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for RESEARCH & EDUCATION

November 15, 2016

Financial Institutions Division
Financial Sector Policy Branch
Department of Finance Canada
James Michael Flaherty Building
90 Elgin Street
Ottawa, ON K1A 0G5

Re: Review of the Federal Financial Sector Framework

E-mail: LegislativeReview-ExamenLegislatif@canada.ca

Thank you for the opportunity to comment on the Interim Report, *Supporting a Strong and Growing Economy: Positioning Canada's Financial Sector for the Future*. We support the efforts of the Canadian Government to consult with stakeholders on how the financial sector framework can more effectively support the Canadian economy and individual Canadians, particularly in light of emerging trends and challenges.

The Shareholder Association for Research and Education (SHARE) is a Canadian leader in responsible investment services, research and education. We work with a network of institutional investors with $14 billion in assets under management helping them to implement responsible investment policies and practices. SHARE is dedicated to improving institutional investment practices to help build a sustainable Canadian economy that protect the long-term interest of investors, communities and society in general.

We would like to focus our comments on the opportunities that we see for the Canadian government to use this review to more closely align Canada's financial sector with sustainability.

1. **What are your views on the trends and challenges identified in this paper? Are there other trends or challenges that you expect to significantly influence the financial sector going forward?**

The consultation paper identifies a range of important trends and opportunities that will impact the financial sector and that need to be addressed in future regulatory and policy frameworks. However, we have identified additional trends that we expect will significantly influence the financial sector in Canada going forward emerging from the need to align financial systems with sustainable development.

In 2015, the international community, including Canada, adopted two ambitious global frameworks: the Sustainable Development Goals[1] (SDGs) and the Paris Agreement.[2] In October 2016, the final *Federal Sustainable Development Strategy* was tabled in Parliament establishing 13 aspirational goals for a more sustainable Canada. These goals include effective action on climate change, clean growth, modern and resilient infrastructure and clean energy among others.

The financial sector will need to play a critical role in closing funding gaps and helping to finance the transition to a low carbon, more sustainable Canadian economy. However, addressing sustainability broadly and the transition to a low-carbon economy bring both risks and opportunities to Canada's financial sector. One of these is climate change. The transformation to a low-carbon economy and the implications of the Paris Agreement will have large-scale impacts on Canada's economy through efforts to both mitigate climate change and adapt to the physical impacts. The financial sector is particularly vulnerable to climate change related risks because of their exposure across all sectors of the economy. However, Canada's financial sector can also position itself to take advantage of new opportunities associated with financing the green economy.

Another aspect of sustainability that emerges as an important trend for Canada's financial institutions is growing wealth inequality. A number of international organizations are voicing their concerns about rising inequality including the International Monetary Fund (IMF) warning of the negative impacts of some neoliberal policies for inequality and growth. The 2016 World Economic Forum Global Risk Report notes that excessive inequality lowers aggregate demand and threatens social security.

The consultation paper's reference to the rise in household debt in Canada is particularly concerning in the context of growing wealth inequality where lower income earners may face greater difficulty in managing their debt. As part of the analysis of inequality, it is critical to acknowledge the growing disparity in financial assets held by households. A study conducted by the Broadbent Institute finds that the bottom half of the population combined

[1] UNDP, 2015, World leaders adopt Sustainable Development Goals, http://www.undp.org/content/undp/en/home/presscenter/pressreleases/2015/09/24/undp-welcomes-adoption-of-sustainable-development-goals-by-world-leaders.html.
[2] United Nations Framework Convention on Climate Change (2016). The Paris Agreement, http://unfccc.int/paris_agreement/items/9485.php.

Box 11170, Royal Centre, 26th Floor, 1055 West Georgia Street, Vancouver, BC V6E 3R5 T 604 408.2456 F 604 408.2525

held less than 6% of financial assets and the bottom 70% of the population only 16%.[3] According to the 2012 Statistics Canada Survey of Financial Security, the median net worth of the poorest 20% was $1,100 in 2012 and for the poorest 10% the median net worth was -$5,100, meaning the owed more in debt than they owned in assets.[4] Within this context of growing wealth inequality, the concept of financial inclusion must be expanded to consider not only the percentage of the Canadian population with a bank account but also the degree to which Canadians have access to the range of financial products and services that can help them achieve financial security throughout their lives including accessible savings and retirement products. Moreover, in addition to looking at financial literacy as the only policy tool to support financial inclusion, there are also important opportunities to consider other policy instruments to address the "supply side" of financial inclusion including incenting financial product innovations, supporting broader transparency and responsible financial advice.

2. How well does the financial sector framework currently balance trade-offs between the three core policy objectives of stability, efficiency and utility?

The purpose of the financial system is to *serve* the real economy. However, the financial sector also has an important role in *shaping* the real economy. In order to align the Canadian economy with climate and sustainability commitments, the utility policy objective should be expanded to address the need for inclusive, environmentally sustainable economic development. Failing to incorporate sustainability as a policy objective can amplify systemic risk in the Canadian economy – emerging from developments such as growing inequality and climate change – and contribute to greater volatility and instability in the system.

3. Are there lessons that could be learned from other jurisdictions to inform how to address emerging trends and challenges?

There are numerous policy innovations emerging in other jurisdictions that could offer lessons and ideas for addressing emerging trends and challenges, including in relation to sustainability. Financial policy makers and regulators in China, Brazil, Netherlands, South Africa, France and the UK have taken steps to introduce market guidelines, standards and incentives to promote capital reallocation, greater transparency from financial sector actors and better risk management.

[3] Broadbent Institute, 2014, Haves and Have-Nots: Deep and persistent wealth inequality in Canada, https://d3n8a8pro7vhmx.cloudfront.net/broadbent/pages/32/attachments/original/1430002827/Haves_and_Have-Nots.pdf?1430002827.

[4] Statistics Canada, Survey of Financial Security 2012, available at: http://www.statcan.gc.ca/daily-quotidien/140225/dq140225b-eng.htm.

For example, France has passed regulation requiring institutional investors to disclose their management of climate-related risks and alignment with global, regional and national low-carbon transition plans. In the UK, the Bank of England has undertaken a prudential review of the climate impacts on the insurance sector. China has introduced a set of policy guidelines for the establishment of a green financial system by the Central Bank and six other regulators.

At the international level, there are several initiatives worth noting that can provide valuable resources and guidance for Canada's financial sector. In 2016, a Green Finance Study Group was established at the G20 to develop options on how to enhance the ability of the financial system to mobilize capital for green investment. The United Nations Environment Programme inquiry into the *Design of a Sustainable Financial System* was established in 2014 to advance policy options to "deliver a step change in the financial system's effectiveness in mobilizing capital towards a green and inclusive economy."[5] The Inquiry calls for a realignment of the financial system and identifies short termism as an issue and suggests government and governance structures be re-calibrated to align with long-term outcomes. Financial policy makers and regulators need to take steps to integrate sustainable development such as guiding principles, regulator mandates, and performance measurement.

In 2015 the Financial Stability Board (FSB) established an industry-led Task Force on Climate-related Financial Disclosures. The Task Force is currently developing recommendations for voluntary, consistent, comparable, reliable and clear disclosures around climate-related financial risks to enable companies to provide information to stakeholders such as lenders, insurers, and investors. While the recommendations will be voluntary, many support them becoming mandatory to be effective and to truly embed climate information into financial decision-making. The final report from the Task Force will be released in December.

4. **What actions could be taken to strengthen the financial sector framework and promote economic growth, including with respect to the identified themes? How should those actions be prioritized?**

As previously indicated, the framework could be strengthened by aligning the overall policy objectives not only with economic growth but also with building an inclusive and environmentally sustainable economy. Broadly speaking, we believe it is important to pursue opportunities in the policy framework to incent capital reallocation to green finance, to mandate greater transparency from financial sector institutions and to support better risk

[5] UNEP Inquiry Report, *The Financial System We Need,* October 2015, available from http://web.unep.org/inquiry/publications.

management across the financial system, particularly for long-term systemic risks such as those that emerge from climate change and wealth inequality.

There are several actions that could be taken to facilitate greater transparency from Canada's financial sector. For example, Canada's Financial Consumer Protection Act requires Canada's banks and insurance companies to produce Public Accountability Statements. The statements are meant to outline each institution's contributions to the economy, society and community development including specific practices such as funding for charitable activities, community work, small business financing, micro-credit programs, banking services for low-income individuals, and employees' participation in the community. This requirement to produce Public Accountability Statements acknowledges the broader responsibility of banks to deliver public goods and to meet public objectives.

In light of the changes that have taken place in the financial sector itself coupled with the increasingly important role that the financial sector plays in the Canadian economy, it would be valuable to consider expanding the information that Canada's banks are required to report in their Public Accountability Statements, including information related to their efforts to improve financial inclusion and increase customer savings levels as well as their efforts to finance the transition to a clean economy. For example, information from banks on their support for the renewable energy sector (i.e. % of lending going to renewable energy), product innovations to incent saving (i.e. % of R&D to innovative savings products), and increases in customer deposits in savings products such as RESPs, for example. All of these disclosures would help to improve transparency on how Canada's banks are helping to build a more sustainable and inclusive Canadian economy.

Another action that would help support greater transparency in the financial system is to build on the efforts by the Ontario government and require federally registered pension plan administrators to disclose to their members and publicly whether and if so how the consideration of environmental, social and governance factors is reflected in the plan's investment policy and practice. The United Kingdom, Australia, France, Sweden and Germany, among others, require ESG disclosure by pension administrators. Federal leadership on ESG disclosure could prompt action by other provinces that have not yet implemented this transparency requirement.

Supporting better risk management processes that address systemic risks such as those from climate change and wealth inequality could also be achieved through the financial sector framework. For example, regulation could require Canada's banks to implement and disclose information on environmental and social risk management systems that address the risks of climate change, for example. More broadly, there is a need for regulators to support processes for considering how Canada's financial institutions can more effectively apply environmental stress tests to their lending portfolios.

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Thank you for giving us the opportunity to provide comments and feedback on the federal financial sector framework. We look forward to continuing the dialogue and to participating in the next steps of this consultation.

Sincerely,

Shannon Rohan
Director of Responsible Investment, SHARE