Roy and Bergeron (2024).
[258] Langton (2022).
[259] See Duclos et al. (2024) for more information on this topic.

sessions focused on SFRI products to fulfill their continuous education obligations, and firms may establish inhouse training programs on SFRI-related considerations.

However, even if they obtain adequate SFRI training, seek information on their clients' sustainability preferences and understand products' environmental characteristics, investment services providers' ability to offer solutions that are aligned with their clients' needs are constrained by the limited availability of high quality SFRI assets. For instance, an investment services provider will not be able to meet his clients' demands for Paris-aligned impact investment products if such assets do not exist in the marketplace. As such, any reform of the duties of investment services providers will have a limited impact unless it is accompanied by regulatory and policy measures that incentivize the development of investment products that meet the preferences of sustainability-oriented investors and, most importantly, that effectively contribute to the alignment of the financial sector with global sustainability commitments.

In addition, the transformative potential of a reform of providers' duties is constrained by investors' willingness to invest in high quality SFRI assets. Some investors are not interested in investment solutions that allow them to achieve positive environmental impact or avoid causing environmental harm. The inclusion of sustainability topics in the KYC process will not change these people's preferences. As noted before, this shows the limits of informational policies, which aim at improving the quality of information shared to stakeholders, without guaranteeing that this information will change stakeholders' behaviour.

Box 10 – EU requirements to seek information on clients' sustainability preferences
In 2022, the EU amended its *Markets in Financial Instruments Directive II* to explicitly require firms providing investment advice and portfolio management services to consider their clients' sustainability preferences as part of the suitability assessment process.[260] Under the amended regulation, these providers are required to collect sufficient information on their clients' sustainability preferences and recommend financial products that reflect these preferences.[261]

[260] J.P. Morgan Asset Management (2022). Sustainability preferences are defined in reference to the environmental objectives set in the EU Taxonomy (see Box 13), investments that contribute to an environmental or social objective as defined in the EU Sustainable Finance Disclosure Regulation (see Box 16) or investments that consider adverse impacts on sustainability factors.

[261] Idem.

4.2.2 *ESG data providers*

a) Description of the segment

Actors of the financial sector commonly rely on financial data to assess securities, negotiate investments, develop financial products and manage assets. Some of this data is obtained from financial data providers, which are specialized firms that collect, analyze, aggregate and distribute financial data.[262] The financial data sector is dominated by large global providers, such as Bloomberg, Refinitiv, MSCI, Morningstar (and its ESG-focused subsidiary, Sustainalytics), S&P, ISS and FactSet.[263]

Over the past few years, the demand for financial data on ESG performance has grown exponentially.[264] The products offered by financial data providers in this segment include[265]:

- **Data**: Provision of data on relevant ESG indicators, such as a firm's carbon footprint, its executive compensation policies, the quality of its diversity and equity programs or the percentage of women on its board of directors. This data may be used by customers to manage risks and opportunities, comply with reporting requirements and comply with ESG investment goals.[266]
- **Ratings and scores**[267]: Aggregation of a selection of ESG data points into a numerical or alphabetical indicator that measures an organization's relative performance compared to its peers. For example, Sustainalytics' ESG Risk Ratings rank firms' ESG risk on a scale of 0 (negligible risk) to 40+ (severe risk).[268] As explained by the data provider, this rating measures "the degree to which a company's economic value is at risk driven by ESG factors" and is meant to be used to compare firms within and across sectors.[269] Investors may use ratings and scores to assess and select assets or as part of shareholder engagement initiatives.
- **Indices**: Establishment of a list of companies based on their performance against a selection of data points (e.g., based on their industry-adjusted ESG score), and weighting of the companies based on their relative size to obtain a numerical metric

[262] International Organization of Securities Commissions (2021).
[263] Idem.
[264] Idem.
[265] Other services include consulting services, certification and second-party opinions, regulatory reporting assistance and advice on ESG ratings improvement techniques. See: IOSCO (2021).
[266] See International Organization of Securities Commissions (2021) at Table 16.
[267] In SN 81-334, the CSA defines ESG ratings and scores as "an assessment of an organization or product's relative ESG characteristics, effectiveness and performance, including its exposure to ESG risks and/or opportunities". See: Canadian Securities Administrators (2024a). IOSCO distinguishes ESG scores and ESG ratings by indicating that the former relies on quantitative analysis, whereas the latter relies on both quantitative and qualitative analysis accompanied by analytical reports. See: International Organization of Securities Commissions (2021).
[268] Sustainalytics (2023a).
[269] Sustainalytics (2023b). As noted by the company, "To be considered relevant in the ESG Risk Ratings, an issue must have a potentially substantial impact on the economic value of a company and, hence, its financial risk- and return profile from an investment perspective."

that measures the aggregated performance of the sampled firms.[270] For example, the "MSCI World ESG Leaders Index" includes a list of 694 large and medium companies weighted based on their market capitalization.[271] Companies that compose this index are selected from a broader MSCI index, and based on their ESG ratings and exposure to ESG controversies.[272] This index excludes companies involved in specific business activities, such as tobacco, fossil fuel extraction, thermal coal power and controversial weapons.[273] ESG indices may be used to develop passive investment funds that aim to build a portfolio that matches the index composition. They may also be used as a benchmark to measure their relative performance by active managers.

Some financial data providers, like S&P and Morningstar (via its subsidiary DBRS), also provide credit rating services.[274] These ratings measure the probability that a borrower, such as a company or a government, fails to meet its financial obligations.[275] Credit ratings allow investors to evaluate borrowers' capacity of payment and negotiate financial terms that reflect borrowers' credit risk (e.g., by charging higher interest rates).[276]

b) Legal framework

Historically, the provision of credit ratings and other financial data services, including the distribution of ESG data, was largely unregulated in North America and Europe. For example, some credit rating agencies (**CRAs**) were allowed to provide advisory services to debt issuers before rating their products, which raised conflict of interest concerns, and some rating methodologies were perceived as being opaque.[277] These issues had important financial stability implications, as CRAs' ratings were sometimes incorporated into regulatory mechanisms, like the calculation of banks' capital requirements.[278]

Following the 2008 financial crisis, financial authorities started to examine whether certain business practices of the main CRAs should be prohibited.[279] As a result of these discussions, provincial securities laws across Canada were amended in 2009 to allow provincial agencies to regulate CRAs (e.g., QSA s.186.2). These amendments led to the adoption of *Regulation 25-101 Respecting Designated Rating Organizations* (**R 25-101**). Only CRAs that are designated by the authorities (referred to as "designated rating organizations", or **DROs**) are subject to this regulation (QSA s.186.1), which requires DROs to establish, maintain and comply with a code of conduct (R 25-101 s.9), and appoint a

[270] As explained by Fichtner et al. (2023), "The purpose of indices is to display the performance of a specific economic entity such as a nation's stock market (e.g., S&P 500) in one single number that is relatively easy to understand and comparable over time. Index providers—the companies that construct indices—have a particularly salient role in capital markets as their decisions whether assets are included or excluded from indices have a strong influence on capital allocation."
[271] MSCI (2024).
[272] Idem.
[273] Companies deriving less than 5% of their revenues from fossil fuel extraction and thermal coal power activities may still be included.
[274] Two other noteworthy credit ratings agencies are Fitch and Moody's.
[275] See s.5 of the QSA for a formal legal definition.
[276] Malaver-Vojvodic (2020).
[277] Idem.
[278] Idem.
[279] Idem.

compliance officer responsible for monitoring the DRO's adherence to its code of conduct and securities legislation (R 25-101 s.12).[280] DROs are also required to keep books and records and make regulatory filings that describe, among other things, their procedures and methodologies to determine credit ratings, their policies and procedures regarding conflicts of interest, and their policies and procedures regarding internal controls (R 25-101, s.14).[281]

The QSA also grants the AMF the power to inspect the affairs of DROs to verify their legal compliance (QSA s.186.3). While it may not regulate the content or methodology underlying a credit rating, the AMF may "impose changes in the practices and procedures" of the DRO if deemed necessary to protect the public (QSA s.186.5 and s.186.6).

In 2021, the QSA was amended again to allow the AMF to regulate financial benchmarks.[282] These amendments followed instances of manipulation of the LIBOR[283], a United Kingdom (**UK**) benchmark, which had led the EU to regulate the use, administration and contribution to certain financial benchmarks.[284] The 2021 amendments to the QSA authorized the AMF to designate benchmarks and their administrators as being subject to the QSA's requirements (QSA s.182.0.1).[285] So far, under the new regulation, only Refinitiv Benchmark Services (UK) Limited has been designated as benchmark administrator, and only the Canadian Dollar Offered Rate has been designated as both a critical and an interest rate benchmark.[286]

Outside of designated credit ratings and designated benchmarks, the provision of financial data services is not subject to specific regulation under provincial or federal law. In other words, the provision of ESG data, ratings and indices is currently unregulated in Canada.

However, investment funds relying on ESG data, ratings and indices are subject to disclosure requirements regarding their use of these services, which can indirectly impact

[280] This regulation reflects the corresponding national instrument adopted by the CSA. See: Canadian Securities Administrators (2012).
[281] For a description of the information that should be provided, see Form 251011F1 Designated Rating Organization Application and Annual Filing provided at the end of R 25-101.
[282] Benchmarks are defined in the QSA as including a "price, estimate, rate, index or value that is regularly determined by applying a formula or method to one or more underlying interests or by evaluating those interests, that is published or made available to the public by onerous or gratuitous title, and that is used as a reference for such purposes as setting the interest or any other sum payable under a contract or a financial instrument, including a derivative within the meaning of the Derivatives Act (chapter I-14.01), setting the purchase or sale price or the value of a contract or a financial instrument, including such a derivative, or measuring the performance of a financial instrument or of an investment fund".
[283] This benchmark tracks the interest rates at which London banks lend to each other. It is commonly used as a reference interest rate in financial transactions.
[284] Canadian Securities Administrators (2023b).
[285] A designated benchmark administrator is required to comply with specific regulatory requirements relating to governance, internal controls, conflicts of interest, codes of conduct, integrity and reliability of the benchmark, the methods used to establish the benchmark and the disclosure of information (QSA s.186.2.1). As with DROs, the AMF may inspect designated benchmark administrators and impose changes in their practices and procedures if necessary to protect the public (QSA s.186.3 and s.186.6).
[286] Stikeman Elliott (2021).

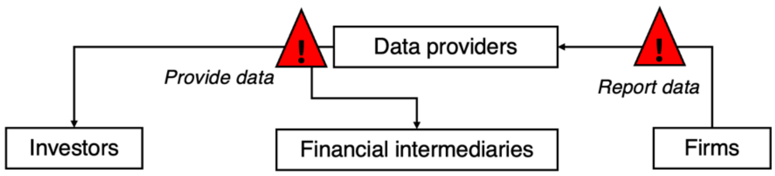
the activities of ESG data providers. In March 2024, the CSA issued a revised version of SN 81-334, which establishes the authorities' expectations for ESG-related disclosures by investment funds.[287] This notice, which is described in detail in subsection 4.3.3, does not directly target ESG data providers. However, the CSA indicates that many funds did not adequately disclose how they used company-level ESG ratings and scores and ESG-related indices and benchmarks. As such, the CSA decided to provide recommendations with respect to funds' disclosures on their use of ESG ratings and indices as part of their investment strategies or sales communications.

SN 81-334 is a very comprehensive document that contains detailed disclosure recommendations for investment funds that use ESG data as part of their investment strategies or sales communications, which will likely address many of the issues relating to the use of ESG data services by investment funds.[288] However, SN 81-334 only applies to investment funds regulated under the QSA, such that other users of ESG data (and, indirectly, consumers of financial products that integrate such data) may not have access to the same information as investors in investment funds under the QSA. For example, a proxy advisor that relies on ESG ratings to formulate voting recommendations would not be subject to SN 81-334's disclosure expectations.

c) Greenwashing risks

As noted above, the ESG data segment is currently unregulated in Canada. However, in its Annual Statement of Priorities 2023-2024, the AMF announced that it would "begin to look at how to regulate ESG rating providers", which could lead to regulatory action in the sector. Other international jurisdictions have already announced measures to regulate the ESG data segment. For example, as summarized in Box 11, the UK government announced in March 2024 that it would introduce legislation to regulate ESG ratings.[289] This announcement took place one month after the European Union approved new rules for the sector. Given the global scope of the main financial data providers, foreign laws and regulations are likely to directly impact the services provided by financial data providers to Canadian users.

Figure 7 – Greenwashing risks in the ESG data segment



Risks arise from both the primary data reported by firms and from the secondary data (such as ratings) disseminated by data providers

[287] Canadian Securities Administrators (2024a).
[288] However, as noted in the recommendations section, the document could provide more specific guidance on the disclosure of ESG methodologies and have stronger conflicts of interest rules.
[289] Reuters (2024).

This surge in interest from regulators in the ESG data segment reflects the growing criticism surrounding the quality and appropriate use of ESG data, ratings and indices. The primary sources of this criticism are summarized below.

Issues with the primary data

Primary ESG data may come from firms' regulatory or voluntary disclosures, company press releases, media reports, third party information and analysis conducted by the provider itself (e.g., by collecting data through questionnaires sent to the companies assessed).[290] ESG data has been criticized for being **inconsistent**: it is often self-reported, unaudited and unverified by third parties, comes in various formats, and may include partial or inaccurate numbers, preventing comparability across issuers.[291] Another issue is the **availability** of ESG data: certain regions and types of firms (especially private, smaller firms) may be underrepresented in datasets.[292] These concerns arise from the lack of regulation around the disclosure and standardization of ESG data.[293] As described in Box 4 and Box 8, upcoming climate-related risk disclosure obligations are likely to help address some of these shortcomings. However, additional measures will be required to improve the quality of data on other environmental characteristics, like biodiversity, water use and waste management.

Issues with ratings

The generation of an ESG rating involves selecting relevant ESG factors and indicators, attributing relative weights and aggregating a firm's performance under each indicator to obtain a single score. ESG scores can be a helpful tool for investors wishing to compare different assets' ESG performance without evaluating dozens of metrics separately. Central banks and financial regulators may also use ESG scores to evaluate climate risks and progress.[294]

However, users should be aware that most ESG ratings tend to be **risk-focused**: they rely on indicators that capture a firm's exposure to financial risks and opportunities. As such, they may not reflect an asset's impact on the environment or society.[295] For example, a highly polluting firm may obtain a high environmental rating if it operates in an area with low exposure to extreme weather events and minimal environmental regulation. While some providers have been working towards the development of impact-focused ratings, this category is still nascent.

Moreover, by definition, ratings require selecting and weighting relevant factors, which necessarily involve **trade-offs and subjective** decisions, which has led to controversial outcomes. In 2023, media outlets reported that S&P had given a lower ESG rating to Tesla,

[290] OECD (2022); International Organization of Securities Commissions (2021); KPMG (2021). As noted in International Organization of Securities Commissions (2021) at pp.10-11, in addition to raw data, providers may also offer screening tools and controversies alerts.
[291] OECD (2022); International Organization of Securities Commissions (2021).
[292] International Organization of Securities Commissions (2021); Paul Weiss (2021).
[293] OECD (2022).
[294] Idem.
[295] This principle can be found in the preamble of the UN PRI declaration. See: Principles for Responsible Investment (undated). See also: Crona et al. (2021) and Simpson et al. (2021).

a manufacturer of electric cars, than to Philip Morris International, a tobacco manufacturer.[296] Some observers have also noted that high ESG ratings may not be correlated with low GHG emissions, as carbon is only one of the many indicators that may be included in a given rating.[297]

In addition, many researchers have found that ESG ratings differ significantly across providers.[298]. In 2022, Berg et al. have decomposed this divergence into three main factors[299]:

- **Measurement divergence** comes from the fact that different providers will select different indicators to measure the same ESG factor. For example, a provider may evaluate a firm's carbon risk by assessing its scope 1 emissions, whereas another provider will include scope 2 and 3 emissions. In their study, Berg et al. found that measurement divergence contributed to 56% of the divergence across providers.
- **Scope divergence** is caused by the fact that different providers will select different factors to assess a firm's overall ESG risk exposure. For example, a ratings provider may decide that climate change and carbon emissions are relevant "E" factors but exclude biodiversity indicators from their methodology. Another provider may decide to include biodiversity factors, resulting in a different final score for the same firm. Berg et al. found that scope divergence was driving 38% of the divergence across providers.
- **Weight divergence** reflects the fact that different providers will allocate different weights to the same ESG attributes. Even if a provider's risk assessment process integrates a comprehensive list of ESG factors, there are several ways to weigh these factors when evaluating an asset's risk profile. For instance, rating providers may allocate a greater weight to social or governance criteria than to environmental criteria, leading to an ESG investment with an overall high degree of exposure to environmental risks. In Berg et al.'s study, weight divergence was associated with 6% of the divergence across providers.

Divergence is not necessarily an issue as long as users are aware of the trade-offs embedded in ESG ratings, allowing them to prioritize certain aspects of an asset's environmental performance. In fact, divergence may be the result of competition between rating providers offering differentiated services.[300]

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[296] Sibarium (2023).For instance, Philip Morris International had obtained a 84 "social" score, whereas Tesla received a score of 20. Similarly, Sustainalytics gave a better ESG score to Tobacco producers Altria and British American Tobacco than Tesla.

[297] Johnson (2023).

[298] Chatterji et al. (2016); Boffo et al. (2020a and 2020b); Berg et al. (2022); International Organization of Securities Commissions (2021). In a 2019 speech, SEC Commissioner Peirce noted that "Even if the rating is not wrong on its own terms, the different ratings available can vary so widely, and provide such bizarre results that it is difficult to see how they can effectively guide investment decisions." See Peirce (2019). Christensen et al. (2021) have found that higher levels of ESG disclosures lead to greater inconsistencies across ESG ratings – which the authors argued could be explained by the fact that "data providers need to make a judgment about whether the disclosure means good or bad performance".

[299] Berg et al., 2022. The authors also find a "halo effect" whereby firms with a high score for some factors will be more likely to be given a high score for other factors by the ratings provider. This effect would explain 15% of the changes in category scores across providers.

[300] As noted by IOSCO, "This diversity of views, independent methodologies, innovation and competition

However, many observers have noted that rating providers tend to **lack transparency** when it comes to disclosing their methodologies. For instance, in 2021, IOSCO noted a "lack of transparency of methodologies including aspects such as the scope of the underlying data, definitions of materiality, the timing of data collection and the frequency of review or update of the ESG ratings or ESG data products".[301] This lack of transparency may prevent users from properly understanding the implications of a given ESG rating, but also companies from improving their performance.[302]

Another issue that researchers have identified is the potential for **conflicts of interests** among ESG rating providers. Contrary to credit rating agencies, ESG rating providers have the ability to offer consultancy services to the companies that they assess.[303] For instance, the consulting side of an ESG rating firm may charge fees to a company for advice about how to improve the rating given by the ESG ratings side of the provider.[304] Some providers have started to separate these two business functions to answer this concern.[305]

Finally, some observers have warned that ESG ratings may attribute **more weight to firms' disclosure of information than actual ESG performance**. In a 2022 study of environmental metrics (the "E" in ESG), researchers found that high environmental scores were not correlated with key climate transition metrics, like lower CO2 emissions, greater emission reductions over time, higher environmental expenditures, and higher use of renewable energy.[306] They also found that "higher E-scoring companies perform more favourably on metrics that assess a company's disclosure of key decarbonization goals, policies and commitments", which may be driven by market capitalization and level of disclosure capacity instead of climate transition actions.[307] In other words, some ratings have been shown to reward the disclosure of climate policies and plans rather than actual emission reduction efforts. This can be highly problematic if investors or regulators use a firm's "E" score as a proxy for its degree of climate transition alignment, as high scoring firms may not actually be low-emitting, low transition risks firms.

Issues with indices

ESG indices leverage ESG data and ratings to build lists of firms that meet a selection of performance criteria, such as a combination of financial performance and ESG risk criteria. These lists can be used to build passive investment funds that track an index: whenever firms enter or exit the index list, the passive portfolio manager will buy or sell shares of these firms to ensure that their fund's portfolio matches the index. The

can be beneficial to the markets and investors, with sufficient transparency and robust governance, calling for providers to issue ratings and data products that are internally consistent with their own disclosed in-house methodologies." (p.38).

301 International Organization of Securities Commissions (2021)

302 Idem.

303 Grandjean (2023).

304 International Organization of Securities Commissions (2021).

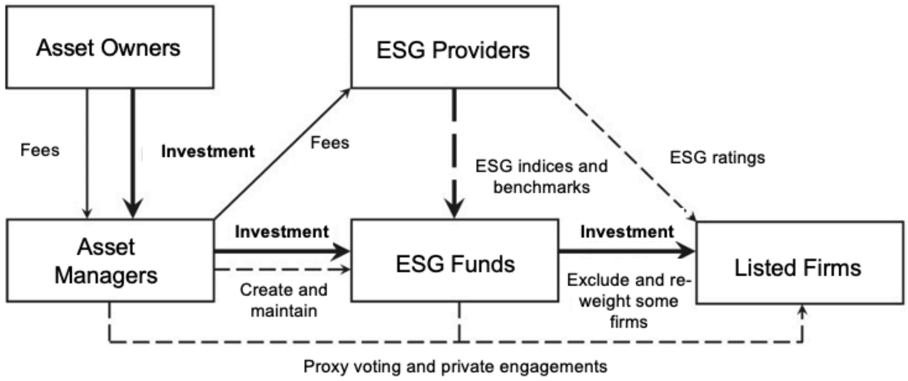
305 Idem.

306 OECD (2022).

307 Idem.

relationship between investors, fund managers, data providers and listed firms is summarized in the figure below, adapted from Fichtner et al.[308]

Figure 8: Overview of the ESG data ecosystem[309]



Driven by the increase in popularity of exchange-traded funds (**ETFs**) in the retail investment world, passive investment strategies have surged in popularity over the past decade, especially in the ESG segment.[310] Between 2017 and 2020, the share of ESG funds with passive strategies has increased by more than 400%.[311] This trend has enhanced the role of index providers in the allocation of capital. It has also affected the behaviour of active funds, which may use ESG indices as benchmarks and to establish their investment strategies.[312]

ESG indices have the same biases and limitations as their underlying ratings. For instance, a passive ESG fund that replicates an ESG index based on risk-focused ratings may not aim to achieve positive environmental impact or avoid negative environmental impact. One study distinguishes three categories of ESG indices:

ESG Integration indices: These risk-focused indices integrate ESG risk factors by taking into consideration a broad range of indicators – typically leveraging data from ESG ratings.[313] These indices represent the vast majority of all ESG indices.[314] ESG Integration indices may allow the inclusion of fossil fuel companies and other carbon intensive assets, despite their significant environmental footprint.

- **Light Green indices**: In addition to integrating ESG risk factors, these risk-focused ratings exclude carbon-intensive industries (such as fossil fuel firms) from their

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[308] Fichtner et al. (2023).
[309] Figure from Fichtner et al. (2023).
[310] As explained by Fichtner et al. (2023), index providers are "setting standards for sustainable investing and de facto steer capital allocation within ESG investing."
[311] Leaders Arena (2020).
[312] Fichtner et al. (2023).
[313] As explained by Fichtner et al. (2023), "broad ESG indices are not likely to create sustainability impact via capital allocation (inside-out or output ESG) but are rather about safeguarding investment performance against adverse effects from climate change and state measures to mitigate it (outside-in or input ESG)."
[314] Fichtner et al. (2023).

composition and allocate a higher weight to environmental factors relative to social and governance factors. These indices represent a minority of ESG indices.[315]

- **Dark Green indices**: These impact-focused indices aim to invest in assets that will facilitate the reduction of emissions and achievement of global climate goals. For instance, these indices may consist of firms that meet certain GHG intensity performance criteria and decarbonization targets. These indices represent a minimal portion of all ESG indices.[316]

As with ratings, the existence of different types of ESG indices is not problematic in itself, as different types of indices may cater to different investor needs. However, the very existence of ESG Integration and Light Green indices can be an important source of confusion for investors investing in funds that track ESG indices. For example, investors may interpret the reference to an ESG index as a sign of sustainability or alignment with the goals of the Paris and Kunming-Montréal Agreements. Similarly, investors may expect that certain categories of environmentally harmful assets, like shares of fossil fuel companies, would systematically be excluded from ESG indices.

Under SN 81-334, certain investment funds that rely on ESG data services must disclose specific information on the ESG data and ratings underlying their investment activities, as discussed further in subsection 4.3.3. Investors should therefore take a close look at this information when choosing to invest in a given fund. However, these disclosure obligations are limited to publicly distributed investment funds regulated under provincial securities law.

As with other segments of the financial sector, the provision of deceptive ESG-related information by data providers can lead to greenwashing risks. For example, in February 2024, a group of NGOs filed complaints before the US, UK and Dutch National Contact Points[317] against three leading providers of ESG indices for an alleged violation of the OECD's Guidelines for Multinational Enterprises.[318] According to the complaint, the providers granted high ESG ratings to companies linked to Myanmar's military and involved in serious human rights abuses in the country, resulting in the inclusion of these firms in the providers' ESG indices. While the case is still ongoing, groups claim that ESG index providers have a responsibility under international corporate accountability standards to prevent human rights and environmental abuses and remediate harm. This case – which could be referred to as a case of "social-washing" given that it is not directly linked to environmental considerations – may be a sign that ESG data providers are likely to be under greater scrutiny as regulatory frameworks become more stringent.

[315] Idem.
[316] Idem.
[317] National Contact Points are non-judicial mediation bodies established by OECD member states to ensure businesses' compliance with the OECD Guidelines for Multinational Enterprises, a non-binding set of international guidelines on responsible business conduct.
[318] Inclusive Development International (2024); Templet-West and Cumbo (2024).

Box 11 – International developments regarding ESG data services

European Union

In 2021, the European Commission published a study that identified three main issues in the ESG ratings, data and research segment: conflicts of interests, lack of transparency and accuracy of rating methodologies, and lack of clarity over the terminology and operations of ESG rating providers.[319] This led the EU to adopt a proposal for a regulation on the transparency and integrity of ESG ratings, which, as of September 15, 2024, is still subject to approval by EU Member States and the European Parliament.[320] Under the proposed regulation, ESG rating providers would be required to:

- Obtain authorization from the European Securities and Markets Authority (**ESMA**) to operate in the EU.[321]
- Establish and implement policies and procedures to ensure that their business interests do not impair their independence and the accuracy of their services.
- Implement measures to prevent conflicts of interest if they conduct certain activities, like providing consulting services to investors and issuing and distributing credit ratings. Moreover, employees directly involved in the rating process would not be allowed to provide these other services, and could not own financial instruments for which they provide ratings services.
- Publish on their website their data sources, methodologies, models and key rating assumptions used in their ESG rating activities.[322]
- Disclose if their ratings are limited to assessing ESG risks, or if they also cover ESG impact.
- Provide separate scores for E, S and G factors, and indicate their respective weights.
- Indicate whether their environmental ratings measure the alignment of an asset with the emission reduction goals of the Paris Agreement.

If they are adopted, the rules will apply to rating providers established in the EU if they issue and publish their ratings in the EU. They would also apply to non-EU providers under certain circumstances.

[319] European Commission (2021).
[320] Council of the European Union (2024).
[321] The regulation proposal establishes exemptions for small ESG providers. Separate processes are established for EU-based and non-EU ratings providers.
[322] This obligation is limited to disclosure: the regulation would prohibit ESMA, the European Commission or other public authorities from interfering with the content of ESG ratings or methodologies (article 26).

This measure would complement the EU Regulation on the Climate Transition Benchmarks, which was adopted in 2019 to establish a benchmark labelling scheme and impose sustainability disclosure requirements on benchmark administrators.[323]

United Kingdom

In 2022, the UK Financial Conduct Authority (**FCA**) commissioned the International Capital Market Association (**ICMA**) and the International Regulatory Strategy Group to establish an industry group that would develop a voluntary code of conduct for ESG data and rating providers for global use.[324] This voluntary code of conduct was released at the end of 2023 and integrates the recommendations formulated by IOSCO in their 2021 study.[325] The code covers governance, quality of ratings, conflicts of interests, public disclosure and transparency, confidentiality and engagement with rated firms and users.[326]

In the first half of 2023, the UK government conducted a consultation on whether to allow FCA to regulate ESG ratings and data product providers.[327] In March 2024, the UK government announced that it had decided to move ahead with regulating ESG rating providers.[328] As of September 15, 2024, the content and timeline of this regulatory initiative had yet to be announced by the government.

[323] European Securities and Markets Authority (undated). This regulation introduced a requirement for all benchmarks administrators (except for interest rate and currency benchmarks) to disclose whether a benchmark pursues ESG objectives and an explanation of how the benchmark's methodology incorporates ESG factors. This regulation also created two categories of climate-related benchmarks: the EU climate transition benchmarks and the EU Paris-aligned benchmarks. Each category is subject to specific methodological and disclosure requirements.
[324] International Capital Market Association (2023a).
[325] Idem.
[326] Idem.
[327] HM Treasury (2023).
[328] Reuters (2024). This decision was reiterated by the UK's new government in August 2024. See: George (2024).

4.3. Product-level claims

Product-level claims are claims about the environmental characteristics of specific financial products. Three categories of products are discussed below: use-of-proceeds (**UoP**) instruments, which include green, social, blue and other sustainability bonds and loans; performance-based instruments, which include sustainability-linked bonds and loans; and investment funds that incorporate SFRI considerations.

The issuance of SFRI products may raise greenwashing risks for both (i) the entity that directly purchases or facilitates the issuance of the SFRI products, such as a bank participating to the issuance of a green bond, and (ii) the retail investor that indirectly purchase the SFRI products, such as an individual purchasing units of a mutual fund that invests in green bonds.

On one hand, issuers of SFRI products may set weak use of proceeds constraints, performance targets or investment goals, or fail to comply with them, misleading investors and lenders about their true environmental attributes. This source of risk may not be a major concern from a policymaking perspective if financial products are traded and negotiated between sophisticated, professional parties like banks and institutional investors.[329] These actors tend to have a deep understanding of the SFRI landscape and are more likely to have the resources and expertise needed to assess a product's sustainability credentials. This is not to say that they will never enter into transactions that may facilitate greenwashing, such as a bank participating in a low-quality sustainability-linked bond issuance. However, they are less likely to be deceived by issuers and borrowers as part of this process.

Conversely, when these instruments are marketed to less informed groups, such as retail investors or the general public, the risks of greenwashing increase. For example, financial actors may embed low-quality SFRI products in the investment solutions that they offer to retail investors (like including falsely "green" bonds in the portfolio of an investment fund labelled as "green").[330] Similarly, financial institutions may invoke their investments in low-quality SFRI products to promote their environmental achievements to attract consumers and signal a positive public image (such as a commitment to meet a given "sustainable" or "green" investment target). These types of deceptive claims are a more significant concern given that retail investors and the general public are less likely to have the resources and expertise needed to evaluate their credibility. In other words, the information asymmetry between the entity making the claim and the person receiving it is greater in this case.

Both sources of risk are addressed in this subsection.

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[329] As noted by Mauffette-Whytte (2022), some institutional investors may even set higher standards than what is legally required to mitigate their exposure to greenwashing risks.

[330] When SFRI instruments are traded and negotiated between sophisticated parties, the likelihood of greenwashing diminishes. Conversely, when these instruments are marketed to less informed groups, such as retail investors or the general public, the risks escalate.

4.3.1. Use-of-proceeds financing

a) Description of the segment

UoP SFRI instruments, which include bonds and loans, are meant to channel funds towards projects or activities that are expected to yield positive environmental or social impact. These instruments are characterized by restrictions on the use of their proceeds by borrowers or bond issuers. These restrictions relate to environmental factors, such as climate change adaptation and/or mitigation, sustainable use and protection of water and marine resources, the transition to a circular economy, pollution prevention and control. UoP restrictions may also pertain to social factors, such as affordable basic infrastructure, access to essential services, affordable housing, employment generation programs, food security and sustainable food systems, and socioeconomic advancement.

Some of these instruments may be tied to specific projects or activities described in the instrument's documentation, while others may be used to finance any activity that meets the instrument's use of proceeds constraints. For example, the Government of Canada recently issued a $4 billion "green" bond, with the condition of allocating the proceeds from the issuance to "green" investment projects.[331]

Box 12 outlines the main categories of use-of-proceeds restrictions prevalent in the marketplace.[332]

Box 12 – Main categories[333] of use of proceeds restrictions

Green: Funds raised through the issuance of green debt must be used to finance projects and activities seen as contributing substantially to specific environmental objectives, such as climate change adaptation and/or mitigation, sustainable use and protection of water and marine resources, the transition to a circular economy, pollution prevention and control.

Social: Funds raised using this type of debt must be directed towards projects and activities relating to "food security and sustainable food systems, socioeconomic advancement, affordable housing and access to essential services such as healthcare".[334]

Transition: This category of debt relates to projects and activities that will allow an entity operating a hard-to-abate and high emitting sector to "transition towards a reduced environmental impact.", notably through the decarbonization of its activities.[335]

Conservation, nature or biodiversity: Funds raised using this type of debt must be used to finance nature conservation and restoration projects and activities, such as projects aimed at protecting ecosystems.

[331] Government of Canada (2024b).
[332] Note that these categories are approximative and do not consist in legal definitions of legitimate use of proceeds restrictions
[333] Other categories include SDGs bonds, sustainability bonds, COVID-19 bonds and gender bonds. For additional information on these categories, see OECD (2021).
[334] Idem.
[335] Idem.

Blue: This sub-category of "green" debt relates to projects aimed at ensuring the sustainability of the ocean economy, such as fostering marine biodiversity and the sustainability of fisheries.[336]

According to data from the Climate Bonds Initiative (**CBI**), green and social debt were the two most common categories of UoP debt in 2023, with a respective global market size estimated at US$2.8 trillion and US$821 billion in 2023.[337] In 2023, Canadian companies issued a total of US$5.7 billion in green bonds.[338] Notable examples of UoP issuances by Canadian organizations include:

- **Desjardins**: In 2021, Desjardins initiated a $500 million sustainable bond offering. Desjardins committed to use the net proceeds from the issuance to finance or refinance loans, investment and projects that meet Desjardins' "green" or "social" eligibility criteria.[339] Desjardins has also set exclusionary criteria to ensure that no funds are used to support businesses primarily involved in certain activities, such as tobacco, thermal coal and unconventional or nuclear weapons.
- **Alimentation Couche-Tard:** In 2021, Alimentation Couche-Tard closed a $US 350 million green bond offering.[340] The company committed to use the net proceeds to finance or refinance "new or existing environmentally friendly projects and community initiatives in six categories: clean transportation; energy efficiency; renewable energy; pollution prevention and control; sustainable water and wastewater management; and green buildings."[341]

UoP instruments may involve higher issuance costs than regular bonds and loans, as issuers and lenders must invest time and resources to establish an issuance framework that sets eligibility and governance constraints, ensure that proceeds are used according to this framework and report to investors and lenders.[342] Issuers and borrowers may be able to offset these costs if they can negotiate lower financing costs for projects with an added environmental or social value.[343] This rate difference, also known as the "greenium", would reflect issuers' willingness to pay a higher price for a financial product that is assumed to achieve environmental or social impact. However, empirical evidence on the existence of the greenium is mixed.[344]

[336] Idem.
[337] Climate Bonds Initiative (2023).
[338] Keidan (2024).
[339] Desjardins Group (2021).
[340] Alimentation Couche-Tard (2021).
[341] Idem.
[342] Fatica and Panzica (2021).
[343] Curtis et al. (2023) note that the evidence on the existence of a greenium for use of proceeds instruments is mixed, shedding doubt on the market's perception of these instruments' credibility.
[344] See footnotes 34 to 37 of Curtis et al. (2023) for a review of the literature on the greenium.

b) Legal framework

i. Mandatory framework

Loans and bonds are two different types of debt instruments that involve the payment of an interest rate and that can be used to issue UoP financing.

Loans are typically negotiated between a lender (or a group of lenders) and a borrower, who may agree on bespoke loan terms that can be renegotiated during the course of the loan period. The parties to a loan agreement have the flexibility to customize the terms of their agreement.[345] For example, the borrower and the lender may agree that the loan's proceeds shall only be used for certain purposes and provide for reporting obligations and sanctions in case of breach.

Bonds are a type of debt securities that may be issued by a wide range of actors, such as corporations, cities and governments.[346] Reporting issuers may issue bonds (as they would do with shares) on financial markets, where bonds can be traded afterwards.[347] Reporting issuers will typically issue corporate bonds through underwriters such as an investment dealer.[348] Bond contracts tend to be more standardized than loan agreements, providing less flexibility to issuers to customize and renegotiate their terms post-issuance.

In addition to the general obligations that exist under contract and consumer protection law with respect to deceptive representations, there are two particular sources of legal mechanisms that may be used to guarantee the integrity of UoP instruments: explicit contractual enforcement rights and regulatory disclosure obligations.

First, debt contracts may include **enforcement mechanisms** that allow lenders and investors to seek remedies in case of breach of the contract's use of proceeds provisions. Bond and loan contracts typically include an "event of default" provision that allows investors to enforce certain rights when an issuer fails to meet material obligations, such as a failure to make a scheduled interest payment.[349] This may include, among other things, requesting the immediate repayment of the loan or the bond's principal and accrued interest, seizing certain assets or seeking payment from a guarantor. Debt contracts may also include "step-up events" provisions that increase the coupon that must be paid by the issuer in case of breach.[350]

UoP debt contracts or indenture may specify that a breach of their use of proceeds provisions – also referred to as a "green default" – constitutes an event of default or a

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[345] In Québec, loan agreements are subject to the contract law provisions of the Civil Code. Previously discussed, the provision of false or misleading information prior to the conclusion of a contract may give rise to legal claims.
[346] Debt securities issued by the Government of Québec and the Government of Canada are expressly exempted from the application of Titles II to VIII of the QSA (QSA s.3(1). Debt securities of certain cooperatives and credit unions also benefit from exemptions to Titles II to VIII to the QSA (QSA s.3).
[347] Bonds may also be privately issued. For a description of the different types of debt securities, see Practical Law Canada Corporate & Securities (2024).
[348] Practical Law Canada Corporate & Securities (2024). For a description of the bond issuance process, see Kravitz, N. and Roy, S. (2010).
[349] Curtis et al. (2023).
[350] Doran and Tanner (2019).

step-up event, allowing lenders and investors to sanction non-compliance. The inclusion of such covenants in a bond or loan contract is voluntary, and empirical evidence suggests that they are not common practice in the bond market.[351] In fact, the market practice has been to include specific liability exclusion clauses and disclaimers in debt contracts that state that a breach of the contracts' use of proceeds provisions does not constitute an event of default, limiting borrowers and investors' enforcement rights.[352] This lack of contractual protections can be an important source of vulnerability for certain categories of investors, like fund managers relying on the environmental credentials of UoP instruments to meet their sustainability commitments or to implement their investment strategies.[353]

Second, as noted in subsection 4.1.1, the QSA requires issuers willing to distribute securities to the public – including bonds – to **issue a prospectus** that must be approved by the AMF (QSA s.11).[354] In addition to providing information about the issuer's financial situation, governance and activities, the prospectus must include a disclosure of the issuer's intended use of the issuance's proceeds.[355] In this disclosure, the issuer must describe the distribution's principal purposes and business objectives and the milestones that must occur for these goals to be achieved [356] A generic statement that the proceeds will be used "for general corporate purposes" does not constitute sufficient disclosure.[357] While there has been no case law on use of proceeds disclosure for UoP bonds under the QSA, this requirement could be interpreted as requiring reporting issuers to provide specific details on their environmental objectives and the environmental characteristics of their project, where applicable.

After the issuance of a bond, reporting issuers are subject **to continuous disclosure obligations**, which may involve reporting on the issuer's use of proceeds. For example, *Form 51-102F1 Management's Discussion & Analysis* states that a reporting issuer's annual MD&A shall provide a comparison of the issuer's previous disclosure about its projected "use proceeds (other than working capital) from any financing, an explanation of variances and the impact of the variances, if any, on [the] company's ability to achieve its business objectives and milestones".[358]

Moreover, a reporting issuer's decision to change how it plans to use proceeds may constitute a "material change" that must be reported as part of an MCR if it constitutes a

[351] Curtis et al. (2023). This study is limited to UoP bonds. Some observers have indicated that such clauses may be less frequent in UoP loans. See: Corke and Myers, 2019, cited by Curtis et al., 2023, at page 51.
[352] Idem. Nevertheless, even in the absence of enforcement rights, a "green default" may lead to reputational consequences for the issuer.
[353]See: Doran and Tanner (2019). As noted by the authors, "A bondholder who is placed in breach of its own investment criteria may be obliged to promptly sell in the secondary market and in so doing may incur a loss. In the absence of express contractual provisions, sustaining a claim for that loss may prove difficult."
[354] Unless an exemption applies.
[355] Item 6 of Form 41-101F1 – Information Required in a Prospectus deals with the prospectus' use of proceeds disclosure requirements.
[356] 6.3 of Form 41-101F1 – Information Required in a Prospectus. Moreover, if more than 10% of the net proceeds are to be used to acquire assets or for research and development purposes, specific information on these assets and research and development programs must be provided.
[357] Canadian Securities Administrators (2021b).
[358] See paragraph (i) of item 1.4 of the form.

"change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the reporting issuer".[359]

The concept of material change in Canadian securities law has been recently interpreted by the Court of Appeal of Ontario, which indicated that in order to be material, a change must (i) impact the activities, the operations or the capital of the issuer, and (ii) be reasonably expected to have a significant impact on the price or value of the securities at issue.[360] The determination of whether a change in an instrument's use of proceeds constitutes a material change is therefore a factual question that depends on the circumstances at issue.

A reporting issuer's failure to meet the QSA's use of proceeds disclosure requirements may lead the AMF to refuse to issue a receipt in respect of a prospectus.[361] Moreover, the remedies described in subsection 4.1.1(a)(iii) may be sought against an issuer that communicates false, misleading or incomplete information in a prospectus about a bond's use of proceeds, fails to disclose material information in its CD Documents or fails to report a material change to investors.[362]

However, bringing claims in these cases may be particularly challenging for plaintiffs.[363] First, a bond's use of proceeds provisions may be framed in relatively general terms with broad cautionary language, allowing defendants to benefit from the safe harbour for forward-looking statements in the context of secondary market compensation claims.[364] Moreover, it may be difficult for plaintiffs to prove any damages. As noted above, empirical evidence is not conclusive on the existence of a greenium. A "green default" resulting from a change in a bond's use of proceeds may therefore not result in a drop in the bond's price.[365] These features may also prevent the qualification of a change in the

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[359] Material change is defined in R 51-102, s.1.1 as meaning "(a) a change in the business, operations or capital of the reporting issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the reporting issuer; or (b) a decision to implement a change referred to in paragraph (a) made by the board of directors or other persons acting in a similar capacity or by senior management of the reporting issuer who believe that confirmation of the decision by the board of directors or any other persons acting in a similar capacity is probable". For case law on this topic, see Rioux (2017).
[360] Coiteux et al. (2023), p.26.
[361] Interestingly, par. 15(3) of the QSA requires the AMF refuse issuing a receipt in respect of a prospectus if " the proceeds from the distribution of the securities that are to be paid into the treasury of the issuer, together with other resources of the issuer, are insufficient to accomplish the purpose of the distribution stated in the prospectus".
[362] As described by Ammerman et al. (2021), "The stringent disclosure obligations, from a practical perspective, can expose green bond issuers to criminal or civil liability to underwriters and/or investors for misstatements or misrepresentations made in a prospectus. Such liability could arise, for instance, if the issuer discloses in the "use of proceeds" section, that it will use the proceeds of the issuance for certain eligible investments, and subsequently it does not."
[363] Gilotta (2023); Curtis et al. (2023).
[364] As noted by Curtis et al. (2023) at p.16, in the US context, "In the unlikely event that an issuer falsely represented its intent to invest in sustainable projects, it could incur liability for the misrepresentation. But the issuer of such a bond remains free to change its mind. If it does not use the proceeds in the expected way, investors have no claim for breach of contract."
[365] Curtis et al. (2023).

use of proceeds as a "material change" that must be disclosed to investors.[366]

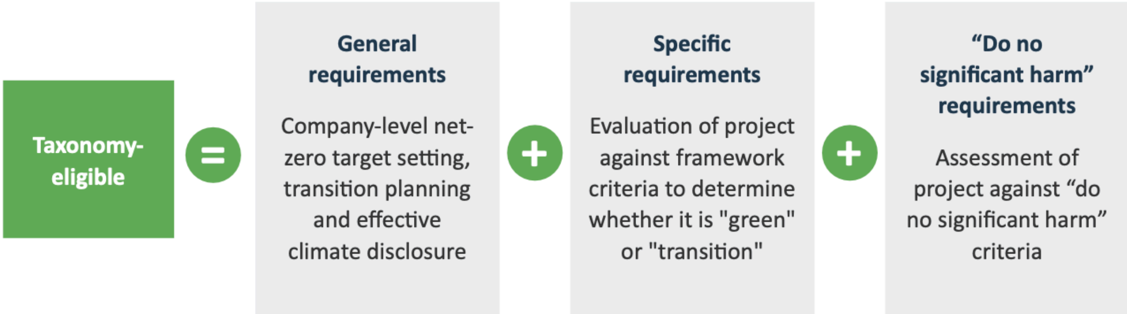
Other than these optional contractual mechanisms and mandatory disclosure requirements, UoP instruments are not subject to any specific provincial or federal regulatory regime in Québec or Canada. There are no legal definitions of which use of proceeds constraints may be sufficient for a bond to be labelled as "green", "blue" of "biodiversity". Private parties are free to negotiate contractual terms that they see fit, and label debt instruments accordingly.

This could change in the future. In 2021, the Government of Canada created the SFAC with the mandate to provide advice to the Minister of Finance and the Minister of Environment and Climate Change on the transition of the financial sector towards more sustainable practices.[367] One of the tasks of SFAC was to establish a Green and Transition Taxonomy (sometimes also referred to as "Sustainable Investment Guidelines" or a "Sustainable Investment Taxonomy") – a technical rulebook that would define criteria to label economic activities as "green" and "transition".[368] A taxonomy would establish a classification system that could be used by investors, firms, policymakers and financial intermediaries to allocate capital towards more sustainable economic activities and elaborate financial policies. Taxonomies can help mitigate greenwashing risks by establishing common definitions and standards for sustainability labels that apply to all market actors. Box 13 summarizes the key developments of this initiative which, depending on the final policy stance of the federal government, could lead to the establishment of non-binding definitions of "green" or "transition" projects that would be officially endorsed by the Government of Canada and that investors could use to label UoP instruments.

Box 13 – Canada's Green and Transition Taxonomy
In March 2023, SFAC's Taxonomy Technical Experts Group released its Taxonomy Roadmap Report, developed in partnership with the Canada Climate Institute and the Institute for Sustainable Finance. While this report is not itself a taxonomy, it contains recommendations on how to establish a green and transition finance taxonomy in the Canadian context. It should be noted that SFAC's non-binding recommendations do not constitute the official policy stance of the Government of Canada.

[366] Coiteux et al. (2023), p.26.
[367] Government of Canada (2023).
[368] As described by SFAC, the purpose of sustainable finance taxonomies is to "provide a standardized approach for benchmarking economic activities that are consistent with domestic and global climate goals. They set screening criteria that allow users, such as investors, companies and financial intermediaries, to evaluate the climate credentials of economic activities (e.g., in connection with investment and business decisions). Globally, taxonomies to date have largely focused on setting criteria for green activities; however, there are growing efforts to broaden the scope to transition activities. Taxonomies are frequently used to set standards for classifying climate-related financial instruments (e.g., green bonds), but, increasingly, they serve other use cases where the benchmarking feature is viewed as beneficial, including in the areas of climate risk management, net-zero transition planning and climate disclosure." (SFAC, 2023). Taxonomies may also be used beyond climate to address sustainability in general, including nature-related and social issues.

Figure 9 – SFAC's proposed taxonomy issuance requirements[369]



In the report, SFAC proposed[370] to impose three cumulative requirements for financial instruments to be taxonomy-eligible:

- **Issuer requirements**: The entity issuing the financial instrument would be required to have set company-level, science-based net-zero targets for 2050 or earlier and an interim target for 2030. The issuer should also prepare a science-based[371] net-zero transition plan and make annual climate-related financial disclosures in line with regulatory requirements, international standards and best practices.
- **Project requirements**: The project shall either meet the taxonomy's "green" or "transition" criteria. Projects would only be eligible if material[372] scope 1, 2 and 3 emissions (excluding carbon offsets[373]) are aligned with a 1.5-degree Celsius climate scenario.

Green projects would be projects "with low or zero scope 1 and 2 emissions, low or zero downstream scope 3 emissions and that produce goods or services that are expected to see significant demand growth in the global low-carbon transition."[374] Green projects could either relate to low or zero-emitting activities (like solar energy generation) or to the activities that enable them (like an electricity transmission line).[375] Projects in markets that are expected to materially decline in 1.5-degree Celsius pathways would not qualify as "green", but they could qualify as "transition" if they meet the required criteria. Projects in

[369] Sustainable Finance Action Council (2023), p.36.
[370] These requirements are general, preliminary proposals from SFAC; they would have to be formalized into technical criteria, thresholds and metrics by the taxonomy's governance bodies and could be expanded or modified during the taxonomy's development phase.
[371] SFAC does not set guidelines on the contents of a science-based net-zero transition plan but it does refer to GFANZ guidance. See: Sustainable Finance Action Council (2023), p.18.
[372] SFAC indicates that "Detailed and transparent materiality criteria will need to be set to categorize activities." See: Sustainable Finance Action Council (2023), p.36.
[373] As noted by SFAC, "allowing projects to purchase carbon offsets that occur elsewhere in the economy weakens the incentive to make the transformative investments necessary to align operations with the global transition." See: Sustainable Finance Action Council (2023), p.40.
[374] Sustainable Finance Action Council (2023), page 5. SFAC gives the following "green" project examples: "green hydrogen production, afforestation projects, zero-emissions vehicle manufacturing (with low-emissions supply chains), electricity transmission infrastructure."
[375] Sustainable Finance Action Council (2023), page 13.

markets unrelated to the transition would also be ineligible for the "green" label (e.g., an important portion of the services sector).

Transition projects would be projects that decarbonize carbon-intensive activities that are consistent with a net-zero transition pathway. This includes both "sectors that historically have high scope 1 and 2 emissions (e.g., iron and steel, chemicals, aluminum and cement production)" and "sectors that historically have high downstream scope 3 emissions (e.g., oil and gas, or gas-fuelled vehicles)".[376] Oil and gas transition projects could be eligible if they "lead to significant emissions reductions from existing assets" (i.e., new oil and gas projects would be ineligible) and do not increase the lifespan of extraction projects. These could include projects installing methane capture equipment on an existing natural gas production facility, with a short to moderate lifespan, or projects installing carbon capture, utilization and storage (also known as CCUS) on an existing oil sand production facility, assuming the facilities have a short to moderate lifespan.

Projects that do not meet these criteria would be ineligible. Any project that (i) relates to solid fossil fuels (including thermal coal-mining and coal-fired power generation); (ii) represents high stranded assets risks in relevant net-zero scenarios; (iii) has scope 1 and 2 emissions that are inconsistent with the net-zero transition; and (iv) is "unable to scale in transition" would also be ineligible.[377]

- **"Do no significant harm" (DNSH) requirements**: The project shall not harm other environmental and social objectives, like indigenous reconciliation, climate adaptation or biodiversity. For example, a project that meets the taxonomy's "green" criteria but leads to the destruction of ecosystems would be ineligible. SFAC would intend to align the DNSH criteria with existing Canadian legal requirements on environmental and social issues. In addition, SFAC recommends considering setting minimum social safeguards that would prevent projects that violate international human and labour rights and anti-corruption and bribery laws.[378]

[376] Sustainable Finance Action Council (2023), page 5. SFAC indicates that the first category refers to "projects that—through making significant emissions reductions—improve the carbon competitiveness of activities exposed to higher carbon costs in the global low-carbon transition. These are projects that do not generate material downstream scope 3 emissions and operate in markets that are expected to remain stable or grow in the transition (due to a lack of economically and technically viable alternatives). Example: a steel production facility that installs an electric arc furnace, or constructing a new blue hydrogen facility with a high emissions capture rate." The second category includes "projects that sell products that, due to high scope 3 emissions and the availability of viable alternatives, are expected to face decreasing global demand in transition. To remain transition-eligible, these projects must have well-defined lifespans that are approximately proportionate to the expected decline in global demand in representative 1.5 °C pathways." Examples of such projects include "installing world-leading methane capture on existing natural gas production (with a short to moderate lifespan), or installing carbon capture, utilization and storage (CCUS) on an existing oilsands facility (with a short to moderate lifespan)."
[377] Sustainable Finance Action Council (2023), page 5. Some financial institutions, such as the Public Sector Pension Investment Board, have already developed their own inhouse taxonomies.
[378] Sustainable Finance Action Council (2023), page 45. As noted by SFAC, these criteria could be required to comply "with major corporate social responsibility frameworks, including the UN Guiding Principles on Business and Human Rights and the OECD Guidelines on Multinational Enterprises."

Projects meeting these three sets of criteria would be allowed to be labelled as taxonomy-aligned green and transition projects. These labels could also be issued to designate the financial instruments used to finance taxonomy-aligned projects.

However, it should be noted that SFAC has regrettably not proposed to establish a regulatory regime with mandatory standards and certification requirements for taxonomy-aligned financial instruments. The proposed taxonomy would not replace private certification schemes and standards, upon which issuers and borrowers may still rely. Consequently, the issuance process would be subject to the same securities law and contract law obligations that were previously outlined in the report. It remains to be determined what would be the demand for taxonomy-aligned instruments, whether taxonomy-aligned bonds would yield a greenium, and whether the government would incentivize the adoption of the "transition" and "green" labels using tax or other policy measures.

With respect to greenwashing risks, a major advantage of a taxonomy is that it sets common definitions across the marketplace, preventing financial actors from selecting weak or vague use of proceeds constraints, improving the comparability of debt instruments and reducing investor confusion. However, from a greenwashing risk mitigation perspective, the proposed framework has significant weaknesses, many of which have been acknowledged by SFAC in their 2023 report:

- **Voluntary:** As noted by SFAC, the voluntary nature of the taxonomy would not prevent firms and investors from developing their own taxonomies and labels in case they find the official taxonomy too stringent. Moreover, it would allow "companies, especially those in higher-emitting sectors [to] bypass the rigours of the taxonomy in favour of continuing to raise capital for transition purposes through the use of traditional financial instruments."[379]

- **Limited to green and transition categories**: Another limitation of the taxonomy is that it is currently limited to only two project categories, namely "green" and "transition". As such, it would not set standards for other UoP labels, like blue, social or conservation bonds.

- **Limited to UoP instruments**: The taxonomy framework proposed by SFAC would only apply to UoP instruments and exclude performance-based instruments like SLBs because "revenues [from UoP instruments] can be clearly and transparently ring-fenced around specific projects."[380] Other taxonomies around the world have expanded their framework beyond use of proceeds instruments, such as Australia.[381]

- **Greenlighting of controversial activities:** Several stakeholders have criticized the possibility that fossil fuels-related projects, such as CCUS and blue hydrogen projects, could be labelled as transition under certain circumstances.[382] As noted by the Canadian Climate Institute in 2024, scientific studies have clearly shown the need to significantly reduce the production and consumption of fossil fuels in order to achieve the goals of the Paris

[379] Sustainable Finance Action Council (2023), page 21.
[380] Arnold (2024), p.10.
[381] Australian Sustainable Finance Institute (2024).
[382] Arnold (2024), p.10.

Agreement. For example, the International Energy Agency has indicated that no new oil and gas projects should be initiated in order to achieve the goals of the Paris Agreement.[383] For this reason, numerous stakeholders have argued that fossil fuel investments should entirely be excluded from the taxonomy, highlighting the risk of taxonomy "greenlighting", i.e., granting an official sustainability label to carbon-intensive activities that raise carbon lock-in risks. Others have stressed the need for major decarbonization investments in the upstream production of oil and gas to achieve Canada's climate targets and competitiveness and suggested imposing rigorous emission reduction criteria to proponents wishing to use the transition label.[384]

- **Focus on projects:** SFAC's proposed taxonomy is meant to help label decarbonization, low and zero emissions projects as green or transition projects. SFAC has indicated that the taxonomy could eventually be expanded to label entire companies or financial institutions based on their portfolios and activities.[385] In the meantime, the taxonomy's project-level focus raises the issue of defining adequate project boundaries in order to assess projects' eligibility.[386] For example, which criteria should be used to assess a project involving multiple companies or facilities from different sectors?[387] Moreover, how would the taxonomy apply to bonds issued by cities and governments? These issues would have to be clarified in the final version of the taxonomy.

These considerations highlight the limitations of simple, aggregated labels of environmental performance, such as green or transition investment labels. By definition, standardized thresholds will always involve trade-offs between different factors and may not provide granular information to investors. As acknowledged by SFAC, "not all green and transition projects are equal in terms of transition performance, and the categorization framework does not capture the important nuances that exist, in terms of relative transition opportunity and risk, of the projects that fall within the broad categories of green and transition."[388] To address this issue, SFAC proposed criteria and methodologies that could be used to evaluate and differentiate the relative greenness or transition potential of different projects and evolve over time as new technologies emerge and environmental science develops.

In the 2023 Fall Economic Statement, the federal government responded to SFAC's Taxonomy Roadmap Report by announcing that it would build upon it to "undertake next steps, in consultation with regulators, the financial sector, industry and independent experts, to develop a taxonomy that is aligned with reaching net-zero by 2050."[389] SFAC's mandate ended on March

[383] International Energy Agency (2023).
[384] In April 2024, more than 70 Canadian environmental groups sent a letter asking the government to establish a taxonomy that makes fossil fuel related investments ineligible to any sustainability label. See: Environmental Defence (2024). See also: Arnold (2024), at p.3. The practice of establishing standards and taxonomies that allow certain activities or products to be labelled as green has been referred to as "greenlighting".
[385] As noted in Arnold (2024), at p.3: "This type of corporate label could facilitate general financing, whereby taxonomy-labelled funds could contribute toward a company's entire operation. The proposed taxonomy approach in Australia, for example, includes a framework for determining whether entire companies are eligible for the green or transition label."
[386] Arnold (2024), p.12.
[387] Idem.
[388] Sustainable Finance Action Council (2023), p.51.
[389] Government of Canada (2023).

31, 2024. In the 2024 Budget, the federal government reiterated that it was working on the development of the taxonomy and would provide a status update later in the year.[390]

Since the publication of the Taxonomy Roadmap Report in March 2023, several stakeholders have publicly criticized the slow pace at which the government has implemented the report's recommendations, including SFAC, which was disbanded on March 31, 2024 following the end of its three-year mandate.[391] Some of these stakeholders have warned that further delays could slow down the allocation of capital towards Canada's transition domestically and internationally as other jurisdictions are moving ahead with the adoption of their taxonomies.[392]

ii. Voluntary frameworks

In the absence of a mandatory state-issued taxonomy that would set standards and definitions for UoP debt, many issuers and borrowers have adopted voluntary frameworks that describe the characteristics of the debt instruments they plan to issue. These frameworks often incorporate the prescriptions of private, voluntary UoP standards.

One example of such standards is the **Green Bond Principles (GBPs)** issued by ICMA.[393] The GBPs were launched in 2014 in partnership with global financial institutions to establish high-level guidance for the industry, seven years after the first green bond was issued by the European Investment Bank.[394] The GBPs set general voluntary principles for the issuance of green bonds.[395] The principles have four core components, which must all be fulfilled for a bond to be labelled as GBP-aligned.

- **Use of proceeds:** A green bond's proceeds may only be used to finance projects that provide "clear environmental benefits". While the GBPs do not establish standards about which projects may qualify as "green", they provide a non-exhaustive list of eligible project categories, such as renewable energy, energy efficiency and pollution prevention projects.[396]

- **Project evaluation and selection**: Issuers must provide investors with information on the environmental sustainability goals of their projects, the processes put in place to assess a project's green eligibility; and complementary information on the management of the projects' environmental and social risks.[397]

[390] Government of Canada (2024a).
[391] Jones and Radwanski (2023); Clean 50 (2024); Jones (2024).
[392] Idem. See also Millani (2024). In this February 2024 survey of Canadian institutional investors, 63% of respondents indicated that "the federal government has not moved fast enough in the development of a Canadian taxonomy, leading to disappointment and a sense that Canada is losing its competitive position."
[393] International Capital Market Association (2021).
[394] Wigley (2023).
[395] ICMA has issued similar principles for social bonds. See: International Capital Market Association (2023b).
[396] International Capital Market Association (2021), p.5. ICMA indicates that the "GBP's purpose is not to take a position on which green technologies, standards, claims and declarations are optimal for environmentally sustainable benefits, it is noteworthy that there are several current international and national initiatives to produce taxonomies and nomenclatures, as well as to provide mapping between them to ensure comparability."
[397] Idem.

- **Management of proceeds**: Issuers should ensure they have an adequate process to track proceeds and ensure proceeds are allocated appropriately.

- **Reporting**: Issuers should report annually on the use of the proceeds until the funds are fully allocated and whenever there are material developments. An annual report should describe the projects financed using the proceeds and their expected impact. Quantitative performance indicators should be used where possible.

In addition to these components, ICMA also recommends that issuers (i) develop a green bond framework that provides background information on the issuer's sustainability strategy and alignment with the GBPs; and (ii) appoint external reviewers to assess, pre-issuance, the alignment of their bond framework with the GBP's core components; and post-issuance, the appropriate tracking and allocation of funds to eligible green projects.[398]

The **Green Loan Principles**, jointly issued by the Loan Market Association (**LMA**), the Asia Pacific Loan Market Association (**APLMA**) and the Loan Syndicated and Trading Association (**LSTA**), provide similar high-level principles for green loans.[399]

The **Climate Bonds Standard** (**CBS**) issued by the CBI is another voluntary green bond framework.[400] The CBS establishes a formal labelling standard that allows issuers to have their green bonds and other financial instruments certified by approved third-parties.[401] The CBS is consistent with the high-level principles established by the GBPs, but its requirements are more specific.[402] For instance, the CBS integrates sectoral criteria that constrain issuers' use of proceeds to activities that meet minimum environmental performance requirements.[403] The CBS certification process can be broken down into three phases:

- **Pre-issuance certification**: To have their instruments certified prior to issuance, issuers must publish a Green Finance Framework that explains how they plan to use and manage the instruments' proceeds, select and evaluate projects and report to investors. Issuers are required to describe the projects and assets that are eligible for financing, the applicable sectoral criteria and the climate-related objectives of the instruments.

- **Post-issuance certification:** After the issuance, at least 95% of the instruments' net proceeds must be used for purposes that meet the GBS sectoral criteria. The proceeds must be allocated within 24 months of issuance unless an extension is granted by the GBS Secretariat. The issuer shall document its selection of eligible projects and assets.

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398 Idem, p.7.
399 Loan Market Association et al. (2023).
400 Climate Bonds Initiative (2024).
401 Examples of third-party certifiers include Sustainalytics, Vigeo Eiris, Ernst & Young and the Center for International Climate Research. See: Flammer (2020).
402 Climate Bonds Initiative (2024), p.16.
403 Climate Bonds Initiative (2024), at item A.3.1.

- **Ongoing certification:** The issuer must prepare annual update reports within 12 to 24 months of the issuance until the instrument's maturity. The reports must describe the issuer's allocation of the instrument's proceeds, its compliance with the eligibility criteria set in its Green Finance Framework and the assessment of the instruments' environmental impacts.

Under the CBS, certified issuers are required to disclose failures to comply with the use of proceeds constraints announced at the time of issuance.[404] If these failures are not adequately corrected, the CBI may revoke an instrument's certification.[405] However, the consequences of decertification are likely to be limited for the issuer. Although a bond contract could theoretically identify decertification as an event of default that triggers enforcement rights, this has not been a common market practice so far.[406]

c) Greenwashing risks

Given their objective to allocate capital to activities with a positive environmental impact, such as emission reduction projects, UoP financing instruments have been identified as an important tool to channel trillions of dollars towards the global climate and nature financing gaps.[407] However, several concerns have been raised in respect of these instruments:[408]

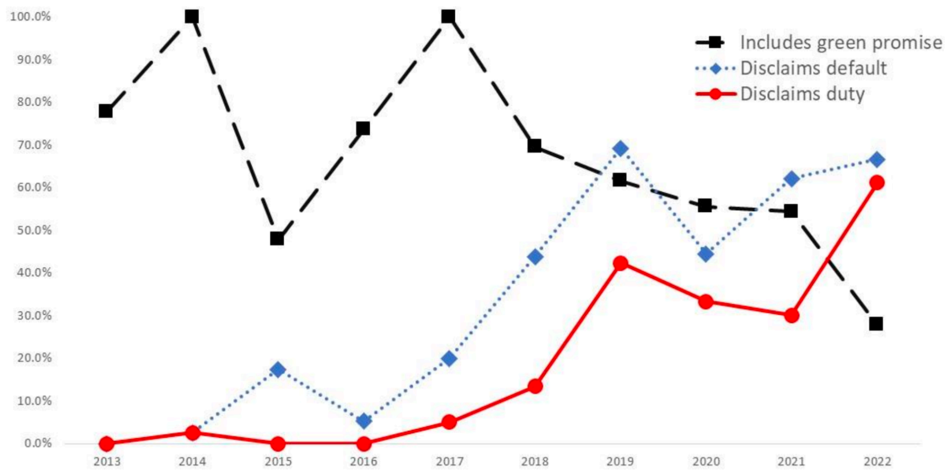
- **Insufficient use of proceeds constraints**: Given the voluntary nature of UoP certification schemes, issuers may set vague, uncertain or misleading use of proceeds constraints, granting them considerable leeway in choosing which projects may be financed.[409] For example, some contracts may limit the issuer's use of proceeds to projects that fit within the GBPs' broad categories, which do not impose any specific environmental performance criteria for projects.[410] In 2023, a study of nearly 1000 green bond issuances that occurred over the last decade found that 37% of them did not include any "green" UoP promises or commitments, and that those which included such wording were often "too broad and vague to give investors meaningful rights".[411] This issue may be exacerbated by the existence of competing voluntary taxonomies and standards with inconsistent eligibility criteria.[412]

[404] Corke and Myers (2019), as cited by Curtis et al. (2023), at page 51.
[405] Idem. As noted by Mauffette-Whyte (2022), non-compliance will typically have to be self-declared by issuers, which increases the potential for abuse.
[406] Idem.
[407] Curtis et al. (2023); Dill (2024).
[408] An additional issue that has been raised in the literature on green bonds is the potential for conflicts of interests between the issuer and the external reviewer or verifier. For a discussion of this issue, see Freeburn and Ramsay (2020); and Mauffette-Whyte (2022). Another limitation, which was briefly discussed in Box 12, is the lack of "tiers" that would allow investors to issue differentiated instruments based on the scope of the environmental impact that they aim to achieve. This issue is discussed by Flammer (2020) at p.123.
[409] Curtis et al. (2023). One example given by the authors is a green bond issued by Hungary.
[410] Curtis et al., 2023, p.23
[411] Curtis et al. (2023).
[412] Mauffette-Whyte (2022); Flammer (2020).

- **Lack of enforcement mechanisms**: The instruments currently lack contractual mechanisms that would allow investors or lenders to seek remedies in case of non-compliance with the instruments' use of proceeds requirements.[413] As noted above, green bond contracts will often not grant any enforcement rights to investors in connection with the use of proceeds constraints, and they will frequently include cautionary language and liability exclusion provisions.[414] This type of wording may even exist in contracts that include promissory language about an intent to allocate proceeds to achieving specific sustainability goals.[415] For example, researchers have found instances of green bond offering circulars that promised that issuance proceeds would be used in alignment with the issuer's green bond framework, while also warning investors that the issuer was not making "any representation" as to "whether the net proceeds will be used to finance and/or refinance" activities that are eligible under the framework.[416] Moreover, as shown in the figure below, the authors have found that the stringency of green bonds' use of proceeds restrictions have weakened since 2013.[417]

[413] Curtis et al. (2023); Doran and Tanner (2019).
[414] Curtis et al. (2023). In their sample, the authors did not identify any bond that expressly identified "green default" as an event of default. Some bonds did include a "catch-all" clause that applied to all material breaches and which could be interpreted as applying to green defaults; however, such bonds often included exclusion clauses aimed at mitigating any liability risks. As explained by the authors: ""These enforcement-related provisions are important because, in their absence, investors' legal remedies may prove inadequate. An issuer's failure to comply with a bond covenant is a breach of contract, which, in principle, entitles investors to a remedy. But even in the case of a payment default, the remedy is not entirely clear. In the context of green bonds, the difficulty is especially acute when the issuer remains current on its payment obligations but fails to honor its commitment with regard to the use of proceeds. In such a case, it would likely prove impossible to quantify the harm to an investor, leaving the investor without a damages remedy." Similarly, as noted by Doran and Tanner (2019), "risk factors in listed green bonds will often specifically highlight that no event of default or put event will be caused if the use of proceeds or reporting referred to elsewhere in the disclosure document are not complied with. (…) Bondholders who are still being paid interest and principal on time per the terms of the green bonds may be unable to show loss, and so may be unable to have effective redress."
[415] Curtis et al. (2023).
[416] Curtis et al. (2023), pp.21-22.
[417] As explained by one stakeholder interviewed by the authors, there would be "no issuer…not one…of an ESG bond willing to bear the risk of legal liability [for failure to fulfill promises]. They would rather not issue than bear such risk (…) right now, this is just feel good… PR stuff." (Curtis et al., 2023, p.32). On the other hand, some other stakeholders interviewed indicated that reputational consequences were sufficient to ensure compliance with the use of proceeds constraints, as "no big issuers willing to risk the reputational sanction" of being accused of greenwashing (Curtis et al., 2023, p.33). However, the authors suggested that the true reason explaining the lack of enforcement mechanisms in UoP instruments may be that "neither investors nor issuers have strong interests in seeing them enforced." (p.44). According to the others, investors that hold green bonds in their portfolios may use them to "market themselves as ESG funds and point to their green bond portfolios to back that marketing", allowing them to be rewarded for their "green" label without having to pay higher rates to firms to achieve environmental and social impact (p.45). This situation could also explain the lack of clear evidence on the existence of a greenium (p.46).

Figure 10 – Evolution of green bond terms between 2013 and 2022[418]



- **Insufficient third-party verification and opaque reporting**: Issuers and borrowers often fail to report comprehensive information on the effective use of proceeds and achievement of environmental and social impact. For example, a 2019 study by the CBI found that only 68% and 53% of green bond issuances respectively resulted in use of proceeds reporting and impact reporting.[419] This lack of transparency decreases the ability of investors and lenders to identify funds misuses and penalize issuers and borrowers that fail to achieve any impact.[420]

- **Lack of additionality**: UoP instruments may be used to finance projects or activities that would have taken place even if the proceed-based investment had not been issued or that could have been financed using a regular type of bond or loan.[421] Moreover, as noted by the OECD, the instruments may be issued to refinance "green projects or assets after the project construction phase is complete", which turns the debt issuance into a refinancing exercise where the environmental benefits of existing projects get monetized.[422]

- **Project-specific / risk of pollution displacement**: UoP debt is usually project-specific.[423] As such, it does not focus on improving an organization's overall environmental performance but rather only specifies that the funds raised through the financing round will be used for specific purposes.[424] For example, a firm may legitimately issue a green bond to fund an emission reduction project that covers 1% of its GHG emissions, while in parallel issuing regular bonds to fund an expansion of its carbon-intensive activities. In this case, the carbon footprint of the issuer's regular

[418] Taken from Curtis et al. (2023).
[419] Climate Bonds Initiative (2019).
[420] Mauffette-Whytte (2022).
[421] Curtis et al. (2023); Fatica and Panzica (2021).
[422] OECD, 2021, p.21; Curtis et al., 2023, p.35.
[423] For example, ICMA notes that the "focus of Green Bonds is on the eligible Green Projects rather than on the issuer itself". See: International Capital Market Association (2023c).
[424] RBC Global Asset Management (2021). For additional examples, see Gilotta (2023), p.13.

bonds would increase, such that the green bond issuance would have no overall effect on the issuer's total footprint. This kind of issue could be prevented by including issuer-level requirements such as those recommended by SFAC in its proposed taxonomy. While the CBS does not impose such requirements, there are instances where the CBI has refused to endorse or has pushed back against green bond issuances from emitters that failed to display adequate alignment with global emission reduction goals at the entity-level.[425] So far, research on the impact of green bond issuances on issuers' overall environmental performance has not led to conclusive results.[426]

Retail investors typically do not directly engage as investors or lenders in UoP debt issuances. However, these financial instruments may be used by financial institutions as a means to achieve their sustainability objectives, which will then be communicated to the public.. They may also be integrated into investment funds and products accessible to individuals. Financial institutions and investment professionals that employ these instruments are likely to be cognizant of the greenwashing risks inherent in UoP instruments. However, retail investors and the general public may lack this awareness.

In January 2024, these risks were highlighted in a complaint filed with the AMF and the OSC by I4PC against the Big Five.[427] In the complaint, I4PC argued that the Big Five set misleading "sustainable finance targets" that rely on the issuance of low-quality UoP instruments. The complaint provides several examples of "sustainable finance deals" facilitated by the institutions that have allegedly led to increases in GHG emissions, such as the facilitation of green bond issuances by an airport operator that planned to expand its activities and by an energy company that planned to increase its consumption of fossil fuels. According to I4PC, "these examples in themselves are instances of misleading disclosure, since they were voluntarily given by the banks to support their sustainable finance activity."[428] The complaint is not resolved yet and could lead to enforcement action by the securities agencies.

In order to mitigate the greenwashing risks associated with UoP instruments, some foreign jurisdictions have started to regulate their use. One example is the European Union, which has adopted standards for green bonds and a green taxonomy. Box 14 summarizes these two measures.

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[425] Freeburn and Ramsay (2020), p.435 and p.437.

[426] For example, Leung, Wan and Wong (2023) found that one third of green bond issuances were followed by an increase in issuers' scope 1 and scope 2 GHG emissions intensity. However, the authors noted that this result may be explained by the fact that some of the environmental benefits of green bonds may only arise in the long term. These results contradict those of an earlier study that found that "compared with conventional bond issuers with similar financial characteristics and environmental ratings, green issuers display a decrease in carbon emissions (per unit of assets) after borrowing on the green segment." – although the authors could not conclude to the existence of a causal effect between the issuances and the results (Fatica and Panzica, 2021). Similarly, Flammer (2021) argued that the issuance of green bonds was a "credible signal of companies' commitment toward the environment" based on the positive correlation between green bonds issuances and CO2 emissions reductions. Along the same lines, Dill (2024) found that green bonds issuances were associated with a 14% reduction in CO2 emissions.

[427] Investors for Paris Compliance (2024a).

[428] Idem, p.14.

Box 14 – The EU Green Bond Standard and the EU Taxonomy

The EU is a leading jurisdiction for the issuance of green bonds. In 2020, more than half of global green bond issuances were from EU organizations.[429] In November 2023, the European Union adopted *Regulation (EU) 2023/2631*, which establishes the European Green Bond Standard (**EU GBS**) as well as optional disclosure standards for bonds labelled as "environmentally sustainable" an "sustainability-linked bonds".[430]

The EU GBS is a voluntary labelling standard that is intended by the EU to become the "gold standard" for green bonds.[431] Issuers do not need to be located in the EU to rely on the EU GBS.[432] Under the EU GBS, the proceeds of a green bond may only be used for an activity that qualifies as green according to the EU Taxonomy, a classification system that sets out environmental performance criteria for different economic activities. Moreover, all the proceeds must be used by the bond's maturity date.

The EU GBS establishes an external review process whereby an external reviewer registered with and supervised by ESMA will be required to verify the issuer's compliance with the EU Taxonomy criteria.[433] Prior to issuance, the issuer will be required to publish a green bond factsheet that identifies the bond's funding goals and environmental objectives, to be reviewed by the external reviewer.[434] After the issuance, the issuer will be required to publish yearly reports indicating that the bond's allocation of proceeds complies with the EU Taxonomy criteria.[435] Once all proceeds have been allocated, the issuer will have to obtain a "post-issuance review" from external reviewers and issue a report on the bond's overall environmental impact.[436]

Compliance with the EU GBS is voluntary. In other words, a green bond issuer may still decide to comply with a competing green bond standard or develop its own green bond taxonomy. The EU GBS may lead to widespread standardization in the market if, for example, there is a market premium associated with compliance with the standard. Issuers may also continue using alternative definitions and standards.[437]

[429] European Commission (2021). The relative size of the green bond market remains modest, however: around 2.6% of all EU bond issuance.
[430] The regulation provides for the establishment of optional disclosure templates for these bonds.
[431] European Commission (2021).
[432] Idem.
[433] Idem.
[434] Idem.
[435] Idem.
[436] Idem.
[437] Hu (2024). As predicted by the author: "In the short term, due to the voluntary nature of the EUGBS, and the above-mentioned factors to be considered after the paradigm shift, it is likely to lead to fragmented sections of the green bonds and regulatory pluralism at the starting phase. The existing and new green issuers are bound to be divided by compliance levels of green bonds issue. In the long term, however, the harmonisation might arise after a fragmented period when uncertainty starts to diminish."

While the EU GBS only applies to green bonds for now, the European Commission has indicated in its 2021 Strategy for Financing the Transition that standards for certification of transition and sustainability-linked bonds were on its agenda.[438]

4.3.2. Performance-based financing

a) Description of the segment

Performance-based SFRI instruments, such as SLBs and sustainability-linked loans (**SLLs**), are meant to incentivize borrowers and issuers to meet pre-defined environmental or social performance targets (collectively, sustainability performance targets, or **SPTs**) that can be measured using key performance indicators.[439]

Performance-based instruments currently represent a minor portion of all debt issued in Canada, but they are becoming increasingly popular. In 2021, they represented around 5% of total "sustainable" debt issued in Canada, compared to almost 0% one year before.[440] These instruments are often used by entities to meet their SFRI targets. For example, 38% of RBC's 2022 "sustainable finance" investments were sustainability-linked instruments, totalling $32 billion.[441] Notable examples of SLBs and SLLs issued in Canada include:

- **Boralex**: In 2021, renewable energy producer Boralex entered into a 5-year, $525 million SLL agreement with a syndicate of eight Canadian and U.S. banks. The agreement provides for a margin adjustment incentive tied to the company's achievement of its commitments to avoid carbon emissions and increase women's representation in management positions.[442]
- **TELUS**: In 2021, telecommunications company TELUS closed a $750 million SLB.[443] Under the company's SLB framework, the interest payable on the notes would increase by 1% per year if it failed to reduce its absolute scope 1 and 2 GHG emissions by 46% from 2019 levels by 2030.

Unlike UoP instruments, which constrain the use of proceeds for specific purposes, financing obtained via performance-based instruments can be allocated to any project or activity.[444] However, the products' interest rates are contingent upon the achievement of SPTs by the entity, such as the reduction of its GHG emissions by a given percentage.[445]

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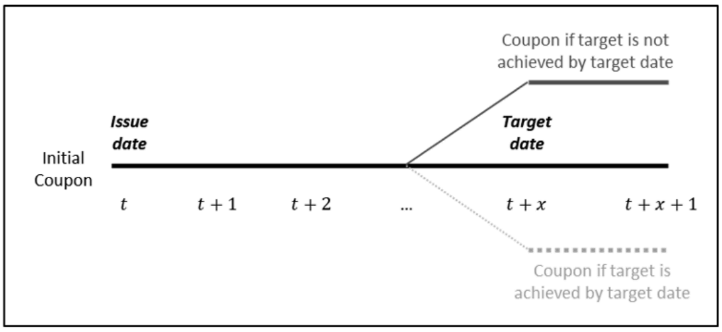
438 European Commission (2021).
439 Sustainable Finance Action Council (2023), p.72.
440 Berkow (2023).
441 Ellmen (2024).
442 BMO Capital Markets (2021).
443 TELUS (2021).
444 Kölbel and Lambillon (2023).
445 Idem.

According to an analysis of SLBs issued globally between 2018 and mid-2022, around half of these bonds incorporated SPTs relating to GHG emissions and energy efficiency.

Figure 11: SLB rate adjustment mechanism[446]



An entity's failure to meet its SPTs can result in financial penalties, typically in the form of higher rates. Conversely, achieving the targets can lead to rate reductions, incentivizing borrowers and bond issuers to improve their environmental performance over time. Typically, debt contracts will provide for upward or downward coupon rate adjustments of 25 basis points, although other step-up rates may be agreed upon.[447]

Some researchers have found that the issuance of SLBs involves a "sustainability premium" that allows issuers to reduce their debt financing costs.[448] In some cases, this premium can be sufficiently important to offset the penalties triggered by an issuer's failure to meet its SPTs.[449]

b) Legal framework

Like UoP instruments, performance-based instruments are subject to the general provisions of the *Civil Code of Québec* and the disclosure requirements applicable to securities distributed to the public. No legal rules define which instruments may qualify as SLBs and SLLs, and private parties are free to set these instruments' SPTs as they wish. Private parties are also free to include liability exclusion clauses and cautionary language to limit the legal consequences of an issuer's failure to meet SPTs or to report on progress. Such clauses are common market practice.[450]

[446] Taken from Kölbel and Lambillon (2023).
[447] Kölbel and Lambillon (2023). According to the authors, around 71% of SLBs issued globally between 2018 and mid-2022 provided for step-ups of 25 bps or lower, or not step up or penalty at all.
[448] For example, Kölbel and Lambillon (2023) find a statistically significant premium of -21.5 basis points. This premium, which would be similar to the "greenium" of UoP instruments.
[449] As described by Kölbel and Lambillon (2023), the average "savings from this reduction in the cost of debt exceed the maximum potential penalty that issuers need to pay in case of failure of the sustainability performance target. This suggests that SLB issuers can benefit from a 'free lunch', i.e. a financial benefit despite not reaching the target."
[450] Ammermans et al., (2021) describe this practice as follows: "Usually, neither the failure to meet any or all SPTs, nor the failure to deliver an SPT certificate generally constitutes an event of default under SLLs, and an explicit carve out is included in the facility agreement to cover such instances. However, a direct consequence of

Voluntary standards and frameworks have also emerged in respect of performance-based instruments, such as ICMA's Sustainability Linked Bond Principles (**SLBPs**).[451] The Sustainability-Linked Loan Principles (**SLLPs**) issued by the LMA, the APLMA and the LSTA establish similar voluntary recommendations for SLLs.[452] Moreover, the CBI also offers certification services for sustainability-linked debt instruments.[453]

There is currently no regulatory initiative in Canada aimed at regulating performance-based SFRI instruments. While the federal Sustainable Investment Taxonomy could theoretically apply to them, SFAC's proposed framework only applies to UoP instruments at the moment.[454]

c) Greenwashing risks

Performance-based instruments have one clear advantage over UoP ones: they reward results instead of the mere allocation of funds to a given project.[455] However, performance-based instruments have also been subject to criticism from various stakeholders[456], as summarized below:

- **Insufficient target-setting, reporting and third-party verification.** Given their voluntary nature, SLB and SLL industry standards lack binding force. Consequently, parties may choose not to adhere strictly to industry best practices, leading to unambitious target setting, inadequate reporting on progress and insufficient third-party verification.[457] For example, a 2021 Reuters analysis of 48 SLBs found that almost half of them included an SPT which allowed the issuer to reduce the rate at which they improved their sustainability performance.[458] Furthermore, reliance on vague, irrelevant, or scarcely verifiable performance indicators may hamper the ability of investors and other stakeholders to compare the performance of an entity against external benchmarks. Some observers, including the United Kingdom's FCA, have warned of the possibility that banks may accept weak SPTs from clients with whom they have a significant commercial relationship, flagging potential conflicts of interest issues. [459] This concern has been reiterated by some representatives of the industry interviewed for the purpose of this report.

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meeting or failing to meet SPTs or to deliver a SPT certificate is an adjustment to the margin." See also Mathew's (2020) recommendation that issuers should make it "clear that a failure to meet an SPT or reporting requirement would not result in a bond event of default."

[451] International Capital Market Association (2024). As noted by Mathew (2020), as with green bonds, "the SLBP make it clear underwriters of SLBs are not responsible if issuers do not comply with their commitments to SLBs and the use of the resulting net proceeds."

[452] Loan Market Association et al. (2019).

[453] Climate Bonds Initiative (undated).

[454] One could however argue that the proposed issuer requirements are similar to performance-based requirements, as an issuer would require to meet entity-level performance goals in order to be taxonomy-eligible.

[455] Ammerman et al. (2021).

[456] Ul Haq and Doumbia (2022).

[457] Curtis et al. (2023).

[458] Wilkes and Bahceli (2021).

[459] Financial Conduct Authority (2023a).

- **Lack of additionality**. Performance-based instruments may reward achievements that would have happened regardless of the existence of an incentive scheme. For example, a firm that is already on track to achieve significant emission reductions over the next five years could issue an SLB to be rewarded for its future achievements, even if the reductions would have happened in the absence of the SLB issuance. This may translate into greenwashing if bond purchasers and lenders start claiming that they have achieved environmental impact by purchasing SLBs or entering into SLLs.

- **Insufficient incentives**. Some observers have noted that the incentives offered by performance-based instruments are unlikely to be sufficient to change the behaviour of firms and trigger significant changes in their environmental performance.[460] As noted above, the interest rate increases and decreases embedded in SLBs and SLLs will typically be very small.[461] Moreover, performance-based instruments will often represent only a minor portion of an entity's total debt, such that an SLB or SLL's rate changes may have a minimal impact on a firm's overall debt costs.[462] In addition, there is evidence suggesting that SLB penalties are so small that the premium associated with SLBs can be greater than the maximum potential penalties that issuers may pay, leading issuers to "benefit from a 'free lunch', i.e., a financial benefit despite not reaching" their performance targets.[463]

- **Gaming of penalties.** Performance-based instruments may be callable on demand, allowing issuers and borrowers to pay back their debt and terminate an instrument before its interest rate steps up.[464] This feature may be particularly problematic if an instrument only provides for penalties many years after its issuance, allowing firms to benefit from advantageous financing rates without taking any action to improve their environmental performance.[465] For example, a 2022 World Bank study found that SLBs with larger coupon step-up penalties were more likely to have later target dates.[466]

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[460] Curtis et al. (2023). Berkow (2023)

[461] Kölbel and Lambillon (2023) find an average premium of -9 basis points on the yield of an SLB compared to conventional bonds. See also: Berkow (2023).

[462] As summarized by the United Kingdom's FCA: "In certain instances, and especially against the backdrop of trust and integrity concerns, the incentives for a borrower to seek an SLL may be low. Small savings on margins may be outweighed by costs and negotiation time with lenders or legal advisors. Some borrowers also seem to be wary of the heightened scrutiny that comes with specifying SPTs and KPIs. We observed that step-ups in margin for failing to meet SPTs among investment grade names were de minimis at around 2.5bps and capped at circa 5bps. These were wider for lower rated and leveraged loans, where step-ups in the 25-30 bps range were observed. Since the inception of the SLL market, no observable increase in these step-ups was noted, despite the changes to the global interest rate environment. We heard that disclosure of missed SPTs may attract scrutiny and be interpreted negatively. However, as the market matures, there are likely to be more instances where SPTs are missed." See: Financial Conduct Authority (2023a).

[463] Kölbel and Lambillon (2023). As noted by Bruno Caron, on the other hand, "If the penalty is too high, then you run the risk of an arbitrage investor coming into the market and buying those bonds". Cited by Berkow (2023).

[464] Curtis et al. (2023). See also: Ul Haq and Doumbia (2022). According to Kölbel and Lambillon's (2023) review of Bloomberg data, almost half of the SLBs issued globally between 2018 and mid-2022 SLB were callable bonds.

[465] Berkow (2023). As noted by Bruno Caron, who is quoted in the article, this issue could be addressed if the regulators required "SLB issuers to pay a portion of the penalty if they choose to call in the bond early."

[466] Ul Haq and Doumbia (2022).

The study also found that SLBs with step-up penalties were more likely to be callable, with call dates set close to the target date.[467]

- **No use of proceeds restrictions and distortive targets**. By definition, performance-based instruments do not impose any restrictions on the use of proceeds. As such, they may be used to finance the expansion of environmentally damaging, carbon-intensive projects and activities.[468] Moreover, performance-based instruments may incentivize firms to cause additional environmental damage by setting intensity-based targets or failing to include DNSH requirements and minimal social safeguards.[469]

In Canada, there have been no enforcement or litigation cases relating to performance-based instruments. However, I4PC's January 2024 complaint to the AMF and the OSC against the Big Five referred to the institutions' reliance on these instruments to achieve their sustainability goals.[470]

This complaint followed the filing by I4PC of a shareholder resolution at RBC's 2022 annual general meeting in connection with an SLB and an SLL issued by natural gas distributor and pipeline operator Enbridge.[471] In 2021, RBC, together with other leading Canadian and US financial institutions, had participated in the $1.1 billion sustainability-linked financing deal, which provided for targets related to GHG emissions intensity reductions, increased racial diversity among staff and women's board participation and did not constrain the use of proceeds.[472] The deal occurred at a time when Enbridge was completing an expansion of its pipeline network, which sparked concerns that the SLB and SLL at issue would translate into an increase in absolute GHG emissions.[473] I4PC's proposal eventually obtained 8% of the votes at RBC's assembly.[474]

Complaints similar to I4PC's have been filed in other jurisdictions. For example, in 2023, advocacy organization Mighty Earth filed a complaint with the U.S. SEC against Brazilian

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[467] Idem.
[468] Berkow (2023).
[469] For example, an SLB may reward an intensity-based emission reduction target that has been achieved by increasing absolute GHG emissions. Similarly, an SLL may only reward certain aspects of environmental performance (e.g., GHG emissions) even if an improvement of these aspects was achieved via severe increase in the harm of other aspects (e.g., biodiversity). Some observers have also noted the fact that performance-based instruments may create perverse incentives for investors and borrowers by rewarding them for an issuer's poor environmental performance. As noted by Freeburn and Ramsay, "this margin ratchet remedy appears to involve a paradoxical outcome for the green-minded investor who profits more in the event of the bond failing to meet its green objectives than if the bond achieved its environmental objectives." This type of situation can be addressed by " requiring the borrower to apply those increased payments either towards the borrower's own green or sustainable projects, or paying the increased payments to charity." See: Milligan (2022).
[470] Investors for Paris Compliance (2024a).
[471] Investors for Paris Compliance (2022).
[472] Woodside (2021).
[473] Idem.
[474] Despite this result, I4PC has continued its efforts to document dubious SLBs and SLLs in which Canadian banks are involved. For example, in its 2023 Bank report card report, I4PC identified at least 9 occurrences in 2021 and 2022 of performance-based instruments the issuance of which has been facilitated by Canadian banks and that have likely resulted in an expansion of carbon intensive activities, mainly in the oil and gas sector.

meat producer JBS regarding its issuance of SLBs.[475] JBS' SLBs were tied to a commitment by the firm to achieve scope 1 and scope 2 net-zero emissions by 2040. However, according to the complaint, labelling the instruments as SLBs was misleading, as JBS' scope 1 and scope 2 emissions only represented around 3% of the firm's climate footprint.[476] The company responded to the complaint by stating that the inclusion of scope 3 emissions targets in the SLBs was impossible because of measurement constraints.[477] NGOs and investors may file similar complaints in Canada in the future.

4.3.3. Investment funds and segregated funds

a) Description of the segment

Investment funds[478] are entities managed by professionals who invest the money pooled by investors according to a given investment policy.[479] Investment funds may invest in diverse assets like shares, bonds and money market instruments.[480] Funds may have different investment strategies and goals, such as achieving long-term growth, steady income, capital preservation or specific objectives like economic development or ESG impact.[481]

Investment funds may integrate ESG factors in their investment activities to respond to the preferences of different types of investors. For example, some investors may want to limit their exposure to financially relevant environmental risks or seize the financial returns associated with the growing demand for less polluting business activities. This may lead investment fund managers to offer investment funds that expressly integrate these criteria in their investment goals, strategies and asset selection processes. Other investors may wish to be more ambitious and avoid investing in activities that accentuate climate change, biodiversity loss and environmental pollution. This may lead to the development of investment funds that exclude certain sectors from their asset portfolio, such as carbon-intensive firms. Finally, some investors may want to achieve both financial and environmental impact by investing in activities that will directly mitigate environmental damage. This can lead investment fund managers to establish impact investment funds that select assets based on their positive environmental impact, such as investments in clean technology companies.

As of December 2023, there were a total of $56.3 billion invested in a total of 369 mutual funds and exchange-traded funds in Canada that claimed to incorporate some SFRI

[475] Mighty Earth (2023).
[476] Idem.
[477] Byrne (2023).
[478] In the context of this report, we do not discuss labour-sponsored investment funds (such as Fonds de solidarité des travailleurs du Québec and Fondaction), venture capital funds, mutual funds distributed in Québec but established in other provinces, investment clubs, pension funds, scholarship plans and state-owned investment funds.
[479] Autorité des marchés financiers (undated b).
[480] Idem.
[481] Idem.

considerations in their investment activities.[482] As described in the table below, such integration may take the form of several different strategies.

Table 4 – Excerpt from CSA's overview of common ESG investment strategies[483]

Name	**Definition**
Screening	The fund applies rules based on defined ESG-related criteria to determine whether an investment is permissible. There are different types of screening, including *exclusionary* or *negative screening*, *best-in-class* or *positive screening*, and *norms-based screening*, which are explained immediately below.
Exclusionary or negative screening	The fund applies rules based on undesirable ESG-related criteria to determine whether an investment is not permitted, including the exclusion of certain types of investments, sectors, or companies from a fund's portfolio based on certain ESG-related criteria.
Best-in-class or positive screening	The fund applies rules based on desirable ESG-related criteria that determine whether an investment is permitted. In some cases, "best-in-class screening" and "positive screening" may have slightly different meanings: • Best-in-class screening: The fund invests in companies that perform better than their peers on certain ESG-related criteria. • Positive screening: The fund invests in companies that meet certain desirable ESG-related criteria.
Norms-based screening	The fund applies rules based on compliance with widely recognized ESG-related standards or norms (such as international conventions) that determine whether an investment is or is not permitted.

[482] The Investment Funds Institute of Canada (2023). This number refers to investment funds that meet the criteria of the Responsible Investment Identification Framework of the Canadian Investment Funds Standards Committee (CIFSC) (see next footnote). These funds represented around 2.5% of the total assets invested, estimated at $2318 billion. See: Canadian Investment Funds Standards Committee (2023a).

[483] The content of this table is directly copied from SN 81-334, at page 3. See: Canadian Securities Administrators (2024a). The 2022 version of SN 81-334 did not include "norms-based screening" as an investment strategy (Canadian Securities Administrators, 2022a). Moreover, it presented negative screening and best-in-class screening as standalone strategies (instead of presenting them as variations of the screening strategy); idem for proxy voting and shareholder engagement. In 2023, the CIFSC published its Responsible Investment Identification Framework, a voluntary framework meant to classify Canadian investment funds that apply "responsible investment" approaches. The framework is aligned with the CFA Institute's Global ESG Disclosure Standards for Investment Products, another voluntary framework. The CIFSC's framework identifies six "responsible investment approaches" which are very similar to those identified in Table 4: ESG integration and evaluation; ESG thematic investing; ESG exclusions; impact investment; ESG related engagement and stewardship; and ESG best in class. On its website, CIFSC publishes a list of Canadian investment funds that fit within one or more of these categories, based on these funds' regulatory filings. See: Canadian Investment Funds Standards Committee (2023a); (2023b).

ESG integration	The fund considers, on an ongoing basis, ESG-related factors within an investment analysis and decision-making process with the aim of improving risk-adjusted returns.
Thematic investing	The fund selects assets to access specified ESG-related trends, such as climate change and the shift to a more circular economy.
Impact investing	The fund invests with the intention of generating a positive, measurable social and/or environmental impact alongside a financial return. The aim is to contribute to, or catalyze, environmental or social improvements.
Stewardship / active ownership	The fund uses investor rights and influence (such as *proxy voting* and *shareholder* or *issuer engagement*, which are explained immediately below) to protect and enhance overall long-term value for clients and beneficiaries, including the common economic, social and environmental assets on which their interests depend. This includes influencing the activities or behaviour of underlying portfolio companies on ESG-related matters.
Proxy voting	The fund votes on management and/or shareholder resolutions in accordance with certain ESG-related considerations or aims.
Shareholder or *issuer engagement*	The fund interacts with the management of the company through meetings and/or written dialogue in accordance with certain ESG-related considerations or aims. The term shareholder engagement is generally used where the fund is a shareholder of the issuer, while the term issuer engagement may be used where the fund is not a shareholder of the issuer but is instead a holder of debt securities of the issuer.

b) Legal framework

A comprehensive assessment of all the rules applicable to the different types of funds offered in Québec would be beyond the scope of this report.[484] However, it should be noted that different regulatory obligations will apply depending on the nature of a fund. In the subsections below, we focus on two broad categories of funds: (i) investment funds as defined in the QSA; and (ii) segregated funds as described in the AMF's *Guideline on Individual Variable Insurance Contracts Relating to Segregated Funds*[485] (**LD Guideline**).

i. Funds regulated under the QSA

The establishment, management and marketing of investment funds are regulated at the provincial level under the QSA, which distinguishes two categories of investment funds: **mutual funds** and **non-redeemable investment funds** (s.5). The main distinction

[484] As noted above, in this report, we do not discuss the rules or exemptions applicable to labour-sponsored investment funds (such as Fonds de solidarité des travailleurs du Québec and Fondaction), venture capital funds, mutual funds distributed in Québec but established in other provinces, investment clubs, pension funds, scholarship plans and state-owned investment funds.

[485] Autorité des marchés financiers (2011).

between these two categories is that the owners of a mutual fund have the right to get their units redeemed at liquidation value upon request at least once per year, whereas non-redeemable investment funds owners do not hold this right.[486]

The units of an investment fund may be distributed to the public; in such a case, a fund will be subject to the QSA's prospectus and disclosure obligations.[487] Investment funds may also be distributed privately to specific categories of investors and be exempted from the QSA's prospectus and disclosure obligations. Exempted investment funds are sometimes referred to as "pooled funds".[488]

The units of a publicly distributed investment fund may be traded on a stock exchange, in which case the fund will be referred to as an "exchange-traded fund", or ETF.[489] ETFs are often passively managed funds that track financial indices, which allows them to charge lower management fees to investors than actively managed alternatives.[490]

Hedge funds are another category of investment funds. They typically employ unconventional, riskier investment strategies than traditional investment funds. As such, they may be more suitable for experienced investors with a greater risk tolerance.[491] Hedge funds are known for their culture of secrecy and the limited information they disclose to investors.[492] As such, they are typically distributed privately, although they may also be distributed publicly if they comply with the QSA's prospectus and disclosure requirements.[493]

Under the QSA, investment funds must be managed by an investment fund manager (**IFM**) responsible for directing the fund's business, operations and affairs (QSA s.5). The implementation of a fund's investment strategy according to its investment policy is under the responsibility of a PM, which may be the same entity as the IFM.[494]

Under s.159.1 of the QSA, IFMs are responsible for the disclosure obligations of investment funds. These obligations vary greatly depending on whether a fund is required to issue a prospectus.[495] Investment funds can be categorized into three distinct groups based on the scope of their disclosure obligations:

- **Funds required to submit a long-form prospectus:** Unless they can submit a short form prospectus or meet any of the exemption criteria, mutual funds and

[486] Brault and Morin (2010). As noted by the authors, to ensure the liquidity of units of these funds, they can typically be transferred between investors.
[487] Idem.
[488] Idem.
[489] Idem.
[490] Fichtner et al. (2023).
[491] Brault and Morin (2010).
[492] Blais-Giroux (2008).
[493] Brault and Morin (2010).
[494] Idem.
[495] These differences result from the fact that certain categories of investors are less vulnerable and more aware of the characteristics and risks associated with investment funds, such that they do not necessitate the information typically found in these documents. See: Blais-Giroux (2008), p.37.

non-redeemable investment funds are required to issue a prospectus as prescribed by s.3.1 of R 41-101.[496] Prospectuses must be approved by the AMF and shall include, among other things, information on the fund's organization, the securities to be distributed, the fund's investment objectives (including its distinctive fundamental nature and features) and its investment strategies (such as the process to select securities, the investment approach and style of portfolio management).[497] The prospectus shall also describe the sectors in which the fund plans to invest and any investment restrictions that it has voluntarily adopted. Moreover, the prospectus shall provide specific information about the fund's performance, risk factors, and any credit ratings received from credit rating organizations. Unless certain steps about the filing of a new prospectus are taken, an investment fund will not be allowed to distribute additional units to the public more than one year after the issuance of its latest prospectus, allowing the AMF to periodically verify that funds comply with their disclosure obligations.[498]

Investment funds required to file a prospectus must comply with the requirements of R 81-102, which prohibits any person from making sales communications that are untrue, misleading or conflicting with the information included in a prospectus or a fund facts document. R 81-102 also regulates comparative advertising and the communication of data about the performance of an investment fund, including performance ratings and rankings.

Publicly distributed investment funds are also required to comply with the continuous disclosure requirements set in *Regulation 81-106 Respecting Investment Fund Continuous Disclosure* (**R 81-106**). This regulation requires investment funds to publish portfolio disclosures on a quarterly basis, as well as annual financial statements, an annual and an interim Management Report of Fund Performance (**MRFP**) and, if more than twelve months have passed since the last receipt by the AMF, an Annual Information Form.[499] The MRFPs shall disclose the investment fund's objective and strategies, changes in its overall level or risk, a summary of its results of operations, recent developments and some financial highlights. Investment funds must also disclose material changes and their proxy voting policies, procedures and record. For additional information on the significance of the proxy voting process, see Box 15.

- **Funds required to submit a simplified[500] prospectus:** Mutual funds that are not traded on a stock exchange must file a simplified prospectus, as prescribed by s.2.1 of

[496] Form 41-101F2 - Information Required in an Investment Fund must be used to prepare the prospectus. ETFs are also required to issue an ETF facts document in accordance with Form 41-101F4 - Information Required in an ETF Facts Document. For ETFs that replicate an index, this document shall disclose the nature and name of the index.
[497] See: Form 41-101F2 - Information Required in an Investment Fund. Item 5 relates to investment objectives, whereas item 6 relates to investment strategies.
[498] Brault and Morin (2010).
[499] Form 81-106F1 Contents of Annual and Interim Management Report of Fund Performance must be used to prepare the MRFP.
[500] Note that in some cases, investment funds may also issue a short form prospectus (which is different than the simplified prospectus). This may be in cases where a reporting issuer has already issued a long form in the past and wants to issue new units to the public.

Regulation 81-101 Respecting Mutual Fund Prospectus Disclosure (**R 81-101**). Mutual funds filing a simplified prospectus must also file a fund facts document for each class or series of securities they issue. This document must describe the fundamental nature and features of the fund, its strategies and objectives, the underlying indices that the fund is tracking (if applicable), its risk level, a description of the investors for whom the fund is suitable, and information about past performance. Like investment funds filing a long form prospectus, mutual funds filing a simplified prospectus are subject to the requirements of R 81-102, R 81-105, R 81-106 and R 81-107.

- **Funds exempted from the obligation to issue a prospectus:** Mutual funds and non-redeemable investment funds may be exempted from the obligation to file a prospectus if they fall under one of the categories identified in *Regulation 45-106 respecting Prospectus Exemptions* (**R 45-106**), such as in situations where an investor meets the definition of "accredited" or "eligible" investor. Exempted investment funds will not be subject to the prospectus, disclosure and sales communications rules listed above.[501] However, they will be required to file a declaration about their exempted status, as required at s.6.1 of R 45-106.[502]

Naturally, funds subject to the prospectus and disclosure obligations described above face more stringent obligations regarding their disclosure of ESG-related information. The CSA issued SN 81-334 to explain how the disclosure and sales communications obligations of investment funds applied to those that incorporate ESG-related criteria in their processes.[503] SN 81-334 distinguishes four different categories[504] of funds based on their consideration of ESG factors.

- **ESG Objective Funds** are "funds whose investment objectives reference ESG factors". Only funds that consider ESG factors as part of their "fundamental nature" or as a "fundamental feature" will be considered as ESG Objective Funds by the CSA.

- **ESG Strategy Funds** are "funds whose investment objectives do not reference ESG factors but that use ESG strategies, where the consideration of ESG factors plays a significant role in their investment process".

- **ESG Limited Consideration Funds** are "funds whose investment objectives do not reference ESG factors but that use ESG strategies, where the consideration of ESG

[501] Brault and Morin (2010).
[502] Brault and Morin (2010).
[503] SN 81-334 was initially published in 2022. In 2022 and 2023, the CSA reviewed the prospectuses, continuous disclosures, holdings, proxy votes and sales communications of a selection of ESG-related funds to assess compliance with SN 81-334, address potential greenwashing cases and determine whether additional policies were required to regulate these funds. In 2024, after completing these reviews, the CSA published a revised version of SN 81-334. See: Canadian Securities Administrators (2024a); Canadian Securities Administrators (2022a; 2024a).
[504] In SN 81-334, CSA indicates that these categories are not intended to be investor-facing labels or classifications and they shall only be used to differentiate funds' disclosure and sales communications obligations.

factors plays a limited role in their investment process". Together with ESG Objective Funds and ESG Strategy Funds, these funds are **ESG-Related Funds**.[505]

- **Non-ESG Funds** are "funds that do not consider ESG factors in their investment process". This includes funds that only invest in an ESG-related asset class (like carbon credit futures) for financial motives, without considering ESG factors.

The more substantial the role of ESG factors in an investment fund's decision-making process, the greater the extent of ESG-related disclosure and information in sales communications the CSA expects from the fund. As a general principle, IFMs should disclose ESG-related information in fund prospectuses using plain language consistent with industry norms. They should also provide explanations of technical terms where appropriate.[506] Some of the specific recommendations provided in SN 81-334 include:

- **Investment objectives and fund name:** If a fund's name refers to an ESG aspect, its investment objectives should reference the ESG aspect mentioned in the fund's name. A fund's name shall not refer to ESG unless its fundamental investment objectives refer to ESG.[507]

- **Suitability:** When describing the suitability of the fund for a particular category of investors, the IFM may state that an ESG Objective Fund "is particularly suitable for investors who have ESG-related investment objectives or who are interested in ESG-focused investments".[508] Other types of funds should not reference ESG in their suitability statement. Moreover, if an ESG Objective Fund focuses on a particular ESG aspect, its suitability statement should indicate it.

- **Investment strategies:** Investment funds should disclose their ESG-related investment strategies in a "[f]ull, true and plain" manner. Investment funds must provide an overview of the "types of investments that the fund may make, the types of ESG strategies used by the fund, the ESG factors considered by the fund, and in the case of an ESG Objective Fund, the ways in which the fund will meet its ESG-related investment objectives".[509] Additional disclosures are required for ESG Objective Funds and ESG

[505] Even if ESG risk factors are considered in a fund's asset selection process, these factors will likely be weighed against non-ESG risk factors (like credit ratings) to evaluate an asset's overall risk profile. For example, a fund manager may conclude that an asset has a high exposure to ESG risks, but still decide to include it in an "ESG fund" if the non-ESG risk profile of the asset is sufficiently low, or if the expected risk-adjusted returns of the asset are sufficiently high.
[506] Canadian Securities Administrators (2024a), p.8.
[507] SN 81-334 provides additional recommendations in respect of funds that track an ESG-related index, invest in underlying funds, intend to generate a measurable ESG outcome or have a carbon offset feature. Similarly, a mutual fund that does not qualify as an ESG Objective Fund should not describe itself as an ESG-focused fund when disclosing its type to investors.
[508] Canadian Securities Administrators (2024a).
[509] Canadian Securities Administrators (2024a), p.12.

Strategy Funds.[510] ESG Objective Funds that "invest in companies that appear to be inconsistent with ESG values", such as a climate transition fund that invests in thermal coal, are encouraged to describe the threshold or parameters applicable to these investments. Moreover, IFMs that manage ESG-Related Funds should have written policies and procedures about the fund's consideration of ESG factors and use of ESG strategies.

- **Use of ESG ratings, scores, indices or benchmarks:** SN 81-334 provides specific guidance for funds that use ESG ratings, scores, indices or benchmarks as part of their principal investment strategies or investment selection process. As noted in subsection 4.2.2, the provision of ESG data services is not subject to specific regulation under provincial securities law, but they are indirectly regulated through the disclosure obligations applicable to the investment funds that rely on them. For example, the CSA indicates that "where an ESG Objective Fund or ESG Strategy Fund uses internal or third-party company-level ESG ratings or scores, or ESG-related indices or benchmarks, as part of its principal investment strategies or investment selection process, the fund should explain how those ratings, scores, indices or benchmarks are used."[511] These explanations should identify the index or benchmark used, the provider of the ratings or scores, and a "description of the methodology used to create the company-level ESG ratings or scores, or ESG-related indices or benchmarks, including, for example, whether the methodology is based on quantitative or qualitative data and the degree to which subjectivity may be involved in the methodology."[512] As described further below, similar requirements exist when ESG ratings, scores and rankings are used as part of an IFM's sales communications on a given fund.

- **Proxy voting, engagement policies and procedures:** If an ESG Objective Fund or ESG Strategy Fund relies on ESG-centered proxy voting as a principal investment strategy, its prospectus or AIF should outline the fund's proxy voting policies and procedures related to ESG factors.

- **Risk disclosure:** All investment funds, regardless of their classification as ESG-Related Funds, are required to disclose material ESG-related risk factors. Moreover, the material risk factors arising from the use of ESG-related strategies by ESG-Related funds, such as concentration risk, shall be disclosed.

- **Continuous disclosure:** SN 81-334 provides guidance on which information shall be disclosed by investment funds that use ESG strategies as part of the MRFP and other continuous disclosure documents. For example, an ESG-Related Fund that uses

[510] SN 81-334 also provides specific recommendations for ESG Limited Considerations Funds, IFMs that apply an ESG strategy to more than one of their funds, funds that use targets for specific ESG-related metrics, funds that invest in underlying funds and funds that use multiple ESG strategies, index-tracking funds that invest in issuers that are not index constituents, funds that obtain exposure to ESG-related investments indirectly, and funds whose names and/or investment objectives include the term "impact". Specific recommendations about funds that use proxy voting or engagement strategies are discussed in Box 14.

[511] Canadian Securities Administrators (2024a), p.14.

[512] Idem.

negative screening as an ESG strategy shall disclose any holding that should have been screened out.

- **Sales communications:** SN 81-334 provides guidance on how IFMs should communicate about the ESG-related credentials of investment funds in order to comply with the requirements of R 81-102. For example, it indicates that sales communications, including those that appear on webpages discussing an IFM's approach towards ESG, should be clear, specific, verifiable and not exaggerated. Moreover, sales communications should not conflict with the information included in the fund's regulatory documents.

- **Use of ESG data in sales communications:** Funds that use ESG ratings, scores, or rankings in their sales communications are subject to additional, specific requirements. For example, funds should only use fund-level ESG ratings, rankings or scores from providers that have an objective methodology applied consistently to all funds and disclosed on the provider's website. To avoid conflicts of interest, IFMs should avoid ESG data providers affiliated with them and avoid paying the providers for their services. Moreover, ESG ratings used in sales communications should not involve cherry-picking and should include accompanying disclosure to avoid being misleading, including a link to the full methodology of the fund-level ESG rating or score.

The guidance, which is very detailed, also addresses the disclosure of a fund's type, its commitment to ESG-related initiatives and the actions that must be taken when ESG-related changes to existing funds occur.

A failure by an investment fund to meet these disclosure and sales communications requirements can result in various legal consequences, the most immediate one being the AMF's refusal to issue a receipt in respect of a fund's prospectus.[513] However, no information is publicly available on the number of prospectus amendment requests made by the AMF because of insufficient ESG disclosures.[514]

In addition, as with other reporting issuers, the QSA grants the AMF the power to inspect the affairs of investment funds to assess compliance with their legal obligations (QSA s.151.1.1). Moreover, the penal and administrative provisions described in subsection 4.1.1 may also apply to inadequate investment fund disclosures.[515] The QSA also allows the FMAT to order an IFM to cease to act as such (QSA s.266). Finally, IFMs, their directors or officers who breach these requirements may engage their responsibility under the QSA's

[513] As noted above, an investment fund will not be allowed to distribute additional units to the public more than one year after the issuance of its latest prospectus. Additional sanctions may be imposed to PMs, IFMs and IDs in certain circumstances. For additional details on this see Duclos et al. (2024).

[514] Similarly, no public information is available on the number of investment fund prospectus applications that were declined by the AMF because of insufficient ESG disclosures.

[515] See notably QSA s.195(3) (failure to furnish information as required under the QSA); s.195(6) (provision of false information to the AMF); s.195.2 (unfair, improper or fraudulent practices to influence the market price of securities); s.196 (misrepresentation in a prospectus); s.197 (other misrepresentations in respect of transaction in a security).

secondary market liability regime, which allow investors to seek compensatory damages before the courts following misrepresentations by a reporting issuer (QSA s.220).

Box 15 – ESG considerations in the proxy voting process

Investment funds may hold securities that carry voting rights. These rights are exercised by an IFM on behalf of a fund as part of the proxy voting process. The proxy voting process allows investment funds to influence the composition of a company's board of directors and to support or reject shareholder resolutions regarding the company's governance, strategy and disclosure practices.

As noted in Table 4, investment funds may use shareholder engagement and proxy voting as ESG-related strategies. For example, an investment fund may engage with a company to seek the disclosure of information about its GHG emissions. An investment fund may also file a shareholder proposal or vote to support a resolution requesting the company to disclose climate-related information to investors.[516] Over the past two years, the level of investor support for climate-related resolutions in Canada has ranged between 14% and 16%.[517].
Investment funds face the task of exercising their voting rights across a myriad of firms. To do so, they often rely on the advice of specialized proxy advisory firms, such as Institutional Shareholder Services and Glass Lewis.[518] These firms' reports provide voting recommendations to investors on each of the shareholder resolutions that will be voted upon during a company's shareholder assembly, including ESG-related shareholder proposals. Proxy advisors may offer off-the-shelf recommendations (also known as benchmark policies) or tailor them according to the proxy voting policies or preferences of a specific client (also known as customized policies).[519] The reports of proxy advisory firms may also incorporate ESG data, ratings and scores sourced from ESG rating agencies.

Proxy advisory firms may be a key tool for investment funds to mitigate greenwashing risks when exercising their voting rights. However, the off-the-shelf voting recommendations of proxy advisors may not always be environmentally sound, especially if they prioritize financial risks over impact.[520] Moreover, proxy advisors may not all share the same views over ESG-related issues, which can lead to contradicting voting recommendations across providers.[521] In addition, the ESG-related recommendations of proxy advisory firms are subject to the same limitations as the ESG data and ratings on which they are based. Finally, despite the recommendations of proxy advisors, there is no guarantee that poor environmental

[516] These two strategies are not mutually exclusive. For example, shareholder proposals may be the result of an unsuccessful engagement campaign.
[517] Stewart (2023); Investors for Paris Compliance (2024b). I4PC reviewed the voting practices of 35 public and private Canadian asset managers to 26 climate-related shareholder proposals and found that 43% of the asset managers assessed had voted against most resolutions.
[518] These two firms are reported to hold approximately 90% of the proxy advisory services market segment. See Boot et al. (2023).
[519] In a 2023 study conducted in the UK, 75% of investors indicated relying on customized policies rather than benchmark policies. See: Financial Reporting Council (2023).
[520] For a description of how proxy advisors integrate ESG considerations in their vote recommendations, see: Larcker and Tayan (2024).
[521] For an example, see Verney (2022).

performance will translate into investor support for climate-related shareholder proposals. While empirical data suggests that investor votes tend to be positively correlated with the voting recommendations of proxy advisors, there is limited data specific to ESG-related proposals.[522]

Proxy services are currently unregulated in Canada. In 2015, the CSA issued *National Policy 25-201 Guidance for Proxy Advisory Firms*, a set of non-binding guidelines identifying best practices for proxy advisors.[523] These guidelines address a wide range of issues, including conflicts of interests, the transparency and accuracy of vote recommendations, the development of proxy voting guidelines, and communications with stakeholders. Given their general nature, these guidelines also apply to ESG-related proxy voting advice. However, the guidelines do not provide any specific recommendations on ESG-related issues.

Under SN 81-334, investment funds using proxy voting and engagement as ESG-related strategies are subject to specific disclosure obligations, which indirectly complement the recommendations set in *National Policy 25-201 Guidance for Proxy Advisory Firms*. For instance, funds that use these techniques as principal investment strategies shall disclose them and describe the "criteria used by the proxy voting or engagement strategy, the goal of the proxy voting or engagement strategy, and the extent of the monitoring process used to assess the success of the proxy voting or engagement strategy."[524] Moreover, SN 81-334 encourages certain funds using ESG-related proxy voting to disclose all past proxy voting records on their websites and summarize how past proxy voting records align with the fund's investment objectives and strategies. Similar recommendations are provided for certain funds that use engagement as a principal investment strategy. While these disclosure guidelines do not directly apply to proxy advisors, they indirectly impact their activities by influencing the type of information that their clients may request.

ii. Funds regulated under the LD Guideline

A segregated fund is a separate and distinct group of assets maintained by an insurer. Retail investors may invest in segregated funds by entering into an Individual Variable Insurance Contract (**IVIC**), a type of insurance product, with an insurance company. An IVIC has two components: an investment component and a guarantee. Under the investment component, the person entering into an IVIC invests in a segregated fund that may feature similar investment features as a mutual fund.[525] The IVIC's guarantee provides insurance coverage on the invested capital in case of death or at the contract's expiration.[526] The level of insurance coverage can vary, typically ranging between 75% and 100% of the capital invested, with different percentages possible for expiration dates (e.g.,

[522] Larcker and Tayan (2024).
[523] Canadian Securities Administrators (2015). The CSA had initially considered the possibility to adopt binding regulations but finally opted for non-binding guidelines, noting the expectation that "proxy advisory firms will voluntarily adopt" the practices and disclosure suggested in the guidelines. Other jurisdictions, such as the US, the UK and the EU, have chosen to regulate proxy advisory services. See: Financial Reporting Council (2023) at pp.12-13.
[524] Canadian Securities Administrators (2024a), page 13.
[525] Côté (2019).
[526] Idem.

after a 10-year period) versus death.[527]

IVICs are life insurance contracts in which the premia are invested by insurance companies.[528] As opposed to investment funds regulated under the QSA, segregated funds are not established as separate legal entities. Insurance companies collect the premia paid under the IVIC, transfer them to an account and use them to invest in securities according to the investment strategy advertised to clients.[529] IVICs may only be sold by life insurance representatives, and investors who purchase an IVIC must pay both an insurance fee and investment management fees.[530] In 2022, $408.5 billion was invested in segregated funds in Québec.[531]

As for any insurance contract, the issuance of IVICs is regulated under the *Civil Code of Québec*, the *Insurers Act* and the Distribution Act.[532] As previously noted, section 1375 of the *Civil Code of Québec* requires the parties to a contract to act in good faith, which has been interpreted by case law as requiring the parties to share information with each other when information asymmetries exist between them. Moreover, the Distribution Act and the CSF Code impose several legal obligations to insurance representatives who distribute IVICs. These obligations are analogous to those of mutual fund representatives described in subsection 4.2.1.[533]

Segregated funds are not subject to the QSA and the regulations promulgated thereunder.[534] In 2011, the AMF published the LD Guideline to address this regulatory gap.[535] To some extent, these requirements replicate those applicable to investment funds under the QSA. For example, the LD Guideline provides guidance regarding the continuous disclosure of information and documents to contract holders, the type of investments that may be made using segregated funds and the applicable accounting and audit requirements.[536]

The LD Guideline also sets the AMF's expectation that insurers will comply with Québec's advertising laws, avoid engaging in unfair or deceptive acts or practices, avoid making

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[527] Investors may only benefit from the guarantee at the end of the contract, making segregated funds suitable for those with a longer investment horizon. For instance, a contract guaranteeing 100% of the capital after a 10-year period ensures that an investor who puts in $100,000 will receive at least $100,000 at the contract's conclusion, safeguarding the capital invested against price fluctuations.

[528] Idem.

[529] Idem. As such, the contract holders do not "own" units of the segregated funds. However, the insurance company will attribute "units" to measure the rights that correspond to the IVIC.

[530] For an overview of the training and qualification requirements applicable to life insurance representatives, see Côté, pp.444-445.

[531] Barcelo (2023).

[532] Côté (2019).

[533] For example, section 27 of the Distribution Act requires insurance representatives to "inquire into their clients' situation to assess their needs" and to "offer their clients a product that meets their needs." Similarly, section 28 of the Distribution Act requires that insurance representatives, "before making an insurance contract, describe the proposed product to the client in relation to the needs identified and specify the nature of the coverage offered."

[534] The QSA expressly exempts IVICs from its application (QSA s.3(13)).

[535] The guideline was adopted under the powers granted by the AMF under the Insurers Act, s. 463.

[536] Autorité des marchés financiers (2011), items 1, 2 and 9.

untrue, misleading, unclear or inconsistent advertisements and clearly identify the sources of the statistics that they use in advertisement.[537] The LD Guideline also provides specific recommendations on the use of performance data and comparisons in advertisements.

The AMF has not issued a guideline equivalent to SN 81-334 in respect of segregated funds. However, as noted in Box 9, in July 2024, the AMF adopted a Climate Risk Management Guideline that applies to provincially-regulated Québec insurers. This guideline includes specific expectations regarding the fair treatment of clients.[538] For example, the Climate Risk Management Guideline sets the AMF's expectations on how financial institutions should account for climate-related risks and opportunities in product design, underwriting, product marketing, product advertising and disclosure to clients. For example, the guideline indicates[539] that a financial institution should "ensure staff, intermediaries and any other persons acting on the institution's behalf who are involved in offering its products are provided with relevant information on [climate-related risks], appropriate tools to assist clients and appropriate training.." This could be interpreted as requiring institutions to ensure that their employees understand the climate-related risks associated with segregated funds, including their ESG-related features.

However, this guideline is not as detailed as SN 81-334 and is not specific to segregated funds. Moreover, as a prudential guideline, it does not have the same legal implications as an enforcement guideline.

Nevertheless, false or misleading representations about the environmental credentials of segregated funds can lead to several sanctions. Under the Distribution Act, it is an offence to make a "misrepresentation to the [AMF], an insured, a client or any other person when pursuing activities governed by this Act or the regulations" (Distribution Act s.469.1).[540] A violation of s.469.1 by an organization can lead to a maximum fine of $1 million, four times the profit realized or half the sums entrusted to or collected by the organization, whichever is the greatest amount (Distribution Act, s.485). However, contrary to investment funds under the QSA, there is no particular liability regime available to investors in segregated funds.[541] In case of breach by an insurer, contract holders may therefore only seek

[537] Autorité des marchés financiers (2011), item 4.
[538] Struthers et al. (2024).
[539] Autorité des marchés financiers (2024a), p.10. Moreover, the "AMF expects disclosure to clients before, when and after a product offered by the financial institution is purchased to address climate-related risks." (p.11).
[540] Life insurance representatives may also be found liable for a failure to their professional responsibilities. For additional information on this topic, see Duclos et al. (2024).
[541] See footnotes 224 to 229 of Côté (2019). As noted by the author: "For its part, the investment fund manager is subject to a regime of presumed fault [under the QSA] and can also exonerate itself by demonstrating having acted with prudence and diligence. Moreover, an investor does not have to demonstrate that they purchased a security by relying on false or misleading information, the causal link being presumed. Similar sanctions are provided for when false or misleading information is provided on the secondary market. In contrast, insurance regulations do not provide for a corresponding civil remedy. To achieve the same result, it is necessary to rely on general civil liability remedies, in particular with regard to the advice and information obligations to which insurers and their representatives are subject as well as the obligations imposed by the [Consumer Protection Act]".

remedies under the *Consumer Protection Act* or under the general contractual liability regime of the *Civil Code of Québec*.[542]

c) Greenwashing risks

In 2022 and 2023, the CSA reviewed the prospectuses, continuous disclosures, holdings, proxy votes and sales communications of a selection of ESG-related funds to assess compliance with SN 81-334, address potential greenwashing and determine whether additional policies were required to regulate these funds. This exercise only covered funds required to issue a prospectus. The CSA identified several problematic practices, including:

- Insufficient disclosures on how a fund considers ESG factors.
- Inconsistent communications between sales communications and prospectus regarding the consideration of ESG factors by an IFM.
- Use of unclear ESG-related terms or concepts in the investment objectives of a fund, such as “sustainable issuers”, “environmental economy” and “clean energy-related companies”.
- Unclear description of a fund’s ESG focus in its investment objectives.
- Unclear or inaccurate disclosure of ESG investment strategies[543], notably with respect to the types of ESG strategies used, the specific ESG factors considered and the evaluation and monitoring of such factors.[544]
- Lack of written policies and procedures relating to a fund’s consideration of ESG factors and/or use of ESG strategies.
- Insufficient description of the ESG-related aspects of the proxy voting policies and procedures of funds identifying proxy voting as an investment strategy, and inconsistencies between these policies and procedures and the description of the fund’s investment strategies.
- Insufficient MRFP disclosure about the fund’s progress or status with regard to meeting ESG-related investment objectives.
- Insufficient disclosure about past proxy voting records and shareholder engagements.
- Failure to comply with the negative screens established as investment strategies.

[542] Idem.

[543] This was the most common misleading practice identified by the CSA. See: Canadian Securities Administrators (2024a).

[544] For example, “staff observed that it was not always clear from prospectus disclosure whether ESG-focused proxy voting and shareholder engagement were principal investment strategies of a fund or whether the IFM had a general proxy voting or shareholder or issuer engagement approach that addressed ESG matters among other matters”. See: Canadian Securities Administrators (2024a).

- Inaccurate, misleading or conflicting ESG-related statements in sales communications.

Despite these findings, there have been no enforcement or private litigation cases relating to investment funds' environmental claims under the QSA. As noted before, this can be partly explained by the fact that other tools are at the disposal of the AMF to foster legal compliance, such that formal legal remedies will only be sought in the most egregious cases. However, as the AMF does not publicly disclose specific information on its private interactions with IFMs regarding sustainability disclosures, it is challenging to evaluate the intensity of the agency's efforts in this area.

That being said, with greenwashing concerns on the rise, it may only be a matter of time before enforcement or private litigation cases start to arise, as is already the case in the United States and Australia.

For example, in May 2022, investment advisor BNY Mellon agreed to pay a US$1.5 million penalty after the SEC found that it misrepresented and omitted information about the ESG credentials of mutual funds under its management. According to the SEC's findings, the firm inaccurately suggested that all investments in these funds were subject to an ESG quality review, which was not always the case.[545] Similar cases brought against DWS and Goldman Sachs respectively led to the payment of US$25 million and $US 4 million in penalties.[546] These cases were foreshadowed by the SEC's 2021 publication of a "risk alert" on ESG investing, which identified several instances of potentially misleading statements by investment advisers, investment companies and private funds engaged in ESG investing.[547]

Australia is another jurisdiction where SFRI claims by investment funds have been under heightened scrutiny. After identifying greenwashing as one of its enforcement priorities for 2023, ASIC successively launched three lawsuits against investment fund managers in relation to their environmental claims.[548] Between April 2023 and June 2024, the ASIC's greenwashing interventions before investment fund managers, listed firms and superannuation trustees resulted in a total of 37 corrective notices, 8 infringement notices and two civil penalty proceedings.[549] In March 2024, ASIC won its first greenwashing civil penalty action against an "ethically conscious" investment fund, which made misleading

[545] U.S. Securities and Exchange Commission, 2022a.

[546] In September 2023, Deutsche Bank subsidiary DWS agreed to pay US$25 million in penalties to settle charges from the SEC relating to the firm's misrepresentations about its ESG investment process and its failure to a sufficient Anti-Money Laundering program. According to the SEC's investigation, DWS had marketed itself as an ESG leader but failed to adequately implement its global ESG integration policy. The SEC also noted that DWS did not adopt policies to ensure the accuracy of its public statements about ESG integrated products. See: U.S. Securities and Exchange Commission (2023a). Another notable case was brought by the SEC against Goldman Sachs Asset Management. In November 2022, the firm agreed to pay a $US 4 million penalty after the SEC found that the firm had failed to adhere to its ESG investment policies for two mutual funds and one separately managed account marketed as ESG. See: U.S. Securities and Exchange Commission (2022b).

[547] U.S. Securities and Exchange Commission (2021).

[548] Australian Securities & Investments Commissions (2023a, 2023b, 2023c, 2023d).

[549] Australian Securities & Investments Commission (2024a).

claims about the exclusion of bond issuers from certain industries, such as fossil fuels.[550] Similarly, in June 2024, the Australian Federal Court found that the trustee of a superannuation fund misled investors by failing to comply with its commitment to exclude investments in the gambling, coal mining and oil tar sands sectors.[551] Moreover, in August 2024, the Federal Court of Australia ordered a superannuation trustee to pay a AU$11.3 million penalty in connection with misleading statements about the trustee's exclusion of investments in carbon-intensive fossil fuels.[552] In addition, ASIC has issued guidelines to help organizations avoid greenwashing when marketing sustainability-related products.[553]

Some jurisdictions have also undertaken regulatory initiatives aimed at improving the transparency and accuracy of ESG-related claims by investment funds. These developments are summarized in Box 16.

Beyond greenwashing risks, it is important to recognize that ESG-related investment funds have inherent limitations as a solution to the environmental crisis. All investment funds, including those aiming for positive environmental impact and those incorporating negative screening filters or investing in best-in-class assets, will always be constrained by the pool of assets in which they may invest. Most economic activities currently involve some degree of negative environmental impacts and a large number of firms are not geared towards effectively contributing to a just, resilient and climate-adapted transition.[554] As such, it can be challenging for investment funds to scale up their investments in environmentally "neutral" or "positive" assets.

Additionally, investment funds' portfolios typically consist of securities that have already been issued, meaning that buying units of an ESG-related investment fund may not result in immediate additional environmental impact. Similarly, certain ESG-related strategies may reward current environmental performance, thereby failing to provide financing to firms seeking to improve their environmental performance.

Finally, it remains unclear how the rising demand for ESG-related investment funds will affect the environmental performance of traditional investment funds. If greater market segmentation leads to "greener" ESG-related funds and "browner" traditional funds without corresponding changes to the overall composition of investable assets, the impact of ESG investment will likely be limited.
For these reasons, any regulatory reform aimed at improving the labelling and communications practices of investment funds need to be combined with other

[550] Australian Securities & Investments Commission (2024b). As explained by ASIC in a press release, the fund's investments "were based on an index called the Bloomberg Barclays MSCI Global Aggregate SRI Exclusions Float Adjusted Index (Index). Vanguard had claimed the Index excluded only companies with significant business activities in a range of industries, including those involving fossil fuels, but has admitted that a significant proportion of securities in the Index and the Fund were from issuers that were not researched or screened against applicable ESG criteria."
[551] Australian Securities & Investments Commission (2024c).
[552] Australian Securities & Investments Commission (2024a).
[553] Australian Securities & Investments Commission (2022).
[554] Morningstar (2022).

complementary regulatory and policy measures, such as environmental laws, taxes and subsidies, to ensure that greenwashing is effectively prevented and that SFRI investments can lead to coherent, long-lasting positive environmental and social impacts.

Box 16 –International developments regarding investment funds

European Union's Sustainable Finance Disclosure Regulation (SFDR)

In 2019, the EU adopted the SFDR in order to establish disclosure rules and technical standards for financial market participants (such as asset managers, pension funds and insurers) and financial advisors. Under the regulation, which follows a double materiality approach, covered entities are required to disclose how they integrate sustainability risks in their activities as well as detailed information on the adverse impact of their activities on sustainability factors.

The SFDR also establishes product-level disclosure requirements at the pre-contractual stage. These requirements vary depending on the type of financial product (including investment funds) at issue. For instance, products that "promote" environmental or social characteristics (often referred to as "article 8" products) and products that have "sustainable investment" as their objective ("article 9" products) are subject to more extensive requirements. Other financial products ("article 6" products), including those that integrate ESG risks as part of the investment process, face less stringent requirements. The SFDR and its technical standards progressively entered into force between 2021 and 2023.

France's voluntary Greenfin and Socially Responsible Investment (SRI) labels

In 2015, France introduced Greenfin, a voluntary labelling scheme for investment funds that allocate more than 75% of their assets to green bonds or activities, as defined in the Greenfin taxonomy.[555] Greenfin sets exclusionary screens for certain sectors, like fossil fuels and nuclear energy.[556] Moreover, the label requires investment funds to establish mechanisms to monitor and report on their ESG performance and impact.[557]

In 2016, the French government introduced the SRI fund label, which sets less restrictive criteria than the Greenfin label.[558] To qualify under the SRI label, an investment fund must integrate ESG criteria in its activities, select assets with higher ESG ratings and report on its performance.[559] Initially, the SRI label did not provide for any exclusionary screens, which allowed investment funds to invest in controversial sectors as long as the selected assets display higher ESG performance than the sector average.[560] However, a revised label was adopted in 2024 to introduce exclusionary screens for companies involved in coal exploitation and in new fossil

[555] Azzouz and Merle (2021).
[556] Idem.
[557] Idem.
[558] Idem.
[559] Idem.
[560] Idem.

fuels exploration, exploitation and refining projects.[561] The revised requirements also provide for the progressive alignment of investment portfolios with the goals of the Paris Agreement.[562]

United Kingdom's Sustainability Disclosure Requirements (SDR)

In 2023, the UK FCA announced the SDR, a package of measures to establish sustainability disclosure requirements and investment labels at the national level.[563] One of the measures introduced as part of the package is an anti-greenwashing rule meant to ensure that sustainability-related claims about financial products and services are "fair, clear and not misleading".[564] Under the rule, sustainability references should be correct, capable of being substantiated, clear, understandable, consider the full life cycle of a product or service and make fair meaningful comparisons.[565] Following the adoption of the rule, the UK FCA has published guidance that provides examples of problematic statements and how to correct them.[566] The anti-greenwashing rule entered into force on May 31, 2024.[567]

The SDR also provides for the establishment of four voluntary sustainability labels to help categorize investment products: "Sustainability Focus", "Sustainability Improvers", "Sustainability Impact" and "Sustainability Mixed Goals".[568] These labels are limited to products that seek to "achieve positive sustainability outcomes only – products using strategies such as ESG integration or basic ESG tilts alone would not qualify".[569] In order to use these labels, a fund must invest at least 70% of its assets in accordance with the label's objectives.[570] Funds will be prevented from using certain sustainability-related terms outside of those authorized under these labels.[571]

The SDR will also introduce new product-level and entity-level (based on the IFRS S1) disclosures as well as naming and marketing rules.[572] This will include a requirement to disclose to consumers the key sustainability characteristics of the financial products that have a label or use sustainability-related terms without a label, such as the product's sustainability objective, its investment policy, strategy and relevant metrics.[573]

United States' ESG disclosure rules

In 2022, the SEC proposed amendments to two of its rules in order to prevent greenwashing by investment funds and investment advisors. First, the SEC proposed to amend its "Names Rule",

[561] Label ISR (2024). See also: Direction Générale du Trésor (2023).
[562] Idem.
[563] Financial Conduct Authority (2024)
[564] Idem, p.3.
[565] Idem, p.7.
[566] Idem.
[567] Edwards et al. (2024).
[568] "Focus" products must invest in assets that focus on sustainability; "Improvers" products must invest in assets that aim to improve sustainability over time; "Impact" products must invest in sustainability solutions; and "Mixed goals" products must invest in a mix of the three other asset categories. See: Carabia and Olausson (2024).
[569] Financial Conduct Authority (2023b).
[570] Carabia and Olausson (2024).
[571] Idem.
[572] Financial Conduct Authority (2023b).
[573] Idem.

which regulates investment fund names, to impose requirements on funds that reference ESG in their name. Under the amendments, investment funds with names that suggest an investment focus on a specific theme or ESG factors must adopt a policy to invest at least 80% of the value of the fund's assets in line with its name.[574] The SEC also proposed additional reporting and recordkeeping requirements for funds subject to the names-related requirements. The amendments were adopted in September 2023.

Second, the SEC proposed new disclosure obligations for investment funds and advisers that incorporate ESG factors in their activities.[575] Under the amendments, which are analogous to the recommendations made by the CSA in SN 81-334, fund prospectuses, annual reports and adviser brochures would be required to disclose specific information about a fund's use of ESG strategies.[576] The amendments also establish a tabular disclosure approach for ESG funds meant to facilitate the comparison of their characteristics by investors and the disclosure by environmentally-focused funds of their portfolio-level GHG emissions.[577] As of September 15, 2024, this proposal had not yet been adopted by the SEC.

Box 17 – Voluntary Carbon Offsets

Voluntary carbon offsets (**VCOs**), which are also called voluntary carbon credits or verified carbon credits[578], are tokens representing the reduction or removal of a specific quantity of GHG emissions in connection with specific climate mitigation projects, measured in tons of CO2 equivalent.[579] Some Canadian authors have referred to VCOs as "non-financial commodities", although the debate on their legal nature is still ongoing.[580] VCOs are typically issued through private carbon offset verification organizations, such as VERRA, Gold Standard, and the American Carbon Registry.[581] These organizations allow project proponents to issue VCOs in connection with projects that meet certain standards. The independent carbon standard setters will typically only issue the VCOs after the emission reductions or emission removals have occurred.[582]

VCOs must be distinguished from the "compliance" carbon credits issued as part of governmental carbon pricing frameworks, such as Québec's emissions cap-and-trade system and Canada's Greenhouse Gas Offset Credit System.[583] VCOs may be purchased by

[574] U.S. Securities and Exchange Commission (2023b).
[575] U.S. Securities and Exchange Commission (undated a)
[576] Idem.
[577] Idem.
[578] These different expressions highlight different aspects of these credits. The expression VCO focuses on the "act" of offsetting emissions, whereas the expression "verified carbon credit" highlights the fact that credits are issued after a third party has verified whether the emissions removals, reductions or avoidance have occurred. For additional information, see: de Lassus St-Geniès and Previti (2024).
[579] There are two main types of GHG mitigation projects: emission removals, which capture and sequester previously released GHGs, and emission reductions, which prevent GHG emissions that would have otherwise occurred. For additional information, see Appendix C of Beaulieu and Bishai (2022).
[580] Sadikman et al. (2022); de Lassus St-Geniès and Previti (2024).
[581] Beaulieu and Bishai (2022).
[582] de Lassus St-Geniès and Previti (2024).
[583] Government of Canada (2024c).

organizations to achieve voluntary GHG emission reduction targets or by investors for speculative purposes.[584] Some companies may also offer consumers to purchase VCOs in connection with carbon-intensive products or services, such as plane flights.

As long as their purchaser does not retire them, VCOs may be traded on financial markets. As a result, even if an entity holds several VCOs, it should not rely on these VCOs to calculate its carbon footprint, as the entity may sell the VCOs in the future and lose the ability to rely on them to calculate its carbon footprint. Once a VCO is retired, it may not be traded again, allowing the purchaser to consider the VCO in the calculation of its carbon footprint.

The use of VCOs to achieve emission reduction goals or to offset the carbon footprint of certain activities is highly controversial. While some have argued that these instruments have a role in mitigating residual GHG emissions and facilitating the allocation of capital towards emission reduction projects, the lack of regulation regarding their characteristics and use makes them more vulnerable to greenwashing risks than compliance carbon pricing instruments. Moreover, VCOs face scale limitations, and there is a risk that they divert firms from reducing their internal GHG emissions (as opposed to offsetting them) or individuals from changing their consumption habits.[585] Moreover, several greenwashing risks have been raised in connection with VCOs[586]:

- **Leakage risk:** The risk that reduced emissions in one area will result in increased emissions elsewhere (e.g., creating a reforestation project on agricultural land while cutting down an existing forest to create new agricultural land).
- **Double counting:** The risk that several entities rely on the same VCO, undermining credibility and distorting global GHG reduction efforts.
- **Additionality:** The risk that the issuance of VCOs does not represent a net reduction or removal compared to what would have happened if a specific voluntary mitigation project (i.e., not required by law or regulations) had not been carried out.
- **Permanence:** The risk that GHG reductions or removals are not sustained over time and reversed (e.g., because of a fire that destroys a reforestation project).
- **Forward-selling**: The risk of lag between the purchase of a VCO and the implementation of the emission reduction or removal project and its impacts on global warming. Typically, VCOs will only be issued after the completion of an emission reduction or removal project (i.e., ex-post). However, some VCOs may also be issued prior to the project's completion (i.e., ex-ante), leading to an emission glut in the short or medium term, with direct environmental impact. While some voluntary VCO standards do not allow the issuance of ex-ante VCOs, compliance with such standards is voluntary in Canada.

[584] International Organization of Securities Commissions (2023).
[585] Beaulieu and Bishai (2022).
[586] Beaulieu and Bishai (2022).

- **Social and environmental impact**: The risk that a project has negative environmental and social impact unrelated to climate change (such as the biodiversity loss caused by a monoculture reforestation project).

In the absence of any specific regulation regarding their issuance, organizations willing to buy and issue high-quality VCOs in Canada will typically rely on voluntary industry standards, such as the Integrity Council for Voluntary Carbon Markets, the Carbon Offsetting and Reduction Scheme for International Aviation (**CORSIA**), the Oxford Principles for Net Zero Aligned Carbon Offsetting, the Voluntary Carbon Markets Integrity Initiative's Claims Code of Practice, and on the services of carbon offsets registration organizations. Appendix C of the CQDE's 2022 climate-washing report provides a summary of these different standards.[587]

Organizations in Canada may also rely on the official guidance issued by governmental authorities, such as the "Pan-Canadian Greenhouse Gas Offsets Framework", a guidance document issued in 2019 by the federal, provincial and territorial governments to facilitate the development of regulatory and VCO programs in Canada.[588] Moreover, organizations willing to use offsets to achieve their net-zero targets may refer to the Net-Zero Challenge Technical Guide, a guide issued as part of a voluntary program designed to encourage firms to transition to net-zero emissions by 2050.[589] Similarly, OSFI's Guideline B-15 and IFRS S2 (which could be incorporated into securities law in the future) both require entities to disclose the use of VCOs.[590]

None of these guidelines or standards establish mandatory rules about the integrity and the trading of VCOs used in Canada. Moreover, the current regulatory framework does not indicate under which circumstances entities may rely on VCOs to substantiate their environmental claims. Theoretically, deceptive environmental claims involving VCOs may lead to enforcement action and private litigation, notably under consumer protection and competition laws. However, no such case has been initiated thus far.[591]

In the past years, regulators in the United States have initiated several initiatives to improve the transparency and quality of the VCO market. For example, in May 2024, the US government

[587] Beaulieu and Bishai (2022).
[588] Canadian Council of Ministers of the Environment (2019).
[589] Government of Canada (2022b). SFAC's proposed taxonomy framework also limits the use of VCOs by project proponents wishing to make taxonomy-aligned claims. See: Sustainable Finance Action Council (2023).
[590] Office of the Superintendent of Financial Institutions Canada (2023); International Sustainability Standards Board (2023).
[591] However, at least one lawsuit has been filed regarding the communication of deceptive information under provincial compliance markets. In 2023, the employee of an Alberta-based consulting firm pleaded guilty to charges relating to the provision of false and misleading information regarding her ability to conduct peer reviews under the Alberta carbon pricing system. Under this system, companies must submit their compliance reports to a third party to ensure regulatory compliance. Third party assurance providers must be accredited under ISO Standard 14065:2013 and individual peer reviewers must complete training according to ISO Standard 14064-3. In the case at issue, the employee conducted peer reviews without having completed the required training. Moreover, the employee used the signature of a former employee of her company (who had completed the training) in order to sign the required documentation, even if that other employee was not involved in the peer review process. The employee was sentenced to a $10,000 fine and was prohibited from working in similar positions for a period of three years. See: Climate Case Chart (2023).

published its Principles for Responsible Participation in Voluntary Carbon Markets, a list of seven voluntary principles that identify best practices for the VCO market.[592]

Along the same lines, California introduced the Voluntary Carbon Market Disclosures Act (**VCMDA**), which became effective on January 1, 2024. The VCMDA establishes disclosure requirements in relation to (i) net-zero, carbon neutrality, and emission reductions claims; (ii) emissions-related claims relying on voluntary carbon offsets; and (iii) the commercialization of VCOs.

In addition, in order to improve the trading of VCOs on financial markets, the US Commodity Futures Trading Commission (**CFTC**) has issued guidance on the trading of VCO derivative contracts, which are financial instruments that derive their value from an underlying VCO.[593] The CFTC has also established an Environmental Fraud Task Force to address fraud with respect to VCOs and ESG-related misrepresentations.[594]

Finally, in 2012, the U.S. Federal Trade Commission issued a revised version of its environmental marketing guidelines, the "Green Guides", to provide guidance on the use of VCOs in the context of marketing claims.[595] For example, the agency indicates that VCOs should be additional, noting that it is deceptive to claim "that a carbon offset represents an emission reduction if the reduction, or the activity that caused the reduction, was required by law."[596] Moreover, the agency recommends that firms "clearly and prominently disclose if the carbon offset represents emission reductions that will not occur for two years or longer."[597]

592 White House (2024). The principles recommend that VCOs be additional, unique, real, quantifiable, permanent, validated and verified by an independent third party, based on robust baselines, and avoid environmental and social harm. The principles also recommend that organizations prioritize emission reductions over offsetting, publicly disclose their use of VCOs and only make public claims rely on high quality VCOs.
593 Commodity Futures Trading Commission (2023a).
594 Commodity Futures Trading Commission (2023b).
595 U.S. Federal Trade Commission (2012).
596 Idem, p.9.
597 Idem.

5. Recommendations

As noted throughout this report, the risks of deceptive environmental and social claims are widespread in the financial sector. These risks can be found in every segment examined in this report, from investment funds and ESG data providers to reporting issuers and issuers of SLBs and UoP bonds. If left unchecked, these risks have the potential to harm consumers, increase investor skepticism and prevent the allocation of funds towards assets and financial products effectively contributing to the economic transformation towards a low-carbon, resilient and just society. They may also hamper the development of robust, mandatory and truly sustainable financial policies, slow down the socio-ecological transition and threaten the stability of the financial system.

In Québec and Canada, greenwashing risks are partly mitigated by the existence of financial, consumer protection, competition and contractual laws that prohibit the communication of deceptive environmental claims to investors. As explained in Section 4, a violation of these rules can lead to severe legal consequences, which range from administrative and penal sanctions to compensation claims from investors.

However, despite a few complaints to the financial authorities by NGOs, public enforcement actions and private litigation related to financial greenwashing in Québec and Canada have been scarce. The situation may change in the near term. Over the past years, the AMF and OSFI have significantly expanded their expertise on climate-related issues. These new capabilities and the recent publication of guidance documents may signal that some authorities plan to intensify their enforcement efforts. Rising investor awareness could also lead private parties to file more numerous compensation cases against financial actors, and regulatory developments could accelerate this trend.

Moreover, in June 2024, the Parliament of Canada adopted amendments to the *Competition Act* that created a new requirement for all firms, including financial actors, to substantiate their environmental benefits claims.[598] Under the new provisions, claims that relate to products, including financial products, must be backed by an "adequate and proper test", a concept that has been interpreted by the courts as a "procedure intended to establish the quality, performance or reliability of something".[599] Similarly, the new provisions require that environmental benefits claims about a business or business activity, including claims about financial institutions or the financial sector, be based on "adequate and proper substantiation in accordance with internationally recognized methodology".[600] The amendments also established a new private right of access to the

[598] McCarthy Tétrault (2024).
[599] In a 2016 summary of the case law on the concept of appropriate and proper testing, the CB indicated that an adequate and proper test "depends on the general impression that the advertisement makes on consumers"; such a test must be "conducted before the claim is made"; "done under controlled circumstances, controlling for external variables"; eliminating subjectivity "as much as possible". Moreover, an adequate and proper test is "not necessarily measured against a test of certainty, but it should establish that the results are not mere chance or a one-time effect, by establishing that the product causes the desired effect in a material manner". Finally, the "results of the testing" must "support the claim made." See: Competition Bureau (2023).
[600] McCarthy Tétrault (2024).

Competition Tribunal for deceptive marketing cases, which will facilitate the filing of private greenwashing lawsuits under the statute.[601] This new right of access will enter into force in June 2025.

While the statute does not define the concept of "internationally recognized methodology", the CB has indicated that it will issue guidance at an accelerated pace to provide its expectations about the new requirements.[602] In July 2024, the CB launched a public consultation seeking feedback from the public regarding the new provisions.[603]

However, despite these measures, further legislative and regulatory actions are needed to effectively mitigate greenwashing risks. These actions are essential to increase the allocation of capital towards a low-carbon, resilient and inclusive global economy, improve investor trust and the credibility of the financial sector, foster the development of the SFRI products and services and ensure that investment decisions reflect investors' true ESG preferences.

Moreover, they would be likely to garner public support, as surveys conducted over the past few years have shown consistent public support for anti-greenwashing measures in the financial sector. For example, in a 2022 survey of Canadian retail investors, 75% of respondents indicated being concerned about greenwashing, and 78% showed support for more stringent and heightened regulation in the financial sector to address greenwashing.[604] Similarly, in a 2023 poll, 65% of Canadians indicated that they support new sustainable finance regulations, and 78% indicated that they would support new regulations against financial greenwashing.[605] Moreover, according to a 2024 survey of Canadian retail investors, 61% mentioned being concerned about greenwashing and transparency within the SFRI space, and 43% believed the sector "lacks clear guidelines or standards."[606]

Recommendations for each segment of the financial sector are listed in Table 5 and described in more detail below. They follow the same order as Section 4 of this report. Each recommendation is categorized based on a proposed timeline of implementation: short term (***), medium-term (**) and long-term (*).

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[601] McCarthy Tétrault (2024).
[602] Competition Bureau (2024a).
[603] Competition Bureau (2024b).
[604] Responsible Investment Association (2022).
[605] Ecojustice (2023).
[606] Mackenzie Investments (2024).

Table 5 – Overview of recommendations

#	Recommendation	Type	Actors	Timeline
Reporting issuers				
1	Finalize DR 51-107	Standards and disclosure	AMF / CSA	***
2	Adopt new regulations to widen the scope of reporting issuers' sustainability disclosures following a double materiality approach	Standards and disclosure	AMF / CSA / Gov Qc / Gov Can	**
3	Amend the QSA to revise the definition of misrepresentation in order to facilitate greenwashing compensation claims in the absence of price effects	Facilitating legal remedies	Gov Qc	**
4	Set greenwashing as an enforcement priority and report on results	Enforcement	AMF / CSA	**
Banks				
5	Amend Guideline B-15 to establish more specific climate-related disclosure requirements	Standards and disclosure	OSFI	***
6	Establish a new prudential guideline to standardize the disclosure of environmental information using a double materiality and holistic approach	Standards and disclosure	OSFI	**
7	Adopt stronger enforcement mechanisms regarding violations of Guideline B-15 and the AMF's Climate Risk Management Guideline	Facilitating legal remedies	Gov Can / Gov Qc	**
8	Publish guidance on FRFIs' environmental claims aimed at consumers	Enforcement	FCAC	*
9	Set greenwashing as an enforcement priority and report on results	Enforcement	FCAC	**
10	Incorporate environmental topics in financial literacy educational programs	Educating the public	FCAC	*
Investment services providers				
11	Engage with training providers to ensure that environmental topics are incorporated in the mandatory training programs offered to investment professionals	Professional obligations	AMF / CSA / CIRO	**
12	Amend financial intermediaries' KYC and suitability requirements to require them to seek information on their clients' environmental preferences	Professional obligations	AMF / CSA / CIRO / CSF / Gov Qc	**
13	Require investment services providers to understand the sustainability characteristics of the products they offer, including the	Professional obligations	AMF / CSA / CIRO	**

	environmental risks and impacts associated with these products, as part of the KYP requirement			
14	Require investment services providers to proactively communicate information on the material sustainability risks and impacts of financial products	Standards and disclosure	AMF / CSA / CIRO / Gov Qc	*
ESG data providers				
15	Amend the QSA to grant power to the AMF to regulate and supervise the provision of ESG data services	Regulate new segments	Gov Qc / AMF / CSA	**
16	Revise SN 81-334 to provide more specific guidance on ESG methodology disclosures and conflict of interest rules	Standards and disclosure	AMF / CSA	***
17	Accelerate the adoption of data disclosure standards and obligations	Standards and disclosure	Gov Can / Gov Qc / AMF / CSA / OSFI	**
18	Amend *National Policy 25-201 Guidance for Proxy Advisory Firms* to set disclosure obligations to proxy advisors with respect to sustainability issues	Standards and disclosure	AMF / CSA	**
SFRI financial instruments				
19	Adopt a mandatory science-based sustainability taxonomy that is aligned with global environmental and human rights commitments	Standards and disclosure	Gov Can	***
20	Integrate the sustainability taxonomy into securities and prudential disclosure requirements	Standards and disclosure	AMF / CSA / OSFI / Gov Can / Gov Qc / CIRO	**
21	Regulate the issuance of UoP instruments	Regulate new segments	Gov Qc / AMF / CSA	**
22	Regulate the issuance of performance-based instruments	Regulate new segments	Gov Qc / AMF / CSA	**
23	Regulate voluntary carbon offsets	Regulate new segments	Gov Can / Gov Qc / AMF / CSA	**
Investment funds and segregated funds				
24	Revise LD Guideline to extend the disclosure obligations formulated in SN 81-334 to segregated funds	Standards and disclosure	AMF	***
25	Set greenwashing enforcement as a priority and report on results	Enforcement	AMF / CSA	**
26	Include ESG-related considerations in the Québec Financial Education Strategy	Educating the public	AMF	*

5.1 Reporting issuers

***Recommendation #1*: Finalize DR 51-107 (AMF / CSA).**

The CSA should adopt a revised version of NI 51-107, which will form the basis of DR 51-107, as soon as possible once the CSSB issues its climate disclosure standard. More than two years have passed since the publication of the CSA's first draft proposal, and Canadian reporting issuers urgently need clearer standards on how to report their exposure to climate-related risks and opportunities.[607] This regulatory measure, which is also recommended by the Québec Expert Group on Adaptation, would act both as a standard-setting measure and as a mandatory disclosure measure.[608] It would improve the quality, quantity and comparability of climate-related data disclosed by reporting issuers, facilitating investment decisions and improving the reliability of ESG ratings.

This measure would also help define the materiality threshold applicable to the disclosure of climate-related information. For instance, it would clarify which specific information, such as an issuer's GHG emissions, must systematically be disclosed by all reporting issuers. By expanding the scope of the information that must be provided in CD Documents, this measure would also empower the AMF and investors to take legal action when faced with deceptive environmental disclosures.[609]

Furthermore, the AMF, in collaboration with its counterparts from the CSA, should ensure that DR 51-107 provides specific guidance to reporting issuers in the area of metrics and targets. Except for GHG emissions accounting[610], the first draft of DR 51-107 did not identify which specific metrics and targets shall be used by issuers to report on their environmental performance. Without consistent metrics and target-setting requirements across issuers, it is difficult for investors to compare climate-related disclosures across issuers. Examples of specific metrics and indicators include the percentage of physical assets exposed to extreme flood risks, the value and percentage of total assets and revenue losses causes by climate-related events, the historical carbon footprint, the number of climate-related litigation events experienced by the issuer, the percentage of capital expenditures and revenues that relate to activities aligned with a sustainability taxonomy, etc.

***Recommendation #2*: Adopt new regulations to widen the scope of reporting issuers' sustainability disclosures following a double materiality and holistic approach (AMF / CSA / Government of Québec / Government of Canada).**

[607] Sarra (2024).
[608] Québec Expert Group on Adaptation (2024).
[609] First, it would increase the quantity of information that is included in CD Documents as opposed to voluntary disclosures, which are not within the purview of the AMF. Second, it would facilitate the proof of materiality by plaintiffs.
[610] DR 51-107 expressly identifies the GHG Protocol as an adequate carbon accounting standard and allow issuers to use other standards if they are comparable to the GHG Protocol. See: Canadian Securities Administrators (2021a).

While the adoption of DR 51-107 would be a step in the right direction, this regulation would only apply to climate-related risks and opportunities. As such, it would not address:

- the disclosure of information regarding the climate-related impact of an issuer's activities, unless such impact is likely to translate into climate-related risks and opportunities;
- other aspects of sustainability than climate change, such as impacts and risks relating to biodiversity, resource extraction, waste management, human rights; and
- the disclosure of organizations' transition plans.

These gaps reduce the quantity, quality and comparability of the information disclosed by reporting issuers regarding their environmental performance, limiting the ability of investors to make investments that are aligned with their environmental preferences and risk appetite.

The AMF, in conjunction with its counterparts from the CSA, should therefore adopt new regulations that would require the disclosure of information on climate-related impacts and on other sustainability issues than climate (such as biodiversity), as is currently the case in Europe under the CSRD.

These standards should be closely aligned with the European Union's ESRS, which provide for the reporting of information on a wide range of sustainability topics using a double materiality approach. Public officials should also engage with Indigenous-led financial organizations, such as the Reconciliation & Responsible Investment Initiative, to ensure that the standards also incorporate indigenous perspectives.

Moreover, the regulations should introduce mandatory third-party assurance of sustainability information to ensure the quality of the information disclosed by issuers. They should also provide for the inclusion of impacted stakeholders in the data collection and reporting process, ensuring that the disclosure reflects the perspectives and views of the communities affected by the reporting issuer's activities.

The establishment of such standards would ensure that this information is comprehensive, science-based and comparable across issuers. These actions would also be aligned with the commitments formulated by the Government of Canada as part of the Kunming-Montréal Agreement on biodiversity and by the Government of Québec in the Plan Nature 2030.[611]

If this proposal does not obtain support from the CSA, the AMF should consider unilaterally adopting the sustainability disclosure requirements described above. Such requirements would provide a competitive advantage to Québec-based issuers, which would benefit

[611] The Kunming-Montréal Agreement set the target of aligning all financial flows with the agreement's goals, which include the protection of at least 30% of the world's ecosystems. See: Convention on Biological Diversity (2022).

from a favourable treatment by sustainability-oriented investors and European supervisory authorities.

As noted in Boxes 4 and 7, this proposal may raise some concerns with respect to compliance costs, mandate limitations and regulatory arbitrage. These concerns could be addressed as follows:

- **Amending the AMF's mandate:** The AMF's mandate could be modified to explicitly allow the agency to require disclosure of information that is material to impact investors, notably by ensuring that the concept of materiality reflects the preferences of all categories of investors.
- **Regulating all firms of a certain size:** To ensure that reporting issuers do not face a disproportional regulatory burden compared to private firms, the Government of Canada or the Government of Québec could choose to make sustainability disclosures mandatory for all firms of a certain size, irrespective of their private or public status, as in the EU.
- **Conditional compliance:** As a last resort, the CSA could establish standards for sustainability impact disclosures and require any reporting issuer making sustainability impact claims to comply with these standards. Reporting issuers could decide not to make such claims (and avoid the regulatory burden associated with the standards), but those choosing to do so would be required to comply. This would require companies seeking to attract impact investors to disclose information in a consistent format while allowing others to avoid any additional regulatory burden.

***Recommendation #3:* Amend the QSA to revise the definition of misrepresentation in order to facilitate greenwashing compensation claims in the absence of price effects (Government of Québec).**

The burden of proof to bring forward lawsuits relating to deceptive environmental disclosures under the QSA is currently hard to meet, preventing plaintiffs from successfully bringing actions against reporting issuers. For example, s.196 of the QSA, which makes it an offence to make a misrepresentation in a prospectus or in CD Documents, only applies with respect to misleading representations or omissions relating to a "material fact", namely a "fact that may reasonably be expected to have a significant effect on the market price or value of securities issued or securities proposed to be issued." (QSA s.5). However, it may be difficult to prove that environmental information meets this definition, especially given that environmental risks and opportunities are sometimes hard to quantify and may not be adequately priced in by the market.[612] Moreover, this provision is limited to claims that appear in a reporting issuer's regulatory filings, preventing the AMF from taking action against deceptive claims communicated on the issuer's website, in press releases or in sustainability reports.

[612] Coiteux et al. (2023).

Similar issues are likely to arise in primary and secondary market claims filed by shareholders, who will also be required to prove that the issuer's claims qualify as misrepresentations under the QSA.[613] Moreover, in the absence of price effects, private plaintiffs may struggle to prove that an issuer's deceptive disclosures caused them any damages.[614] Furthermore, while secondary market claims may be filed in respect of representations communicated outside of regulatory filings, this will only be possible for documents that "would reasonably be expected to affect the market price or value of a security of the issuer" (QSA s.225.3).

This framework allows issuers to make false or misleading representations to investors as long as their deceptive representations do not lead to market price fluctuations. This situation raises serious market efficiency and integrity issues, as unrestrained greenwashing can impact the public's trust in financial markets and slow down the allocation of capital towards less polluting assets.

To address this situation, the Government of Québec should amend the QSA to adopt a different definition of misrepresentation that reflects the fact that greenwashing may not result in price effects. In addition, the government should expand the scope of s.196 of the QSA to cover misrepresentations in other documents than CD Documents. This would allow the enforcer to seek penal remedies for deceptive environmental claims made outside of their regulatory filings.

***Recommendation #4:* Set greenwashing as an enforcement priority and report on results (AMF / CSA).**

In its 2022 SN 51-364 notice, the CSA noted an increase in the number of potential greenwashing claims and referenced several examples of problematic disclosure practices among issuers.[615] As noted before, these claims raise important risks for the integrity and stability of the financial system.

However, the AMF's 2024-2025 Annual Statement of Priorities does not list greenwashing as an enforcement priority, although the AMF's 2021-2025 Strategic Plan identifies greenwashing as an "issue to keep an eye on".[616]

The AMF and its counterparts should intensify their enforcement actions to send a strong signal that reporting issuers will be sanctioned if they fail to meet their environmental disclosure obligations. To achieve this goal, anti-greenwashing enforcement should be set as a priority in the AMF's next Annual Statement of Priorities and Strategic Plan.

Moreover, the agency should report on the results of its enforcement efforts by disclosing annually the number and status of the complaints, investigations and enforcement actions relating to reporting issuers' SFRI claims. This would be consistent with the reporting practices of securities regulators from other jurisdictions, such as Australia,

[613] Idem.
[614] Idem.
[615] Canadian Securities Administrators (2022b).
[616] Autorité des marchés financiers (2024c; 2021).

which regularly reports on its efforts in this space. For example, in August 2024, ASIC issued a detailed report on its regulatory interventions made in 2023-2024 with respect to greenwashing misconduct, providing statistics, case studies and comments on its enforcement activities and observations.[617]

[617] Australian Securities & Investments Commission (2024a).

5.2. Banks

***Recommendation #5:* Amend Guideline B-15 to establish more specific climate-related disclosure requirements (OSFI).**

The adoption of Guideline B-15 was a significant step towards more transparent environmental disclosures by FRFIs, including banks. However, Guideline B-15 is generic and principles-based, granting significant leeway to FRFIs to interpret and implement its provisions. For example, the guideline requires FRFIs to disclose the metrics used to assess climate-related risks and opportunities but it allows the institutions to choose which metrics to use.[618] Similarly, the guideline requires FRFIs to disclose the "amount and percentage of assets of business activities vulnerable to climate-related risks", without defining the term "vulnerable". The guideline also requires FRFIs to disclose if they intend to use carbon offsets to achieve their GHG emissions targets, but it does not require them to provide information on the quality of such offsets[619] (i.e., permanence, third-party certification, double counting, etc.).

OSFI should amend Guideline B-15 to prescribe more specific disclosure requirements. These requirements should, among other things:

- Provide specific disclosure guidance that incorporates domestically or internationally recognized standards and indicators for the measurement of physical and transition risks.
- Establish formal requirements for target-setting and climate transition plans.
- Prevent claims based on the use of UoP and performance-based instruments that fail to meet minimum quality standards, such as those of a government-issued, mandatory sustainability taxonomy (see Recommendation #20).
- Require FRFIs to disclose whether their activities are aligned with the goals of the Paris and Kunming-Montréal Agreements.
- Require FRFIs to disclose whether they have engaged in or financed lobbying activities that may exacerbate climate-related risks.
- Require FRFIs to disclose any interlocking directorates that may impact the independence of directors with respect to the management and oversight of an institution's climate-related risks.
- Require reporting entities to disclose detailed information about the characteristics of the VCOs that they use (quality, certification, third-party assurance, etc.) and prevent

[618] We acknowledge the existence of certain specific quantitative metrics, like GHG emissions.
[619] For example, do they need to be permanent, certified by third parties, prevent double counting, etc.?

entities from formulating net-zero targets that primarily rely on the purchase of VCOs.[620]

In an effort to harmonize and align the AMF's Climate Risk Management Guideline with Guideline B-15, the AMF should consider following the same recommendation.

***Recommendation #6:* Establish a new prudential guideline to standardize the disclosure of environmental information using a double materiality and holistic approach (OSFI).**

Like DR 51-107, Guideline B-15 focuses on climate-related financial risks and opportunities. As such, it does not address the disclosure of information on climate-related impact and other environmental aspects than climate, such as biodiversity. OSFI should consider issuing additional guidelines on other components to establish a comprehensive environmental performance disclosure framework. As noted in recommendation #2, this guidance should be closely aligned with the reporting frameworks that already exist or are under development at the international level.

***Recommendation #7:* Adopt stronger enforcement mechanisms regarding violations of Guideline B-15 and the AMF's Climate Risk Management Guideline (Government of Canada / Government of Québec).**

Guideline B-15 is a prudential guideline, and the BA does not provide deterrent enforcement mechanisms that would ensure FRFIs' compliance with its requirements. To address the situation, the Government of Canada should require banks to include in their PAS the information prescribed by Guideline B-15. Some banks already include information about their environmental initiatives in their PAS, and expanding the mandatory content of this document to encompass environmental risks and opportunities would be a beneficial progression. This measure would not require any legislative amendments, as the contents of the PAS are set in the *Financial Consumer Protection Framework Regulations*. The PAS must be filed with the FCAC Commissioner, which would ensure that the FCAC, an agency with proven enforcement capacity, monitors the disclosures filed by banks on a yearly basis. A violation of the requirement to prepare a PAS constitutes an offence under s.980 of the BA, which can lead to severe criminal fines.

Similar enforcement mechanisms could be implemented by the Government of Québec for provincially-regulated financial institutions, notably by extending the reporting requirements established at s.162 of the FinCoop Act, ensuring that legal sanctions can be imposed on organizations that fail to meet their climate disclosure obligations.

[620] These requirements could be similar to CAFA's proposed requirement that entities using VCOs to achieve their climate targets (i) only use VCOs relating to credible carbon removal projects; and (ii) only use VCOs when no other feasible mitigation or abatement of emissions is possible. See CAFA, s.5(3) and s.6.

***Recommendation #8*: Publish guidance on FRFIs' environmental claims aimed at consumers (FCAC).**

FRFIs are increasingly making environmental claims aimed at consumers, ranging from the advertisement of "green" mortgages and insurance products to the promotion of their ambitious "sustainable investment" goals. While deceptive claims about environmental attributes can already lead to severe sanctions under the BA, the FCAC has not issued enforcement guidelines on the topic. This creates legal uncertainty, as FRFIs are unaware of the FCAC's enforcement approach regarding environmental claims. To address the situation, the FCAC should issue guidance about deceptive environmental marketing claims addressed to consumers, as it did in the past for other types of problematic business practices.[621]

***Recommendation #9*: Set greenwashing as an enforcement priority and report on results (FCAC).**

The FCAC has extensive enforcement powers with respect to deceptive marketing practices by FRFIs. However, so far, the agency has not used these powers to act against FRFIs making deceptive environmental claims, and the agency has not established a team dedicated to environmental considerations. Moreover, as previously noted, the FCAC's Business Plan for 2022-2023 to 2024-2025 and 2021-2026 Strategic Plan do not identify greenwashing as an enforcement priority.[622]

To address this situation, the FCAC should set greenwashing enforcement as a priority in its future Business Plan and Strategic Plan. The agency should also establish a team of experts to proactively investigate potential violations to the BA and take legal action where necessary. Finally, the FCAC should report on the status and results of its anti-greenwashing enforcement efforts in its annual report.

***Recommendation #10:* Incorporate environmental topics in financial literacy educational programs (FCAC).**

As noted previously, Canadians currently have a limited understanding of SFRI products and services: according to a 2024 survey, 70% of Canadian retail investors know "little or nothing" about responsible investment, and 21% have "never heard of it".[623] This lack of knowledge widens the information asymmetry between financial institutions and their customers, amplifying the potential for greenwashing.

To address the situation, the FCAC should incorporate content on environmental issues and SFRI products and services as part of its educational programs. This would help consumers of financial products better understand the common meaning of different SFRI claims and the environmental characteristics of commonly offered financial products and services. The agency should leverage the knowledge developed by other governmental

[621] Financial Consumer Agency of Canada (2024).
[622] Financial Consumer Agency of Canada (2021a); Financial Consumer Agency of Canada (2023a).
[623] Responsible Investment Association (2024).

agencies and departments and collaborate with industry associations that have already started to develop training materials, such as Finance Montréal, the IPF and the Responsible Investment Association.

5.3. Investment services providers

***Recommendation #11:* Engage with training providers to ensure that environmental topics are incorporated in the mandatory training programs offered to investment professionals (AMF / CSA / CIRO).**

Most categories of investment professionals receive little mandatory training on SFRI products and services, which limits their ability and willingness to recommend and provide advice on these products. Training on SFRI solutions should be incorporated in the mandatory training requirements that new investment professionals must undertake to practice in Québec. Professionals who are already qualified should also be subject to mandatory training on the SFRI segment as part of their continuous education requirements. Similar obligations could be imposed on individuals responsible for the management and regulatory compliance of investment services providers.[624]

The qualifications required for investment professionals are established in the Distribution Act, R 31-103 and CIRO's Rule 2600. These regulations outline specific courses offered by third-party providers such as the IPF, the CFA Institute, and the Canadian Securities Institute. The AMF and CIRO would need to engage with these organizations to obtain amendments to their respective course materials.

***Recommendation #12:* Amend financial intermediaries' KYC and suitability requirements to require them to seek information on their clients' environmental preferences (AMF / CSA / CIRO / CSF / Government of Québec).**

Investment services providers are required to seek information on their clients' investment needs, objectives and situation to offer products that are aligned with these characteristics. However, providers' KYC obligations do not expressly refer to client's environmental preferences, such that this topic often remains undiscussed. Several surveys have shown that a large proportion of Canadian retail advisors were never asked about their interest in SFRI products and services by their financial advisors.[625]

Achieving positive environmental impact and avoiding environmental harm are important investment needs and objectives for certain investors. For example, investors may be reluctant to invest in highly polluting sectors or activities and prefer investing in sectors that help reduce global GHG emissions and preserve biodiversity. They may also want to obtain credible information about any trade-offs existing between SFRI products and traditional investment solutions.

[624] This reflects the conclusions formulated by Duclos about the role of managers in preventing organizational deficiencies. See: Duclos (2021).
[625] ÉducÉpargne (2022); Responsible Investment Association (2024).

To address this, the AMF (in collaboration with its counterparts from the CSA), the Government of Québec and CIRO should amend the KYC and suitability obligations set in R 31-103, the CSF Regulation, the CSF Code and the IIROC Rules to require intermediaries to seek information on their clients' environmental preferences and take them into consideration when offering investment solutions.

In 2021, CIRO's expectation that the obligation to acquire "sufficient information" about clients' "investment needs and objectives" must include ESG preferences was a first step.[626] However, this expectation should be extended to all providers and formally included in rules and regulation, as is the case in the EU. This obligation should include a formal requirement to ask clients about their desire to invest in assets that are aligned with the goals of the Paris and Kunming-Montréal agreements.

***Recommendation #13*: Require investment services providers to understand the sustainability characteristics of the products they offer, including the environmental risks and impacts associated with these products, as part of the KYP requirement (AMF / CSA / CIRO).**

Investment services providers are already required to understand the characteristics of the products and services that they offer to clients. However, to avoid any doubts, the AMF, its CSA counterparts and CIRO should amend the rules and regulations that establish providers' KYP obligations to provide for an express requirement for investment professionals to take reasonable steps to understand a product's environmental characteristics, and for firms to provide training and information on these characteristics to the professionals that they employ.

*Recommendation #14: Require investment services providers to proactively comm***unicate information on the material sustainability risks and impacts of financial products (AMF / CSA / CIRO / Government of Québec)**

As previously noted, investment services providers are required to provide specific information to their clients under existing regulations. This information requirement could be expanded to cover the disclosure of information on the material environmental risks and impacts of financial products, when such information is accessible. For example, as suggested in Recommendation #20, investment funds could be required to disclose whether their investment policies are aligned with the criteria of a sustainability taxonomy; in turn, investment services providers recommending a specific investment fund to their clients could be required to proactively discuss whether the fund is taxonomy-aligned.

This obligation would be consistent with the comments made by the AMF in the context of its Climate Risk Management Guideline, which notes that clients of financial products

[626] Canadian Investment Regulatory Organization (2021).

"may underestimate their risk exposures and level of tolerance to climate-related risks, including their vulnerability to extreme weather events."[627]

5.4. ESG data providers

<u>Recommendation #15:</u> Amend the QSA to grant power to the AMF to regulate and supervise the provision of ESG rating services (Government of Québec / AMF / CSA).

The provision of ESG rating services is not directly regulated under the QSA. As stated in SN 81-334, investment funds that rely on ESG ratings, scores and rankings must disclose detailed information about their use of these services in their investment strategies and sales communications. This disclosure regime is extensive and addresses most of the issues associated with ESG ratings, scores and rankings, including the transparency of methodologies, rating divergence, data cherry-picking, representativeness, and the distinction between ESG risk and impact.

However, investment funds subject to SN 81-334 are not the only users of ESG rating services. For example, segregated funds that rely on ESG ratings are not subject to any disclosure obligations in respect of their use of these services. Similarly, proxy advisory services may rely on ESG ratings in order to provide voting recommendations, without having to disclose information about these services to their clients. As a result, investors do not all benefit from the same degree of transparency regarding ESG ratings.

One way to address the situation would be for the Government of Québec to introduce new provisions in the QSA to give express jurisdiction to the AMF to regulate the provision of ESG rating services, as is already the case for credit rating agencies.[628] The AMF, in conjunction with its CSA counterparts, could then impose requirements about the transparency and standardization of ESG rating services and conflicts of interests, which could be closely aligned with the disclosure expectations set in SN 81-334 as well as those proposed by the EU (see Box 11 for details).[629]

The measures should ensure that all direct and indirect users of ESG rating services have access to transparent, comparable and independent ESG data. They should also allow the AMF to directly monitor the activities of these firms and make ESG rating providers directly liable for any false or misleading representations resulting from their services. However,

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[627] Autorité des marchés financiers (2024a), p.11. This guideline is a prudential guideline that is not meant to regulate the distribution of securities. However, the conclusions formulated by the AMF in this document are informative. For example, the guideline indicates that disclosure materials should be "drafted in clear and plain language and presented in a format that facilitates reading and comprehension, including disclosure about extreme weather events or the climate-related risks of the target client group or affecting the product".

[628] As recommended by IOSCO, "Where regulators have authority over Credit Rating Agencies (CRAs) or exchanges that also issue ESG ratings and data products, these regulated entities should consider whether there exists the potential for conflicts of interest between a CRA's or an exchange's offerings and its ESG ratings or data product offerings, and if so, the steps they could consider to mitigate and address those potential conflicts of interest." See: International Organization of Securities Commissions (2021). An alternative to this measure would be for the AMF to adopt disclosure guidelines that apply to the other users of ESG ratings (i.e., other than investment funds subject to SN 81-334), such as segregated funds.

[629] Council of the European Union (2024).

these measures should not go as far as allowing the AMF to require providers to follow a particular methodology or to offer specific services, as this would unduly harm competition between providers, innovation and the independence of providers.

***Recommendation #16:* Revise SN 81-334 to provide more specific guidance on ESG methodology disclosures and conflict of interest rules (AMF / CSA).**

As noted above, SN 81-334 is a very detailed and relatively comprehensive document. However, there are two areas where it lacks specificity: ESG rating methodology disclosures and conflicts of interest. The CSA should revise SN 81-334 as follows to address these two gaps:

- **Define the concept of "methodology" and provide guidance on methodology disclosure expectations:** SN 81-334 requires funds to disclose the ESG methodologies of their data providers under certain circumstances but does not provide a definition of this concept. The notice should provide a clear description of what should be included in a fund's "methodology" disclosure. This should include a requirement to disclose each of the indicators used by a data provider to measure ESG risks and an indication of whether the data used by the provider is self-reported, independently verified and/or involves the participation of relevant stakeholders, such as impacted communities. The methodology disclosure should also state whether the chosen indicators reward transparency instead of performance (e.g., rewards disclosure of environmental policies and GHG emissions, instead of rewarding real transition progress and efforts, like emission reductions and investments in research and development); whether they are limited to the assessment of ESG risks or also cover ESG impact; whether they measure the alignment of an asset with the goals of the Paris and Montréal-Kunming Agreements; and how data gaps are addressed (e.g., by estimations, use of data averages, etc.).[630]

- **Strengthen conflicts of interest rules**: SN 81-334 indicates that sales communications should not rely on the services of ESG data providers who are paid by certain entities for their rating services, such as the fund's IFM. However, it does not prevent ESG rating providers from offering consulting services to the firms that they rate. The notice's requirements should therefore be extended to prevent funds from relying on ESG data providers that have failed to implement conflicts of interest prevention measures, such as the separation of providers' consulting and rating activities. The notice should also indicate that ESG rating providers should prevent their employees from owning financial instruments for which they provide rating services.

***Recommendation #17:* Accelerate the adoption of data disclosure standards and obligations (Government of Canada / Government of Québec / AMF / CSA / OSFI).**

The quality of ESG data services is highly dependent on the availability of comprehensive, consistent, and accurate data. Existing and upcoming federal and provincial climate-related disclosure obligations will significantly improve the quality of

[630] International Organization of Securities Commissions (2021); OECD (2021).

climate-related data, especially firm-level greenhouse gas emissions. However, even after the implementation of these measures, there will remain significant gaps and consistency issues with environmental performance data, especially for other aspects than climate-related risks. For example, there are currently data gaps with respect to:

- the disclosure of nature-related financial risks;
- the disclosure of environmental impact; and
- the disclosure of climate-related risks by private corporations incorporated under provincial legislation.

The Government of Canada, the Government of Québec and the different financial authorities should therefore collaborate to standardize the disclosure of environmental performance data and ensure that all corporate entities are subject to climate-related disclosure obligations, irrespective of their statute of incorporation.

***Recommendation #18*: Amend National Policy 25-201 Guidance for Proxy Advisory Firms to set disclosure obligations to proxy advisors with respect to sustainability issues (AMF / CSA).**

In Canada, proxy advisers, like ESG data providers, operate without formal regulation. However, they are expected to comply with the non-binding principles set in the CSA's *National Policy 25-201 Guidance for Proxy Advisory Firms*. This document discusses how proxy advisory firms are expected to manage conflicts of interests, ensure the transparency and accuracy of vote recommendations, develop proxy voting guidelines and communicate with stakeholders. The document does not specifically refer to sustainability considerations, granting providers significant discretion in determining how to report their approach to sustainability and in what format.

Under SN 81-334, investment funds using proxy voting and engagement as ESG-related strategies are subject to specific disclosure obligations, which may translate into information requests to proxy advisors. However, certain users of proxy voting services, such as institutional investors, are not covered by the disclosure expectations of SN 81-334.

In other segments of the financial sector, such as reporting issuers and investment funds, the CSA has issued specific guidelines to ensure that information available to investors is comprehensive, consistent and comparable. In line with this approach, the CSA should amend *National Policy 25-201 Guidance for Proxy Advisory Firms* to establish clear disclosure expectations regarding sustainability issues. The amendments should be closely aligned with the proxy voting disclosure requirements of SN 81-334 and should also address the following topics:

- **Data input and choice of indicators**: Proxy advisors should be expected to disclose information regarding their use of sustainability data (including the methodologies of any ESG ratings that inform their recommendations) and their selection of sustainability indicators.

- **Sustainability focus**: Proxy advisors should be expected to disclose how their voting policies incorporate sustainability considerations, and whether these recommendations follow a simple or double materiality approach.

- **Opportunity to comment**: Proxy advisors should be expected to provide issuers with a timely opportunity to comment on and respond to sustainability-related voting recommendations.

A more ambitious version of this reform would be to introduce new provisions in the QSA to allow the AMF to supervise proxy advisors and establish formal disclosure requirements through regulation. The CSA has previously considered the possibility of regulating proxy advisors (though not specifically in the context of ESG-related issues) and could revisit this possibility.[631] Any regulatory measure to this effect should preserve the independence of proxy advisors and protect them from any political interference.

5.5. SFRI financial instruments

***Recommendation #19:* Adopt a mandatory science-based sustainability taxonomy that is aligned with global environmental and human rights commitments (Government of Canada)**

There is currently no official, mandatory taxonomy that market actors must use to classify assets, projects and activities from a sustainability perspective. This situation has led market actors to develop their own sustainability taxonomies, definitions and labels, which contributes to investor confusion and allows greenwashing to take place.

To address the situation, the Government of Canada should establish a sustainability taxonomy that classifies economic activities based on their potential to deliver environmental or social benefits and their alignment with relevant international obligations such as the goals of the Paris and Kunming-Montréal Agreements.

To prevent the greenlighting of environmentally damaging activities, this taxonomy should exclude activities that raise risks of carbon lock-in and fossil fuel expansion projects, which are incompatible with global environmental commitments. Such a limitation would constitute a minor financial constraint for firms operating polluting assets, as it would not prevent any activities from being financed. It would simply deprive environmentally damaging projects from the potential benefits of displaying a sustainability label.

While the taxonomy may initially focus on green and transition activities, it should be gradually expanded to cover a wider range of sustainability aspects (such oceans and

[631] See: Canadian Securities Administrators (2015). Similarly, in 2021, the Capital Markets Modernization Taskforce established by the Government of Ontario suggested the establishment of regulation in this sector, with the goal of providing issuers with a right to "rebut" proxy advisors' reports and limit conflicts of interests. See: Capital Markets Modernization Taskforce. The EU, the US and the UK have also established binding rules for proxy advisors regarding conflicts of interests and the public disclosure of information. See: Simmons & Simmons LLP (2018); U.S. Securities and Exchange Commission (undated b); PwC Australia (2021).

biodiversity) and allow differentiation (for example, by providing for a "ranking" system that distinguishes light green from dark green projects). The taxonomy should be based on scientific criteria that would evolve over time as new technologies emerge and environmental science develops.

***Recommendation #20:* Integrate the sustainability taxonomy into securities and prudential disclosure requirements (AMF / CSA / OSFI / Government of Canada / Government of Québec / CIRO)**

To ensure the widespread adoption of the taxonomy described at Recommendation #19 and prevent the emergence of competing labels with weaker criteria and monitoring processes, OSFI, the AMF and its CSA counterparts should integrate the taxonomy into financial laws and regulations following its adoption by the Government of Canada. To prevent market disruptions and ensure a timely reallocation of assets, this integration should be done in two steps.

In the near term, market actors should be expected to disclose information on their alignment with the criteria of the taxonomy. For instance:

- **Investment funds.** The AMF could amend R 81-106 to set its expectations that all investment funds distributed to the public disclose whether their investment policies are aligned with the taxonomy's criteria and the percentage of their Canadian assets that are taxonomy-aligned. Similarly, investment funds could be required to fill up a taxonomy alignment checklist and disclose it to investors in their prospectus or fund facts document.

Table 6 – Example of taxonomy alignment checklist

Fund type	ESG Objective
Excludes fossil fuel assets	YES
Percentage of taxonomy-aligned "green" assets	35%
Investment policy requires investments in taxonomy-aligned "green" assets	NO

- **Financial intermediaries.** The AMF and CIRO could modify the disclosure obligations of financial intermediaries to ensure that any product recommendation is accompanied by a taxonomy-alignment disclosure at the pre-contractual stage.

- **Reporting issuers.** The CSA could amend the prospectus disclosure requirements of reporting issuers to require them to indicate whether they plan to use the proceeds of an issuance to finance projects that comply with the definitions established in the taxonomy. The CSA could also adopt additional disclosure requirements with respect to an issuer's alignment with the taxonomy, such as requiring issuers to disclose in their regulatory filings the percentage of their capital expenditures that are taxonomy-aligned, where relevant.

- **Financial institutions**. As suggested in Recommendation #5, OSFI and the AMF could respectively amend Guideline B-15 and the Climate Risk Management Guideline to require financial institutions to disclose specific information about their alignment with the taxonomy's criteria (e.g., percentage of assets or loans issued that are taxonomy-aligned).

In the medium term, financial actors should be prohibited from advertising a financial product, project or entity in Canada as "green" or "transition" unless it meets certain taxonomy alignment criteria, which would effectively establish a non-exclusive[632] mandatory labelling regime for SFRI claims. For instance:

- **Investment funds.** The CSA could amend the disclosure requirements of investment funds to require that funds that label themselves as "green" hold a minimum percentage of assets certified as green under the taxonomy, excluding any asset associated with significantly harmful activities (e.g., exclusions for activities or entities responsible for human rights violations; exclusions for carbon intensive activities, etc.). The percentage should be precisely calibrated to ensure that both the number and characteristics of eligible funds are appropriate.[633] This approach would be consistent with the naming rules proposed by ESMA, the UK and the US, which all establish percentage of asset thresholds.[634]

- **Debt instruments.** The AMF could amend R 41-101 to require that reporting issuers wishing to distribute securities with a sustainability label, such as green or transition bonds, comply with the taxonomy's criteria, including its DNSH, social safeguards and net-zero alignment requirements.

Additional policies could also be considered by the Government of Canada and the Government of Québec to foster the adoption of the taxonomy, such as incorporating its criteria in public procurement rules, using it to develop public investment programs, requiring state-owned entities to report on their taxonomy-alignment, etc.

In order to ensure the truthfulness of taxonomy alignment claims, the Government of Canada or the Government of Québec could establish a mandatory taxonomy-alignment independent verification mechanism. As with the Canadian Organic Standards, the governments could rely on a third-party service delivery model to oversee compliance with the label.[635] Under this model, a government agency would authorize certification bodies – like the CBI – to certify alignment with the taxonomy. The governments could

[632] Other sustainability labels could exist, but the use of the terms covered by the taxonomy (such as the words "green" or "transition") would be restricted to taxonomy-aligned assets.
[633] Setting exclusion criteria that are too stringent could reduce the market relevance of the fund label, whereas setting weak criteria could facilitate greenwashing. See: European Securities and Markets Authority (2022);
[634] Morningstar (2024); Carabia and Olausson (2024); U.S. Securities and Exchange Commission (2023b).
[635] Government of Canada (2021b).

also adopt a free of charge central depository administered by environmental ministries where certified projects, activities or products could be listed.[636]

By embedding the taxonomy in financial disclosure requirements, Québec and Canada would join the list of jurisdictions that have already developed sustainability labels for investment products, like France and the UK.

***Recommendation #21*: Regulate the issuance of UoP instruments (Government of Québec / AMF).**

As noted previously, one of the greenwashing concerns raised by UoP instruments is the risk that an issuer sets insufficient UoP constraints. As noted in Recommendation #19, this risk should be addressed by requiring UoP bond issuers to comply with the criteria of a government-issued taxonomy. This would effectively create a formal standard for the eligibility of UoP instruments, as is currently contemplated in the EU.

Another greenwashing concern associated with UoP instruments is the risk of pollution displacement, i.e., the possibility that the issuance of an UoP instrument does not lead to an overall improvement of the issuer's sustainability performance. This risk could also be addressed by adopting a mandatory sustainability taxonomy, notably through the imposition of sufficient company-level requirements on issuers (e.g., environmental targets, transition plans and sustainability disclosures), as proposed by SFAC.

However, even if a mandatory taxonomy were adopted, additional sources of UoP greenwashing risk would remain. To address them, the Government of Québec should amend the QSA to allow the AMF to adopt regulation regarding the issuance of such instruments. This regulation should:

- Require issuers to develop a UoP bond framework as per ICMA's GBPs to provide background information on the issuer's sustainability strategy and alignment with the requirements of the taxonomy.
- Require issuers to appoint an external reviewer to assess, pre-issuance, the sufficiency of its UoP bond framework and its alignment with the taxonomy, and post-issuance, the appropriate tracking and allocation of funds to eligible projects, as well as impact. The regulation should set minimum requirements for the qualification of external reviewers.
- Require issuers to demonstrate, in their prospectus disclosures, that the issuance of the instrument will lead to positive sustainability impact that would not have been achieved but for its issuance.
- Require issuers to disclose, in their CD Documents, information in respect of the management of the instrument's proceeds, reporting on the allocation of funds and the instrument's impact, and the results of the external review.

[636] As recommended by the OECD (2021).

- Require issuers to systematically disclose any change in the use of proceeds of a UoP instrument that is not aligned with the taxonomy's criteria.

These requirements, which could be inspired from those of the GBP or the CBS, would ensure that all UoP bonds issued under the QSA meet sufficient transparency and accountability standards.

To ensure national alignment, this measure should be implemented in coordination with the governments of other provinces and the AMF's CSA counterparts.

As a complementary measure, the CSA should revise *Staff Notice 41-307 (Revised) – Concerns regarding an issuer's financial condition and the sufficiency of proceeds from a prospectus offering* to clarify its disclosure expectations in respect of UoP instruments and indicate that liability exclusion clauses and disclaimers that make UoP disclosures meaningless are inconsistent with R 41-101's requirements.[637]

***Recommendation #22*: Regulate the issuance of performance-based instruments (Government of Québec / AMF / CSA).**

Developing a sustainability taxonomy could theoretically mitigate some greenwashing risks associated with performance-based instruments. For instance, a taxonomy could establish minimum SPTs that issuers must meet and impose UoP restrictions to ensure that performance-based instruments do not support environmentally and socially detrimental activities.

SFAC's proposed issuer constraints, which mandate that an issuer must set net-zero targets to be eligible under the taxonomy, already represent some form of SPTs. However, in the version proposed by SFAC, the taxonomy framework is not well-suited for labeling performance-based instruments given its focus on projects.

If the Government of Canada were to issue a taxonomy that is incompatible with the issuance of performance-based instruments, the Government of Québec should amend the QSA to allow the AMF to adopt regulation regarding the issuance of such instruments. This regulation, which could draw from existing voluntary performance-based standards like ICMA's SLBPs, should:

- Set minimum requirements with respect to target-setting, reporting and third-party verification.
- Require issuers to demonstrate, in their prospectus disclosures, that the issuance of the instrument will lead to positive sustainability impact that would not have been achieved but for its issuance.
- Set minimum requirements with respect to the establishment of financial incentives and prevent the gaming of penalties.

[637] Canadian Securities Administrators (2021b).

- Establish minimum social and environmental safeguards, such as prohibiting the use of proceeds for environmentally harmful activities and requiring that issuers align with specific net-zero pathways.

This measure would be consistent with Recommendation #5, which suggests limiting the ability of financial institutions to make environmental claims that rely on low quality performance-based instruments.

To ensure national alignment, this measure should be implemented in coordination with the governments of other provinces and the AMF's CSA counterparts.

As a complementary measure, the CSA should revise *Staff Notice 41-307 (Revised) – Concerns regarding an issuer's financial condition and the sufficiency of proceeds from a prospectus offering* to clarify its disclosure expectations in respect of performance-based instruments.

***Recommendation #23*: Adopt new legislation to regulate voluntary carbon offsets, ensuring that they meet specific quality standards and requiring the disclosure of their characteristics to purchasers (Government of Canada / Government of Québec / AMF).**

As opposed to compliance carbon credits, VCOs are not directly regulated in Québec and Canada. While existing or upcoming climate-related disclosure rules do require reporting entities to disclose information about how they plan to use VCOs to achieve their climate targets, these measures are insufficient to guarantee the integrity of the VCO market.[638]

First, these rules do not establish any integrity requirements that would prevent entities from purchasing low quality VCOs to achieve their climate targets. Second, they do not apply to VCOs purchased in other contexts than for the achievement of climate targets, such as VCOs purchased by consumers for compensation purposes. Third, these obligations only apply to entities that are subject to a mandatory climate-related disclosure regime, which would exclude a large number of purchasers of VCOs. Fourth, these disclosure obligations are too general to allow stakeholders to assess the quality of the VCOs purchased by a reporting entity.

To address this situation, the Government of Québec or the Government of Canada could regulate VCOs by establishing a new law on VCOs akin to the one recently adopted by California. This law could rely on one of the several VCO integrity principles and standards developed by public and private organizations, such as CORSIA.

Under this law, all firms should be required to abide by minimum standards when making environmental claims that rely on VCOs to consumers, investors and the general public

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[638] For example, Guideline B-15 indicates that FRFIs that set GHG emissions targets must disclose their targets both with and net of carbon offsets and disclose the type of offset used. IFRS S2, which may be eventually integrated in DR 51-107, provides for similar disclosures. The standard also requires entities to disclose "which third-party scheme(s) will verify or certify the carbon credits" and "any other factors necessary for users of general purpose financial reports to understand the credibility and integrity of the carbon credits the entity plans to use (for example, assumptions regarding the permanence of the carbon offset)". See International Sustainability Standards Board (2023), pp.17-18.

(e.g., prohibition of ex-ante VCOs, permanence requirements, requirement to retire a VCO from the market before it can be used to make climate-related claims, etc.). The law should also introduce disclosure requirements to ensure that users and issuers of VCOs provide comprehensive and standardized information about the characteristics of these instruments. The statute could be administered by the respective environmental ministries of the federal or provincial governments or, if it is enacted by the Government of Québec, by the AMF. Finally, the statute should clarify the legal status of VCOs and establish a centralized registry of certified VCOs, which would also be administered by environmental ministries or the AMF.

These measures would be consistent with Recommendation #5, which suggests requiring financial institutions to disclose detailed information about the characteristics of the VCOs that they use and prevent entities from formulating net-zero targets that primarily rely on the purchase of VCOs.

In the meantime, the governments could adopt regulations under the section 128 of the *Competition Act* or s.350 of the Québec *Consumer Protection Act* to define under which circumstances a representation relying on VCOs is considered false or misleading.

5.6. Investment funds and segregated funds

***Recommendation #24:* Revise the LD Guideline such that the disclosure expectations formulated in SN 81-334 also apply to segregated funds (AMF)**

The guideline that sets the AMF's disclosure expectations in respect of segregated funds is currently silent on ESG-related disclosure. Investment funds regulated under the QSA, on the other hand, are subject to very detailed ESG-related guidelines. The AMF should amend the LD Guideline to ensure that ESG-related disclosure expectations are consistent across all investment funds and insurance products with an investment component distributed to the public, irrespective of the entity that distributes them.

***Recommendation #25:* Set greenwashing enforcement as a priority and report on results (AMF / CSA)**

SN 81-334 was initially published in 2022. In 2024, the CSA published a revised version of the notice in which it noted having observed several deceptive practices among investment funds with respect to ESG investing. However, despite these practices, no public ESG-related enforcement measures have been undertaken by the AMF against IFMs under the QSA. Moreover, as noted above, the AMF's 2024-2025 Annual Statement of Priorities does not list greenwashing as one of the agency's enforcement priorities.

Now that they have clearly set their ESG-related disclosure expectations, the AMF and its CSA counterparts should intensify their enforcement efforts and seek sanctions against IFMs that engage in deceptive ESG-related marketing and disclosure practices. Anti-greenwashing enforcement should be listed in the AMF's next Annual Statement of Priorities as a priority.

Moreover, the agency should report on the results of its enforcement efforts, notably by disclosing in its annual report the number of ESG-related investigations undertaken by the agency, the number of investment funds that were asked to edit their prospectus because of problematic ESG-related claims, etc. As noted above, this would be consistent with the reporting practices of securities regulators from other jurisdictions, such as Australia.[639]

***Recommendation #26:* Include ESG-related considerations in the Québec Financial Education Strategy** **(AMF)**

There remain several myths among retail investors with respect to ESG investment funds. Some investors are confused about the risk-return profile of these products, whereas others may interpret "ESG integration" as a sign of environmental performance. The AMF does have a page providing educational content on SFRI on its website, which provides some documentation and tools regarding SFRI products and approaches.[640] However, this content should be enhanced and embedded in all government-led financial education initiatives. The AMF, together with its counterparts from other provinces and the CSA, should invest in financial literacy programs to raise awareness of ESG-related considerations and ensure that retail investors choose financial products that are aligned with their environmental preferences. These activities should be integrated into the Québec Financial Education Strategy launched by the AMF in 2024 and delivered in partnership with industry partners, such as Finance Montréal, the IPF and the Responsible Investment Association.[641]

[639] Australian Securities & Investments Commission (2024a).
[640] Autorité des marchés financiers (undated c).
[641] Autorité des marchés financiers (2024d).

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