INVESTORS for PARIS COMPLIANCE

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BEST PRACTICES FOR CANADIAN BANKS' NET ZERO IMPLEMENTATION

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Preface

Several Canadian banks have now made a commitment to reach net zero in their business operations—including financed emissions—by 2050. But what does that mean and how will they get there?

Investors for Paris Compliance is a relatively new initiative working with investors who believe that the transition to net zero represents a major economic opportunity, while seeking to hold Canadian publicly traded companies accountable for living up to their commitments to make it so. We have prioritized working on Canada's major banks which hold such an important position in our economy, with the ability to allocate capital to helpful or harmful activities.

We have surveyed the experience from other jurisdictions and the literature to map out a set of best practices for Canada's major banks as they transition to net zero. This is the first of two reports—in early 2022 we will benchmark the five major banks against these best practices based on publicly available information and on communication with the banks.

Introduction

In August of 2021, the Intergovernmental Panel on Climate Change (IPCC) released its Sixth Assessment Report[1] summarizing the latest climate science, a report that United Nations Secretary-General Antonio Guterres called a "code red for humanity."

The report says that it is "unequivocal" that human activity is causing widespread and rapid changes to our land and oceans, and we risk hitting tipping points of rapid ice sheet melt and forest dieback. Guterres said:

> "The alarm bells are deafening, and the evidence is irrefutable: greenhouse gas emissions from fossil fuel burning and deforestation are choking our planet and putting billions of people at immediate risk."[2]

Along with impacts on people, the climate crisis poses large risks to banks and investors. As the Bank of Canada says[3]:

> "The physical effects of climate change are already apparent in the increasing number and severity of extreme weather events, such as flooding, hurricanes and wildfires. The resulting catastrophic losses can have significant, widespread impacts on the financial system."

For example, the World Meteorological Organization estimates that climate change has already led to a five-fold increase in extreme weather events over the past five decades, costing US$3.6 trillion in losses.[4] The Insurance Institute of Canada finds that since the 1980's, insurance pay-outs for severe weather damage claims have doubled every five to ten years, putting the insurance industry itself at risk.[5]

In the summer of 2021, the entire town of Lytton, BC was incinerated and over 850,000 hectares of forest burned in BC, more than twice the 10-year average and third highest ever after 2018 and 2017.[6] The BC coroner's service estimated that 595 people died in the summer heat.[7] In November 2021 extensive flooding in BC destroyed highways and railways and is expected to be the costliest disaster in Canadian history, outstripping the $3.58 billion insurance losses in the 2016 Fort McMurray fires.[8]

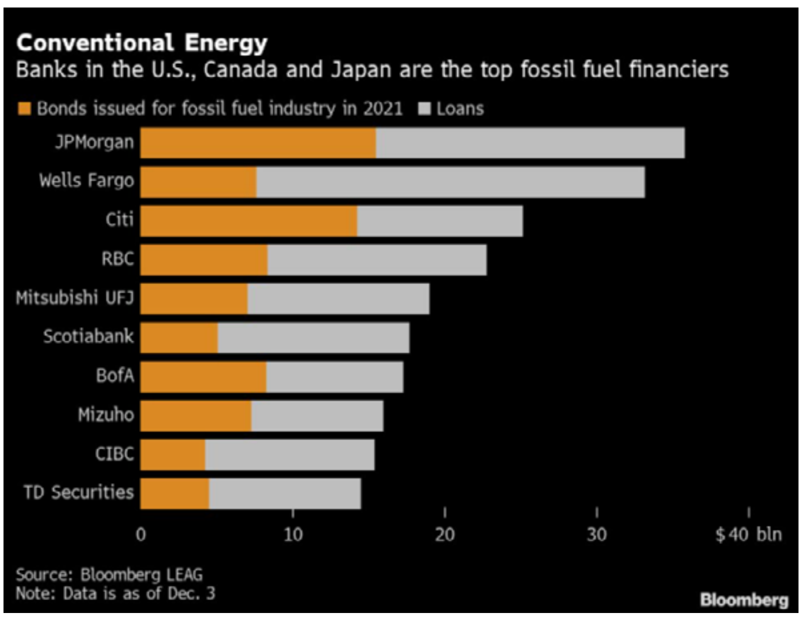
A study by the Oxford Sustainable Finance Group and the 2 Degree Investing Initiative found that the yearly additional cost to the global financial sector of delaying the transition to net zero beyond 2026 could reach US$272 billion every year that sufficient climate action is not taken.[9] Insurance giant Swiss Re estimates that Canada could lose up to 6.9% of its GDP annually by 2050 without more ambitious climate action.[10]

Part of the duty of Canada's banks is to manage risk, yet their activities are driving up investor risk by enabling massive Scope 3 emissions.[11] For example, two recent studies document the magnitude of these banks' activity funding fossil fuels.

The annual *Banking on Climate Chaos* report[12] by a global coalition of NGOs finds that since the Paris Agreement was signed and through 2020, Canada's five largest banks financed over half a trillion US dollars' worth of fossil fuel activity around the world, including over US $230 billion in fossil fuel expansion. All five rank in the top 25 banks globally funding fossil fuels.

A report by the Dutch research group Profundo for Greenpeace Canada[13] used a different methodology but found results in the same ballpark for the same banks in the same timeframe - CAD $694 billion in loans and underwriting to fossil fuels, including $477 billion in loans, $216 billion in underwriting, and $84.8 billion into coal, the dirtiest fossil fuel.

Bloomberg[14] found this trend continued into 2021 with Canada's banks among the top funders of fossil fuels in the world.



These activities clash with the emerging nature of fiduciary duty in a world facing a climate crisis.[15] If banks are to act in the interests of their beneficiaries, then they should act in ways that reduce risk rather than increase it. Climate impacts are now material to investors and are set to become even more so. Banks fail investors when they enhance those impacts.

Investors also stand to gain shareholder value with a transition to a clean economy. The Global Commission on the Economy and Climate found that bold action on climate change could lead to economic gains of US$26 trillion between 2018 and 2030.[16]

Globally, banks have started to take responsibility and reposition around lower-carbon business. Banque Postale in France[17] and Nedbank in South Africa[18] have announced plans to exit fossil fuels entirely. NatWest pledged to stop lending and underwriting to oil and gas companies without a credible transition plan in line with the Paris Agreement.[19] Others, including Desjardins[20] and Credit Mutuel[21] have adopted policies phasing out the most carbon intensive fossil fuels like coal. Banks like Barclays[22] and NatWest[23] have set targets for overall or sector-specific financed emissions reductions.

In Canada, over the past year each of the five largest banks has pledged to reach "net zero" in their financed emissions by 2050 and to devote hundreds of billions for "sustainable finance." The six largest banks in Canada also joined—as a group—the Net-Zero Banking Alliance.[24]

The Net-Zero Banking Alliance

The Net-Zero Banking Alliance (NZBA) is a voluntary industry initiative convened by the United Nations and inspired by former Bank of Canada and Bank of England Governor Mark Carney. It bears exploration given its prominence in this discussion. When a bank joins up with the NZBA, it commits[25] to:

- Transition lending and investing (but not yet underwriting) to align with net zero by mid-century or sooner, consistent with a maximum temperature rise of 1.5 degrees by 2100.
- Use decarbonization strategies from credible sources with no/low overshoot and relying conservatively on negative emissions technologies.
- Setting a 2030—or sooner—target for GHG-intensive sectors, guided by the UNEP-FI Guidelines for Climate Target Setting for Banks.[26]
- Publish annually on progress using recognized GHG reporting protocols.

When the NZBA was launched, it was criticized for its leisurely pace and its failure to address fossil fuels given its members' role facilitating that industry.[27] As one critic put it, it was "rather like a global anti-smoking campaign not mentioning cigarettes."[28] And, as a voluntary initiative, the question of accountability is a key one.

Partly in response to these critiques, during the 2021 Glasgow climate talks Mr. Carney released a statement[29] encouraging "immediate" action, promising membership removals where necessary, and "Spurring leadership beyond the baseline, including accelerating the phase-out of fossil fuels in line with the science." The statement also said that members' 2030 targets should represent a fair share of the 50% decarbonization needed by the end of the decade, a more specific marker for that date.

While those statements go further than the original language, the actual commitments of the banks remain the same, and time will tell whether their actions live up to the increased ambition.

The Role of the Regulator

While banks themselves should pursue net zero in order to seize investor opportunity and reduce company risk, there is also a role for the regulator in addressing systemic risk, setting consistent standards and levelling the playing field.

Regarding systemic risk, as with the 2008 financial crisis, individual financial institutions themselves are creating systemic risk by massively financing fossil fuels that increase emissions that threaten collective security—and therefore require curtailment of these activities through regulation in order to avoid a "Climate Lehman Moment."[30]

To date the cautious response of the regulators in Canada has been to pilot climate stress testing and to propose mandatory disclosure in the belief that better information flow will suffice. Given the urgent need to decarbonize the financial system, it's unlikely this will be enough. Canada's banking regulator has left the door open a crack to a "regulatory capital approach",[31] and the pressure to open that door fully will only mount.

Regarding consistent standards, other countries have moved more quickly on developing taxonomies for "sustainable finance" to provide common definitions and to safeguard against greenwashing. Canada so far has avoided a democratic and transparent process of standard setting, instead encouraging industry to devise its own rules for "transition finance" after Canada's Expert Panel on Sustainable Finance rejected other international standards, saying they would penalize Canadian heavy industry.[32]

At some point, Canadian regulators will need to step in to take control over a Canadian taxonomy process, both to ensure the credibility of the process through diverse representation and to sanction the outcome. Should a Canadian taxonomy water down rules and allow for outcomes like carbon lock-in, this will conflict with other jurisdictions like the EU and lead to investor uncertainty. It will also hinder climate progress through the misallocation of capital.

Canadian banks are facing growing reputational risks due to their fossil fuel financing.

Best Practices for Canadian Banks and Net Zero

Details about how the banks will decarbonize their activities or whether and how their "sustainable finance" pledges are connected with net zero pathways are scarce. This lack of specificity, coupled with massive ongoing fossil fuel financing—even for projects that expand fossil fuel use—is creating reputational risk for the banks.

To help Canada's banks achieve their net zero pledges, this is a good time to outline best practices regarding what a credible and timely approach consists of. This also helps investors and the general public hold banks accountable for credible implementation.

1. Paris-Aligned Net Zero Targets

The Paris Agreement set the goal of limiting global temperature rise to well below 2 degrees, and 1.5 degrees if possible. Article 2.1c of the Paris Agreement contains the goal "to make all financial flows consistent with a pathway towards low-emissions, climate-resilient development."

The IPCC's *Special Report Global Warming of 1.5C*[33] makes clear that limiting warming to 1.5 degrees is necessary to have a low probability of facing some of the worse impacts. To achieve this, the world needs to reach net zero emission by 2050, including halving emissions by 2030.

Canada's major banks have expressed support for the principles of the Paris Agreement but are still to demonstrate that their practices will actually be Paris aligned. What will it take to do so?

1.1 Measure and report annually the full extent of bank business with climate impacts, including lending, underwriting, and investments.

First, banks need to accurately measure the full extent of their business transactions with greenhouse gas impacts in order to assess risk and to measure progress. This must include all transactions, including lending, underwriting, and investing. Underwriting is often overlooked, but by one estimate accounted for 65% of the 60 largest global banks' fossil fuel activity in 2020.[34] This should also include a 'look through' to any financial intermediary in order to avoid disclosure avoidance.

Where it is material, banks must include the Scope 3 emissions of their clients in their accounting, since for certain clients such as the fossil fuel and automotive sectors, this is where the vast majority of emissions will reside.

There will be data and measurement challenges, but this should not stop banks from accounting for the significant majority of emissions enabled with their business activities as soon as possible, using data proxies if necessary, then improving on data methods and quality each year.

These emissions numbers should be publicly reported on each year, together with all underlying methodological assumptions. Canada's major banks have now joined the Partnership for Carbon Accounting in Financials (PCAF)[35] which currently provides for standardization and reporting for at least lending and investing.

1.2 Choose Paris alignment methodologies that are based on a reliable 1.5-degree outcome with limited overshoot and minimal reliance on negative emissions technologies and offsets.

There is significant variation in climate scenarios used to plan for emissions reductions, with large implications for permitted bank activities depending on which one(s) are chosen. A more permissive scenario will have a lower likelihood of achieving climate goals. A bank should therefore choose a more conservative scenario with a higher likelihood of success.

More permissive scenarios will plan for emissions "overshoot" that breaks our carbon budget and relies on negative emissions to come back into balance. That will also include a heavy reliance on expensive and unproven technology like Carbon Capture Utilization and Storage (CCUS). Banks should instead choose scenarios that rely on actual emissions reductions for the vast majority of progress, such as Pathways 1 and 2 in the IPCC *Special Report on Global Warming of 1.5C*. This is consistent with the guidance provided by the NZBA.

Likewise, the use of carbon offsets should be a last resort to eliminate residual emissions if the world is to achieve meaningful decarbonization.

Targets can be expressed in terms of absolute emissions reductions and/or intensity reductions (per business unit). Because intensity targets can still lead to emissions growth, they must be coupled with absolute targets if banks rely on them. Intensity targets are particularly unsuited to the fossil fuel industry since the intensity reduction can only go so far - you cannot decarbonize the end product.

Banks may consider joining international initiatives seeking standardization and certification of target setting such as the Science-Based Targets Initiative (SBTi).[36] These are evolving to fill gaps and increase their comprehensiveness.[37]

1.3 Establish 2030 targets to at least halve absolute emissions, and short-term targets to motivate immediate action.

Banks are to be congratulated on setting an intention to reach net zero by 2050. Building on 1.2 above, a credible pathway to get there will include setting clear targets for lending, investing and underwriting that at least halve absolute emissions by 2030.

Halving emission by 2030 is based on the IPCC *Special Report on Global Warming of 1.5C*. This needs to be done to avoid greater cumulative emissions if higher emissions are allowed to continue for a longer period. Targets should also be set for sooner than 2030 in order to motivate immediate action. Without proximate targets with implications for business today, movement will be delayed, and those proximate targets must be based on appropriate levels of ambition according to climate science.

As noted above, at the Glasgow COP, Mark Carney clarified that NZBA members' 2030 targets should represent a fair share of the 50% decarbonization needed by the end of the decade.

2. Sectoral Policies and Special Places

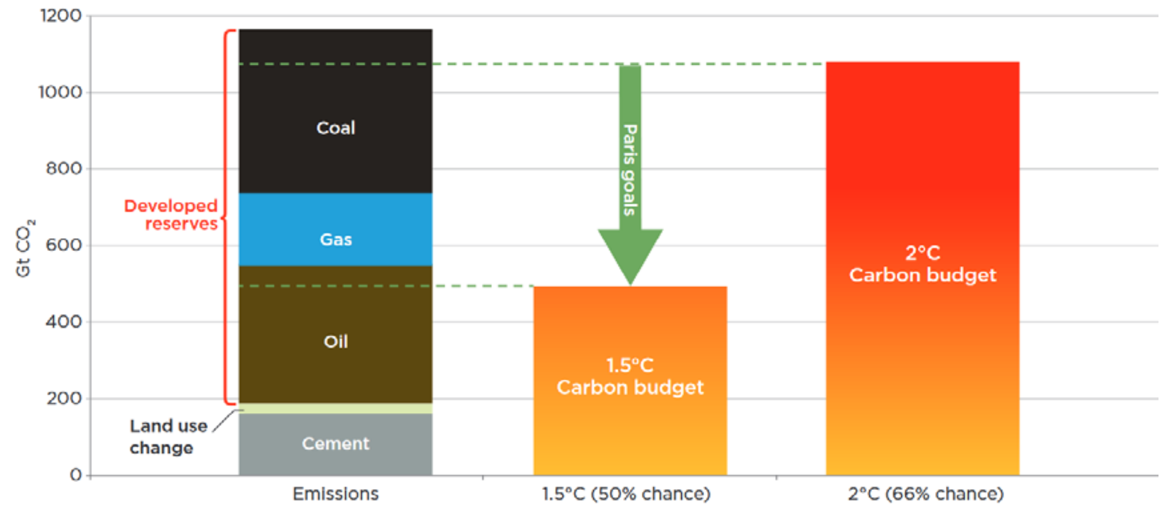
Banks' decarbonization strategies will require sectoral policies dealing with high-carbon sectors like the fossil fuel industry to complement the target setting in section one. And, alongside the climate crisis there is also a biodiversity crisis, again enabled by negative financial flows. Canada's banks have taken some steps towards recognizing their role in those flows, but a more comprehensive approach is required.

2.1 Cease business activity enabling new fossil fuel production and infrastructure right away.

The International Energy Agency (IEA) models a net zero pathway in its World Energy Outlook 2021 and finds that "there is no need for investment in new fossil fuel supply"[38] because "no new oil and gas fields are required beyond those already approved for development."[39]

This corresponds to other analyses that find we already have enough developed fossil fuel reserves to exceed not just our 1.5-degree carbon budget, but our 2-degree budget as well.

FIGURE ES-1: CARBON DIOXIDE (CO_2) EMISSIONS FROM DEVELOPED GLOBAL FOSSIL FUEL RESERVES, COMPARED TO CARBON BUDGETS WITHIN RANGE OF THE PARIS GOALS



Sources: Oil Change International analysis based on data from Rystad Energy, IEA, World Energy Council, IPCC and Global Carbon Project.[1]
Remaining carbon budgets shown are as of 1 January 2020.

While there is a need to rapidly wind down existing fossil fuel activity, financing new fossil fuel activity is actively pushing in the opposite direction. This is also true for new infrastructure - pipelines, refineries, etc - that enable more fossil fuel activity. To properly align with net zero, Canada's banks must cease all business activities that facilitate new production or transmission of fossil fuels.

New fossil fuel infrastructure is relatively easy to define and identify as are new coal projects, but there is some complexity in defining what new oil and gas production is relative to existing production. Oil and gas reserves are categorized as Proven and Probable, and within Proven reserves there are Developed and Undeveloped reserves.[40] Using these categories, new oil and gas activity can be understood as anything that results in a reserve going from Probable to Proven, or from Undeveloped to Developed.

Because much fossil fuel activity is not funded by specific project finance, banks will need to put safeguards into general corporate finance so that financing does not enable fossil fuel expansion. Where such safeguards are unenforceable, banks will need to end their relationship with companies engaging in fossil fuel expansion.

2.2 Strengthen coal phase out policies.

As the dirtiest and most carbon-intensive fossil fuel, coal must be first on the list for replacement with renewables. Dozens of financial institutions around the world now have policies to phase out coal funding,[41] yet Canadian banks continue to enable its production with billions in financing.[42] Some of Canada's banks have a sectoral policy regarding coal, but only one to date—Desjardins—has a policy[43] that meets the emerging international consensus[44] on coal phase out.

Desjardins has committed to completely phase out coal by 2030 in Europe/OECD, and by 2040 in the rest of the world. Desjardins will also not provide financial services to companies that:

- Operate or develop coal mines
- Have greater than 10% or 5 GW, installed coal power generation capacity
- Are building, extending, or renovating coal mines, power plants or infrastructure

Other Canadian banks should meet or exceed this policy.

2.3 Reduce exposure to oil sands.

As global companies like Shell[45] and Deutsche Bank[46] exit the oil sands, Canada's banks face the growing risk of being lenders of last resort to some of the world's highest-cost[47] and highest-carbon[48] oil at a time when global oil use is set to peak and decline.[49] While several international banks have passed policies limiting their exposure to the oil sands,[50] Canada's five major banks occupy the top six spots for oil sands lending, extending over US$76 billion since the Paris Agreement.[51]

Oil sands companies have correctly identified the existential threat to their business model and have responded with the "Oil sands pathways to net zero,"[52] a pitch for a system-wide carbon capture utilization and storage (CCUS) project. There are two major challenges with this proposal:

1. *It relies on massive subsidies for unscaled technology.*
   The industry wants taxpayers to pick up two thirds of the estimated C$75 billion cost[53] for a project that would be bigger than all the current CCUS projects in the world put together.[54] This has never been done at this scale and major challenges and risks remain regarding complexity, safety, energy use, water use,[55] and other factors. And, for the one third of the cost borne by oil sands companies, this adds to an already higher-cost product at a time when oil demand is set to peak and decline, favouring low-cost jurisdictions.[56]

2. *It is a textbook example of carbon lock-in.*
   Unlike using CCUS for products like steel or cement, using it for oil still leaves 70-80% of the emissions unabated when that product is burned.[57] Investing in 'lower carbon' oil and waiting for a return on that investment delays the transition needed away from oil entirely if the math of net zero is to add up. The only way to meet net zero goals is to reduce oil production, not to lock in more of it with more investment.

In addition to carbon, the oil sands pose other material risks for banks and investors. The Alberta Energy Regulator estimated the financial liabilities for oil sands mining at $130 billion, mostly due to toxic tailings.[58] The Alberta government, however, holds less than $1 billion in liability security from oil sands companies and has failed repeatedly to enforce its own standards for tailings, leading to what the regulator itself calls an "increasingly underfunded liability."[59]

There is currently little recognition of the need to transition in the Canadian oil industry. The major companies are planning on expanding 30% above 2020 levels of production by 2030.[60] This compares to the IEA projecting a 18% decline in oil use by 2030 in its net zero pathway.[61] Reducing exposure to the oil sands is a prudent step for banks to take both to reduce business risk and to be able to meet their net zero targets.

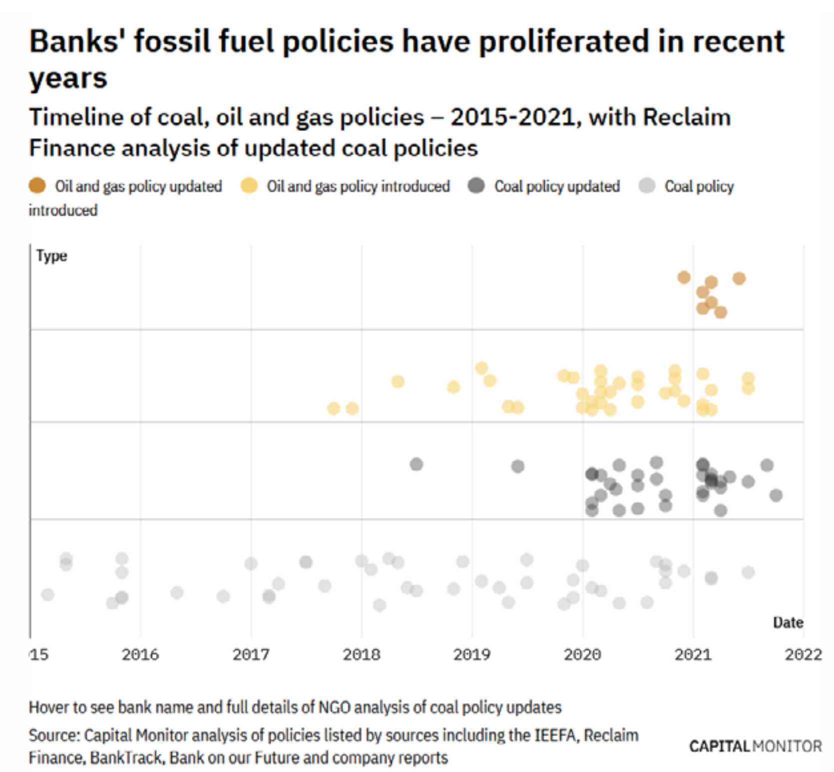
2.4 Expand special places exclusions beyond the Arctic.

At the request of the Gwich'in, each of Canada's major banks now has an exclusion policy prohibiting financing of industrial activities in the Arctic or Arctic National Wildlife Refuge,[62] a precedent recognizing that there are special places in the world deserving of special attention.

While there are still loopholes in these Arctic policies,[63] the precedent warrants building on. For example, if the Arctic, then why not also the Amazon, the lungs of the planet, currently facing potential tipping points for irreversible damage?[64]

Rather than an ad-hoc place-by-place approach to sensitive places, a more systematic solution should be found at the bank policy level. For example, the Taskforce on Nature-Related Financial Disclosures[65] (TNRFD) is now working to deliver a risk management and disclosure framework for nature-related risks. It estimates that half of the world's economic output - US$44 trillion - is moderately or highly dependent on nature and negative financial flows puts that at risk. Canada's banks should join the TNRFD with a view to developing comprehensive policy on special areas and biodiversity loss.

At COP 26 in Glasgow, a finance sector road map for eliminating deforestation was released,[66] and 30 financial institutions with over US$8.7 trillion committed to end investment in deforestation-linked activities.[67] To date, none of Canada's banks have signed up.



3. Sustainable Finance

Canada's banks have pledged hundreds of billions of dollars for sustainable finance, which could help significantly with the transition to net zero. But, to date there is no agreed-upon definition of "sustainable finance," and no necessary connection between projects and companies receiving that finance and net zero pathways.

Worse, there is the prospect of reputational risk to the banks and to the entire concept of sustainable finance by granting such finance to controversial or high-carbon companies or projects. Allegations of greenwashing have already been made against Canadian banks in this regard.[68] This undermines investor confidence.

Ultimately, given the global nature of capital and the need for standardized information, defining what qualifies as "sustainable finance" cannot be left up to any one bank or industry to define—we need consensus. The EU is a first mover in this regard with its taxonomy for sustainable activities,[69] and other countries, including Canada, are playing catch-up.

3.1 Support the development of a credible and democratic Canadian sustainable finance taxonomy; define "transition finance" to avoid carbon lock-in.

Canada's banks should support the development of a sustainable finance taxonomy resulting from a democratic process convened by the relevant regulators. It should be obvious how the taxonomy relates to a credible net zero pathway for the Canadian and global economy, consistent with the latest climate science and avoiding obvious pitfalls like carbon lock-in.

Unfortunately, Canadian regulators lag in this regard. Instead, the Canadian Standards Association (CSA) has been convening industry actors behind closed doors to develop a "transition" taxonomy for activities deemed on their way to sustainable.[70] Given the process and those invited, it is likely to water down criteria to allow activities precluded by more credible standards and to invite charges of "greenwashing."[71]

Carbon lock-in is a particular risk of a weak transition taxonomy. The EU taxonomy safeguards against this by defining transitional activities as:

- Those for which no low-carbon alternatives are available and have emissions profiles as best in sector; and
- Those that do not hamper the development and deployment of low-carbon alternatives; and
- Those that do not lead to lock-in of carbon intensive assets[72]

Under this, an oil company installing EV chargers in its gas stations would qualify as "transition," but an efficiency upgrade to one of its refineries would not, even if it reduces emissions, because it locks in a carbon-intensive asset. Canada's taxonomy needs the same safeguards on transition finance if it is to be credible and internationally accepted.

It is in the interest of Canada's banks to get the definitions of sustainable finance right. As such, they should support a democratic process convened by the relevant regulators that results in a credible and widely accepted standard for sustainable finance in general.

3.2 While a taxonomy is in development, ensure financing labelled "sustainable" is consistent with a credible net zero pathway, with external verification.

It may take some time for a democratic and credible Canadian sustainable finance taxonomy to emerge. In the meantime, Canada's banks are already extending products such as green bonds and sustainability-linked loans.

Currently, it is up to the banks themselves to determine what activities qualify under these products. There are several voluntary global initiatives to define principles for these products such as the Sustainability Linked Loan Principles,[73] the Green Bond Principles,[74] the Social Bond Principles,[75] and the Sustainability Bond Guidelines.[76]

None of these initiatives require consistency with credible net zero pathways, nor do they preclude obvious red flags such as the financing of fossil fuels. Indeed, Canada's big banks recently participated in a billion dollar "sustainability-linked" loan to pipeline company Enbridge at the same time it was expanding Line 3 with the equivalent emissions impact of 50 new coal fired power plants. The project was also opposed by affected Indigenous Peoples.[77]

If banks sustainable finance products are to maintain credibility in the short term, banks themselves need to tighten up the criteria for these activities to align quantitatively with their net zero emissions reductions pathways. This must include precluding fossil fuel financing of any kind, even pollution abatement since that equates to carbon lock-in. Projects facing significant First Nations opposition should not receive bank financing of any kind, let alone financing that is branded "sustainable."

For investors to properly evaluate sustainable finance programs, banks need to report comprehensively on product delivery and conduct external verification for use of proceeds and impact reports.

4. Just Transition and Indigenous Rights

The Paris Agreement references the imperatives of a "just transition of the workforce and the creation of decent work and quality jobs."[78] It notes that climate impacts will disproportionately affect those already vulnerable, including "workers in the informal economy, indigenous and tribal peoples, and youth." And it states that climate mitigation will lead to job creation, job substitution, job elimination, and job transformation and redefinition.

The World Benchmarking Alliance (WBA) defines "just transition" this way:

> "A just transition can be described as the transition of economies, sectors and companies to low carbon, socially just and environmentally sustainable activities."[79]

A just transition is in the interests of banks and investors, since done well, the transition will both avoid the worst impacts of the climate crisis while creating jobs and reducing inequality and improving the business environment. Done badly, it could lead to stranded assets, stranded workers, and stranded communities, driving up investor uncertainty and undermining business interests.

In the UK, banks have joined organized labour and other stakeholders in The Banking on a Just Transition Project,[80] while in France banks have joined Investors for a Just Transition.[81] Globally, 161 investors managing US$10.2 trillion endorsed a *Statement of Investor Commitment to Support a Just Transition on Climate Change.*[82]

The WBA has developed a set of just transition indicators to score company performance under the following categories:

- Social dialogue and stakeholder engagement
- Just transition planning
- Creating and providing or supporting access to green and decent jobs
- Retaining and re- and/or up-skilling
- Social protection and social impact management
- Advocacy for policies and regulation

Both the WBA and the CA100+ will be benchmarking companies around the world on just transition performance.

4.1 Adopt just transition programs and products, and hold clients accountable for their just transition performance.

Banks have a role to play designing products and services that facilitate a just transition, focusing on geographies with greater physical risks (e.g., mortgage holders in fire or flood-prone areas) and greater transition risks (e.g., workers in former fossil fuel areas). Banks should also have programs assisting communities where they operate that are particularly vulnerable to climate impacts and transition issues, such as front-line Indigenous communities.

With the recent climate-linked disasters in BC, Canada's banks responded to assist affected communities. A just transition approach would turn that response into more proactive and robust programs anticipating further disruptions.

As just transition benchmarking becomes popularized by the WBA and CA100+, banks should track their clients' performance, rewarding those with good performance with preferential products, and holding accountable those with bad performance, including potentially ending those relationships.

4.2 Strengthen work on Reconciliation, including bank policy and practice on Free, Prior, and Informed Consent.

Canada is in the early stages of reckoning with its colonial past and with its relationships with Indigenous Peoples. In June 2021 Canada passed into law the United Nations Declaration on the Rights of Indigenous Peoples, which includes provisions that the "free, prior, and informed" consent" (FPIC) of Indigenous Peoples be secured for projects that affect their lands and territories.[83] Much work remains to turn reconciliation into reality.

Each of Canada's major banks has begun to recognize its role in this process, with various declarations and programs concerning Indigenous Peoples. Each is also a signatory to the Equator Principles,[84] a risk management framework for assessing and managing environmental and social risk in development projects, which includes the necessity of achieving FPIC in projects that significantly impact Indigenous territories, and a commitment to not finance projects or companies that fail to uphold the Principles.[85]

Despite this, there have been several high-profile instances over recent years when Canadian banks have financed major fossil fuel expansion projects vociferously opposed by Indigenous Peoples, including:

- The Dakota Access Pipeline: Part of the Bakken pipeline project from North Dakota to Illinois, it was routed away from Bismarck due to concerns over impacts and instead next to the Standing Rock Indian Reservation, threatening water and cultural sites. Major protests resulted in hundreds of arrests by militarized police and international attention.

- Trans Mountain Pipeline: An oil sands expansion pipeline across BC with associated oil tankers is opposed by several First Nations along the route who have gone to court in an effort to stop it. It is also opposed by the BC government and local municipalities. Dozens of protestors have been arrested.

- Coastal Gas Link: A new methane gas pipeline across Northern BC opposed by all five traditional clans of the Wet'suwet'en First Nation whose territory it runs through. Indigenous land defenders have been removed repeatedly by heavily armed RCMP, resulting in protests across Canada that caused significant economic disruption.

- Line 3: An oil sands pipeline expansion project in Minnesota fought in court by Native American Tribes due to impacts on their traditional territories. Over 800 Indigenous and non-Indigenous people have been arrested protesting the project, with the project proponent Enbridge flowing through millions for policing operations.[86]

Canada's major banks financed these projects and/or project proponents. None spoke out questioning whether FPIC had been met. In fact, in the midst of the Line 3 controversy, the banks extended Enbridge a $1 billion "sustainability-linked" loan.[87]

On their pathway towards reconciliation, Canada's banks need to strengthen their policies and practices on FPIC. It is not enough to outsource this obligation to clients, especially where there is obvious controversy. Banks need their own internal tests of whether consent has been met before approving financing, conducting their own due diligence with affected Indigenous Peoples rather than relying on information from the project proponent who is biased towards approval.

Banks' FPIC policies and practice should be improved and strengthened in close consultation with First Nations leadership, with annual public reporting on their implementation. Some possible improvements are laid out in Oxfam's report *Consent Is Everybody's Business: Why Banks Need To Act on Free, Prior, and Informed Consent,*[88] including:

- Be prepared to accept "no" for an answer

- Set time-bound, measurable, and resourced road maps to operationalize FPIC and publicly report on them

- Include FPIC in client contracts

- Align staff inducements to respect human rights, not just to promote business

- Assign responsibility for FPIC in credit facilities arranged by other banks

- Create a grievance mechanism at the bank

Canada's banks have policies to protect the Arctic National Wildlife Refuge — these policies should be extended to protect biodiversity worldwide.

5. Governance, Client Engagement, and Advocacy

Banks' governance and internal systems evolved to serve the fossil fuel era. These will need to change to serve the net zero era.

Regarding governance, a recent study of the background of bank directors around the world found that Canadian banks have the highest percentage of directors with past or current ties to polluting industries—62%, compared to 44% in the US, 34% for Europe, and 31% for the UK.[89]

Regarding systems, a survey of banks by the World Resources Institute found many banks have set up incentive structures that work at cross-purposes with decarbonizing their operations:

> "The bank's incentive structure is still focused on quantitative and short-term triggers. Banks expressed some concerns that policies related to Paris alignment might create the impression amongst staff that opportunities for new financial transactions—and, therefore, the potential for reward—are unnecessarily restricted."[90]

This speaks to banks' relationship with current or prospective clients, where the dictum has been "the more, the better." Even as it becomes apparent that some clients are either unwilling or unable to make the transition to net zero, banks are reluctant to give up their business, even though this is inconsistent with hitting emissions reductions targets.

Bloomberg found this to be a source of tension inside banks between executives on the sustainability side and those on the commercial side who are at loggerheads due to competing revenue and climate goals—"Often the sustainability staff lose the argument."[91]

Regarding advocacy, Canada's bank CEOs have traditionally seen their role to speak out in favour of oil infrastructure expansion, with one CEO calling the energy industry "Canada's family business."[92] Another Canadian bank is a member of the Canadian Association of Petroleum Producers, even though that association consistently lobbies against climate action.[93]

5.1 Reorient bank governance, compensation, and staff evaluation around net zero.

Banks need to reorient their governance and systems around the net zero economy and their role in it. This starts at the top by recruiting more board members and senior managers with expertise in a green and just transition and with low-carbon enterprise. Indigenous leadership should also be present at the highest levels.

For staff compensation, staff across all divisions should be incentivized to meet the bank's net zero targets and relieved from contradictory signals such as pulling in more fossil fuel business to boost compensation. The bank's net zero strategy should be reflected in employee evaluation exercises across all divisions.

5.2 Establish and publicize clear metrics for client engagement and accountability, including ending business relationships; connect this to publicly available benchmarks.

While all Canadian banks say they prefer to "work with" existing clients on the transition to net zero rather than seek out new clients instead, this must not become a signal that there is no accountability for those unwilling or unable to make the journey. As CitiBank CEO Michael Corbat said:

> "We must be willing to have frank conversations with our clients about what they need to do to reduce their emissions — and if we aren't aligned on the need to make this transition, then we must have the courage to walk away."[94]

Banks need to publicize clear metrics for clients to meet net zero, write those into contracts with clients, and when it is apparent that those are not being met, must implement accountability mechanisms such as less favourable terms and ultimately ending business relationships. Heightened accountability must be applied to high carbon sectors such as the fossil fuel industry where the disconnect between "net zero" language and actual performance is the greatest.[95]

For example, Credit Suisse has designed Client Energy Transition Frameworks where it categorizes clients on a scale from "unaware" to "green" and reports on the numbers of clients in each category. It has committed to phase out relationships with those not taking action.[96]

While banks need to maintain client confidentiality, this must not be a cloak to hide bad performance. The CA100+ and the World Benchmarking Alliance are two initiatives that seek to measure the performance of companies around the world, including on net zero, and this reporting should become a part of how banks engage with clients and how they report on that process. Banks should explain publicly if they continue to do business with clients with bad scores, and what their intentions are to remedy that, or when they will end those relationships.

5.3 Establish consistency and transparency in bank advocacy for net zero.

Canada's banks have a large degree of advocacy influence, both at the public policy and the corporate level. If we are to achieve a climate safe world, that influence must be brought to bear to press for stronger net zero policies at all levels.

This begins at the public policy level, sending clear signals to governments for stronger climate action and ending lobbying for inconsistent measures such as new fossil fuel infrastructure. Banks should disclose all lobbying activities related to emissions policies and should withdraw from any industry association taking positions to weaken climate action.

At the corporate level, Canada's banks are major shareholders in publicly traded companies. As such, they have the opportunity to vote for climate-friendly directors and resolutions, and against the opposite. Because banks are voting on behalf of their customer investors, the latter should be consulted, and votes logged in real time for increased transparency and accountability.[97]

Summary of Best Practices and Net Zero

1. Paris-Aligned Net Zero Targets

1.1 Measure and report annually the full extent of bank business with climate impacts, including lending, underwriting, and investments.

1.2 Choose Paris alignment methodologies based on a reliable 1.5-degree outcome with limited overshoot and minimal reliance on negative emissions technologies and offsets.

1.3 Establish 2030 targets to at least halve absolute emissions and 2025 targets to motivate immediate action.

2. Sectoral Policies and Special Places

2.1 Cease business activity enabling new fossil fuel production and infrastructure right away.

2.2 Strengthen coal phase out policies.

2.3 Reduce exposure to oil sands.

2.4 Expand special places exclusions beyond the Arctic.

3. Sustainable Finance

3.1 Support the development of a credible and democratic Canadian sustainable finance taxonomy; define "transition finance" to avoid carbon lock-in.

3.2 While a taxonomy is in development, ensure financing labelled "sustainable" is consistent with a credible net zero pathway, with external verification.

4. Just Transition and Indigenous Rights

4.1 Adopt just transition programs and products and hold clients accountable for their just transition performance.

4.2 Strengthen work on Reconciliation, including bank policy and practice on Free, Prior, and Informed Consent.

5. Governance, Client Engagement, and Advocacy

5.1 Reorient bank governance, compensation, and staff evaluation around net zero.

5.2 Establish and publicize clear metrics for client engagement and accountability, including ending business relationships; connect this to publicly available benchmarks.

5.3 Establish consistency and transparency in bank advocacy for net zero.

Endnotes

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