January 13, 2022

Nova Scotia Securities Commission
Ste. 400, Duke Tower
5251 Duke St.
Halifax, NS B3J 1P3

Keith MacMaster – Purdy Crawford Fellow in Business Law
Amanda Chiong – JD Candidate
Schulich School of Law
Dalhousie University
Halifax, Nova Scotia
kemacmas@dal.ca

Re: Comments on Proposed National Instrument 51-107 Disclosure of Climate-related Matters and companion policy

Experience with TCFD recommendations

1. For reporting issuers that have provided climate-related disclosures voluntarily in accordance with the TCFD recommendations, what has been the experience generally in providing those disclosures?

- N/A

Disclosure of GHG Emissions and Scenario Analysis

2. For reporting issuers, do you currently disclose GHG emissions on a voluntary basis? If so, are the GHG emissions calculated in accordance with the GHG Protocol?

Dalhousie University first established a greenhouse gas (GHG) inventory base year for the 2009 fiscal year (April 1, 2008 – March 31, 2009). The base year was subsequently updated to the 2010 fiscal year (April 1, 2009 – March 31, 2010), as more reliable and complete data records became available.

The Dalhousie GHG inventory identifies all direct (Scope 1) and indirect (Scope 2) emissions under the university's operational control, as well as other indirect (Scope 3) emissions (commuting travel, paper, and water). In 2018, Dalhousie began including paper and water emissions in its Scope 3 calculations; however, unless specified otherwise, these emissions are excluded from figures that compare totals with 2009-10 because this data was not available in the base year.[1]

[1] Dalhousie University Office of Sustainability, *Greenhouse Gas (GHG) Inventory Report 2019-2020*, (March 2021) online: https://cdn.dal.ca/content/dam/dalhousie/pdf/dept/sustainability/resources/publications-and-plans/Dalhousie%20University%20GHG%20Inventory%202019-20.pdf at 4.

Dalhousie University calculates its GHG emissions following a verified reporting protocol.[2]

We highly recommend that better guidance on protocols accompany any new instrument or regulation. As detailed below, uncertainty on reporting protocols and taxonomies partially drives a lack of reporting.

3. For reporting issuers, do you currently conduct climate scenario analysis (regardless of whether the analysis is disclosed)? If so, what are the benefits and challenges with preparing and disclosing the analysis?

Dalhousie University's Office of Sustainability has conducted climate scenario analysis, using global climate models based on historical temperature and precipitation data to project key vulnerabilities and impacts on university operations and stakeholders and to identify priorities for action[3].

We highly recommend that some form of scenario analysis be recommended for company-level disclosure. Scenario analysis will assist portfolio managers in making company and industry-level comparisons, which is difficult to conduct under current disclosure requirements.

4. Under the Proposed Instrument, scenario analysis would not be required. Is this approach appropriate? Should the Proposed Instrument require this disclosure? Should issuers have the option not to provide this disclosure and explain why they have not done so?

Scenario analysis can be an important tool for issuers to reduce risk. For example, internal shadow pricing can help companies make decisions about emission reduction strategies and investments.[4] Scenario analysis allows an organization to explore and understand how various combinations of climate-related risks may affect its businesses, strategies, and financial performance over time. This can improve investor confidence in the issuer's strategy to address and respond to climate change.

Disclosure of scenario analyses would improve the evaluation of the resilience of Canadian issuers and the financial system at large.[5]

---

[2] Ibid at 13.

[3] Dalhousie University Office of Sustainability, *Sustainability Climate Change Plan (2019)* online: https://cdn.dal.ca/content/dam/dalhousie/pdf/dept/sustainability/resources/publications-and-plans/Sustainablity%20Climate%20Change%20Plan%202019%20(Final).pdf.

[4] Carbon Pricing Leadership Coalition, *Draft Report of the Task Force on Net Zero Goals and Carbon Pricing* (International Bank for Reconstruction and Development (The World Bank, 2021) at 37.

[5] Network for Greening the Financial System, *The Macroeconomic and Financial Stability Impacts of Climate Change Research Priorities* (2020) online: https://www.ngfs.net/sites/default/files/medias/documents/ngfs_research_priorities_final.pdf at 5.

One of the key recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) is for companies to assess and disclose the resilience of their strategy, taking into consideration multiple climate scenarios, including a two degree or lower scenario.[6] Moreover, the TCFD concludes that getting started with scenario analysis is not difficult or time-consuming.[7] It also does not require additional staff. Thus the regulatory burden would be minimal.

As the TCFD recommends scenario analysis, we recommend that scenario analysis be included in disclosure requirements under the proposed instrument.

5. The TCFD recommendations contemplate disclosure of GHG emissions, where such information is material.

- *The Proposed Instrument contemplates issuers having the option to disclose GHG emissions or explain why they have not done so. Is this approach appropriate?*

The "comply-or-explain" model recommended by the TCFD has been implemented in many jurisdictions, beginning in the United Kingdom. Adopting this model would bring Canadian securities disclosure requirements into alignment with this global standard. It is noted that this model provides issuers with significant flexibility[8], which may be connected to consistently high levels of overall compliance under such models.[9]

However, it is not clear whether the global diffusion of this model has improved the standards of corporate governance overall.[10] A primary issue with the "comply-or-explain" model is that it may be difficult to assess and compare the adequacy of explanations.[11] A study analyzing compliance based on annual reports and proxy statements of all listed Canadian issuers in 2006 indicated that firms could use the flexibility of the explanations to implement varied corporate governance practices that were more firm-specific and therefore more effective, rather than mere adherence to industry best practices.[12] In order to ensure that the "comply-or-explain" approach is effective, there should be clear repercussions for missing or incomplete explanations to encourage adequate and detailed explanations for non-disclosure.

---

[66] TFCD, *Guidance on Scenario Analysis for Non-Financial Companies* (October 2020) online: https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD_Guidance-Scenario-Analysis-Guidance.pdf.
[7] Ibid at 2.
[8] Virginia Harper Ho, "Comply or Explain and the Future of Nonfinancial Reporting" (2017) 21 Lewis & Clark Law Review 317, online: https://ssrn.com/abstract=2903006 at 331.
[9] Ibid at 334.
[10] Iain MacNeil & Irene-Marie Esser, "The Emergence of 'Comply or Explain' as a Global Model for Corporate Governance Codes" (2021) European Business Law Review (Forthcoming, 2022), online: https://ssrn.com/abstract=3775736 at 40.
[11] Harper Ho, *supra* at 333.
[12] Yan Luo & Steven E. Salterio, "Governance Quality in a Comply or Explain Governance Disclosure Regime" (2014) 22 Corporate Governance 461 at 475.

- *As an alternative, the CSA is consulting on requiring issuers to disclose Scope 1 GHG emissions. Is this approach appropriate? Should disclosure of Scope 1 GHG emissions only be required where such information is material?*

The current Proposed Instrument defines materiality in a problematic way. The current definition asks if "a reasonable investor's decision whether or not to buy, sell or hold securities in the issuer likely be influenced or changed if the information in question was omitted or misstated." This fails to account for qualitative materiality and issues that may become material over time.

The definition of materiality with regards to climate should be adjusted. The Guiding Principles of the IIRC defines materiality as "information about matters that substantively affect the organization's ability to create value over the short, medium and long term."[13] "Value" encompasses a holistic view of the enterprise and forces the company to value the firm over the short-medium and long-term, instead of managing quarter-to-quarter to maximize share price over the short term. Updating to a principles-based definition of materiality, using a transnational framework to guide behaviour would ensure that firms disclose the necessary information for stakeholders to make informed decisions.

The European Union favours the "double materiality" approach, which asserts that disclosure should address the impact of sustainability factors on a company and the impacts on society and the environment.[14] This was incorporated to address comparability, accuracy, and insufficiency of publicly available information for investors and stakeholders.[15] Under double materiality, something that is not financially material may still be included, which can be useful if it later becomes financially material due to trends in financial markets and public policies. This approach also encourages issuers to consider longer-term time horizons and the possibility of issues becoming material over those longer time horizons.[16] This approach could be emulated effectively in Canadian policy.

In terms of requiring disclosure of Scope 1 GHG emissions, these are the easiest to quantify and trace. Issuers may already be subject to existing GHG emissions reporting programs. Therefore, this may not present a significant burden to such companies.

---

[13] IIRC, T*he International IR Framework*, (2013) online: https://www.integratedreporting.org/resource/international-ir-framework/ at 5.

[14] *Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment*, and amending Regulation (EU) 2019/2088 PE/20/2020/INIT, online: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32020R0852&from=EN.

[15] European Commission, “Questions and Answers: Corporate Sustainability Reporting Directive Proposal”, online: https://ec.europa.eu/commission/presscorner/detail/en/QANDA_21_1806.

[16] European Commission, *Guidelines on reporting climate-related information*, online: https://ec.europa.eu/finance/docs/policy/190618-climate-related-information-reporting-guidelines_en.pdf at 8.

- *Should disclosure of Scope 2 GHG emissions and Scope 3 GHG emissions be mandatory?*

There is an understanding that the determination and calculation of Scope 2 and Scope 3 GHG emissions are often much more complicated, resulting in an increased burden on issuers. However, this burden is mitigated by the GHG Protocol and other reporting standards, which provide technical guidance on calculating Scope 2 and Scope 3 emissions.[17]

Investors are likely interested in issuers' GHG emissions throughout the value chain; a majority of Canadian investors agreed that "Canadian corporations should set goals for their businesses to achieve net-zero emissions by 2050."[18] Indirect emissions (Scopes 2 and 3) increased more than Scope 1 emissions from 1995-2015[19] and are an important part of overall emissions within the "net-zero" goal. Scope 3 emissions have been posited to represent up to 75% of an industry's carbon footprint.[20] As such, calculation and disclosure of indirect emissions benefit investors and stakeholders by allowing them to assess issuers' response to climate risk and benefits the issuers themselves by creating a better understanding of their carbon footprint to inform strategic decision-making.

However, expanding disclosure requirements to include Scopes 2 and 3 are not without concerns. The inclusion of indirect emissions may create an issue with information overload, providing investors and stakeholders with more information than is useful. There may also be concerns with double-counting, where emissions are counted multiple times due to the overlapping nature of characterization by different companies.[21] In Australia, it was found that the comparability of Scope 3 emissions, in particular, maybe at issue, as the nature of these emissions introduces significant uncertainty and imprecision.[22]

- *For those issuers who are already required to report GHG emissions under existing federal or provincial legislation, would the requirement in the Proposed Instrument to include GHG emissions in the issuer's AIF or annual MD&A (if an issuer elects to disclose these emissions) present a timing challenge given the respective filing deadlines? If so, what is the best way to address this timing challenge?*

6. The Proposed Instrument contemplates that issuers that provide GHG disclosures would be required to use a GHG emissions reporting standard in measuring their GHG emissions, being the GHG Protocol or a reporting standard comparable with the GHG Protocol (as described in

---

[17] Greenhouse Gas Protocol, "Scope 2 Guidance" online: https://ghgprotocol.org/scope_2_guidance, GHG Protocol, "Scope 3 Standard" online: https://ghgprotocol.org/standards/scope-3-standard.

[18] Responsible Investment Association, *2021 RIA Investor Opinion Survey* (2021) at 17.

[19] Edgar G Hertwich and Richard Wood, "The growing importance of scope 3 greenhouse gas emissions from industry" (2018) 13 Environ. Res. Lett. 104013 at 3.

[20] J. Downie, & W. Stubbs, "Corporate Carbon Strategies and Greenhouse Gas Emission Assessments: The Implications of Scope 3 Emission Factor Selection" (2012) 21 Bus. Strat. Env. 412-422 online: https://doi.org/10.1002/bse.1734, YA Huang YA, CL Weber & HS Matthews, "Categorization of Scope 3 emissions for streamlined enterprise carbon footprinting" (2009b) 43 Environmental Science and Technology 8509– 8515.

[21] Hertwich and Wood at 5.

[22] Downie *supra*.

the Proposed Policy). Further, where an issuer uses a reporting standard that is not the GHG Protocol, it would be required to disclose how the reporting standard used is comparable with the GHG Protocol.

- *As issuers have the option of providing GHG disclosures, should a specific reporting standard, such as the GHG Protocol, be mandated when such disclosures are provided?*

Mandating a specific reporting standard would address concerns about consistency and comparability of disclosures. Without standardization, the data will not be comparable across companies, firms, projects or industries. Only with relatable standardized data can more comprehensive climate financial models be created.

- *Is the GHG Protocol appropriate for all reporting issuers? Should issuers be given the flexibility to use alternative reporting standards that are comparable with the GHG Protocol?*

While flexibility is important for issuers, it is more important for investors and fund managers to be able to verify and compare companies and industries.

- *Are there other reporting standards that address the disclosure needs of users or the different circumstances of issuers across multiple industries, and should they be specifically identified as suitable methodologies?*

There are several transnational and international frameworks that can address the disclosure needs of users and different circumstances across multiple industries, including the CDP, Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB), Corporate Reporting Dialogue (CRD), and the European Union's Technical Expert Group Taxonomy.[23] These frameworks have proven reliable, verifiable, auditable, and comparable across companies and sectors.

The well-reported and researched CDP (formerly the Carbon Disclosure Project) collects globally reported climate change, water, and forest risk data.[24] As of 2017, many large companies such as TD and Suncor Energy have reported under the CDP.[25] In 2021, the CDP reached a record number of disclosures and announced that its reporting standard would expand its definition of "environment" to include planetary boundaries, including oceans, land use, biodiversity, food production, and waste.[26] Furthermore, the CDP holds its reporters to third-party verification standards, which is important to assess accuracy.[27] Studies have also

[23] Keith MacMaster, "Implementing Climate Related Financial Disclosure in Canada" (2022) [Forthcoming].
[24] CDP, "About Us" online: https://www.cdp.net/en-US/Pages/About-Us.aspx.
[25] *Canada Report 2017*, by CDP (New York: CDP, 2017).
[26] CDP, "CDP reports record number of disclosures and unveils new strategy to help further tackle climate and ecological emergency", online: https://www.cdp.net/en/articles/media/cdp-reports-record-number-of-disclosures-and-unveils-new-strategy-to-help-further-tackle-climate-and-ecological-emergency
[27] CDP, "Verification", online: https://www.cdp.net/en/guidance/verification

shown that carbon emissions reported in CDP are more extensive than those reported in social reports.[28]

The Global Reporting Initiative ("GRI") helps businesses and governments understand and communicate their impact on critical sustainability issues such as climate change, human rights, governance and social well-being.[29] The GRI's current iteration focuses on materiality of information, contextual disclosures about an organization, and the proper management approach to report how a company manages its material topics.[30] The GRI defines Material Aspects as those that reflect the organization's significant economic, environmental, and social impacts; or substantively influence stakeholders' assessments and decisions.[31] However, studies with the GRI show that even A and A+ rated companies have problems with vague disclosures.[32]

The Sustainability Accounting Standards Board ("SASB") is an independent nonprofit organization that sets standards to guide companies' disclosure of financially material sustainability information to their investors. Standards identify the subset of environmental, social, and governance issues most relevant to financial performance in each of 77 industries.[33] SASB standards are tied to financial performance and are industry-specific. The Sustainability Accounting Standards Board takes a narrower, investor-focused view, following the definition of materiality used by the US Securities and Exchange Commission. They add value via their materiality map, guiding firms and investment institutions to identify and compare disclosure topics.[34] However, the SASB's proposal of a new definition of materiality will be "information is material if omitting it or misstating it could influence decisions that the primary users of general-purpose financial reports make based on financial information about a specific reporting entity.[35] This definition of materiality still relates only to financial information (and thus share price). It does not expressly necessitate the need for a long-term value horizon, while other frameworks have more substantive recommendations.

The Corporate Reporting Dialogue is a joint initiative of the eight leading standards-setting organizations, including the CDP, GRI, international accounting standards, and others.[36]

---

[28] Florence Depoers, Thomas Jeanjean, & Tiphaine Jérôme, "Voluntary Disclosure of Greenhouse Gas Emissions: Contrasting the Carbon Disclosure Project and Corporate Reports" (2016) 134:3 J Bus Ethics 445–461.
[29] Global Reporting Initiative, "Consolidated Set of GRI Sustainability Reporting Standards 2016" (19 October 2016) online: https://www.globalreporting.org/Pages/default.aspx.
[30] *Ibid.*
[31] *Ibid* at 6.
[32] David Talbot & Olivier Boiral, "GHG Reporting and Impression Management: An Assessment of Sustainability Reports from the Energy Sector" (2018) 147 J Business Ethics 367.
[33] SASB, "About us", online: https://www.sasb.org/about/
[34] SASB, "Materiality Map" online: https://www.sasb.org/standards/materiality-map/
[35] *Ibid.*
[36] Corporate Reporting Dialogue, CDP, Climate Disclosure Standards Board, Financial Accounting Standards Board (observer), Global Reporting Initiative, International Accounting Standards Board, International Integrated Reporting Council, International Organization for Standardization, and Sustainability Accounting Standards Board, online: http://corporatereportingdialogue.com/.

Its Better Alignment Project aligns corporate reporting with preparing for effective and coherent disclosures.[37] Whichever is selected, all provide much greater environmental disclosures than those currently required under securities legislation. The accounting industry must be a valuable player in climate disclosures. If mainstream financial documentation is emphasized, the updated financial disclosures will require synthesis with current and future accounting practices. Comparability and standardization are themes underlying much of the discussion. The Statement of Common Principles of Materiality by the Corporate Reporting Dialogue identifies practical means of aligning materiality frameworks. A joint document by the eight large disclosure organizations provides a useful template for updating ideas of materiality.[38] The Statement notes the different definitions from a legal and financial perspective and the definitions from the various organizations.

Incorporating the CDP or another global framework into securities disclosure requirements would offer a significant step forward in data dissemination. Moreover, as 71% of US companies and 76% of Canadian companies report to the CDP, legislating their mandatory use would not be unduly burdensome. It would be useful to have the Proposed Instrument allow for alternative options beyond the GHG Protocol.

In June 2020, the European Union's Technical Expert Group published its taxonomy. The taxonomy assists in planning and reporting disclosures relating to the transition to an economy consistent with the European Union's environmental objectives. The taxonomy disclosure obligations encourage reporting towards meeting screening criteria and reporting on their achievement. Not every investment and financing decision is expected to create additional environmental benefits.[39] Developing a taxonomy for sustainable investing, defining a green bond standard and an eco-label are examples of the main elements that will influence and guide investors.[40]

Financial market participants offering financial products in Europe must now incorporate disclosures referencing the Taxonomy. The taxonomy disclosure requirements vary depending on product categories and are aligned with the definitions in the *Regulation on Sustainability-Related Disclosures in the Financial Services Sector.*

On 21 April 2021, the Commission proposed a Corporate Sustainability Reporting Directive ("CSRD"). The goal is to get sustainability reporting to be on an equal footing with financial reporting. The CSRD's proposed enlarged scope is needed to cover more companies that significantly impact the environment and society. In its consultation on reforms to its Non-

---

[37] Corporation Reporting Dialogue, "Better Alignment Project", online: http://corporatereportingdialogue.com/wp-content/uploads/2018/11/Corporate-Reporting-Dialogue-Better-Alignment-Project.pdf.

[38] Corporate Reporting Dialogue, *Statement of Common Principles of Materiality of the Corporate Reporting Dialogue, online at:* http://corporatereportingdialogue.com/wp-content/uploads/2016/03/Statement-of-Common-Principles-of-Materiality1.pdf.

[39] *TEG final report on the EU taxonomy*, by EU Technical Expert Group on Sustainable Finance (European Commission, 2020) at 8.

[40] MacMaster, supra.

Financial Reporting Directive, the European Union favoured double materiality. Canada could adopt this approach to expand securities disclosure further to encourage alignment between financial and environmental or climate-related disclosures.

7. The Proposed Instrument does not require that GHG emissions be audited. Should there be a requirement for some form of assurance on GHG emissions reporting?

There should be an independent auditing mechanism for GHG emissions reporting to ensure accuracy and compliance with reporting standards.

8. The Proposed Instrument permits an issuer to incorporate GHG disclosure by reference to another document. Is this appropriate? Should this be expanded to include other disclosure requirements of the Proposed Instrument?

Permitting an issuer to incorporate GHG emissions disclosure by referring to another document may present a hurdle to the comparability of data across issuers, as these other documents would not be standardized. If the information in the other document is identical to what would be included in the disclosure, allowing issuers to reference that other document could be acceptable. However, there is no practical way to ensure this without incurring increased costs of inspecting non-standardized documents on a case-by-case basis.

A French study comparing disclosures under the CDP to individual corporate reports indicates that the information provided via these two communication channels differs significantly. In particular, it was found that voluntary corporate reports tended to report much lower GHG emissions amounts.[41] It is suggested that this is due to management "cherry-picking" emissions sources based on what is perceived to be most important to the wider audience of the corporate reports.[42] There were also discrepancies in the delineation of the scopes of the emissions reported, with some corporate reports omitting reference to scopes entirely.[43] Without standardization of this basic delineation, it is impossible to determine what scope of emissions issuers are not reporting.

Usefulness and benefits of disclosures contemplated by the Proposed Instrument

9. What climate-related information is most important for investors' investment and voting decisions? How is this information incorporated into these decisions? Is there additional information that investors require?

There has been a significant trend among Canadian investors towards broadly emphasizing climate change mitigation and adaptation.[44] A majority of Canadian investors are

---

[41] F. Depoers, T. Jeanjean & T. Jérôme, "Voluntary Disclosure of Greenhouse Gas Emissions: Contrasting the Carbon Disclosure Project and Corporate Reports" (2016) 134 Journal of Business Ethics 445 online: https://doi.org/10.1007/s10551-014-2432-0 at 445.

[42] Ibid at 456.

[43] Ibid at 454.

[44] Responsible Investment Association, *2020 Responsible Investing Trends Report* (RIA, 2020) at 12.

also interested in seeing the companies they invest in become net-zero by 2050.[45] The leading reasons for incorporating ESG factors into investment and engagement decisions are managing risk, improving returns over time, meeting a client or beneficiary demands, and fulfilling a fiduciary duty.[46] Canada's most prominent responsible investment strategy is ESG integration, where ESG factors are "systematically and explicitly embed[ed]… into traditional investment analysis and decision-making."[47] Investors may accomplish this by referencing SASB standards and assessing materiality to identify financially material issues.[48] Investors also use ESG information to practice active ownership through shareholder participation mechanisms such as voting, proposals, and dialogue with management.[49] Climate change was the most common ESG issue referenced in investor engagement programs in 2019.[50] Investors may also incorporate environmental disclosure information into decision-making by adopting screening strategies to either include or exclude securities based on ESG characteristics.

10. What are the anticipated benefits associated with providing the disclosures contemplated by the Proposed Instrument? How would the Proposed Instrument enhance the current level of climate-related disclosures provided by reporting issuers in Canada?

The enhanced disclosures contemplated by the Proposed Instrument will help Canadian issuers and markets align with global reporting standards and help guide investment decisions. Portfolio managers, insurers, and financial institutions create financial products and require significant amounts of information to assess risk and value companies and projects. While there is a need for private model building by finance companies, there is also a vital need for a more significant amount of publicly available information. There is a real and pressing issue with information asymmetry, as shareholders do not have access to all material information, and the broader stakeholder has even less information. Increased and more robust climate-related disclosures as contemplated in the Proposed Instrument can help ameliorate this issue.

Costs and challenges of disclosures contemplated by the Proposed Instrument

11. What are the anticipated costs and challenges associated with providing the disclosures contemplated by the Proposed Instrument?

While there are costs with any filing, they would be immaterial to other financial burdens. As part of becoming public entities, public companies accept financial burdens with regulatory oversight. It is difficult to believe that most companies, which are extremely profitable will be harmed in any way by a few additional disclosure requirements.

[45] Responsible Investment Association, 2021 RIA Investor Opinion Report, online: https://www.riacanada.ca/research/2021-ria-investor-opinion-survey/.
[46] *2020 Responsible Investing Trends Report* supra at 11.
[47] Ibid at 18.
[48] Ibid.
[49] Ibid at 19.
[50] Ibid at 21.

12. Do the costs and challenges vary among the four core TCFD recommendations related to governance, strategy, risk management, and metrics and targets? For example, are some of the disclosures more (or less) challenging to prepare?

Yes, we recognize that not all data is the same. Some metrics are quantitative and easy to collect. Other factors, mainly social factors, are qualitative and thus more difficult to translate into quantitative disclosures. A taxonomy would greatly alleviate some of the burdens and challenges of preparing disclosures.[51]

13. The costs of obtaining and presenting new disclosures may be proportionally greater for venture issuers with scarce resources. Would more accommodations for venture issuers be needed? If so, what accommodations would address these concerns while still balancing the reasonable information needs of investors? Alternatively, should venture issuers be exempted from some or all of the requirements of the Proposed Instrument?

Guidance on disclosure requirements

14. We have provided guidance in the Proposed Policy on the disclosure required by the Proposed Instrument. Are there any other tools, guidance or data sources that would be helpful in preparing these disclosures that the Proposed Policy should refer to?

The EU Taxonomy, SFDR Regulation, the proposed Securities and Exchange updates to Regulation S-K, the SASB and IIRC frameworks should all be helpful. Please see the two attached documents for additional information and references.[52]

Moreover, the C3IA, as proposed by the Taskforce for Sustainable Finance[53], should be implemented by the securities administration in conjunction with the federal government. This would provide all of the data required and lower costs.[54]

15. Does the guidance set out in the Proposed Policy sufficiently explain the interaction of the risk disclosure requirement in the Proposed Instrument with the existing risk disclosure requirements in NI 51-102?

V Prospectus Disclosure

16. Form 41-101F1 Information Required in a Prospectus does not contain the climate-related disclosure requirements contemplated by the Proposed Instrument. Should an issuer be required to include the disclosure required by the Proposed Instrument in a long-form prospectus? If so,

---

[51] Keith MacMaster, "Implementing Climate Related Financial Disclosure in Canada" (2022) [Forthcoming].
[52] Keith MacMaster, "Responsible Investing: Access Denied" (2019) 34:3 Banking & Finance Law Review 387–415; Keith MacMaster, *Responsible Investing: Access Denied* (LLM, Dalhousie University, 2018) [unpublished].
[53] *Submission to Expert Panel on Sustainable Finance*, by Keith MacMaster (Ottawa, Ont.: Smart Prosperity, 2019).
[54] See Keith MacMaster, "More Data, Less Problems: A Case for More Precise Climate Data in Investment Allocation" (13 August 2020), The FinReg Blog: https://sites.law.duke.edu/thefinregblog/2020/08/13/more-data-less-problems-a-case-for-more-precise-climate-data-in-investment-allocation/.

at what point during the phased-in implementation of the Proposed Instrument should these disclosure requirements apply in the context of a long-form prospectus?

Initial disclosure requirements, through the prospectus, should be as robust as continuous disclosure requirements. Investors and stakeholders should be able to access climate-related information from the very start.

Phased-in implementation

17. The Proposed Instrument contemplates a phased-in transition of the disclosure requirements, with non-venture issuers subject to a one-year transition phase and venture issuers subject to a three-year transition phase. Assuming the Proposed Instrument comes into force December 31, 2022 and the issuer has a December 31 year-end, these disclosures would be included in annual filings due in 2024 and 2026 for non-venture issuers and venture issuers, respectively.

- *Would the transition provisions in the Proposed Instrument provide reporting issuers with sufficient time to review the Proposed Instrument and prepare and file the required disclosures?*
- *Does the phased-in implementation based on non-venture or venture status address the concerns, if any, regarding the challenges and costs associated with providing the disclosures contemplated by the Proposed Instrument, particularly for venture issuers? If not, how could these concerns be addressed?*

Future ESG considerations

18. In its comment letter to the IFRS Foundation's consultation paper published in September 2020, the CSA stated that developing a global set of sustainability reporting standards for climate-related information is an appropriate starting point, with broader environmental factors and other sustainability topics to be considered in the future. What broader sustainability or ESG topics should be prioritized for the future?

The 2015 Sustainable Development Goals ("SDGs") influence corporate disclosures.[55] Best practices for corporate disclosures have not yet materialized, although they are being developed to assist companies with qualitative and quantitative disclosures per target.[56] Recommended disclosures include carbon emissions, the number of indigenous rights violations, air quality, gender equality, infrastructure spending, women in leadership positions,

---

[55] UN, *Transforming Our World: The 2030 Agenda for sustainable development. Draft resolution referred to the United Nations summit for the adoption of the post-2015 development agenda*, United Nations General Assembly, 2015) sixty-ninth session. UN Doc. A/70/L.1 of (18 September 2015); Libby Bernick, "Can SDGs Shape the Future of Corporate Disclosure?" Blog (25 October 2017) online: http://www.csrwire.com/blog/posts/1862-can-sdgs-shape-the-future-of-corporate-disclosure.

[56] PwC, Business Reporting on the SDGs, Analysis of the Goals and Targets (Global Compact and GRI, 2018) at 2, 11, 198; UN Global Compact, "Action Platform: Reporting on the SDGs", online: https://www.unglobalcompact.org/take-action/action-platforms/sdg-reporting.

access to water and other water issues, and many others.[57] Using the SDGs for sustainable investing is growing, with 40% of US money managers stating the SDGs were a factor.[58]

There is a process of developing a framework for corporate reporting for the SDGs. This framework will incorporate environmental, social, and governance factors into valuations, assess the materiality of impacts, quantify impacts, measure additional metrics, compare against targets, make targets sector-specific, and make these practices comparable across industries and companies.[59]

There are still gaps where disclosures are not available. Gaps include social inclusiveness, the equitable sharing of global resources, and the lack of meaningful environmental targets such as water access and carbon emissions reductions.[60] For women and girls especially, the reality of water scarcity, or other climate-related disruptions to water supply, often translates into increasing numbers of hours seeking out safe water for themselves and their families.[61] The low level of climate financing directed at ensuring basic water sanitation and hygiene access is still of concern. Water projects are estimated to be only a tenth of climate investments, accounting for 0.3% of global climate finance.[62]

Sincerely,

Keith MacMaster

---

[57] Business Reporting on the SDGs, *supra* at 26, 31, 49, 61, 65, 67, 72–75.
[58] Global Sustainable Investment Alliance, *2018 Global Sustainable Investment Review*, (2018) online: http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf.
[59] UN GC, "The Ten Principles of the UN Global Compact" online: https://www.unglobalcompact.org/what-is-gc/mission/principles; Eduardo Ortas, Igor Álvarez & Ainhoa Garayar, "The Environmental, Social, Governance, and Financial Performance Effects on Companies that Adopt the United Nations Global Compact" (2015) 7 Sustainability 1932; UN GC, "SDG Toolbox" online: https://www.unglobalcompact.org/sdgs/sdg-toolbox.
[60] *Business Reporting on the SDGs, Analysis of the Goals and Targets, a study by PwC*, by PwC & GRI (Global Compact and GRI, 2018) at 51, 11, 22, 38; Joyeeta Gupta & Courtney Vegelin, "Sustainable development goals and inclusive development" (2016) 16 International Environmental Agreements 433 at 441.
[61] Catarina de Albuquerque "The Climate Solution Must Include Water, Sanitation, and Hygiene" May 2021, online: http://sdg.iisd.org/commentary/guest-articles/the-climate-solution-must-include-water-sanitation-and-hygiene/?utm_medium=email&utm_campaign=SDG%20Weekly%20Update%20-%206%20May%202021&utm_content=SDG%20Weekly%20Update%20-%206%20May%202021+CID_1004460bd71f5fb5e7989c3b429db3af&utm_source=cm&utm_term=Read.
[62] *Ibid; s*ee also Nathaniel Mason, et.al. *Just add water: a landscape analysis of climate finance for water* (Overseas Development Institute, 2020) at 21.

Keith MacMaster

Implementing Climate-Related Financial Disclosure in Canada

Introduction

In February 2020, the Ontario provincial government established the Capital Markets Modernization Taskforce to review and modernize Ontario's capital markets.[1] The 2008 financial crisis, the ongoing global pandemic, the heightened sense of the severity of global climate change, and the long timeframe from the previous regulatory review, highlighted a need for modernizing Canada's largest capital market. In July 2020, the Capital Markets Modernization Taskforce (the "Taskforce") released its first consultation report, and the final report was released in January 2021.[2] The final report of the Taskforce outlines seventy-four recommendations aimed at strengthening Ontario's capital markets. Conducted through the lens of investor protection, the changes are intended to help modernize governance standards and proxy voting frameworks. The Taskforce proposes that the securities commission mandate disclosure of material environmental, social, and governance information compliant with specific international recommendations for issuers through regulatory filing requirements.[3] Where feasible, the proposed enhanced disclosure will align with global reporting standards.[4]

[1] Government of Ontario, "Ontario Appoints Members of Taskforce to Review Capital Markets Government taking steps to strengthen Ontario's economy", online: <https://news.ontario.ca/en/release/55674/ontario-appoints-members-of-taskforce-to-review-capital-markets>; Government of Ontario, "Ontario Economic Outlook and Fiscal Review: A Plan to Build Ontario Together", online: <https://budget.ontario.ca/2019/fallstatement/contents.html>.
[2] *Final Report*, by Capital Markets Modernization Taskforce (2021); *Consultation Report*, by Capital Markets Modernization Taskforce (2020).
[3] Capital Markets Modernization Taskforce, *supra* note 2 at 27.
[4] These global standards are discussed below.

The Taskforce report followed the Taskforce for Climate Disclosures ("TFCD").[5] The TCFD was established to develop recommendations for more effective climate-related disclosures to promote more informed investment, credit, and insurance underwriting decisions. The TFCD report, released in 2017, advocated for "disclosing clear, comparable and consistent information about the risks and opportunities presented by climate change."[6] Information will "lead to the smarter, more efficient allocation of capital, and help smooth the transition to a more sustainable, low-carbon economy."[7] The TFCD established that climate-related financial disclosures should be provided within mainstream annual financial filings for public companies. One fundamental limitation of the recommendations stemmed from the conclusion that:

> organizations should make financial disclosures in accordance with their national disclosure requirements. If certain elements of the recommendations are incompatible with national disclosure requirements for financial filings, the Task Force encourages organizations to disclose those elements in other official company reports that are issued at least annually, widely distributed and available to investors and others, and subject to internal governance processes that are the same or substantially similar to those used for financial reporting.
>
> There remains a lack of clarity as to how these bodies are analyzing or contemplating ESG risks and how they intend to interact with the financial sector in this regard. There is some concern that certain requirements may not reflect the evolving nature of risk.[8]

Responding to the TFCD report, Canada's Ministers of Environment and Climate Change and Finance appointed the Expert Panel on Sustainable Finance to "engage a wide range of stakeholders on opportunities and challenges relating to sustainable finance and climate-related risk disclosures, and to recommend next steps for the Government of Canada to consider in promoting a low carbon, clean economic growth in Canada."[9] In 2019, the Expert Panel released

---

[5] *Recommendations of the Task Force on Climate-related Financial Disclosure*, by TFCD (2017); *Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures*, by TFCD (2016); FSC-TFCD, "Task Force on Climate-related Financial Disclosures | TCFD - Homepage", online: *TCFD* <https://www.fsb-tcfd.org/>.
[6] TFCD, *supra* note 5 at i.
[7] *Ibid.*
[8] *Ibid* at iv.
[9] *Interim Report of the Expert Panel on Sustainable Finance*, by Expert Panel on Sustainable Finance (2018) at 1.

its final report after engaging stakeholders in climate-related risk disclosures. The Expert Panel, led by the new Governor of the Bank of Canada, Tiff Macklem, stated that "outdated perceptions about the materiality of environmental, social and governance issues within the scope of fiduciary duty may hinder responsiveness to risks opportunities. Sustainable finance is generally not seen or treated as a significant return driver or strategic priority.[10]

The Expert Panel concluded that data collection, disclosure(s), and enhanced modelling will be vitally necessary to build robust, timely and accessible information on climate risks to reduce and adapt to their impacts.[11] Among the Expert Panel's fifteen recommendations included suggestions to:

- Provide Canadians with the opportunity and incentive to connect their savings to climate objectives,
- Establish the Canadian Centre for Climate Information and Analytics as an authoritative source of climate information and decision analysis,
- Define and pursue a Canadian approach to implementing the Task Force's recommendations on Climate-Related Financial Disclosures (TCFD),
- Clarify the scope of fiduciary duty in the context of climate change,
- Embed climate-related risk into monitoring, regulation and supervision of Canada's financial system.[12]

Neither the Expert Panel nor the Taskforce provided much detail on how they would proceed with their recommendations.

This article aims to argue for more complete and in-depth corporate disclosures of environmental information and provide specific recommendations to aid in the modernization of climate finance. This article posits that the TFCD and Expert Panel recommendations cannot be implemented unless and until provincial securities laws change to update definitions of

---

[10] *Final Report of the Expert Panel on Sustainable Finance*, by Expert Panel on Sustainable Finance (Gatineau Quebec: Canada, 2019) at 7.
[11] Expert Panel on Sustainable Finance, *supra* note 10; Expert Panel on Sustainable Finance, *supra* note 9.
[12] Expert Panel on Sustainable Finance, *supra* note 10 at recommendations 2, 4, 5, 6, 8.

materiality to enhance disclosure requirements. This would also mean that any changes recommended by the Capital Markets Modernization Taskforce could not be implemented, as they currently rely on the TFCD.

This disclosure requirement starts with a need for an updated definition of materiality in securities and corporate law.[13] This article investigates whether domestic securities requirements provide sufficient material disclosures of environmental, social, and governance ("ESG") issues. Second, if it is found that the definition of materiality should be updated, then the article will look to transnational frameworks to fill in the gaps in the disclosures of material information. Third, the article will analyze whether there is sufficient disclosed information to allow portfolio managers to create accurate valuations based on environmental and social factors. Does the finance community require new models that more accurately incorporate risk in a post-pandemic, low-carbon world?

This article will proceed as follows. The first section provides an overview of responsible/sustainable investing. The second section analyzes domestic securities laws in Canada, the United States, Europe, and international approaches to materiality. This section shows the need for more significant material disclosures and enhanced financialization of environmental and social risks. It illustrates how Canadian and the United States' current disclosure requirements are inadequate and will recommend new potential definitions. The third section will investigate the fiduciary duties of portfolio managers. It scrutinizes Canadian and American mutual funds to show that current financial models do not adequately incorporate environmental and social information. Finally, the article offers several recommendations and

[13] As noted by recommendation 5.3 of the Expert Panel

possible ways to incorporate environmental and social factors into valuation models. Climate models cannot be improved, and sustainable investments cannot be genuinely created until disclosures are improved.

Defining Responsible Investing

By some estimates, total global economic losses from natural disasters and human-made catastrophes in 2017 were USD $337 billion, and global insured losses from disaster events were USD $144 billion.[14] Sustainable finance aligns sustainable development and investor incentives in the global financial system.[15] Upwards of $1 trillion of new investment dollars per annum are required to fund sustainable projects, with approximately $43 trillion of current assets at risk due to climate change.[16]

Financial institutions are perceived as unseen polluters as they finance activities that cause pollution, such as oil and gas, and thus have a pivotal role in developing the risk adjustment metrics to address environmental and social issues.[17] Financial institutions currently do not have comprehensive, deal-by-deal climate-risk assessments across their portfolios and often have only minimal relevant climate attributes of their borrowers, investee companies or clients.[18]

---

[14] *Managing Physical Risk: Leveraging Innovations in Catastrophic Risk Modelling*, by Maryam Golnaraghi (Geneva Association, 2018).

[15] Stephen Kim Park, "Social Bonds for Sustainable Development: A Human Rights Perspective on Impact Investing" (2018) 0:0 Business and Human Rights Journal 1 at 13.

[16] TFCD, *supra* note 5 at iii.

[17] Nichola Saminather, "Canada's banks and investors face dilemma in meeting emissions target", (3 May 2021), online: <https://www.reuters.com/business/sustainable-business/energy-reliant-canada-banks-investors-face-dilemma-meeting-emissions-target-2021-05-02/>; Benjamin Richardson, "Financing Sustainability, the New Transnational Governance of Socially Responsible Investment" (2009) 74 Yearbook of International Environmental Law at 75; John Conley & Cynthia Williams, "Global Banks as Global Sustainability Regulators?: The Equator Principles" (2011) 33:4 Law and Policy 542.

[18] Joseba Eceiza, Banking imperatives for managing climate risk (McKinsey & Co., June 2020) online: https://www.mckinsey.com/business-functions/risk/our-insights/banking-imperatives-for-managing-climate-risk.

Responsible investing ("RI") attempts to allow investors and financers to make a substantial return on their investment while doing so in an environmentally, socially and ethically friendly manner.[19] Responsible Investing represents approximately 50.6% of Canada's investment industry.[20] Total US-domiciled assets under management using sustainable investing strategies grew from $8.7 trillion at the start of 2016 to $12.0 trillion in 2018, increasing 38 percent.[21] In the United States, the leading motivation is client demand, while 50% also cite other influencers: to fulfill mission or values, to pursue social or environmental benefits, to improve returns over time, to minimize risks and to fulfill a fiduciary duty.[22]

Responsible investment is generally seen as different and separate from socially responsible investment. Socially responsible investment is seen as an ethical concept, while responsible investment considers other factors. There has been a gradual evolution from socially responsible ethical concerns to a more holistic responsible investing model.[23]

There is no universally accepted single definition of what constitutes a responsible investment. However, generally accepted classifications include negative/exclusionary screening, positive/best-in-class screening, ESG integration, sustainability-themed investing, impact or community investing, corporate engagement, shareholder action, and climate finance.[24] Negative screens could include oil and gas, gambling, or other activity. Impact investing is

---

[19] Richardson, Benjamin, *Socially Responsible Investment Law: Regulating the Unseen Polluters* (New York: Oxford University Press, 2008).
[20] *2020 Canadian Responsible Investment Trends Report*, by Responsible Investment Association (2020) at 4.
[21] The Forum for Sustainable and Responsible Investment, "Current and Past Trends Reports – 2018 Trends Report" online: https://www.ussif.org/currentandpast.
[22] *2018 Global Sustainable Investment Review*, by Global Sustainable Investment Alliance at 14.
[23] Christophe Rivelli, "Socially Responsible Investing: From Mainstream to Margin?" (2017) 39 International Business and Finance 711 at 716.
[24] Responsible Investment Association, *supra* note 20 at 6; Global Sustainable Investment Alliance, *supra* note 22 at 7.

defined as targeted investments, typically made in private markets, aimed at solving social or environmental problems and is included within a broader scope of responsible investing.[25] An example could include a renewable energy project in a developing country.

Climate finance is understood to support adaptation and mitigation activities, but what counts as climate finance varies.[26] Institutional investors control significant amounts of global shareholdings and actively engage the firms they invest in promoting environmental and social factors within their portfolio companies.[27] Sustainable investing is intended to be more inclusive without drawing distinctions between related terms such as responsible and socially responsible investing.[28] For this article thus, responsible and sustainable investing will be used interchangeably.

Many institutional and retail clients demand that their portfolio managers consider environmental and social issues when making investment decisions.[29] Clients are asking their portfolio managers to engage the investee companies actively. Institutional investors are now deeply involved with company leadership in reciprocal communication, building a two-way relationship with management. This relationship rarely gets the newsworthy attention it deserves, yet it is perhaps more effective at bringing about change.[30]

---

[25] Global Sustainable Investment Alliance, *supra* note 22 at 4.

[26] Nathanial Mason et al., Just add water: a landscape analysis of climate finance for water, October 2020, online: https://washmatters.wateraid.org/publications/just-add-water-climate-finance

[27] Joakim Sandberg, "Socially Responsible Investment and Fiduciary Duty: Putting the Freshfields Report into Perspective" (2011) 101 Journal of Business Ethics 143.

[28] Global Sustainable Investment Alliance, *supra* note 22 at 3.

[29] Riikka Sievänen, Hannu Rita, & Bert Scholtens, "The Drivers of Responsible Investment: The Case of European Pension Funds" (2013) 117:1 J Bus Ethics 137–151 at 139–141; Global Sustainable Investment Alliance, *supra* note 22 at 14.

[30] Jeanne M Logsdon & Harry J Van Buren, "Beyond the Proxy Vote: Dialogues between Shareholder Activists and Corporations" (2009) 87:S1 J Bus Ethics 353–365 at 362.

There are studies showing sustainable funds outperform non-sustainable funds.[31] Some studies conclude that responsible investing underperforms non-responsible.[32] Many studies show no statistical difference in the performance of either type of investing.[33] Of the ones that show no statistical difference, or those that show negative results, the conclusions most often affirm a need for greater transparency by requiring additional disclosures or other legislative reform.[34]

---

[31] Benjamin R. Auer, "Do Socially Responsible Investment Policies Add or Destroy European Stock Portfolio Value?" (2016) 135 J Business Ethics 381;
This study shows the importance of screens on performance of funds:

(i) Negative screens excluding unrated stocks from a representative European stock universe allow investors to significantly outperform a passive investment in a diversified European stock benchmark portfolio.

(ii) Additional negative screens based on environmental and social scores neither add nor destroy portfolio value when cut-off rates are not too high. In contrast, governance screens can significantly increase portfolio performance under similar conditions. Thus, investors in the European stock market can do (financially) well while doing (socially) good.

(iii) Because of a loss of diversification, positive screens can cause portfolios to underperform the benchmark. This implies that investors should concentrate on eliminating the worst firms";

For the Canadian context, see Tessa Hebb, *Canadian SRI Mutual Funds Risk / Return Characteristics* (Carleton Centre for Community Innovation: Carleton University, 2015) pub R15-02;
In the Indian context, see Vanita Tripathi & Varun Bhandari, "Do Ethical Funds underperform conventional Funds? – Empirical Evidence from India" (2015) 4:2 International Journal of Business Ethics in Developing Economies; Gunnar Friede, Timo Buschi and Alexander Bassen, "ESG and financial performance: aggregated evidence from more than 2000 empirical studies" (2015) 5 J Sustainable Fin. & Inv. 210.

[32] Kathrin Lesser, Felix Rößle & Christian Walkshäus, "Socially responsible, green, and faith-based investment strategies: Screening activity matters!" (2016) 16 Finance Research Letters 171.

[33] Michael Trudeau, "Non-ethical funds outperform ethical rivals" (2011) Financial Advisor 1. Yet, this same article stated, "prior to the unravelling of the financial crisis and the subsequent economic downturn, ethical funds had their noses ahead of their non-ethical peers over the short term and were holding their own over the long term."

[34] Paulo Leite, & Maria Céu Cortez, "Style and performance of international socially responsible funds in Europe" (2014) 30 Research in International Business and Finance 248; M Cortez, F Silva, & N Areal, "The Performance of European Socially Responsible Funds" (2009) 87:4 J Business Ethics 573; J. Humphrey, & D. Tan, "Does it Really Hurt to be Responsible?" (2014) J Business Ethics 375; Jon Entine, *Pension Fund Politics: The Dangers of Socially Responsible Investing* (Washington: The AEI Press, 2005); Richard Copp, Michael Kremmer & Eduardo Roca, "Should Funds Invest in Socially Responsible Investments during Downturns? Implications for the Fiduciary Responsibilities of Investment Fund Trustees" (2010) 19:1 Griffith L. Rev. 86.

Disclosure & Materiality

Both primary and secondary public markets are an important component of capital formation. Companies listed on stock exchanges require capital to finance projects.[35] The primary market is where securities are first issued and sold to investors. Secondary markets are where investors buy and sell securities. The secondary market functions through an exchange or other over-the-counter mechanism, giving investors further opportunity to participate in growth prospects. Institutional and retail investors use secondary markets to create wealth, save for retirement and achieve other financial goals. Companies must disclose material information when they list on public markets.

This section will overview materiality and highlight disclosures in three key areas: environmental disclosures, human rights/gender disclosures, and executive compensation. It will compare Canadian, United States, European Union requirements, and transnational framework requirements to disclosure. It will then give key recommendations for potentially new materiality definitions that securities commissions could adopt.

Mandatory disclosures of material information are a critical component of securities regulation.[36] Securities law is concerned with disclosing material risk factors relating to the corporate issuer and its business.[37] Timely, accurate, and efficient disclosure of information and data is one primary way to achieve the goals of securities legislation.[38] Historically, corporate and securities laws in North America only weighed factors aimed at the primacy of profit and

---

[35] TMX Market Intelligence Group, "TSX-V YTD New Listings" (15 February 2018) online: https://www.tsx.com/listings/current-market-statistics.

[36] Christopher Nicolls, *Securities Law*, 2nd ed (Toronto: Irwin Law, 2018) cs 5, 6 & 9; Shi Zhen, "The impact of portfolio disclosure on hedge fund performance" (2017) 126 Financial Economics 36.

[37] *Continuous Disclosure Obligations*, OSC NI 51-102 (30 June 2015) at Form 51-102F2, Item 5.2.

[38] *Securities Act*, RSO 1990, c S5, s 2.

shareholder value maximization.[39] This view is changing, as shareholders may ultimately benefit from adopting non-financial measures, giving some weight to adding environmental or social factors to investor decisions.[40] Materiality is central to sustainable finance. Nevertheless, what appears to be a straightforward concept is proving slippery in practice and is triggering disagreements that could have significant implications for how companies disclose environmental and social indicators and how regulators construct market infrastructure.[41]

[39] Lawrence E Mitchell, "Groundwork of the metaphysics of corporate law" (1993) 50:4 Washington and Lee law review 1477 at 1485; Gregory Scott Crespi, "Maximizing the wealth of fictional shareholders: which fiction should directors embrace?" (2007) 32:2 The Journal of corporation law 381 at 383–386; Andrew Keay, "Shareholder Primacy in Corporate Law: Can it Survive? Should it Survive?" (2010) 7:3 European company and financial law review 369; Bryce C Tingle, "Two Stories About Shareholders" (2021) 58:1 Osgoode Hall law journal (1960) 57 at 70.
[40] Andrew Keay & Rodoula Adamopoulou, "Shareholder Value and UK Companies: A Positivist Inquiry" (2012) 13:1 European Business Organization Law Review 1–29 at 11; Bryce C Tingle, *supra* note 39 at 70.
[41] Arne Staal, "Materiality in sustainable investment: in the eye of the beholder" online https://www.climateaction.org/news/materiality-in-sustainable-investment-in-the-eye-of-the-beholder.

Canada

Securities laws are designed to "provide protection to investors from unfair, improper or fraudulent practices, and to foster fair and efficient capital markets and confidence in capital markets."[42] Determining materiality is crucial as to whether environmental or social factors need to be disclosed.[43] According to Professor Ford, "core definitions of materiality and disclosure should be broad and principles-based."[44]

In Canada, a material fact is currently defined as "a fact that would reasonably be expected to have a significant effect on the market price or value of the securities."[45] There are typically two types of documents, the initial documentation or prospectus and the ongoing continuous disclosure documents.[46] The prospectus must provide full, true and plain disclosure of all material facts relating to the securities issued or proposed to be distributed.[47] Any material fact or material change is required to be disclosed. A material change is defined as any change in the issuer that would reasonably be expected to have a "significant effect on the market price or value of a security of the issuer" or "whether a reasonable investment fund considers it important in determining whether to purchase or hold the security."[48]

The new paradigm for investors and fund managers is gradually shifting away from shareholder primacy to a multi-stakeholder engagement primacy model.[49] For example, in the

---

[42] Nicolls, *supra* note 36; *Securities Act*, RSNS 1989, c 418 at ss. s1A (1), 1.2(aab); *A Provincial/Territorial Memorandum of Understanding Regarding Securities Regulation (2004) online: https://www.securities-administrators.ca/aboutcsa.aspx?id=7*, by CSA; *Securities Act*, *supra* note 38 at ss 1.1, 143(13).

[43] *Disclosure Standards*, OSC NP 51-201 (12 July 2002).

[44] Cristie Ford, "Principles-Based Securities Regulation in the Wake of the Global Financial Crisis" (2010) 55 McGill LJ 257 at 268.

[45] *Securities Act*, *supra* note 38, s 1.1.

[46] *NI 51-102*, *supra* note 37 at s. 4(A.3); Continuous Disclosure Obligations CP 51-102CP (30 June 2015).

[47] *Securities Act*, *supra* note 38 at 61(1); *General Prospectus Requirements*, OSC NI 41-101 (6 July 2017).

[48] *Securities Act*, *supra* note 38, s 2.1(v).

[49] Edward Waitzer & Johnny Jaswal, "The Good Corporate Citizen" in *The Next Generation of Responsible Investing* (New York: Springer, 2012) at 127; Virginia Harper Ho, "'Enlightened Shareholder Value':

oft-cited cases of *BCE* and *Peoples*, the Supreme Court of Canada asserted that it might be legitimate for a board to consider the interests of a broad range of stakeholders when making decisions. These stakeholders include, but are not limited to, "shareholders, employees, suppliers, creditors, consumers, governments and the environment."[50]

The fixation on market price causes many problems and is a significant source of short terminism. Many executives only look at short-term profits and returns, even so far as to only look quarter by quarter. Environmental issues such as climate change are long-term problems, and effects may not be seen in one quarter. Nations such as Canada have weak records regarding climate disclosures, and in part, this may be due to lax national or provincial requirements for public disclosures.[51] Scholars have called for new transdisciplinary foundations to develop new, more powerful insights that extend beyond narrow disciplinary boundaries.[52]

Financial institutions fund types of projects and have a strong voice in the financing and investing of environmental projects.[53] In Canada, environmental disclosures are material if a "reasonable investor's decision whether or not to buy, sell or hold securities of the issuer would

---

Corporate Governance Beyond the Shareholder-Stakeholder Divide" (2010) 36:1 J Corp L 59; Eric Orts & Alan Strudler, "Putting a Stake in Stakeholder Theory" (2009) 88:Supplement 4 Journal of Business Ethics 605; David Yosifon, *Corporate Friction: How Corporate Law Impedes American Progress and What To Do About It* (Cambridge University Press, 2018).

[50] *BCE Inc. v 1976 Debentureholders*, 2008 SCC 69, [2008] 3 SCR 560 [BCE] at para 40; *Peoples Department Stores Inc. (Trustee of) v Wise*, 2004 SCC 68, [2004] 3 SCR 461 [Peoples]; *Stelco Inc.* (Re) (2005), 75 OR (3d) 5, 253 DLR (4th) 109 (CA); *Catalyst Fund General Partner I Inc. v Hollinger Inc*. (2004), [2004] OTC 1025, 1 BLR (4th) 186 (Sup Ct), aff'd (2006), 79 OR (3d) 288, 266 DLR (4th) 228 (CA) Waitzer and Sarro, supra at 814.

[51] CDSB, *Ready or not: Are companies prepared for the TCFD recommendations? A geographical analysis of CDP 2017 responses* (March 2018) at 8, 9, 18, 19, 21.

[52] Monika I Winn & Stefano Pogutz, "Business, Ecosystems, and Biodiversity: New Horizons for Management Research" (2013) 26:2 Organization & environment 203–229; Elisa Morgera, "Global Environmental Law and Comparative Legal Methods" (2015) 24:3 Review of European, comparative & international environmental law 254–263; Peer Zumbansen, "Defining the space of transnational law: legal theory, global governance, and legal pluralism" (2012) 21:2 Transnational law & contemporary problems 305.

[53] Erin Dooley, "UNEP finance initiative" (2006) 114:8 Environmental Health Perspectives 1.

likely be influenced or changed if the information was omitted or misstated."[54] Five material disclosure requirements are relevant: "environmental risks, trends and uncertainties, environmental liabilities, asset retirement obligations, and financial and operational effects of environmental protection requirements."[55] Environmental risks are further broken into five categories: litigation, physical, regulatory, reputation and business model.[56] These environmental issues must be disclosed in filings in continuing disclosure documents.[57]

Material financial information may not be captured because its long-term or contingent nature can be difficult to quantify.[58] Targets and goals, such as carbon reduction targets or water reduction targets, may be considered forward-looking information and require disclosure.[59] There is guidance to assist with materiality determinations of forward-looking targets but no consequences to the firm if they are not followed.[60] However, there is significant ambiguity in the language, allowing companies to opt-out of disclosure with no threat of penalties. It is not required to disclose carbon, water, waste or other specific climate data or targets for reducing emissions.

Financial data includes mortgage defaults, delinquencies from meteorological events (e.g., hurricanes and storms), hydrological events (floods), climatological events (heat waves, cold waves, droughts, and wildfires), geophysical events (e.g., earthquakes and volcanic eruptions), loans, and insurance in significant flood and fire zones. It would also require a robust

---

[54] *Environmental Reporting Guidance*, CSA Staff Notice 51-333 (27 October 2010) at 5–7.
[55] *Ibid* at 8.
[56] *Ibid* at 9–10.
[57] *Ibid* at 8; see also *Annual Information Forms*, BCSC Form 51-102F2 (30 June 2015); OSC, "Continuous Disclosures" online: http://www.osc.gov.on.ca/en/Companies_continuous-disclosure_index.htm; Thompson Reuters, "Annual Information Form (AIF)" online: https://ca.practicallaw.thomsonreuters.com/0-570-0162?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1.
[58] *Ibid* at 13.
[59] *Ibid* at 20.
[60] *Guidance Regarding the Application of Forward-Looking Information Requirements under NI 51-102 Continuous Disclosure Obligations*, CSA Staff Notice 51-330 (20 November 2009).

dataset on economic conditions, industry trends, and geopolitical risks that affect borrowers' creditworthiness, maturity or tenor of a loan, expected loss, including the probability of default, exposure at default, and value of posted collateral. It would also necessitate integrating social information, such as human rights, health and labour.

Gender diversity is gaining momentum as an important material disclosure topic. The Ontario Securities Commission, in its Staff Notice 58-401, highlighted the importance of gender diversity in broadening boards' skills and perspectives.[61] Disclosures regarding the number of women on boards of directors and whether the corporation has policies and targets for female representation must be disclosed.[62] These disclosures have been criticized as weak.[63] On the other hand, gender diversity disclosure has been criticized as unnecessary, ineffective and not material.[64] Evidence shows that having additional women on boards improves company performance and environmental disclosures.[65]

The *Canada Business Corporations Act* ("CBCA") has made amendments to gender disclosure, but only for proscribed companies, not privately held companies. Securities

---

[61] *Disclosure Requirements Regarding Women on Boards and in Senior Management,* OSC Staff Consultation Paper 58-401 (20 July 2013) at 5.

[62] CSA Notice, *Staff Review of Women on Boards and in Executive Officer Positions – Compliance with NI 58-101 Disclosure of Corporate Governance Practices*, CSA Multilateral Staff Notice 58- 309 (5 October 2017) at 5. A recent update of the *Canada Business Corporations Act* minorities, aboriginals and peoples with disabilities, see Bill C-25, An Act to amend the Canada Business Corporations Act, the Canada Cooperatives Act, the Canada Not-for-profit Corporations Act and the Competition Act, 1st Sess, 42nd Parl, 2015-2016-2017-2018, (assented to 1 May 2018) SC 2018, c. 8.

[63] Kim Willey, ''Bringing Canadian Women on Board: A Behavioural Economics Perspective on Whether Public Reporting of Gender Diversity Will Alter the Male-Dominated Composition of Canadian Public Company Boards and Senior Management" (2017) 29:1 Canadian J Women and the Law 182 at 209.

[64] Galit A Sarfaty, "Human rights meets securities regulation" (2013) 54:1 Virginia journal of international law 97.

[65] Bank of America, Merrill Lynch, "Women the X-Factor" (7 March 2018) (New York, BoA, 2018) online: https://mlaem.fs.ml.com/content/dam/ML/pdfs/ml_women-the-X-factor-BAML-Report.pdf at 1; CH Taljaard, Michael Ward & Chris Muller, "Board Diversity and Financial Performance: A graphical Time-Series Approach" (2015) 3:4 SAJEMS NS 18 25-448; Martin Conyona & Lerong Hec, "Firm performance and boardroom gender diversity: A quantile regression approach" (2017) 79 J Business Research 198.

legislation should follow the CBCA's lead and create greater clarification on enhanced reporting on female and minority participation. Shareholder control rights provided by Canadian and American incorporation statutes are still "so weak that they scarcely qualify as part of corporate governance."[66]

Taxes and other royalties and revenues paid to governments require disclosure, as recently mandated by the Canadian government for extractive industries.[67] Recent cases like the charges against SNC-Lavalin Group Inc. highlight the need to add more social metrics in investment analyses.[68] SNC-Lavalin is alleged to have committed misrepresentation in the company's continuous disclosure obligations.[69] Misrepresentation occurs from an "untrue statement of material fact, or an omission to state a material fact that is required to be stated, or that is necessary to make a statement not misleading in the light of the circumstances in which it was made."[70] There are civil liabilities for misrepresentation, whether or not the party relied upon the misrepresentation.

Consequently, if improper factors are omitted or misstated, a company could be liable to its investors.[71] Companies are adding a labour due diligence process to their processes and the processes of their supply chains.[72] Labour and human rights are often less analytically

---

[66] Bryce C Tingle, *supra* note 39 at 72.
[67] *Extractive Sector Transparency Measures Act*, S.C. 2014, c. 39, s. 376.
[68] *Drywall Acoustic Lathing and Insulation, Local 675 v. SNC-Lavalin Group Inc*., 2015 ONCA 718 (CanLII); *Trustees of the Drywall Acoustic Lathing and Insulation Local 675 Pension Fund v SNC-Lavalin Group Inc*., 2017 ONSC 2188 (CanLII).
[69] *Ibid* at para 1.
[70] *Securities Act*, *supra* note 38, s 1.1.
[71] *Drywall Acoustic*, *supra* note 135 at para 62, 66. *Drywall Acoustic Lathing and Insulation Local 675 Pension Fund (Trustees of) v. SNC-Lavalin Group Inc*., [2016] O.J. No. 4918 at para 47, 51.
[72] George Benaur, David Dixon & Jonathan Lenzner, "Evolving Compliance Regulations Impact Scope of Due Diligence; Corporations face greater obligations regarding international supply chain management" (2014) 217:9 NJ L. Rev. 38; Lahra Liberti, "OECD 50th anniversary: The updated OECD guidelines for multinational enterprises and the new OECD recommendation on due diligence guidance for conflict-free mineral supply chains" (2012) 13:1 Business L. Int. l 35.

quantitative, so judging a company's social metrics is more difficult.[73] This leverage-based responsibility provides a rationale for investors to promote social and environmental returns to society.[74]

Executive compensation is a vital material governance issue.[75] Greater transparency on public companies' compensation policies will allow investors to make better-informed voting and investment decisions and help align management's incentives.[76] Executive compensation is often tied to share price. There is an incentive for executives to 'game the system' by focusing on short-term profits to exclude long-term value through stock options, bonuses and other payment mechanisms. Securities disclosure and materiality need to align executive behaviour to long-term value. Updating the definition of materiality will help to align behaviours.

In Canada, several jurisdictions have expressly mandated the permissibility of integrating environmental and social factors into their investment philosophies.[77] The *Ontario Pension Benefits Act*, *Regulation 909,* requires pension funds in Ontario to disclose in their investment policies information about whether environmental, social and governance factors are incorporated into the plan's investment policies and procedures and, if so, how those factors are incorporated.[78] Manitoba also expressly allows for non-financial considerations in its pension

---

[73] UN Human Rights, "Conceptualizing Indicators for Human Rights, Issues to Address in Human Rights Measurement" (18 January 2013) online: https://www.ohchr.org/documents/issues/HRIndicators/AGuideMeasurementImplementationChapterII_en.pdf.

[74] Benjamin J Richardson, "Socially Responsible Investing for Sustainability: Overcoming Its Incomplete and Conflicting Rationales" (2013) 2:2 TEL 311–338 at 322.

[75] *Statement of Executive Compensation, OSC* NI 51-102, Form 51-102F6 (31 October 2011).

[76] Bill Rice, Chair of the CSA, *Canadian Securities Regulators Proceed with Enhanced Executive Compensation Disclosure Requirements,* Press Release (22 July 2011).

[77] Riikka Sievänen et al, "From struggle in responsible investment to potential to improve global environmental governance through UN PRI" (2013) 13:2 Int Environ Agreements 197–217 at 203, 212; *Fiduciary Duty in the 21st Century – Canada Roadmap*, by UNEP FI (New York: UNEP FI, 2017) at 5.

[78] *Ontario Pension Benefits Act, Reg*. 909 s. 78(3); FSCO, *Investment Guidance Notes: Environmental, Social and Governance (ESG) Factors*, IGN-004, (1 January 2016).

legislation.[79] The Canadian Pension Plan, the nation's federal pension scheme, has internally mandated the inclusion of sustainability factors into financial analysis, despite enacting legislation's silence.[80]

Divestment can occur either from poor financial performance or by being in an undesired sector or industry, such as the oil and gas industry. The Canada Pension Plan refuses to divest, and screening techniques, including negative screens, are not used. Proxy voting is a key priority; "voting proxies is not only our fiduciary responsibility as a shareholder; it is also a crucial way to convey our views to boards of directors and management."[81] Divestment is not seen as a priority for the Canada Pension Plan, as "divestment can lead to substantially lower returns, and not result in changed corporate behaviours."[82] Additionally, several major banks counter the argument to divest by arguing that Canada is an oil sands country and has obligations to fund oil.[83]

However, not all public companies disclose environmental, social or governance issues, especially climate. The top reasons cited for not disclosing were:

> 1) conclusion that climate change-related risks are not material to the issuer currently,
> 2) the lack of a common framework for measuring environmental factors,
> 3) already addressed climate change-related risks by disclosing broader physical or environmental risks in their documents,
> 4) uncertainty exists with respect to the specific effects of climate change which prevents a reliable assessment of how, or to what extent, climate change, considered in isolation, would affect previously identified physical risks affecting the issuer's operations,
> 5) policy and regulatory frameworks' changes to be uncertain, which presented challenges for issuers to predict these risks' financial impact. [84]

---

[79] Manitoba, *Pension Benefits Act*, C.C.S.M. c. P32 s. 28, 28.1.

[80] CPPIB, *Sustainable Investing Policy 2016* (Toronto/Ottawa: CPPIB, 2017); CPPIB, 2015 Report on Sustainable Investing (Toronto: CPPIB, 2016) online: http://www.cppib.com/content/dam/cppib/How%20we%20invest/Responsible%20Investing/Responsible%20investing%; *Canada Pension Plan Investment Board Act,* SC 1997 c. 40 , *CPPIB Regulations* SOR/99-190

[81] CPPIB, "Proxy Voting" online: http://www.cppib.com/en/how-we-invest/sustainable-investing/proxy-voting/.

[82] Mark Wiseman, Twitter feed, (6 June 2016) online via Twitter: @cppib.

[83] Nichola Saminather, Canada's banks and investors face dilemma in meeting emissions target (3 May 2021) online: https://www.reuters.com/business/sustainable-business/energy-reliant-canada-banks-investors-face-dilemma-meeting-emissions-target-2021-05-02/.

[84] *Report on Climate change-related Disclosure Project*, CSA Staff Notice 51-354 (21 March 2017).

From this report, issues of materiality, uncertainty, and lack of common disclosure frameworks are significant reasons for non-reporting.

United States

United States securities laws require publicly traded businesses to file extensive disclosures about their operations, capital structure, financial performance and provide periodic updates.[85] The current jurisprudence in the United States, led by the Delaware Supreme Court's decisions in *Unocal* and *Revlon*, rests exclusively within the shareholder primacy camp.[86] Moreover, the U.S. Supreme Court in its *TSC Industries v. Northway* states that an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.[87]

Prospectus and continuous disclosure obligations in the United States are similar to those in Canada, as both require full true and plain disclosures of material facts.[88] The *Securities Acts* and *Securities and Exchange Commission Acts* in the United States mandate disclosures of material facts, like its Canadian counterparts.[89] This mandate requires disclosure if a reasonable investor would attach importance to whether they would purchase the security.[90] The Securities

---

[85] Ann Lipton, "Mixed Company: The Audience for Sustainability Disclosures" (2018) 107 Georgetown Law Review 81.
[86] *Unocal Corp v Mesa Petroleum Co*, 493 A (2d) 946 (Del 1985); *Revlon, Inc. v MacAndrews & Forbes Holdings, Inc*., 506 A (2d) 173 (Del 1986); Waitzer and Sarro, supra at 793.
[87] *TSC Industries, Inc. v. Northway, Inc*., 426 U.S. 438, 449 (1976). The materiality standard was reaffirmed by the Supreme Court in *Basic Inc. v. Levinson*, 485 U.S. 224, 232 (1988)
[88] Natalie Nowiski, "Rising above the Storm: Climate Risk Disclosure and its Current and Future Relevance to the Energy Sector" (2018) 39:1 Energy Law Journal 1 at 5.
[89] *Securities Act of 1933* 15 U.S.C. § 77a et seq., *Securities and Exchange Act, 1934*, 15 U.S.C. § 78a et seq. Pub.L. 73–291, 48 Stat. 881, enacted June 6, 1934; s. 4.; *Securities Commission Act*, 15 U.S.C. §§ 77a-77aa 20, 15 U.S.C. §§ 78a-78pp.
[90] *Securities Act Rule* 405, 17 C.F.R. § 230.405; *Exchange Act Rule* 12b-2, 17 C.F.R. § 240.12b-2.

& Exchange Commission ("SEC"), like their Canadian counterparts, has been criticized for having weak enforcement policies for environmental disclosures.[91]

Like the Canadian approach, the Management Discussion & Analysis ("MD&A") provides a narrative to the financial statements from management's perspective, enhancing financial information disclosures and improving cash flow and earnings quality.[92] The MD&A discusses past performance but emphasizes future earnings potential.[93] The disclosure provided should be "clear, communicating to shareholders management's view of the company's financial condition and prospects."[94] Similar to other disclosure requirements, the reporting threshold is that of materiality.[95]

United States environmental reporting originated in the 1970s.[96] These early disclosures focused on litigation and the cost of environmental discharges.[97] *Securities Act Rule* 408[98] and *Exchange Act* Rule 12b-20, added in the early 1980s, require a registrant to disclose "such further material information, if any, as may be necessary to make the required statements, in light

[91] David Gelles, "S.E.C. Is Criticized for Lax Enforcement of Climate Risk Disclosure" New York Times (23 January 2016) online: https://www.nytimes.com/2016/01/24/business/energy-environment/sec-is-criticized-for-lax-enforcement-of-climate-risk-disclosure.html.

[92] *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*, SEC, 17 CFR Parts 211, 231 and 241 [Release Nos. 33-8350; 34-48960; FR-72] (29 December 2003).

[93] SEC, *Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures*, Release No. 33-6835 (May 18, 1989) [54 FR 22427 (May 24, 1989)] ("1989 MD&A Interpretive Release") (setting forth a two-step analysis for disclosure of material forward-looking information in MD&A.

[94] Instruction 2 to Item 303(a) of Regulation S-K [17 CFR 229.303(a)].

[95] Item 303 of Regulation S-K 17 CFR 229.303.

[96] Release No. 33-5170 (July 19, 1971) [36 FR 13989]; Interpretive Release No. 33-6130 (September 27, 1979) [44 FR 56924] (the "1979 Release"), which includes a summary of the legal and administrative actions taken about environmental disclosure during the 1970s. More information relating to the Commission's efforts in this area is chronicled in Release No. 33-6315 (May 4, 1981) [46 FR 25638].

[97] Interpretive Release No. 33-6130 (September 27, 1979) [44 FR 56924] (the "1979 Release"), which includes a summary of the legal and administrative actions taken about environmental disclosure during the 1970s. Release No. 33-6315 (May 4, 1981) [46 FR 25638].

[98] 17 CFA 230.408.

of the circumstances under which they are made."[99] Item 101 deals with the discharge of materials on companies' capital expenditures,[100] while Item 103 details disclosures required for environmental litigation.[101]

The American Law Institute's ("ALI") production of the *Third Restatement of Trusts* codified the modern *Prudent Investor Rule*.[102] Essentially, this requires a trustee to diversify the portfolio in an integrated and optimized manner and not simply minimize risk and maximize profit.[103] The Securities and Exchange Commission clarified voting obligations in 2003, adopting disclosure rules for proxy voting.[104] The commission noted that in 2002 there was a shareholder proposal seeking to require a major fund to disclose its proxy votes on social and environmental issues, which generated significant support from fund shareholders. Further, they stated: "regardless of whether all or a majority of, investors are interested in proxy vote disclosure, we believe that fund shareholders interested in this information have a fundamental right to know how the fund has exercised its proxy votes on their behalf."[105]

Currently, R*egulation S-K* and *Regulation S-X* require disclosure of specific environmental issues.[106] SEC Guidance in 2010 ("2010 Guidance") stated:

---

[99] 17 CFR 240.12b-20.
[100] Release No. 33-6383 (3 March 1982).
[101] 17 CFR 229.103.
[102] American Law Institute, *Restatement of the Law Third, Trusts*, (2007) §§ 70 to 92 c. 17.
[103] Corina Weigl, "Prudent Investor Rule and Modern Portfolio Theory" (2014) 33 Estate Trust & Pensions Journal 145 at 151.
[104] SEC, "Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management investment companies" (January 31, 2003) 17 CFR Parts 239, 249, 270, and 274; The SEC further clarified that investment advisors must also disclose. See SEC, *Proxy Voting by Investment Advisors* (January 31, 2003) 17 CFR Part 275; Richardson, *supra* at 314-317.
[105] *Ibid.,*
[106] *Part 229—Standard Instructions for Filing Forms Under Securities Act of 1933, Securities Exchange Act of 1934 and Energy Policy and Conservation Act of 1975 - Regulation S-K*, 17 CFR Part §229; *PART 210—FORM AND CONTENT OF AND REQUIREMENTS FOR FINANCIAL STATEMENTS, SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934, INVESTMENT COMPANY ACT OF 1940, INVESTMENT ADVISERS ACT OF 1940, AND ENERGY POLICY AND CONSERVATION ACT OF 1975 - Regulation S-X*, 17 CFR Part 210.

> "…financial risks associated with climate change **may** arise from physical risks to entities other than the registrant itself. For example, climate change-related physical changes and hazards to coastal property can pose credit risks for banks whose borrowers are located in at-risk areas. Companies also may be dependent on suppliers that are impacted by climate change, such as companies that purchase agricultural products from farms adversely affected by droughts or floods." [107]

According to this Guidance, climate change issues **may** (emphasis added) trigger disclosure requirements.[108] Climate change risk (including reputation and weather risk) is a substantial risk that may require disclosure in the MD&A.[109] In the case of MD&A disclosures, the impact of pending legislation or cap and trade systems may also trigger disclosure.[110] There is also specific guidance for the insurance industry.[111] Several states have mandatory reporting mandates for carbon emissions, although such an analysis is beyond this paper's scope.[112] There is no guidance for water or other environmental issues. These disclosure requirements do not cover all environmental issues. Water, waste, and the medium to long-term effects of a changing climate are just a few of the shortcomings of current requirements.

This lack of proscribed regulation and the word "may" in climate change materiality regulations is problematic. Companies' fixation on share price allows for significant 'wiggle room' to state that certain climate information is immaterial and does not need disclosure. Even without updating materiality, there is a solution to the vagueness of current disclosure requirements. The Environmental Protection Agency is still asking for greater availability of

---

[107] *Commission Guidance Regarding Disclosure Related to Climate Change 17 CFR PARTS 211, 231 and 241*, by SEC, [Release Nos. 33-9106; 34-61469; FR-82] (SEC, 2010) at 7.

[108] *Part 229—Standard Instructions for Filing Forms Under Securities Act of 1933, Securities Exchange Act of 1934 and Energy Policy and Conservation Act of 1975 - Regulation S-K*, *supra* note 106 at Items 101, 103, 303 & 503(c); SEC, *supra* note 107 at 22.

[109] SEC, *supra* note 107 at 25.

[110] *Ibid* at 23.

[111] NAIC, "Insurance Regulators Adopt Climate Change Risk Disclosure" (2009) online: www.naic.org/Releases/2009_docs/climate_change_risk_disclosure_adopted.htm.

[112] EPA, "State and Local Climate Change Laws" online: http://epa.gov/climatechange/wycd/stateandlocalgov/state_reporting.html

climate information.[113] Specifically, the agency asks for more information to link climate and weather data to labour supply, health, mortality and morbidity.[114] It is necessary to obtain better climate data, calculations on the impact of carbon taxes or carbon pricing mechanisms, emission intensities, and their variabilities across industries and sectors. These models will assist in creating environmental benefit factors, described below.

Human rights reporting is also coming into the mainstream in the United States. Issues ranging from conflict minerals and payments to governments are beginning to be reported.[115] Much of the movement about social rights is not solely predicated on financial returns but also concerns other than wealth building.[116] The Securities and Exchange Commission produced standards for assessing diversity policies and practices of regulated entities.[117] The standards included an organizational commitment to diversity and inclusion, employment practices; procurement and business practices; and practices to promote transparency of organizational diversity.[118]

As in Canada, there is a great debate as to whether securities laws are the best avenue to address human rights concerns. Some argue that securities laws may make these measures effective as companies take notice of securities laws.[119] Securities laws may also raise the profile on human rights issues. The main argument against disclosures of human rights issues is that this

---

[113] EPA, "Letter to Scott Pruitt, Subject: SAB Advice on the Use of Economy Wide Models in Evaluating the Social Costs, Benefits, and Economic Impacts of Air Regulations" (29 September 2017) EPA doc.EPA-SAB-17-012.
[114] *Ibid* at 58.
[115] Sarfaty, *supra* note 64 at 98, 106–107.
[116] Lipton, *supra* note 85 at 84.
[117] *Final Interagency Policy Statement Establishing Joint Statements for Assessing the Diversity Policy and Practices of Entities Regulated by the Agencies*, SEC Release No. 34-75050; File No. S7-10-15 (10 June 2015).
[118] SEC, "Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Securities and Exchange Commission - Frequently Asked Questions" SEC 80 FR 33016 at 1.
[119] Sarfaty, *supra* note 64 at 109.

information may be 'information overload' while not material.[120] Others argue that human rights reporting has little to do with the purpose of securities laws, may not affect corporate behaviour, and could even push people to conflict.[121] Thus there is great debate on human rights issues, with some going so far as to claim that diversity initiatives could negatively impact company performance.[122]

In 2009, the SEC adopted disclosure rules to enhance corporate governance factors, such as executive compensation and board diversity.[123] This rule requires disclosing whether the board nominating committee has a policy on diversity.[124] In 2016, the SEC issued a Concept Release[125] on the Business and Financial Disclosure under *Regulation S-K* (the "2016 Concept Release.")[126] The 2016 Concept Release was developed due to calls from investors interested in the potential relevance of environmental and social variables in assessing shareholder value, due to the inadequate disclosure of climate change and other environmental risks.[127] The 2016 Release requested comments related to whether additional disclosures were necessary.[128]

Comments to this release were mixed. Most submissions agreed that there is a lack of environmental and social factors in disclosure analyses.[129] Most also agreed that risk represents

---

[120] *Ibid* at 113.
[121] *Ibid* at 100, 106, 110.
[122] Amanda Packel, "Government intervention into board composition: Gender quotas in Norway and diversity disclosures in the United States" (2016) 21:2 Stanford J L, Bus. & Fin. 192 at 201; Aaron Dhir, *Challenging Boardroom Homogeneity* (Cambridge University Press, 2015) at 67.
[123] *Part 229—Standard Instructions for Filing Forms Under Securities Act of 1933, Securities Exchange Act of 1934 and Energy Policy and Conservation Act of 1975 - Regulation S-K*, *supra* note 106 at Items 402 & 407(c)(2)(vi).
[124] SEC, "Proxy Disclosure Enhancements" online: https://www.sec.gov/rules/final/2009/33-9089-secg.htm.
[125] U.S. SEC, *Business and Financial Disclosure Required by Regulation S-K* [hereinafter 2016 Release], 81 Fed. Reg. 23915; Release No. 33-10064; 34-77599; File No. S7-06-16 (Apr. 13, 2016).
[126] SEC, 17 CFR Parts 210, 229, 230, 232, 239, 240 and 249 Release No. 33-10064; 34-77599; No. S7-06-16.
[127] *Ibid* at *Part* 208.
[128] William Thomas & Annise Maguire, *SEC Studying Change of Regulation S-K to Require ESG Disclosures Client Memorandum (*7 November 2016) (Willkie Farr and Gallagher, LLP: New York, 2016).
[129] Senator Mark Warner, ES157157, (19 July 2018) at 1; Kurt N. Schacht & James Allen, CFA Institute, "Re: Business and Financial Disclosure Required by Regulation S-K (File No. S7-06-16)" (6 October 2016) at 10.

an evolving term, causing issues to be material in some years while not in others. The goal should be to ensure that adequate measurement, authentication, and disclosure of these factors are undertaken by issuers so that investors can fully understand the long-term potential for the companies in which they invest. Others propose a principles-based approach, which removes any specific dollar threshold from a materiality analysis.[130] According to Professor Brown,

> While some commenters believe that the problem can be solved through increased guidance and enforcement by the Commission, most do not. Instead, changes to the disclosure regime are needed.[131]

However, no additional amendments to S-K have been made, and considerable uncertainty still exists for materiality and disclosures. On 4 March 2021, the SEC created a climate and environmental task force to identify environmental and climate misconduct proactively.[132] Further, on 15 March 2021, the SEC issued a request to evaluate current disclosure rules and sought public input on potential ramifications on updating regulations S-K and S-X.[133] As of the submission date, more than 3,000 comments have been received. Of those that were available, several comments may underscore a reason why updates to disclosures and materiality are neither necessary nor wanted.

Many believe that current definitions of materiality are sufficient and that current rules already mandate sufficient disclosure.[134] Others argue that standards and standardization would reduce fragmentation.[135] Further, some believe that financial or non-financial silos should not be

---

[130] For example, see Richard Levy, Chairman, Committee on Corporate Reporting Financial Executives International, "Subject: File No. S7-06-16: Concept Release on Business and Financial Disclosure Required by Regulation S-K" (3 October 2016) at 7.

[131] J. Robert Brown, University of Denver Sturm College of Law, "Subject: File No. S7-06-16" (3 October 2016) at 1.

[132] SEC, "SEC Announces Enforcement Task Force Focused on Climate and ESG Issues" online: https://www.sec.gov/news/press-release/2021-42.

[133] SEC, Public Input Welcomed on Climate Change Disclosures" online: https://www.sec.gov/news/public-statement/lee-climate-change-disclosures.

[134] Institute of Management Accountants, "Re: Request for Public Input on Climate Change Disclosures" 12 June 2021, online: https://www.sec.gov/comments/climate-disclosure/cll12-8911438-244321.pdf

[135] Ibid.

created. Others believe that it is simply not the SEC's role to mandate disclosure. Others believe that a one-size-fits-all approach would generate climate-related information of interest only to a minority of shareholders and investor activists.[136] However, this view is primarily based on the lack of one international framework emerging as dominant. Thus, materiality and disclosures should only be updated after these frameworks develop so that companies and industries can be compared.[137] As discussed below, many of these framework organizations are working together to make one set of standards, to reduce this fragmentation. Finally, many believe a principles-based approach with clear rules on liability must accompany any requirement of additional climate disclosures.[138]

However, it is for these reasons that many are championing additional disclosure. For example, many believe that the lack of high-quality, comparable, decision-useful information on material climate information and ESG factors makes it harder for the market to efficiently allocate capital to companies that generate strong long-term financial returns.[139] Further, these investors note that several jurisdictions mandate additional disclosure of climate information of firms issuing securities to the public.

The Securities and Exchange Commission should work with investors and issuers on material issues relevant to specific industries.[140] They need to ensure that adequate

---

[136] National Investor Relations Institute, Subject: Public Input Welcomed on Climate Change Disclosures, 11 June 2021, online: https://www.sec.gov/comments/climate-disclosure/cll12-8907317-244255.pdf
[137] Ibid.
[138] Ibid.
[139] Neuberger Berman Group LLC, Re: Public Input on Climate Change Disclosures, 11 June 2021, online: https://www.sec.gov/comments/climate-disclosure/cll12-8907251-244243.pdf ; Revolving Door Project, "Re: Public Statement: Public Input Welcomed on Climate Change Disclosures, Acting Chair Allison Herren Lee, 15 March 2021, online: https://www.sec.gov/comments/climate-disclosure/cll12-8907318-244256.pdf
[140] CFA Institute, *re: Business and Financial Disclosure Required by Regulation S*-K (File No. S7-06-16), (letter to SEC) (6 October 2016) at 10; the CFA Institute governs the Chartered Financial Analyst ("CFA") designation. The CFA is the preeminent designation required to become a portfolio manager. The CFA has stated that in their next CFA program curriculum, the content devoted to environmental, social, and

measurement, authentication and disclosure of responsible factors are undertaken by issuers so that investors can fully understand the long-term value of a company.[141] The CFA Institute recommended a flexible approach that allows industries not to worry about disclosures that do not apply.[142] They conclude:

> many issuers already provide lengthy sustainability or ESG reports to their investors, so many issuers will not face a new and burdensome cost by collecting, verifying and disclosing ESG information. We believe that all issuers should be held to the same disclosure standards on sustainability and public policy issues. [143]

It is not only the Securities and Exchange Commission that is facing resistance. The federal Department of Labour noted that for the *Employee Retirement Income Security Act,* "where environmental, social and governance issues are material to the economic value of an investment, those issues form part of the fiduciary's analysis."[144] They continue that these issues "are not merely collateral considerations or tie-breakers, but rather are proper components of the fiduciary's primary analysis of the economic merits of competing investment choices."[145]

Though the matter is subject to some debate, the federal Employee Retirement Income Security Act ("ERISA") is often interpreted to require that fund managers act only to maximize the fund's wealth, regardless of social concerns.[146] However, fiduciaries are not permitted to sacrifice investment return or take on additional investment risk to use plan investments to

---

governance factors will increase by 130%. See, CFA Institute, "CFA Institute Is Committed to Sustainable Investing" online: https://www.cfainstitute.org/en/research/esg-investing/sustainable-investing

[141] *Ibid* at 10.

[142] *Ibid* at 18.

[143] *Ibid* at 19.

[144] US Department of Labor, Interpretive Bulletin (IB 2015-01) *on Economically Targeted Investments (ETIs) and Investment Strategies that Consider Environmental, Social and Governance (ESG) Factors* (2015).

[145] US Department of Labor, *Fact Sheet on IB 2015-01* (22 October, 2015) online: https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/etis-and-investment-strategies-that-consider-esg-factors.pdf.

[146] David Webber, The Use and Abuse of Labor's Capital, 89 N.Y.U. L. REV. 2106 at 2119–21

promote collateral, social policy goals.[147] In late 2020, the Department of Labor went further only to allow financial metrics and clarify that ERISA plan fiduciaries may not subordinate return or increase risks to promote non-pecuniary objectives.[148] They state:

> Public companies and their investors may legitimately pursue a broad range of objectives, subject to the disclosure requirements and other requirements of the securities laws. Pension plans and other benefit plans covered by ERISA, however, are bound by statute to a narrower objective: Prudent management with an "eye single" to maximizing the funds available to pay benefits under the plan. Providing a secure retirement for American workers is the paramount, and eminently worthy, "social" goal of ERISA plans; plan assets may never be enlisted in pursuit of other social or environmental objectives at the expense of ERISA's fundamental purpose of providing secure and valuable retirement benefits.[149]

The final rule recognizes instances where one or more environmental, social, or governance factors will present an economic business risk or opportunity that qualified investment professionals would appropriately treat as material under generally accepted investment theories. In June 2020, the Department of Labor proposed a further amendment to the investment duties.[150] The proposal acknowledged that sustainability factors could be pecuniary factors, but only if they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories.[151] Public support was mixed, and there is much opposition (and support for) the proposal. Many of the comments argue that the approach is incongruent with that of other regulators who require consideration of financially material factors and focus on the importance of disclosing those factors. However, the greatest misunderstanding is the continued separation of environmental, social and governance factors solely from non-financial metrics. As such, several states are taking a different approach.

---

[147] U.S. Department of Labor, Field Assistance Bulletin No. 2018-01 - Superseded by 85 FR 72846 and 85 FR 81658 FIELD ASSISTANCE BULL. NO. 2018-01.

[148] 85 FR 72846 at 72848.

[149] *Ibid.*

[150] 85 FR 39113 (June 30, 2020).

[151] *Ibid.*

New York state believes in divestment and is going one step further; the New York Common Fund is suing Exxon Mobil Corporation, a publicly-traded oil company, claiming that its deceived shareholders on climate change.[152] Exxon, the applicants argued, did not disclose its effects on climate change. A New York court ruled that "Exxon Mobil made any material misstatements or omissions about its practices and procedures that misled any reasonable investor."[153]

New York state has followed this up with several shareholder resolutions, including setting targets and lowering carbon emissions.[154] As late as May 2019, the fund supported a shareholder resolution to separate the chief executive position from the chair of the board, claiming, "when the CEO [chief executive officer] serves as board chair, it not only presents an inherent conflict of roles but is also a larger warning sign of bad corporate governance as it raises serious questions that the board may be merely a rubber stamp instead of providing genuine oversight." DiNapoli added that "Exxon's board's refusal to adequately address significant shareholder concerns and properly account for climate risk in its operations, even as its competitors do so, presents a governance crisis. Exxon's failure to demonstrate that it is prepared to take steps toward the transition to a lower carbon future puts its business at risk. We encourage other investors to join us in voting to separate the roles of chair and chief executive officer."[155]

---

[152] *People of the State of New York, by Barbara Underwood, Attorney General of the State of New York v. Exxon Mobil Corporation*, Index No. 452044/2018, filed October 24, 2018, online: https://ag.ny.gov/sites/default/files/summons_and_complaint_0.pdf.

[153] *People v Exxon Mobil Corp*., 2019 N.Y. Misc. LEXIS 6544, 2019 NY Slip Op 51990(U), 65 Misc. 3d 1233(A), 119 N.Y.S.3d 829, 49 ELR 20199, 2019 WL 6795771 (N.Y. Sup. Ct. December 10, 2019).

[154] Office of the New York State Comptroller, "NYS Comptroller DiNapoli and Church of England Call on ExxonMobil to Set Targets for Lowering GHG Emissions" (17 December 2018) online: https://www.osc.state.ny.us/press/releases/dec18/121718.htm

[155] *Notice of Exempt Solicitation*, "Form PX14A6G Exxon Mobil Corp." Filed by New York State Common Retirement Fund, online:

The state of Massachusetts has taken on the cause, also alleging a breach of disclosures.[156] While the claim will not proceed in Federal court, it may proceed in state court. Thus, in the United States, court action will not change disclosure practices. It is up to securities commissions and investors to force companies to disclose.

According to Waitzer and Sarro, corporate purpose does not lend itself to any clear or constant definition. Rather, courts' understanding of corporate purpose adapts over time to reflect evolving social norms and expectations regarding the proper role of the corporation in society.[157] Further, Tingle notes that "all that we are concerned about at present is whether the empirical evidence supports the good shareholder story: It does not. Regulators and market participants should therefore be cautious about automatically associating measures that increase shareholder power with improvements in the market."[158]

Europe, discussed next, is one of the jurisdictions that require additional disclosures. In a global investing world, there is potential for investors to move their finances to jurisdictions with more robust climate legislation in place.

Europe and the United Kingdom

Under Accounting Directive 2013/34/EU, the European Union enacted financial and non-financial reporting requirements for large and public firms.[159] According to this directive:

> Annual financial statements pursue various objectives and do not merely provide information for investors in capital markets but also account for past transactions and enhance corporate governance. Union

---

https://www.streetinsider.com/SEC+Filings/Form+PX14A6G+EXXON+MOBIL+CORP+Filed+by%3A+NEW+YORK+STATE+COMMON+RETIREMENT+FUND/15477798.html

[156] *Massachusetts v. Exxon Mobil Corp*., 2020 U.S. Dist. LEXIS 93153, 50 ELR 20136, 2020 WL 2769681 (D. Mass. May 28, 2020).

[157] Edward J Waitzer & Douglas Sarro, "In Search Of Things Past And Future: Judicial Activism And Corporate Purpose" (2019) 55:3 Osgoode Hall law journal 791.

[158] Bryce C Tingle, *supra* note 39 at 107.

[159] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.

> accounting legislation needs to strike an appropriate balance between the interests of the addressees of financial statements and the interest of undertakings not being unduly burdened with reporting requirements.

The directive takes a principles-based approach to reporting to avoid companies creating a group structure containing multiple layers of undertakings. Like Canada and the United States, annual financial statements should be prepared on a prudent basis and give a true and fair view of an undertaking's assets and liabilities, financial position, and profit or loss.[160] The directive also bases reporting on materiality:

> The principle of materiality should govern recognition, measurement, presentation, disclosure and consolidation in financial statements. According to the principle of materiality, information that is considered immaterial may, for instance, be aggregated in the financial statements. However, while a single item might be considered to be immaterial, immaterial items of a similar nature might be considered material when taken as a whole. Member States should be allowed to limit the mandatory application of the principle of materiality to presentation and disclosure. The materiality principle should not affect any national obligation to keep complete records showing business transactions and financial position.[161]

Material means the status of information where its omission or misstatement could reasonably be expected to influence decisions that users make based on the financial statements of the undertaking. The materiality of individual items shall be assessed in the context of other similar items.[162] Thus, materiality, like Canada and the United States, was solely based on financial factors. However, environmental and social factors are to be included:

> The management report and the consolidated management report are important elements of financial reporting. A fair review of the development of the business and its position should be provided in a manner consistent with the size and complexity of the business. The information should not be restricted to the financial aspects of the undertaking's business, and there should be an analysis of environmental and social aspects of the business necessary for an understanding of the undertaking's development, performance or position.[163]

Further, Article 19(1) states:

> To the extent necessary for an understanding of the undertaking's development, performance or position, the analysis shall include both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters.

---

[160] *Ibid* at Preamble (6), Article 6(1)(c), Article 8, Article 9(1).
[161] *Ibid* at Preamble (17), Article 2(16).
[162] *Ibid* at Article 2(16).
[163] *Ibid* at Preamble (26).

Thus, the preamble uses the term should, indicating that the firm did not require an environmental and social factors analysis. However, Article 19(1), the use of shall, includes non-financial indicators, suggesting that environmental factors are important. The directive also provided for enhanced transparency of payments made to governments. Large undertakings and public-interest entities active in the extractive industry or logging of primary forests should disclose material payments made to governments in the countries they operate in a separate report on an annual basis.[164]

Directive 2014/95/EU, also called the *Non-Financial Reporting Directive*, sets out the rules on disclosing non-financial and diversity information by certain large companies.[165] It amends portions of Directive 2013/34/EU, as the environmental and social factors were deemed incomplete.[166] As a result, the following articles are inserted:

> (6) To enhance the consistency and comparability of non-financial information disclosed throughout the Union, certain large undertakings should prepare a non-financial statement containing information relating to at least environmental matters, social and employee-related, respect for human rights, anti-corruption and bribery matters. Such statement should include a description of the policies, outcomes and risks related to those matters and should be included in the management report of the undertaking concerned. The non-financial statement should also include information on the due diligence processes implemented by the undertaking, also regarding, where relevant and proportionate, its supply and subcontracting chains, in order to identify, prevent and mitigate existing and potential adverse impacts. It should be possible for Member States to exempt undertakings which are subject to this directive from the obligation to prepare a non-financial statement when a separate report corresponding to the same financial year and covering the same content is provided.
>
> (7) Where undertakings are required to prepare a non-financial statement, that statement should contain, as regards environmental matters, details of the current and foreseeable impacts of the undertaking's operations on the environment, and, as appropriate, on health and safety, the use of renewable and/or non-renewable energy, greenhouse gas emissions, water use and air pollution.
>
> Article 19a - Non-financial statement
>
> 1. Large undertakings which are public-interest entities exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year shall include in the management report a non-financial statement containing information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, relating

---

[164] *Ibid* at Article 41(1).

[165] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

[166] *Ibid* at Preamble, (2), (3).

to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, including:

(a) a brief description of the undertaking's business model;
(b) a description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented;
(c) the outcome of those policies;
(d) the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks;
(e) non-financial key performance indicators relevant to the particular business.

Where the undertaking does not pursue policies in relation to one or more of those matters, the non-financial statement shall provide a clear and reasoned explanation for not doing so.

Diversity requirements are also updated:

(g) a description of the diversity policy applied in relation to the undertaking's administrative, management and supervisory bodies with regard to aspects such as, for instance, age, gender, or educational and professional backgrounds, the objectives of that diversity policy, how it has been implemented and the results in the reporting period. If no such policy is applied, the statement shall contain an explanation as to why this is the case.'[167]

The obligation to disclose diversity policies in relation to the administrative, management and supervisory bodies with regard to aspects such as, for instance, age, gender or educational and professional backgrounds should apply only to certain large undertakings. Disclosure of the diversity policy should be part of the corporate governance statement, as laid down by Article 20 of Directive 2013/34/EU. If no diversity policy is applied there should not be any obligation to put one in place, but the corporate governance statement should include a clear explanation as to why this is the case.[168]

The directive did not update definitions of materiality, only noting that:

> The undertakings which are subject to this directive should provide adequate information in relation to matters that stand out as being most likely to bring about the materialization of principal risks of severe impacts, along with those that have already materialized.[169]

Guidance on informing disclosures was released in 2017.[170] These non-binding guidelines build on international frameworks, as discussed below. The guidelines clarify that the directive introduced a new element to be considered when assessing the materiality of non-financial information.[171] However, materiality is also context-based. It may be appropriate to directly compare relevant non-financial disclosures among companies in the same sector. This

[167] *Ibid* at Article 19A(2).
[168] *Ibid* at Preamble (18).
[169] *Ibid* at Preamble (8).
[170] European Commission, *Communication from the Commission — Guidelines on non-financial reporting (methodology for reporting non-financial information* C/2017/4234 (2017).
[171] *Ibid* at section 3.1.

guidance also provided factors to be taken into account. These include business model risk, strategic risk, goals, strategies, management approach and systems, values, tangible and intangible assets, and value chain risk. The guidance further asserts that material misstatements should not mislead users of information. A company's performance may, for example, be presented concerning its strategies and broader goals. Companies are expected to describe how non-financial issues relate to their long-term strategy, principal risks and policies.[172]

The European Union and the United Kingdom created expert panels to make recommendations based on the TFCD report.[173] Europe's Technical Expert Group ("TEG") commenced its work in July 2018. In January 2019, the European Commission, after reviewing the final report of the TEG, updated its guidelines on climate-related disclosures.[174]

This 2019 guidance updates and recognizes that the content of climate-related disclosures may vary between companies according to several factors, including the sector of activity, geographical location and the nature and scale of climate-related risks and opportunities.[175] Companies should, in any case, seek to ensure that climate-related information is easily accessible for intended users. The guidance also partially clarified materiality stating that climate-related information can be considered an environmental matter.[176] The guidelines also introduce a double materiality perspective:

- The reference to the company's "development, performance [and] position" indicates financial materiality, in the broad sense of affecting the value of the company. Climate-related information should be reported if it is necessary to understand the company's development, performance, and position. This perspective is typical of most interest to investors.

[172] *Ibid*.
[173] *Accelerating Green Finance*, by Roger Gifford, Green Finance Initiative (2018); *TEG final report on the EU taxonomy*, by EU Technical Expert Group on Sustainable Finance (European Commission, 2020); *Financing a Sustainable European Economy*, by EU High-Level Expert Group on Sustainable Finance (2018); *Taxonomy Technical Report*, by EU Technical Expert Group on Sustainable Finance (2019).
[174] European Commission, *Communication from the Commission — Guidelines on non-financial reporting: Supplement on reporting climate-related information* C/2019/4490 (2019/C 209/01).
[175] *Ibid* at section 2.1.
[176] *Ibid* at Section 2.2.

- The reference to “impact of [the company’s] activities” indicates environmental and social materiality. Climate-related information should be reported if it is necessary to understand the company's external impacts. This perspective is typical of most interest to citizens, consumers, employees, business partners, communities and civil society organizations. However, an increasing number of investors also need to know about investee companies' climate impacts to understand better and measure their investment portfolios' climate impacts.
- Companies should consider using the proposed disclosures in these guidelines to decide that climate is a material issue from either of these two perspectives.[177]

The alternative approach to such narrow financial materiality is double materiality, which asserts that disclosure should address the impact of sustainability factors on a company and the impacts on society and the environment.[178] This reflects that sustainability information is of interest to a broader range of stakeholders than just shareholders. This double materiality from the European Union differs from the TFCD and securities laws in other jurisdictions, which consider financial materiality only.

In early March 2019, the European Parliament adopted rules requiring asset managers to use a common reporting standard to disclose how they consider environmental and social factors and prevent them from greenwashing or overstating their commitment to sustainable investing. Regulation EU 2019/2088 notes:

> Disclosures to end investors on the integration of sustainability risks, on the consideration of adverse sustainability impacts, on sustainable investment objectives, or the promotion of environmental or social characteristics, in investment decision-making and advisory processes are insufficiently developed because such disclosures are not yet subject to harmonized requirements.[179]

Financial market participants and financial advisers should be required to disclose specific information regarding their approaches to integrating sustainability risks and considering adverse sustainability impacts.

---

[177] *Ibid.*
[178] *Ibid.*
[179] European Commission, *Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector* at Preamble (5).

In November 2019, the European Union enacted Regulation 2019/2088, aimed at sustainability-related disclosures in the financial services sector.[180] A sustainability risk means an environmental, social or governance event or condition that, if it occurs, could cause a negative material impact on the value of the investment. This regulation will be discussed further in the fiduciary duty section below.

In June 2020, the European Union's Technical Expert Group published its taxonomy. The taxonomy assists in planning and reporting disclosures relating to the transition to an economy consistent with the European Union's environmental objectives. The taxonomy disclosure obligations encourage reporting towards meeting screening criteria and reporting on their achievement. Not every investment and financing decision is expected to create additional environmental benefits.[181] Developing a taxonomy for sustainable investing, defining a green bond standard and an eco-label are examples of the main elements that will influence and guide investors.

Financial market participants offering financial products in Europe must now incorporate disclosures referencing the Taxonomy. The taxonomy disclosure requirements vary depending on product categories and are aligned with the definitions in the *Regulation on Sustainability-Related Disclosures in the Financial Services Sector.*

On 21 April 2021, the Commission proposed a Corporate Sustainability Reporting Directive ("CSRD"). The goal is to get sustainability reporting on an equal footing with

---

[180] European Commission, *Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector* PE/87/2019/REV/1, updated Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, PE/20/2020/INIT.

[181] EU Technical Expert Group on Sustainable Finance, *supra* note 172 at 8.

financial reporting. The CSRD's proposed enlarged scope is needed to cover more companies that significantly impact the environment and society. In its consultation on reforms to its Non-Financial Reporting Directive, the European Union favoured double materiality.

Investors, including the Church of England, are now divesting their shares of companies like Exxon.[182] In the United Kingdom, *The Occupational Pension Schemes (Investment) Regulation* requires a pension fund's Statement of Investment Principles to include "the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realization of investments; and their policy (if any) concerning the exercise of the rights (including voting rights) attaching to the investments."[183]

The *UK Stewardship Code,* overseen by the Financial Reporting Council,[184] sets standards when institutional investors should actively intervene, including sustainable risk matters.[185] This 'enlightened shareholder value model' advanced a paradigm shift to include the non-shareholder stakeholders.[186] There is a trend to more active management underlined by strong growth in assets deployed for corporate engagement, which grew 14 percent from an already high base over the two years. Owners and producers increasingly feel they need to be more vocal and show their engagement through their ownership rights.

---

[182] Akshat Rathi and Alastair Marsh, "Church of England unloads Exxon shares on failed emission goals" 9 October 2020, online: https://www.bnnbloomberg.ca/church-of-england-unloads-exxon-shares-on-failed-emission-goals-1.1505434

[183] UK, *The Occupational Pension Schemes (Investment) Regulations 2005, 2005 No. 3378 at s 2(3)(b)vi.*

[184] Financial Reporting Council, *The UK Stewardship Code* (September 2012) at Principle 4.

[185] *Ibid.;* Ben Heinemann Jr., "A 'Stewardship Code' for Institutional Investors" (2010) Harvard Business Review, online at: https://hbr.org/2010/01/a-stewardship-code-for-institu

[186] Harper Ho, *supra* note 49 at 111.

The EU, in its consultation on reforms to its *Non-Financial Reporting Directive*, came out in favour of double materiality.[187] It agrees with the approach taken by the Global Reporting Initiative ("GRI"), which focuses not only on shareholders but also on other stakeholders. The danger here is that this approach can be perceived as lacking a focus on investors' concerns. A sustainability risk means an environmental, social or governance event or condition that, if it occurs, could cause a negative material impact on the value of the investment, as specified in sectoral legislation.[188]

The 2019 regulation maintains the requirements for financial market participants and financial advisers to act in the best interest of end investors, including but not limited to conducting adequate due diligence before making investments. However, and in contrast to the direction gone by the Department of Labour in their proposals for the *Employee Retirement Income Security Act*, financial market participants and financial advisers should integrate into their processes, including in their due diligence processes, and should assess continuously not only all relevant financial risks but also including all relevant sustainability risks that might have a relevant material negative impact on the financial return of an investment or advice.[189] The regulation goes further by stating that financial advisers should disclose how they take sustainability risks into account in the selection process of the financial product presented to the end investors before providing the advice, regardless of the sustainability preferences of the end investors.[190]

---

[187] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 PE/20/2020/INIT.
[188] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector PE/87/2019/REV/1
[189] *Ibid* at Preamble (12).
[190] *Ibid* at Preamble (15).

European regulation and proposals recognize and attempt to overcome several common themes underly disclosure resistance. The taxonomy helps with the fragmentation of what is and is not sustainable. Updating definitions of materiality to have financial and non-financial components can help overcome the resistance that climate information may not have quantitative impacts. The third common theme is the lack of standardization of international frameworks.

Transnational Frameworks

Instruments of transnational governance are not 'hard' international law but are 'soft law' normative mechanisms regulating and guiding behaviours of the target entities.[191] These soft law instruments are neither irrelevant nor non-binding; instead, they serve three purposes: rule setting, monitoring, and agenda-setting.[192] New governance theories propose that societies transcend traditional deterrence and punitive measures and move towards normative and self-regulating activities.[193]

The 2015 Sustainable Development Goals ("SDGs") influence corporate disclosures.[194] Best practices for corporate disclosures have not yet materialized, although they are being

[191] David Ong, "From 'International' to 'Transnational' Environmental Law: A Legal Assessment of the Contribution of the 'Equator Principles' to International Environmental Law" (2010) 79 Nordic J Int. L.35 at 45.

[192] A Boyle, "Some Reflections on the Relationship of Treaties and Soft Law" (1999) 48:4 Int. & Comp. L.Quar.901; B Jacobsson & K Sahlin-Andersson, "Dynamics of soft regulations" in *Transnational governance: Institutional dynamics of regulation;* M Djelic & K. Sahlin-Andersson (eds.) (Cambridge: Cambridge University Press, 2006).

[193] Eric Orts, "A Reflexive Model of Environmental Regulation" (1995) 5:4 Business Ethics Quar.779 at 780; Dhir, *supra* note 133 at 95.

[194] UN, *Transforming Our World: The 2030 Agenda for sustainable development. Draft resolution referred to the United Nations summit for the adoption of the post-2015 development agenda*, United Nations General Assembly, 2015) sixty-ninth session. UN Doc. A/70/L.1 of (18 September 2015); Libby Bernick, "Can SDGs Shape the Future of Corporate Disclosure?" Blog (25 October 2017) online: http://www.csrwire.com/blog/posts/1862-can-sdgs-shape-the-future-of-corporate-disclosure.

developed to assist companies with qualitative and quantitative disclosures per target.[195] Recommended disclosures include carbon emissions, the number of indigenous rights violations, air quality, gender equality, infrastructure spending, women in leadership positions, access to water and other water issues, and many others.[196] Using the SDGs for sustainable investing is growing, with 40% of US money managers stating the SDGs were a factor.[197]

There is a process of developing a framework for corporate reporting for the SDGs. This framework will incorporate environmental, social and governance factors into valuations, assess the materiality of impacts, quantify impacts, measure additional metrics, compare against targets, make targets sector-specific, and make these practices comparable across industries and companies."[198]

There are still gaps where disclosures are not available. Gaps include social inclusiveness, the equitable sharing of global resources, and the lack of meaningful environmental targets such as water access and carbon emissions reductions.[199] For women and girls especially, the reality of water scarcity, or other climate-related disruptions to water supply, often translates into increasing numbers of hours seeking out safe water for themselves and their families.[200] The low level of climate financing directed at ensuring basic water sanitation and

---

[195] *Business Reporting on the SDGs, Analysis of the Goals and Targets, a study by PwC*, by PwC & GRI (Global Compact and GRI, 2018) at 2, 11, 198; UN Global Compact, "Action Platform: Reporting on the SDGs", online: <: https://www.unglobalcompact.org/take-action/action-platforms/sdg-reporting>.
[196] PwC & GRI, *supra* note 194 at 26, 31, 49, 61, 65, 67, 72–75.
[197] Global Sustainable Investment Alliance, *supra* note 22.
[198] UN GC, "The Ten Principles of the UN Global Compact" online: https://www.unglobalcompact.org/what-is-gc/mission/principles; Eduardo Ortas, Igor Álvarez & Ainhoa Garayar, "The Environmental, Social, Governance, and Financial Performance Effects on Companies that Adopt the United Nations Global Compact" (2015) 7 Sustainability 1932; UN GC, "SDG Toolbox" online: https://www.unglobalcompact.org/sdgs/sdg-toolbox.
[199] PwC & GRI, *supra* note 194 at 51, 11, 22, 38; Joyeeta Gupta & Courtney Vegelin, "Sustainable development goals and inclusive development" (2016) 16 International Environmental Agreements 433 at 441.
[200] Catarina de Albuquerque "The Climate Solution Must Include Water, Sanitation, and Hygiene" May 2021, online: http://sdg.iisd.org/commentary/guest-articles/the-climate-solution-must-include-water-

hygiene access is still of concern. Water projects are estimated to be only a tenth of climate investments, accounting for 0.3% of global climate finance.[201]

PRI

The United National Principles of Responsible Investing ("PRI") is the seminal work related to sustainable investment in asset management. Signatories to the PRI have a combined $68 trillion in assets under management.[202] Signatories believe that the environmental and social principles will lead to long-term financial benefits.[203] The United Nations Principles of Responsible Investing and other international organizations have further assisted the responsible investing uptake providing frameworks for pension funds to integrate non-financial factors.[204] Under stakeholder salience theory, companies become signatories to the PRI for pragmatic reasons, including organizational legitimacy, utilitarian power and enhanced management values.[205] Unfortunately, the PRI does not demonstrate or necessitate any performance standard nor require any audit or verification system.[206]

---

sanitation-and-hygiene/?utm_medium=email&utm_campaign=SDG%20Weekly%20Update%20-%206%20May%202021&utm_content=SDG%20Weekly%20Update%20-%206%20May%202021+CID_1004460bd71f5fb5e7989c3b429db3af&utm_source=cm&utm_term=Read

[201] *Ibid.* See also Nathaniel Mason, et.al (2020). Just add water: a landscape analysis of climate finance for water. Overseas Development Institute (ODI) at 21.

[202] UN, “Principles of Responsible Investing” online: https://www.unpri.org/; MSCI & PRI, *Global Guide to Responsible Investment Regulation 2016* (New York: MSCI, 2016). By way of comparison, The Equator Principles (“EPs”) are a set of benchmarks for determining and managing environmental and social risk in projects. See Equator Principles, “The Equator Principles” online: http://www.equator-principles.com/resources/equator_principles_III.pdf; Sebastian Eisenbach, Dirk Schierkec et al, “Sustainable Project Finance, the Adoption of the Equator Principles and Shareholder Value Effects” (2014) 23 Business Strategy & Environment 375 at 390; Conley and Williams, *supra* note 7 at 565 & 568; Manuel Wörsdörfer, “Equator Principles: Bridging the Gap between Economics and Ethics?” (2015) 120:2 Business and Society Review 205 at 211-214.

[203] Sievänen et al, *supra* note 77.

[204] Claire Woods & Roger Urwin, “Putting Sustainable Investing into Practice: A Governance Framework for Pension Funds” (2010) 92:1 J Business Ethics 1.

[205] Arleta Majoch, Andreas Hoepner & Tessa Hebb, “Sources of Stakeholder Salience in the Responsible Investment Movement: Why Do Investors Sign the Principles for Responsible Investment?” (2017) 140 J Business Ethics 723 at 735.

[206] Benjamin J Richardson & Wes Cragg, “Being Virtuous and Prosperous: SRI’s Conflicting Goals” (2010) 92:S1 J Bus Ethics 21–39 at 31.

The PRI instructs on how to integrate responsible investing into portfolio analysis, with four principal strategies suggested.[207] The first incorporates fundamental financial strategies in company valuation.[208] Second, the PRI includes quantitative strategies to build models that integrate sustainability factors.[209] Third, smart beta strategies financialize risk.[210] Smart beta strategies enhance risk-adjusted returns through exposure to specific desired characteristics.[211] They use simple, rules-based and transparent portfolio construction techniques. Typical characteristics used include capitalization/size, dividend yield, value, momentum, and volatility.[212] The fourth adds a weighting factor. These issues are then weighted according to schemes, such as capitalization-weighted, equal weighting, and factor weighing.[213] Strategies exist for passive/index managers to influence portfolio construction to account for the index's potential risk.[214]

CDP

The well-reported and researched CDP (formerly the Carbon Disclosure Project) collects globally reported climate change, water, and forest risk data.[215] The CDPs 820 institutional investors, holding over US$95 Trillion in assets, include some of the world's largest financial institutions.[216] Improved financial performance is a crucial driver of companies adopting the

[207] *Practical Guide to ESG Integration for Equity Investing*, by UN PRI (New York: UN PRI, 2016) at 13.
[208] *Ibid* at 22.
[209] *Ibid* at 36.
[210] *Ibid* at 43.
[211] Ronald N Kahn & Michael Lemmon, "Smart Beta: The Owner's Manual" (2015) 41:2 Journal of portfolio management 76–83 at 76.
[212] Ben Laurence, "In search of Patterns" (2017) London Business School Review 52 at 52.
[213] Nicholas Alonso & Mark Barnes, "Efficient Smart Beta" (2016) 25:1 J Investing 103-115 at 104.
[214] UN PRI, *supra* note 206 at 50.
[215] CDP, "About Us" online: https://www.cdp.net/en-US/Pages/About-Us.aspx.
[216] CDP, "Investor Members and Signatories" online: https://www.cdp.net/en/investor/signatories-and-members#7045b83784a78ee84c56f99c6ad0eb78.

CDP.[217] The use of the CDP as a reporting tool has increased steadily, from 50% in 2011 to 71% in 2017 for the United States.[218] Unfortunately, they lag in water and deforestation reporting and board oversight,[219] showing flaws with voluntary reporting. Canada fares better on all three measures, with board-level oversight for 76% of reporting companies on climate change, 71% on water and 33% for forests.[220] Reporting is very sector-specific, ranging from a 73% response rate for the information technology and telecommunications services sector, 40% for energy companies, to a low of 35% for utilities.[221] As of 2017, sixty (60) companies, including eighteen (18) from the energy sector, have developed a carbon price.[222] CDP will take a sector-based approach to disclosure in the future, which is vital as not all environmental issues apply uniformly.[223] There will also be a greater emphasis on board and senior management oversight of climate-related issues.[224]

Most investors in the exempt market are individuals, with individual investors growing year-over-year. Studies have also shown that carbon emissions reported in CDP are more extensive than those reported in social reports.[225] There are still inconsistencies in reporting and data content even within the CDP.[226] It is time-consuming to undertake to review all financial data for a company. Standardizing information should be a priority. Accounting entries are

---

[217] Gunnar Friede, Timo Busch & Alexander Bassen, "ESG and financial performance: aggregated evidence from more than 2000 empirical studies" (2015) 5:4 J Sustainable Finance & Investment 210.
[218] CDP, *US Report 2017 Key Findings on Governance, ESG and the Role of the Board of Directors* (New York: CDP, 2017) at 10.
[219] *Ibid* at 11.
[220] *Canada Report 2017*, by CDP (New York: CDP, 2017) at 4.
[221] *Ibid* at 11.
[222] *Ibid* at 7.
[223] CDP, "Disclosure in 2018" online: https://www.cdp.net/en/companies-discloser/disclosure-in-2018.
[224] CDP, "CDP Question Changes and Map: 2017 to 2018" (21 June 2018) online: https://www.cdp.net/en/guidance/guidance-for-companies.
[225] Florence Depoers, Thomas Jeanjean, & Tiphaine Jérôme, "Voluntary Disclosure of Greenhouse Gas Emissions: Contrasting the Carbon Disclosure Project and Corporate Reports" (2016) 134:3 J Bus Ethics 445–461.
[226] *Ibid* at 447.

standardized. Carbon and water reporting should also become standardized.[227] Standardization should lead to enhanced integration and financialization of climate projects.[228]

Incorporating the CDP or other transnational framework into securities disclosure requirements would offer a significant step forward in data dissemination. Moreover, as 71% of US companies and 76% of Canadian companies report to the CDP, it would not be unduly burdensome to legislate their mandatory use. Rather, securities legislation would be apt to allow for one framework to be used, with options provided by the securities commission. In other words, the regulation could provide options on the choice of framework.

GRI

The Global Reporting Initiative ("GRI") helps businesses and governments understand and communicate their impact on critical sustainability issues such as climate change, human rights, governance and social well-being.[229] The GRI's current iteration focuses on materiality of information, contextual disclosures about an organization, and the proper management approach to report how a company manages its material topics.[230] The GRI defines Material Aspects as those that reflect the organization's significant economic, environmental, and social impacts; or substantively influence stakeholders' assessments and decisions.[231]

---

[227] Lauren Caplan, "Regulating the Levers of Globalization: Integrating Corporate Social Responsibility into the Capital Raising Process" in Karen Buhman, Lynn Roseberry & Mette Morsing, eds, *Corporate Social and Human Rights Responsibilities: Global Legal and Management Perspectives* (UK: Palgrave Macmillan, 2011) 235 at 238–239.
[228] *Ibid* at 242–243.
[229] Global Reporting Initiative, "Consolidated Set of GRI Sustainability Reporting Standards 2016" (19 October 2016) online: https://www.globalreporting.org/Pages/default.aspx.
[230] *Ibid.*
[231] *Ibid* at 6.

The GRI is regarded as the most comprehensive guide to developing sustainability reports.[232] Despite criticisms, the GRI impacts and shapes corporate CSR activities.[233] Studies with the GRI show that even A and A+ rated companies have problems with vague disclosures.[234] Disclosure practices must be improved.[235]

SASB

The Sustainability Accounting Standards Board ("SASB") is an independent nonprofit organization that sets standards to guide companies' disclosure of financially material sustainability information to their investors. Standards identify the subset of environmental, social, and governance issues most relevant to financial performance in each of 77 industries.[236] SASB standards are tied to financial performance and are industry-specific.

The Sustainability Accounting Standards Board takes a narrower, investor-focused view, following the definition of materiality used by the US Securities and Exchange Commission. They add value via their materiality map, guiding firms and investment institutions to identify and compare disclosure topics.[237] However, the SASB has one glaring weakness. Their proposal of a new definition of materiality will be "information is material if omitting it or misstating it could influence decisions that the primary users of general-purpose financial reports make based on financial information about a specific reporting entity.[238] This definition of materiality still relates only to financial information (thus share price) and does not expressly necessitate the

---

[232] KPMG, *International survey of corporate responsibility reporting 2011* (Zurich: KPMG International, 2011).
[233] Laurence Vigneau, Michael Humphreys & Jeremy Moon "How Do Firms Comply with International Sustainability Standards? Processes and Consequences of Adopting the Global Reporting Initiative" (2015) 131 J Business Ethics 469 at 472.
[234] David Talbot & Olivier Boiral, "GHG Reporting and Impression Management: An Assessment of Sustainability Reports from the Energy Sector" (2018) 147 J Business Ethics 367.
[235] *Ibid* at 375.
[236] SASB, "About us", online: https://www.sasb.org/about/
[237] SASB, "Materiality Map" online: https://www.sasb.org/standards/materiality-map/
[238] *Ibid.*

need for a long-term value horizon. However, other frameworks have more substantive recommendations.

CRD

The Corporate Reporting Dialogue is a joint initiative of the eight leading standards-setting organizations, including the CDP, GRI, international accounting standards, and others.[239] Its Better Alignment Project aligns corporate reporting with preparing for effective and coherent disclosures.[240] Whichever is selected, all provide much greater environmental disclosures than those currently required under securities legislation. The accounting industry needs to be a valuable player in climate disclosures. If they emphasize mainstream financial documentation, updated financial disclosures require synthesis with current and future accounting practices. Comparability and standardization are themes underlying much of the discussion.

The Statement of Common Principles of Materiality by the Corporate Reporting Dialogue identifies practical means of aligning materiality frameworks. A joint document by the eight large disclosure organizations provides a useful template for updating ideas of materiality.[241] The Statement notes the different definitions from a legal and financial perspective and the definitions from the various organizations.

---

[239] Corporate Reporting Dialogue, CDP, Climate Disclosure Standards Board, Financial Accounting Standards Board (observer), Global Reporting Initiative, International Accounting Standards Board, International Integrated Reporting Council, International Organization for Standardization, and Sustainability Accounting Standards Board, online: http://corporatereportingdialogue.com/.

[240] Corporation Reporting Dialogue, "Better Alignment Project", online: http://corporatereportingdialogue.com/wp-content/uploads/2018/11/Corporate-Reporting-Dialogue-Better-Alignment-Project.pdf.

[241] Corporate Reporting Dialogue, *Statement of Common Principles of Materiality of the Corporate Reporting Dialogue, online at:* http://corporatereportingdialogue.com/wp-content/uploads/2016/03/Statement-of-Common-Principles-of-Materiality1.pdf.

IIRC

The Guiding Principles of the IIRC defines materiality as "information about matters that substantively affect the organization's ability to create value over the short, medium and long term."[242] The framework's determination process provides a principles-based guide to presenting a report.[243]

The IR frameworks' definition of materiality would be an essential step to update Canadian and US securities legislation definitions. A change from share price to value in the definition goes well beyond a semantic difference. Value encompasses a holistic view of the enterprise and forces the company to value the firm over the short-medium and long-term instead of managing quarter to quarter to maximize share price over the short term. The value would also necessitate a change to view climate and other environmental factors as substantive.

Sustainable finance regulation, via international framework development, fits well within pluralist theories of law.[244] The definitions of materiality used by the GRI, the CRD and the IIRC go beyond the shareholder and beyond what would influence a share price to a more holistic stakeholder model that focuses on medium- and long-term value creation. This is a subtle difference that has significant ramifications. While more climate disclosures may not immediately change the share price and thus, not be materiality from the current definition, it could affect long-term value. Companies with higher emissions compared to other firms could be negatively impacted. Thus, an emphasis on long-term value would be material.

As noted above, many companies do not disclose due to a lack of a common framework. The credibility of disclosure is difficult to assess, which is why reputable international projects like the CDP provide quantifiable metrics. All transnational frameworks state the need for data,

---

[242] IIRC, T*he International IR Framework*, (2013) at 5.
[243] *Ibid* at 18.
[244] Peer Zumbansen, "Transnational Legal Pluralism" (2010) 1:2 Transnational Legal Theory 141.

but none provides the necessary data for companies to analyze. The currently available information needs to be organized, combined and aligned so that environmental reports and financial disclosures contain identical information.[245] This organization also provides the legitimacy firms need to promote sustainable activities.[246]

In September 2020, five leading framework and standard-setting organizations—CDP, CDSB, GRI, IIRC and SASB—announced a shared vision for a comprehensive corporate reporting system that includes financial accounting and sustainability disclosure, connected via integrated reporting. Standardized and enhanced disclosures would allow better comparisons between companies and construct sustainable and responsible portfolios. Human rights are less inherently quantifiable than environmental factors like carbon emissions, and due diligence techniques must identify impacts.[247] Future research should investigate any reports and recommendations provided by this shared vision.

Summary

This still shows an inherent problem with sustainable, responsible investment. There is still a tendency to see environmental, social, and governance factors as non-financial. The word non-financial was voted as the most hated term in responsible investing research. Even the concept of double materiality, which seems to be a compromise, sees responsible investment as having non-financial terms. Most portfolio managers have not financially integrated returns or risks of environmental or social factors into their models. These can reasonably be included

---

[245] Caplan, *supra* note 226 at 242–243.
[246] F Fortanier, A Kolk, & J Pinkse, "Harmonization in CSR reporting" (2011) 51:5 Management Int. Rev. 665.
[247] Sally Engle Merry, *The Seductions of Quantification, Measuring Human Rights, Gender Violence and Sex Trafficking* (University of Chicago Press, 2016); Claret Vargas, "Measuring What Matters: A Key Challenge in Human Rights and Business" *http://blogs.lse.ac.uk/businesshumanrights/2016/06/21/claret-vargas-measuring-what-matters/#more-767* (21 June 2016).

without standardization; however, accurate comparisons can only be made if the disclosures are similar.[248]

There are other counterarguments to promoting additional disclosure. First, too much information can be as negatively impactful as not enough.[249] There are common themes on problems with disclosures. They include materiality, forward-looking information, frameworks, policy certainty, benchmarks, and other standard metrics. Corporate managers may not always provide investors with all information that investors deem material, particularly qualitative materiality. Quarterly reporting has been noted as an issue, both by market participants and the Taskforce.

Second, a common problem exists among most jurisdictions. All of these definitions of materiality and disclosure apply only to public companies. As long as a company does not make its securities available to the public, something easier and easier to do, no disclosures are required, even if such information has the same societal relevance as the sustainability disclosures currently demanded of public companies. For example, the total number of listed issuers in Canada has declined. The annual number of new listings on the smaller venture exchange has dropped from 337 in 2010 to 77 as of September 2020. In 2010, there were 187 new listings per year on the Toronto Stock Exchange, compared to 137 as of September 2020.[250]

From stakeholder feedback, the Taskforce heard that the cost to access public markets is a significant barrier to capital raising, especially for smaller issuers and entrepreneurs. In addition, public companies experience ongoing regulatory reporting requirements. Listed

[248] Caplan, *supra* note 226 at 243.
[249] Eugene Ellmen, Social Investment Organization, ``Comments on proposed amendments to statement of executive compensation, and form 51-102F6`` *Letter to CSA* (17 February 2011).
[250] Capital Markets Modernization Taskforce, *supra* note 2.

companies are subject to greater disclosure requirements and regulatory and public scrutiny regarding their business, operations, financial results, share price movements, management and director performance, executive compensation, corporate governance practices and insider reporting.

Emerging companies increasingly rely on the availability of alternative sources of funds, such as angel investors, venture capital and private equity, often to avoid the high costs and compliance that comes with public funding. For sophisticated investors, the private markets have become an important element of portfolio diversification, given the opportunities to earn higher returns than in the public markets. Apart from the lower cost of accessing private markets, company shareholders with the greatest decision-making powers also elect to remain private to maintain control, maximize returns, or seek exit or cash-out options outside public markets. The increased allocation of capital to private markets and the growth of alternative exit options have reduced the demand for public offerings. Future research must investigate how changes to materiality could affect private and alternative investments.

Finally, many companies argue about the lack of impact these disclosures have on portfolio manager behaviour.[251] This approach arguably ignores issues that may rapidly become material over time. Without proper disclosures, neither investors nor financial advisors will know the potential risks within a particular investment. Materiality and share price are intertwined, causing significant pushback on disclosing information. A transition from the share price to long-term value would alleviate some of these concerns. Securities law mandates certain disclosures, but a lack of uniformity and comparable data is difficult to find. Many nations struggle to find a balance between material disclosure and information overload.

---

[251] Sitikantha Parida, & Terence Teo, "The impact of more frequent portfolio disclosure on mutual fund performance" (2018) 87 J Banking & Fin. 427.

Fiduciary Duties and Financial Fund Construction

Portfolio managers owe a fiduciary duty to their clients. Fiduciary duties require that fiduciaries make a complete disclosure of all relevant material information. A fiduciary relationship occurs when a "significant interaction of social and/or economic importance exists that creates an implicit dependency and peculiar vulnerability of the beneficiary to the fiduciary."[252] There was, and still is, perceived conflict between a fund manager's fiduciary duties and the implementation of environmental and social guidelines in investment decisions.[253] An inherent conflict of interest exists; the ethics of integrating sustainability information against the ethics of a fiduciary.[254] Fiduciary duties generally allow for the incorporation of sustainability information in most jurisdictions.[255] While the evidence is mixed (due to a lack of disclosures), the research shows that disclosing environmental and social information improves performance by promoting a certain level of market behaviour.[256]

Investors are beginning to recognize that sustainability risks threaten a firm's profit.[257] These investors are becoming more active in their voting processes. Voting rights attached to the

---

[252] Mark Vincent Ellis, "Fiduciary Duties in Canada, loose-leaf" in *Loose Leaf* (Toronto: Carswell, 1988); Leonard Rotman, "Understanding Fiduciary Duties and Relationship Fiduciarity" (2017) 62:4 McGill LJ 1 at 10; Rotman, Leonard, "Fiduciary Law's Holy Grail: Reconciling Theory and Practice in Fiduciary Jurisprudence" (2011) 91 Boston University Law Review 921 at 933.

[253] William Ransome & Charles Samford, *Ethics and Socially Responsible Investment, A philosophical Approach* (Farnham: Ashgate, 2013); Magnus Jansson & Sandberg, Joakim, "Should pension funds' fiduciary duty be extended to include social, ethical and environmental concerns? A study of beneficiaries' preferences" (2014) 4:3 Journal of Sustainable Finance & Investment 213 at 214.

[254] Jansson & Sandberg, Joakim, *supra* note 252 at 214.

[255] *A Legal Framework for the Integration of environmental, social and governance issues into institutional investment*, by Freshfields, Bruckhaus and Deringer (London: UNEP FI, 2005) at 13, 154; Richardson, *supra* note 17 at 541; Sandberg, *supra* note 27 at 144.

[256] Robert Heinkel, Alan Kraus & Josef Zechner, "The Effect of Green Investment on Corporate Behavior" (2001) 36:4 J Financial and Quantitative Analysis 431 at 447.

[257] Bert Scholtens & Riikka Sievanen, "Drivers of Socially Responsible Investing: A Case Study of Four Nordic Countries" (2013) 115 J Business Ethics 605; Deborah Rupp, Cynthia Williams, & Ruth Aguilera, "Increasing

ownership of common shares can provide the power to change the market to better non-financial metrics.[258] Activist shareholders, "through moral suasion, coalition formation, and publicity-seeking," can often be influential in their attempts to change corporate behaviours.[259] A lack of information to make quantitative analyses further makes activist investing important, as investors must build dialogues rather than use data as evidence of the necessity of change. Voting rights attached to the ownership of common shares can provide the power to change the market to understand non-financial metrics better. Failing to vote shares, voting without considering the consequences of the effects, or voting arbitrarily breaches a fund manager's duty of care.[260] Large asset managers, such as Blackrock, are pressured to divest companies in the oil and gas industry.[261] Divestment sounds morally superior but then leaves investors unable to do anything about the companies that are 'doing badly.' Activist investing attempts to hold directors and executive officers accountable for their behaviour.

Additionally, sustainable investing may pose diversification risks due to negative screens limiting the number of companies available for investment.[262] Yet, environmental and social factors may limit downside risk, in which case they would lower the risk on a client's portfolio.[263] A negative screen, such as divesting from oil and gas or coal, may have a limited impact. The

---

Corporate Social Responsibility through Stakeholder Value Internalization (and the Catalyzing Effect of New Governance): An Application of Organizational Justice, Self-Determination and Social Influence Theories" in *Managerial Ethics: Managing the Psychology of Morality*, Marshall Schminke (ed.) (New York: Routledge, 2010) 69.

[258] SHARE, *Model Proxy Voting Guidelines* (Vancouver: SHARE, 2017); SHARE's proxy voting service allows institutional investors to exercise their voting rights responsibly, online: https://share.ca/services/proxy-voting/.

[259] Jeanne M. Logsdon & Harry J. Van Buren, *supra* note 30 at 353.

[260] *OECD Guidelines for Multinational Enterprises* (OECD Publishing, 2011) at 12.

[261] Charles Kennedy, "Environmentalists: BlackRock's Exxon Vote Is Moment Of Truth" oilprice.com (5 May 2021) online: https://oilprice.com/Latest-Energy-News/World-News/Environmentalists-BlackRocks-Exxon-Vote-Is-Moment-Of-Truth.html

[262] Ick Jin, "Is ESG a systemic risk factor for US equity mutual funds" (2018) 8:1 J Sustainable Finance and Investment 72 at 73.

[263] *Ibid* at 75.

greater risk to retail investors is the lack of clear, meaningful, and timely disclosures (both quality and quantity).[264]

The next section diverges from the traditional legal analysis. Many, if not most lawyers, are unfamiliar with portfolio management and financial analysis techniques. I will briefly overview several key concepts to bridge the gap between legal concepts of materiality and legal risk disclosures and financial concepts of risk and return. This section is relevant as it attempts to show that the current lack of disclosures may partially negate the creation of responsible or sustainable funds.

Portfolio managers need not only maximize financial returns but also minimize risk. Risk, and the greater need for oversight on it, were further heightened during the financial crisis of 2008.[265] This transnationalization of risk was due, in part, to the weakness of domestic laws regarding disclosures and lack of risk management oversight.[266] This soft law evolution is consistent with a new governance theoretical model as responsible investing is a complex mix of hard and soft norms.[267] Thus, the environment can potentially be both a source of risk and risk minimization.

Modern Portfolio Theory is a framework on portfolio construction that attempts to maximize an asset's expected return per given unit of risk.[268] It formalized the theory of

---

[264] RIA, *Comments Regarding CSA Consultation Paper 33-404: Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives toward their Clients,* (September 26, 2016) online: http://www.osc.gov.on.ca/documents/en/Securities-Category3-Comments/com_20160926_33-404_abbeyd.pdf.
[265] Richardson, *supra* note 74 at 313.
[266] Nowiski, *supra* note 88 at 8.
[267] WA Bogart, *Permit but Discourage: Regulating Excessive Consumption* (New York: Oxford University Press, 2011) at 49-50.
[268] Harry Markowitz, "Portfolio Selection" (1952) 7:1 J Finance 77; Mehdi Beyhaghi & James Hawley, "Modern portfolio theory and risk management: assumptions and unintended consequences" (2013) 3:1 J Sustainable Finance & Investment 17 at 21.

diversification of assets as a necessary part of a properly created investment portfolio.[269] Having certain restrictions that narrow down the number of potential investments will increase risk.[270] In other words, it formalized the concept of "do not put all your eggs in one basket."[271] Risk-averse investors can construct investment portfolios that optimize their expected returns based on their acceptable personal risk level.[272] Portfolios that fall below the efficient frontier are too risky for their expected level of return.[273] For example, investors with capital in coastal real estate might want more data on physical climate risk and rising sea levels. Investors with exposure to coal or oil and gas may be more concerned about regulatory interventions in response to climate risk.[274]

Many investors define risk as the mathematical standard deviation between a price of a stock or a bond.[275] Nevertheless, variance and standard deviation are symmetric measures that count abnormally high returns as risky as abnormally low returns.[276] Risk is relevant only for a downward drop in prices, known as downside risk.[277] As previously discussed, financial risk management requires the disclosure of information.[278] There are many risk measures (like value

---

[269] Jonathan Hoekstra, "Improving biodiversity conservation through modern portfolio theory" (2012) 109:17 PNAS 6360.

[270] Elisabeth Ausen Engen & Erika Nylander, "Risk and Return of Ethical Funds: The Case of UN PRI" (2015) Master's Thesis (unpublished); Philippe Bertrand & Vincent Lapointe, "How performance of risk-based strategies is modified by socially responsible investment universe?" (2015) 38 International Review of Financial Analysis 175 at 176.

[271] Stephen Ross, Franco Modigliani, et al., *Corporate Finance, 11th ed*., (McGraw-Hill, 2015) at Ch. 11.

[272] Investopedia, "Modern Portfolio Theory" online: https://www.investopedia.com/walkthrough/fund-guide/introduction/1/modern-portfolio-theory-mpt.aspx.

[273] *Ibid.*

[274] Robert Engle, et al., "Hedging Climate Change News" (17 January 2019), SSRN Preprint, online: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3317570 at 9. This study takes a different approach to risk, in that it creates a climate change vocabulary to use as news to create a hedging strategy. However, the theory is the same. Bad environmental news, such as a larger carbon footprint for one firm as compared to others, will create a negative climate score. They state that "no news is good news" at 12.

[275] Hebb, *supra* note 51 at 8.

[276] *Ibid.*

[277] Matthew Sherwood & Julia Pollard, "The risk-adjusted return potential of integrating ESG strategies into emerging market equities" (2018) 8:1 J Sustainable Finance & Investment 26 at 31.

[278] Andrew Ang, Joseph Chen & Yuhang Xing, "Downside risk" (2006) 19:4 Review of Financial Studies 1191.

at risk measures) that may reflect investors' true preferences.[279] Currently, none of the global soft law transnational instruments necessitates a reconceptualization of risk.

Company-level risk includes a firm's cost of capital. A firm's cost of capital includes the cost of equity and the cost of debt to determine an overall cost of capital for a firm. The cost of capital partially dictates what interest rates financial institutions will lend money and what return rates equity investors will expect. The higher the cost of capital, the lower the profit a company or project will have. A higher implied sustainability component to the cost of capital would have financial lenders charge more interest in companies with environmental or social concerns.[280] Any new paradigm should mandate the inclusion of the cost of environmental harms, such as climate change or human rights abuses, to the cost of capital.

The social cost of carbon or shadow carbon tax is often mentioned as a method to include the climate and other environmental factors into analyses. The shadow value of carbon is equal to the cost of reducing the last tonne of emissions needed to achieve the climate stabilization targets at the lowest cost.[281]

Adding an internal price on carbon, for example, would raise the cost of capital for the firm.[282] On the other hand, the inclusion of improved environmental risks would lead to a

---

[279] Benjamin Peyo, "Synthesis of Modern portfolio theory and sustainable investment" (2012) 33 J Investing 33 at 34.
[280] Sudheer Chava, "Environmental Externalities and Cost of Capital" (2014) 60:9 Management Science 2223.
[281] Carbon Pricing Leadership Coalition, *Report of the High-Level Commission on Carbon Prices* (29 May 2017) (International Bank for Reconstruction and Development and International Development Association / The World Bank, 2017) at 32; Carbon Pricing Leadership Coalition, Carbon Pricing Leadership Report 2020/21 (International Bank for Reconstruction and Development and International Development Association / The World Bank, 2021)
[282] Max R. Sarinsky, "Discount Double-Check: An Analysis of the Discount Rate for Calculating the Social Costs of Carbon" (2016) 19 N.Y.U. J Legislation & Public Policy 215.

decrease in the cost of capital, which should lead to enhanced financial performance.[283] This performance would be especially pronounced during economic downturns,[284] which explains responsible investments conclusively outperforming non-responsible funds during the 2008 financial crisis.[285] Internal carbon pricing at a price level that would align with low carbon investments can also be used for scenario analyses to evaluate risks and opportunities in evaluating investment decisions.[286] The use of internal shadow pricing can help companies make decisions about emission reduction strategies and investments. These emission reductions and their shadow pricing could be mandated to align with jurisdictions implementing a national carbon tax.

However, few companies set an internal carbon price and those that do usually set the price at an artificially low (and thus non-material) level.[287] Junkus & Berry noted that measures of responsible behaviour are generally qualitative, only annually reported, and often based on self-reporting by firms.[288] Other firms fear that setting a carbon price and publishing it could lead to litigation, as noted in the comments to the Securities and Exchange Commission above. The *New York v Exxon* case above shows that this is a possibility. However, it also shows that companies have little worry about being penalized for disclosing carbon pricing at present.

---

[283] Mark Sharfman & Chitru Fernando, "Environmental Risk Management and the Cost of Capital" (2008) 29:6 Strategic Management J. 569 at 590; Pieter Trinks & Bert Scholtens, "The Opportunity Cost of Negative Screening in Socially Responsible Investing" (2017) 140 J Bus. Ethics 193 at 197.

[284] Shan Xu, Dochi Liu, & Jianbal Huang, "Corporate social responsibility, the cost of equity capital and ownership structure: An analysis of Chinese listed firms" (2015) 40:2 Australian J Management 245.

[285] This shows another potential limitation of current performance studies. Most only measure returns over a short time period. Rather, more studies over a long time horizon, with several market cycles is required to give a true risk measurement.

[286] Carbon Pricing Leadership Coalition, *Draft Report of the Task Force on Net Zero Goals and Carbon Pricing* (International Bank for Reconstruction and Development/ The World Bank, 2021) at 29.

[287] CDSB and CDP, *Ready or not: Are companies prepared for the TCFD recommendations?* (March 2018) at 11, 14, 22; Draft Report of the Task Force on Net Zero Goals and Carbon Pricing, supra note 284 at 13-14.

[288] Joan Junkus & Thomas D Berry, "Socially responsible investing: a review of the critical issues" (2015) 41:11 Managerial finance 1176–1201 at 1195.

Having clear regulations that mandate disclosure, updating definitions of materiality to include carbon pricing, developing a taxonomy that guides shadow carbon pricing, and creating safe harbour provisions preventing litigation would assist in developing additional disclosure of carbon risks. An explicit carbon price floor would address concerns about international competitiveness.[289]

Shadow pricing of carbon can be quantified. However, social harms, which can impact a firms' reputation, brand and loyalty, are difficult to quantify.[290] Investors are unable to effectively assess human rights risk, given the current slate of frameworks and disclosures.[291] A risk-based due diligence procedure could identify a range of potential issues, including the areas of employment, bribery, extortion, and consumer interests. Other metrics are extremely difficult to quantify in practice, such that "the inability to design calculative devices that assign a market value to ESG criteria often leads to ESG issues being abandoned."[292] For example, reporting on human rights risks is weak,[293] and investor-based duties on human rights are ambiguous.[294]

Disclosures focusing on broad social issues, such as indigenous rights, supply chain, and governance structures, are also qualitative.[295] Disclosure in a human rights context may be

---

[289] Carbon Pricing Leadership Report 2020/21, supra note 280 at 20.
[290] Sara Seck, "Indigenous Rights, Environmental Rights, or Stakeholder Engagement? Comparing IFC and OECD Approaches to Implementation of the Business Responsibility to Respect Human Rights" (2016) 12:1 McGill J Sustainable Development Law 51 at 61; Cristal Russell, Dale Russell, & Heather Honea, "Corporate Social Responsibility Failures: How do Consumers Respond to Corporate Violations of Implied Social Contracts?" (2016) 136 J Business Ethics 759.
[291] Stephen Kim Park, *supra* note 15 at 13.
[292] Diane-Laure Arjaliès & Pratima (Tima) Bansal, "Beyond numbers: How investment managers accommodate societal issues in financial decisions" (2018) 39:56 Organization Studies 691 at 710, I Huault & H Rainelli-Weiss, "A market for weather risk? Conflicting metrics, attempts at compromise and limits to commensuration" (2011) 32 Organization Studies 1395.
[293] Shift, *Human Rights Reporting Are Companies Telling Investors what they need to know*? (New York: Shift, 2017) at 30.
[294] Benjamin J. Richardson & Wes Cragg, *supra* note 205 at 32.
[295] *Ibid* at 33.

ineffective as the information may be "difficult to interpret because they are only proxies for the probability of human rights abuses, and the regimes ignore the considerable heterogeneity among companies concerning the probability of risk, which complicates comparisons across disclosures."[296] There is debate about the construction and use of quantitative data on whether they fully reflect qualitative factors.[297] Data indicators that allow for comparisons could be defined through social phenomena by naming them and attaching rights concepts to quantitative factors.[298] This lack of measurable risk is especially true among fixed-income managers.[299] Equity managers often use visuals (such as emojis) to create a dissonance from financial numbers.[300] This makes evaluating companies and assets extremely difficult, but it is not impossible to create quantitative data from qualitative factors.[301]

A shadow price of social harm could be developed to complement a shadow price on carbon. Financial analysts could use a model such as a risk model as the basis for the development of a shadow price of social harm. One model of risk is the Fama and French three-factor model. The Fama and French model of risk add size and value factors to the market.[302] It posits that individual firms have excess business risk and are mispriced.[303] The model values risk over a longer time horizon, stating that a longer-term competitive advantage will overcome any

---

[296] Adam Chilton & Galit A Safarty, "The Limitations of Supply Chain Disclosure Regimes" (2017) 53:1 Stanford J Int L 1 at 23.
[297] Merry, *supra* note 246 at 15.
[298] *Ibid* at 14; Sally Engle Merry, "Measuring the World. Indicators, Human Rights, and Global Governance" (2011) 52:S3 Current Anthropology S83–S95; Kevin E Davis, Benedict Kingsbury & Sally Engle Merry, "Indicators as a Technology of Global Governance" (2012) 46:1 Law & Society Review 71–104.
[299] Chilton & Safarty, *supra* note 295 at 32.
[300] Diane-Laure Arjaliès & Pratima (Tima) Bansal, "Beyond numbers: How investment managers accommodate societal issues in financial decisions" (2018) 39:56 Organization Studies 691 at 711.
[301] Merry, *supra* note 246 at 24.
[302] EF Fama, & KR French, "Common risk factors in the returns on stocks and bonds" (1993) 33:1 J. Finan. Economics 3.
[303] *Ibid.*

short-term disadvantage.[304] While this theory does not explicitly posit adding environmental or other social risk factors, it does provide evidence to show that mispricing risk can lead to a mispriced asset.[305] According to Fama and French, if factors such as human rights are not included, then the asset would be mispriced.

The discounted cash flow model is the most commonly used financial valuation tool.[306] This model attempts to form a basis for valuing equities by using cash flow and the cost of capital to calculate an expected share price.[307] The greater the risk of a project, asset or firm, the lower the price or value it should have. Adding material environmental and social risks to the cash flow model would lower the company's value or project. For example, in 2007, Steuer et al. proposed a "suitable investor" portfolio.[308] This suitable investor could either be in the form of a social cost of carbon or added to a project's value as the "portfolio social responsibility quotient."[309]

A second approach would add an environmental premium to environmentally beneficial projects or companies. For example, a State Street Global Advisors Study provided early evidence of environmental leaders' performance superiority.[310] It showed a 1.19% per year (119 basis points) performance improvement. This performance improvement became known as the

---

[304] *Ibid.*
[305] Bertrand & Lapointe, *supra* at 177.
[306] Jean Tirole, *The Theory of Corporate Finance* (Princeton University Press, 2006).Aswath Damodaran, *Damodaran on Valuation: Security Analysis for Investment and Corporate Finance* (Wiley, 2006), McKinsey, *Valuation: Measuring and Managing the Value of Companies*, 6th ed (Wiley, 2015) Lutz Kruschwitz, & Andreas Loeffler, *Discounted Cash Flow: A Theory of the Valuation of Firms* (Wiley: Wiley Finance Series, 2005).
[307] *Ibid* at Ch. 5.
[308] Ralph Steuer, Yue Qi & Markus Hirschberger, "Suitable-portfolio investors, nondominated frontier sensitivity, and the effect of multiple objectives on standard portfolio selection" (2007) 152 Ann Oper Res 297 at 298.
[309] *Ibid* at 309.
[310] K. Gluck & Y. Becker, "Can Environmental Factors Improve Stock Selection" (2004) 5 J Asset Management 220.

'Sustainability Premium.'[311] Unfortunately, including this premium in the financial analysis does not currently occur. I have shown the example of the ERISA pension fund above, as the regulators purposely do not allow these factors to become financial factors. Therefore, a third potential approach would be to add sustainability beta factors.[312] The UN PRI, as previously noted, aids in adding beta financials. Adding sustainability as a beta factor would assist in sustainable fund construction and make company valuations more accurate.

An environmental or social benefit-risk factor would encapsulate many considerations and provide a more accurate representation of a firm's value.[313] This benefit-risk factor would increase the cost of capital for debt projects that have negative environmental impacts and decrease capital costs for projects that have positive environmental impacts.

There is no consensus on which screens to use and what factors to use to value the assets that remain in the portfolio. In other words, there is still a great deal of dispute on what constitutes a responsible investment. The European Union's taxonomy is designed to alleviate this issue. However, there is no taxonomy equivalent in Canada or the United States, and there is no theoretical model to help determine the optimal tradeoff between risk, return, and the amount of responsibility.[314] Most research firms incorporate sustainability only after all financial and non-financial metrics have been included.[315] Measuring, disclosing, and then financializing environmental and social risk while having a verified, audited system would solve many of these issues and allow proper valuations of companies.

---

[311] *Ibid* at 222.
[312] Meir Statman & Denys Glushkov, "Classifying and Measuring the Performance of Socially Responsible Mutual Funds" (2016) 42:2 J Portfolio Management 140.
[313] Junkus & Berry, *supra* note 287 at 1195.
[314] Thomas Berry & Joan Junkus, "Socially Responsible Investing: An Investor Perspective" (2013) 112 J Business Ethics 707 at 708.
[315] UN PRI, *Responsible investment in infrastructure, A compendium of case studies* (UNEP FI, 2011) at 23.

Portfolio theory is not perfect and has many disadvantages, but it is a useful theory to backstop an analysis for this section.[316] There are two reasons for this. First, most portfolios mandate diversification. A Canadian equity fund will have a broad diversification of Canadian equities. Second, risk is conceptually misunderstood and improperly measured.

Fund Analysis

Many real-world responsible funds appear to include the same underlying holdings as equivalent to their non-responsible counterparts.[317] I will argue that the principal reasons for the similarity between underlying holdings of sustainable and non-sustainable funds are twofold. First, the Canadian stock market may be too small to provide the diversification necessary to create a proper broad-based sustainable fund. Second, and more importantly, underlying companies do not provide sufficient and robust disclosures to allow portfolio managers to have the data required to make proper valuations based on environmental factors. This keeps the line separated between financial and non-financial data.

In Canada, there are approximately thirty (30) unique responsible mutual funds available to retail advisors.[318] By way of comparison, there are well over 2,000 unique mutual funds in Canada.[319] Of the "Big Six" banks, only the Royal Bank of Canada ("RBC") and the Bank of Montreal ("BMO") offer RI products.[320] The RBC Vision Canadian Equity Fund is a closeted

[316] Frank Sortino, The *Sortino Framework for Constructing Portfolios* (Elsevier, 2010).
[317] It is extremely difficult to conduct an analytical study using scientific methods as a researcher cannot separate the variables that constitute an investment portfolio. These variables include management style of the fund, the influence of alpha, the amount of risk a fund is permitted to take, the size of the fund, transaction costs, geographic limitations, minimum (or maximum) allowable company capitalization, industry/sector restrictions, and many other influences. This article does not attempt such an analysis.
[318] RIA, *Responsible Investment Funds in Canada*, online: https://www.riacanada.ca/ri-marketplace/investment-options/.
[319] Morningstar is a service that lists all available mutual funds, ETFs, and stocks for sale in Canada and the United States. As of April 26, 2020, there are over 18,600 mutual funds alone. As a back check to ensure that no RI fund was missed in the RIA report, the author went through each of the funds to ensure that all were covered. The first step was to filter all the “fee based” products, which left 10,600 funds.
[320] RIA, *supra note 308*.

index fund,[321] meaning that the underlying holdings are very similar to an index fund. The RBC Vision Bond Fund does not have any green bonds or any underlying green assets and invests only in government bonds.[322] Saying this Vision Bond fund is a valid, responsible fund would also mean that every Canadian bond fund would qualify as a responsible bond fund, as they have the same holdings. The BMO Women in Leadership fund uses a positive screen, concentrating on women's importance in senior leadership positions.[323] The BMO Fossil Fuel Free Fund follows the negative screen/divestment mandate of eliminating companies that derive a substantial portion of their income from oil and gas activities.[324]

I also examined offerings by independent investment managers[325] (Investors Group, Manulife, Sun Life, and Industrial-Alliance).[326] Manulife and Sun Life do not have RI offerings. Mackenzie Investments offers the MacKenzie Global Environmental Equity Fund, the Global Sustainability and Impact Balanced Fund and the Global Women's Leadership Impact Fund.[327] The IA-Clarington INHANCE Canadian Equity Class appears to benefit from negative screens

---

[321] RBC Global Asset Management, *RBC Vision Canadian Equity Fund*, Fund Facts (Toronto, RBC).

[322] RBC Global Asset Management, *RBC Vision Bond Fund*, Fund Facts (Toronto, RBC).

[323] BMO, "Invest with Impact, Invest in Women", online: https://bmoforwomen.bmo.com/invest-with-impact-invest-in-women/; BMO, "Women in Leadership Fund" Fund Facts, online: https://www.bmo.com/gam/ca/investor/products/mutual-funds/product?fundId=37646#.

[324] BMO Asset Management Inc., *BMO Fossil Fuel Free Fund*, Fund Facts (Toronto: BMO).

[325] Investors Group, *Socially Responsible Investing*, online: https://www.investorsgroup.com/en/investments/products/socially-responsible-investing-sri; Manulife, online: http://www.manulifeam.com/ca/About-Us/Responsible-Investment-at-Manulife-Asset-Management/ .

[326] Desjardins, online: https://www.desjardins.com/ca/personal/wealth-management/our-solutions/responsible-investement/index.jsp.

[327] MacKenzie Investments, Global Women's Leadership Fund, online: https://www.mackenzieinvestments.com/en/products/mutual-funds/mackenzie-global-womens-leadership-fund#05279; Global Environmental Equity Fund, online: https://www.mackenzieinvestments.com/en/products/mutual-funds/mackenzie-global-environmental-equity-fund#05786 ; Global Sustainability and Impact Balanced Fund, online: https://www.mackenzieinvestments.com/en/products/mutual-funds/mackenzie-global-sustainability-and-impact-balanced-fund#05256 MacKenzie Investments, "Investing with Impact" (10 October 2017) online: https://www.mackenzieinvestments.com/en/about/press-releases/2017-october-10-investing-with-impact-mackenzie-investments-announces-two-new-products.

and activist investing.[328] On the downside, the remaining holdings are still Canadian corporations found in most Canadian equity funds.

This shows that in a small stock market like the Toronto Stock Exchange, it may be impossible to build a broadly diversified, responsible mutual fund of Canadian equities that satisfied diversification mandates. On the other hand, it could also mean that large Canadian companies have adopted environmental and social practices and thus are responsible.

Northwest & Ethical Investments L.P. ("NEI" Investments), a wholly-owned subsidiary of Aviso Wealth Inc., is the only Canadian asset manager to use third-party money managers to construct its portfolios exclusively.[329] NEI's Environmental Leaders fund does show sustainable characteristics, illustrating that sustainability-themed investing may be the valid RI fund available. However, as evidenced by the NEI Canadian Equity Fund RS (formerly Ethical Canadian Fund A), broad-based integration funds do not show this quality, which holds the same equities as a non-sustainable fund (in different quantities).[330] The same holds for Desjardins and their lineup of SocieTerra funds. The two that show responsible or sustainable characteristics, the Desjardins SocieTerra Cleantech Fund and the Desjardins SocieTerra Environment Fund, are specialized niche funds that focus on sustainability investing.[331]

---

[328] IA Clarington Investments, "IA Clarington Inhance Canadian Equity SRI Class, Manager commentary" (30 September 2020) online: https://iaclarington.com/price-performance/funds/equity?wc=5008 .

[329] NEI Investments, *The NEI Investments Portfolio Manager Selection and Monitoring Process: Committed to Exceptional Portfolio Management* (Toronto: NEI, 2016).

[330] NEI Investments, *NEI Canadian Equity RS Fund, Fund Facts* (31 December 2020).

[331] Desjardins Funds, "Desjardins SocieTerra Cleantech Fund, Fund Facts" online: https://www.fondsdesjardins.com/information/00168_adf_a_en.pdf.

Overall, most broad-based responsible funds are not materially different from non-responsible funds or the broader index, providing evidence confirming previous research.[332] The public market is small, and there are very few large tradable liquid companies. However, the United States does not fare any better. Funds offer the potential to be more diversified than Canadian funds, given the larger number of companies based in the United States and its more diversified economy. However, there is still a tendency for funds to either closet index or mirror closely one of the non-responsible fund products.

Once disclosures are developed, portfolio managers, insurers, and economic modelling agencies can build the models necessary to incorporate this new disclosure information. However, building a robust disclosure dataset would require a new software platform, as noted by the Expert Panel.[333] In the interim, updated definitions of materiality would at least coerce public firms to disclose additional information so that portfolio managers can incorporate information on an ad hoc company-by-company basis. Thus, while the above analysis concludes that environmental or social factors are not correctly integrated into financial models, this is not an admonition of the funds and managers developing the financial products. On the contrary, most are using the most up-to-date information they can obtain. A holistic solution would include carbon and climate, water usage, forest degradation, human rights and social impacts, taxation in foreign jurisdictions, royalty payments, minority/diversity board

[332] Paul Hawken, *Socially Responsible Investing: How the SRI Industry has Failed to Respond to People who Want to Invest with a Conscience and what can be Done to Change it* (California: National Capital Institute, 2004) at 16.

[333] Keith MacMaster, "More Data, Less Problems: A case for more precise climate data in Investment Allocation", FinDev Blog, Global Financial Markets Center, Duke University School of Law, online: https://sites.law.duke.edu/thefinregblog/2020/08/13/more-data-less-problems-a-case-for-more-precise-climate-data-in-investment-allocation/

representation, aboriginal rights, and adherence to the Sustainable Development Goals into one cohesive set of disclosures.

Conclusion

Portfolio managers, insurers, and financial institutions create financial products and require significant amounts of information to assess risk and value companies and projects. There is a need for private model building by finance companies, but there is also a vital need for a more significant amount of publicly available information. The information asymmetry problem is a real and pressing issue, as shareholders do not have access to all material information, and the broader stakeholder has even less information. Part of the reduction in the share of the European investment market may lie in the robust debate over defining sustainable investing.

Canadian corporate and securities laws require enhanced disclosures and materiality. Without more meaningful data, the disclosure will not provide any additional information than currently conveyed. Disclosures must also be standardized, much like accounting data. Without standardization, the data will not be comparable across companies, firms, projects or industries. Only with relatable standardized data can more comprehensive climate financial models be created. The top four reasons for considering environmental and social factors are (1) managing risk, (2) improving returns over time, (3) meeting client or beneficiary demand, and (4) fulfilling a fiduciary duty.

Integrating environmental, social, and governance factors partially depends on materiality. However, materiality is only relevant if adequately disclosed.[334] Materiality should concern itself with value, not share price. Material matters should have short, medium- and long-term timeframes without a misguided effort on short-term results. The effects of climate change will be material, especially over the long term.

Unfortunately, there is no comprehensive framework nor an organized set of data to allow an investor to incorporate all information required. Until securities commissions conclusively and decisively deem environmental and social information as material, disclosures will be ineffective at creating positive and meaningful change. Both Canada and the United States could adopt additional mandatory disclosures. While there are still issues with transnational frameworks, they provide additional data (including emissions and emissions intensities), which will assist portfolio managers.

Companies need to determine which SDGs apply to them and report with accurate data. This will require a significant change to the notion of materiality. Domestic securities laws do not provide sufficient material disclosures, and transnational frameworks fill in most, but not all, gaps.

There are important considerations that derive from this analysis. The first is that companies that actively state that they follow sustainable principles need to develop and construct funds that follow responsible investing's core principles, not merely to the letter of

[334] OECD, *Responsible business conduct for institutional investors Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises* (2017) at 43.

these principles but also its spirit. A data hub and analytics solution can automate this analysis and assist with the comparability of companies.[335]

Double materiality is potentially a solution. However, the difference between financial and double materiality is often just about time horizons. What is material for society and the environment ultimately becomes financially material for the company. A day trader will not be concerned about the possible introduction of tighter labour laws in five years. A pension fund with obligations to beneficiaries decades into the future will be far more likely to scan the horizon for structural changes in the economy and society.

Materiality is dynamic. Issues important to the human species change over time; few considered emitting greenhouse gases a material issue 25 years ago. As such, legal definitions must evolve and be able to evolve without legislative change. Materiality is also partly subjective. An investor does not know which specific sustainability themes for a given company will become financially material in the future. Updating to a principles-based definition of materiality, using a transnational framework to guide behaviour would ensure firms disclose the necessary information for stakeholders to make informed decisions, now and thirty years from now.

[335] Smart Prosperity, *Bridging the Transparency Gap in Sustainable Finance* (25 August 2020) online: https://institute.smartprosperity.ca/bridging-transparency-gap.

Responsible Investing: Access Denied

Keith Edward MacMaster[*]

Retail investors are increasingly demanding responsible investments as part of their portfolios. Retail investors also, generally, require the services of an advisor. This article argues that traditional mutual funds, while structurally able to provide responsible investments, have not provided responsible holdings to their mass affluent retail investing clientele. While institutional investors, and certain very wealthy retail investors, have a multitude of options to avail themselves of responsible investments, mass affluent retail investors have less of an ability to invest responsibly. Advisors and investors do not have access to the majority of responsible investments, nor are advisors adequately trained or properly compensated to provide advice on these products. Regulatory changes to advisor licensing and training are recommended to address these problems to provide mass affluent retail investors with better access to responsible investing options.

Les particuliers exigent de plus en plus de leurs conseillers en investissement que leurs portefeuilles soient composés de placements responsables. Selon l'auteur de cet article, les fonds communs de placement classiques sont en mesure de répondre à cette demande, mais ils ne le font pas même pour des clients particuliers aisés. Les investisseurs institutionnels et les investisseurs particuliers très fortunés ont une kyrielle d'options; cependant, les individus moins fortunés restent sur la touche : ils n'ont pas accès à la majorité des placements responsables et leurs conseillers n'ont ni la formation ni la rémunération appropriées pour faire des recommandations sur les produits de cette nature. Il faudrait apporter des modifications d'ordre réglementaire à la procédure d'octroi de permis aux conseillers ainsi qu'à leur formation pour combler ces lacunes si on veut permettre aux clients particuliers aisés d'avoir un meilleur accès aux placements responsables.

1. INTRODUCTION

The following story forms the basis of this article. I was sitting in my office on an ordinary Thursday afternoon. The firm that I worked for, one of Canada's largest financial institutions, often gets "walk-in" clients. An elderly gentleman walked into our branch, presented a large cheque, and told the customer service representative (CSR) that he had just sold his house. The CSR asked if the client would like to speak with an investment expert. The client agreed, and after the normal introductions, financial reviews, and the "Know your Client" (KYC)

---

[*] Keith Edward MacMaster is a PhD candidate, Dalhousie University.

procedures, I asked what his intentions were with the money. The client told me that he wanted to invest it in "some sort of ethical or socially friendly way, I am not sure on the right lingo." I told him that our bank (all bank advisors are mutual fund licensed, so by law I was only allowed to provide advice on mutual funds, and only that bank's mutual funds as all advisors can only sell proprietary products) had such a fund. Fortunately, I knew what socially responsible investing was, as most advisors do not. I printed off the Fund Facts, which is the regulatory required document that describes the fund (described in more detail in the retail disclosure section below) and discussed the fund with the client. The house sale was approximately $400,000, so I did not need to refer him to our high net worth group (minimums of $1 million are required). The client agreed, and the transaction was completed. After the client left my office, I researched the fund in more depth. I noticed some peculiarities and began to wonder if this fund was truly socially responsible. I also researched on Morningstar the other funds available at other institutions and noticed many similarities. This discovery led me to asking myself, "Are clients with less than $1 million dollars actually getting responsible investments? Do truely responsible investments of mutual funds actually exist or are financial institutions peddling funds masquerading as responsible?" I, like many advisors, was solely compensated via commissioned sales, and so my income was funded by the transaction. However, I was paid less on this fund than I would have been if I had pushed some of the bank's other funds. Thus, I also wondered if other advisors, even if they knew about responsible investing, would have provided the advice knowing their compensation cheque would be lower than if they suggested other funds. All of these issues made me think that most Canadians do not have access to ethical, environmental and socially responsible funds, and this is a big problem.

The above example is far too common for a financial advisor and forms the basis for this article. The structure and regulation of licensing, standard of care, compensation and education for retail advisors create barriers for the mass affluent investor to access responsible investments (RIs). This article will answer the question of whether legal, regulatory, and policy reform is required to enhance the promotion of responsible investing vehicles and whether regulatory licensing requirements must be updated to allow mutual fund licensed representatives to sell a broader array of investment vehicles to ensure that Mass Affluent investors have access to RI.

The "reasonable investor hypothesis" surmises that the best way to generate returns is to understand long-term economic, social and environmental realities, and relates to a desire to reduce risk.[1] Most individuals in the developed world are "middle income" earners and must personally save for retirement, known as the "Mass Affluent" retail investor.[2] Government sponsored and employer

---

1 Cary Krosinsky, Nick Robins, & Stephen Viederman, "After the Credit Crisis — The Future of Sustainable Investing" in *Next Generation of Responsible Investing*, Tessa Hebb (ed.) (Springer: 2012) at Ch. 2.

2 Rob Garver, "Banks Try, Try Again to Woo the Mass Affluent" (2010) 10 American

pension plans are not designed to fully fund retirements, or help invest for other purposes, so there is a real and substantial need for retail investments.[3] Many Mass Affluent investors want to make a substantial return on their investments, all while doing so in an environmentally and socially responsible manner.[4] Individuals, in large part, are unskilled at creating financial plans and require a financial advisor to help them with their retirement and investing goals.[5] As retirement today can mean a timeframe of 25 years or longer, long-term returns become vitally important, as the world will change in the upcoming decades.[6] Simply put, without retail advisors, most individuals would not have the abilities to invest.[7]

RI is investing in a responsible manner, while requiring profit maximization.[8] There is "no authoritative definition," of RI,[9] however; accepted classifications include negative and positive screens, Environmental, Social & Governance (ESG) integration, sustainability themed investing, impact investing, and corporate engagement/activist investing.[10] Positive screens include companies with positive influences, while negative screens eliminate undesirable companies

---

Banker 10 at 14; Strategy&, *Wealthy, Young & Ambitious: How banks can profitably serve the rising mass affluent* (PwC/Strategy&, 2013).

[3] Many self-employed do not have access to a government plan or to an employer pension plan and must invest solely in retail products to fund their retirements; Government of Canada, *Canada Pension Plan* (December 27, 2018), online: < https://www.canada.ca/en/services/benefits/publicpensions/cpp.html > ; the United States uses the social security system, online: < https://www.ssa.gov/benefits/retirement/ > .

[4] Benjamin Richardson, *Socially Responsible Investment Law: Regulating the Unseen Polluters* (New York: Oxford University Press, 2008).

[5] Kevin Dorey, "When do you need a financial advisor?", Chronicle Herald (February 1, 2017); Meryl Landau, "Do You Need a Financial Adviser?", U.S. News & World Report (September 1, 2011).

[6] Sun Life Financial Inc., *Retirement Now Report* (Toronto: Sun Life, 2016) at 7; Treasury Board Canada, "Sources of Retirement Income" (December 30, 2016), online: < https://www.canada.ca/en/treasury-board-secretariat/services/pension-plan/plan-information/retirement-income-sources.html > ; Emily Brandon, "The Top 10 Sources of Retirement Income", US News (May 13, 2014), online: < https://money.usnews.com/money/blogs/planning-to-retire/2014/05/13/the-top-10-sources-of-retirement-income > ; Kenneth S. Shultz & Mo Wang, "Psychological Perspectives on the Changing Nature of Retirement" (2011) 66:3 American Psychologist 170 at 172.

[7] *Ibid*.

[8] Benjamin Richardson & Wes Cragg, "Being Virtuous and Prosperous SRI's conflicting goals" Paper presented in the Principles of Responsible Investment Academic Conference (Ottawa, ON: October 2009).

[9] Benjamin Richardson, "Socially Responsible Investing for Sustainability: Overcoming Its Incomplete and Conflicting Rationales" (2013) 2:2 Transnational Environmental Law 311 at 313.

[10] Global Sustainable Investment Alliance, *2016 Global Sustainable Investment Review*, online: < http://www.gsi-alliance.org/members-resources/trends-report-2016/ > at 7 [GSIA].

or industries.[11] Impact investing is "targeted investments, typically made in private markets, aimed at solving social or environmental problems."[12] RI is moving away from command and control screens, favouring holistic integration of ESG issues.[13] This evolution is consistent with a "New Governance" theoretical model that believes that firms that place an emphasis on ESG will have less risk and better returns.[14]

This belief in lower risk for RI is important, as retail investors see risk only as a downward drop in prices.[15] Mass Affluent investors have a goal and timeframe to invest.[16] The psychological phenomenon of "loss aversion" relates to investors being more concerned about losses than gains.[17] For retail investors, risk is fundamentally asymmetric.[18]

RI products, in general and over a long-time horizon, produce positive returns. The "good management hypothesis" theorizes that the better the governance of a firm, the better the results should be both financially and reputationally.[19] While there is still some debate in the literature, overall, it appears that RI products outperform their non-RI counterparts.[20] So, if RI

---

[11] Thomas Berry & Joan Junkus, "Socially Responsible Investing: An Investor Perspective" (2013) 112 J Business Ethics 707 at 708; H. Boerner, "SRI: Passing Fad or an Investment Approach on the Rise? Sustainable and Responsible Investment Outpaces Most Traditional Indexes and Equity Returns during Downturn" (2011) 16:1 Corp. Fin. Rev 37 at 38; Jacquelyn Humphrey & Darren Lee, "Australian Socially Responsible Funds: Performance, Risk and Screening Intensity" (2011) 102 J Business Ethics 519 at 520; Mark Rhodes, "Information Asymmetry and Socially Responsible Investment" (2010) 95 J Business Ethics 145; Pieter Trinks & Bert Scholtens, "The Opportunity Cost of Negative Screening in Socially Responsible Investing" (2017) 140 J Business Ethics 193.

[12] GSIA, *supra* note 10 at 4.

[13] Natalie Nowiski, "Rising above the Storm: Climate Risk Disclosure and its Current and Future Relevance to the Energy Sector" (2018) 39:1 Energy LJ 1 at 8.

[14] WA Bogart, *Permit but Discourage: Regulating Excessive Consumption* (New York: Oxford University Press, 2011) at 49-50; Mark DesJardine, Pratima Bansal, & Yang, "Bouncing Back: Building Resilience Through Social and Environmental Practices in the Context of the 2008 Global Financial Crisis" (2017) 3 J Management 1.

[15] Matthew Sherwood & Julia Pollard, "The risk-adjusted return potential of integrating ESG strategies into emerging market equities" (2018) 8:1 J Sustainable Finance & Investment 26 at 31.

[16] Franklin Parker, "Quantifying downside risk in goal-based portfolios" (2014) 17:3 J Wealth Management 68.

[17] *Ibid.* at 69.

[18] Frank Sortino, *The Sortino Framework for Constructing Portfolios*, (Elsevier, 2010); Victoria Dobrynskaya, *Downside Risk in Stock and Currency Markets*, (September 2014) PhD Dissertation, London School of Economics, [unpublished manuscript].

[19] Benjamin Auer, & Frank Schumacher, "Do Socially (ir)Responsible investments pay? Evidence from international ESG Data" (2016) 59 Quarterly Review of Economics and Finance 51 at 52.

[20] Europe: Benjamin Auer, "Do Socially Responsible Investment Policies Add or Destroy

products produce better returns than non-RI funds, and clients want to invest in these products, why is there such little uptake? This article addresses this question by showing that current research has failed to address the problems of advisor licensing as an underlying root cause of RI uptake. The licensing of retail advisors impacts RI in terms of both the legal structures utilized, the accessibility of these structures to the Mass Affluent and the compensation offered to advisors.[21] The point of emphasis for this article is that certain products are promoted more enthusiastically than others due to the larger sales commissions embedded in these products.[22]

This article compares Canadian requirements against those in the United States (US) and Australia as these nations have well-established stock markets and a robust Mass Affluent population.[23] This article will conclude that Canada should adopt certain US and Australian licensing provisions to allow a broader array of investments to be made available to the Mass Affluent, including allowing retail advisors access to a broader range of RI products, along with enhanced training and education requirements. This article will also argue that securities laws focus on the type of structure, rather than its underlying complexity, as a way to regulate products and may be partly to blame for the dearth of RI investments available to the Mass Affluent. Construction of RI investments that Mass Affluent investors can access is sorely needed.

Outside the scope of this article are environmentally related disclosure issues, which are weak and are not uniform among jurisdictions.[24] Stephen Kim Park notes that investors must be able to analyze the outcomes of their investments.[25]

European Stock Portfolio Value?" (2016) 135 J Business Ethics 381; Tessa Hebb, *Canadian SRI Mutual Funds Risk / Return Characteristics* (Carleton Centre for Community Innovation: Carleton University, 2015) pub R15-02; Vanita Tripathi & Varun Bhandari, "Do Ethical Funds underperform conventional Funds? Empirical Evidence from India" (2015) 4:2 Int J Business Ethics in Developing Economies; Gunnar Friede, Timo Buschi and Alexander Bassen, "ESG and financial performance: aggregated evidence from more than 2000 empirical studies" (2015) 5 J Sustainable Finance & Investment 210; Kathrin Lesser, Felix Rößle & Christian Walkshäus, "Socially responsible, green, and faith-based investment strategies: Screening activity matters!" (2016) 16 Finance Research Letters 171; Michael Trudeau, "Non-ethical funds outperform ethical rivals" (2011) Financial Advisor 1; Gerasimos Grompotis, "Evaluating a New Hot Trend: The Case of Water Exchange-Traded Funds" (2016) 6:4 J Index Investing 103.

21 Mark Van Hoecke, "Methodology of Comparative Legal Research" (2015) Law and Method 1 at 3; E. Morgera, "Global Environmental Law and Comparative Legal Methods" (2015) 24:3 Review of European, Comparative & Int Env L 254.

22 Rhys Bollen, "'There is no Alpha': Bounded Rationality in the Mutual Funds Market" (2013) 28:2 Banking and Finance Law Review 225 at 227.

23 Jeff Desjardins, "Top 20 Stock Exchanges by Market Capitalization", Visual Capitalist (April 10, 2017), online: < http://www.visualcapitalist.com/20-largest-stock-exchanges-world/ > .

24 Task Force on Climate Related Disclosures, *Final Report — Recommendations of the Task Force on Climate Related Financial Disclosures* (June 2017).

Qualitative factors often lead to ESG issues being abandoned, and may preclude an accurate ESG "score",[26] which makes evaluating companies/assets difficult, but not impossible.[27] Junkus & Berry noted that many performance studies have data problems.[28] There is a need to conduct further research on ranking schemes and techniques.[29] Also, outside scope, are the problems with the individual funds themselves. Hawken concluded that many funds are masquerading as responsible when they really adopt conventional investment approaches.[30] Many RI funds are "'plain vanilla' funds, holding the same companies as non-RI funds."[31] It is doubtful that any broad-based plain vanilla RI fund could properly incorporate all ESG factors. Future research should attempt to answer this question.

This article will proceed as follows: it will introduce basic fund structures such as mutual funds, exchange traded funds, bonds and community economic development investment funds; next, the article will compare Canadian provisions against US and Australian counterparts for licensing, advisor standard of care, suitability/know your client, retail document disclosure, fee structures and education requirements; then the article will analyze licensing and suitability against the fund structures; and, will conclude that most advisors do not have access to most RI vehicles which limits the choice available to retail investors and minimizes uptake of RI.

2. ADVISOR REGULATION

Investor licensing is directly related to which products are able to be sold to the retail public. Many RI vehicles are implemented in forms inaccessible to the Mass Affluent.[32] As such, retail RI faces a headwind, not only from valuing the

---

[25] Stephen Kim Park, "Social Bonds for Sustainable Development: A Human Rights Perspective on Impact Investing" (2018) 0:0 Business and Human Rights J 1 at 5.

[26] Diane-Laure Arjaliès & Pratima Bansal, "Beyond numbers: How investment managers accommodate societal issues in financial decisions" (2018) 39:56 Organization Studies 691 at 710.

[27] Sally Engle Merry, *The Seductions of Quantification, Measuring Human Rights, Gender Violence and Sex Trafficking* (University of Chicago Press: Chicago Series in Law and Policy, 2016) at 24.

[28] Joan Junkus & Thomas Berry, "Socially responsible investing: a review of the critical issues" (2015) 41:11 Managerial Finance 1176 at 1195.

[29] *Ibid.* at 1196.

[30] Paul Hawken, *Socially Responsible Investing: How the SRI Industry has Failed to Respond to People who Want to Invest with a Conscience and what can be Done to Change it* (California: National Capital Institute, 2004); Karen Benson, TJ Brailsford & JE Humphrey, "Do socially responsible investment managers really invest differently?" (2006) 64:4 J Business Ethics 337 at 352.

[31] Guy Dixon, "Confused about Ethical Investing?", Globe and Mail (April 15, 2017), online: <https://www.theglobeandmail.com/globe-investor/confused-by-ethical-investing-heres-a-primer/article34332548/>; SIF, "Fast Facts", online: <https://www.ussif.org/fastfacts>.

ESG scores of companies, but from its own distribution system: the financial advisor network.[33] Advisors need education, incentives, and the ability to sell RI funds, but current licensing provisions prevent retail advisors from accessing, recommending, or being knowledgeable about RI investments.[34] Six concepts are detailed in this article: licensing, advisor duties, suitability, document disclosure, fee structures, and education. Bollen notes that "actively managed mutual funds may be more promoted, and advisers may have an incentive to recommend products that provide them with better remuneration."[35] Fee arrangements that disincent advisors to provide certain choices for clients should be curtailed.

(a) Why Does this Matter — An Overview of Products

Over one-third of Canadians own mutual funds, accounting for 31% of financial wealth.[36] Approximately 43% of US households (55 million households) own mutual funds.[37] A mutual fund investor obtains instant diversification and access to a broad array of underlying investments.[38] Securities laws serve to align investment decisions with the interests of fund members, so the portfolio is structured to match investment objectives stated in its Prospectus.[39] Mutual funds can be rebalanced easily,[40] and in registered

---

32 Outside scope is the Accredited Investor, which exempts certain investors from disclosure obligations, *Securities Act* (Ontario), R.S.O. 1990, c. S.5, s. 73.3 [OSA], *Prospectus and Registration Exemptions*, OSC NI 45-106 41 OSCB 4574 at Part 2.3, Greg Oguss, "Should Size or Wealth Equal Sophistication in Federal Securities Laws?" (2012) 107:1 Northwestern University L Rev 285. Generally Accredited Investors have access to IIROC dealers and as such have the full range of products available to them, based on an arbitrary wealth threshold that has no relationship to knowledge or competency.

33 The systems are separated into the asset management network, those who build and construct the funds, and the broker-dealer market, who distribute these funds to end users.

34 EU High Level Expert Group on Sustainable Finance, *Financing a Sustainable European Economy, Final Report* (European Commission, 2018) at 28.

35 Bollen, *supra* note 22 at 227.

36 IFIC, "Statistics and Facts", online: <https://www.ific.ca/en/info/stats-and-facts/>.

37 ICI, *Review of Trends and Activities in the Investment Company Industry* (2017 Investment Company Fact Book, ICI, 2017); Sarah Holden, *ICI Study: 55 Million US Households Own Mutual Funds* (ICI, 2017).

38 *Investment Funds*, OSC NI 81-102 (2017) 41 OSCB 9993 [NI 81-102]; *Mutual Fund Prospectus Disclosure Rule*, OSC NI 81-101 (2017), 40 OSCB 1584 [NI 81-101]; *Investment Company Act of 1940*, 15 U.S.C. §§ 80a-1 to 80a-64; LL Gremillion, *Mutual fund industry handbook: a comprehensive guide for investment professionals* (Hoboken, N.J.: John Wiley & Sons, Inc., 2005); John Haslam, *Mutual Funds Portfolio Structures, Analysis, Management, and Stewardship* (Hoboken, N.J.: Wiley, 2010); William Bertin & Laurie Prather, "Management structure and the performance of funds of mutual funds" (2009) 62 J Business Research 1364 at 1367.

39 OSA, *supra* note 32, s. 116(a); *Investment Fund Continuous Disclosure,* OSC NI 81-106, (2018) 41 OSCB [NI 81-106].

40 Kent Thune, "How and When to Rebalance your Portfolio", Balance (April 5, 2018),

accounts can be rebalanced without tax consequences.[41] Downside issues include substantial restrictions on the underlying investments — done to "protect" the retail investor[42] — high fees,[43] and explicit and "closet" indexing.[44] Alpha is the measure of active return on an investment.[45] Actively managed funds have larger fees than passive funds, lowering returns, and 66-75% of US active managers underperform the market, while in Canada, the percentage soars to 91%.[46] Many RI funds use active management including diversification strategies, proxy voting, and ESG integration.[47] This management puts RI funds at a disadvantage as exchange traded funds are generally less expensive.

An exchange traded fund (ETF) is a marketable security that tracks an index, commodity, bond, or basket of assets.[48] ETFs trade like stocks on an exchange, with higher liquidity, a wider range of investing strategies, and lower fees than mutual funds, making them attractive to investors.[49] ETFs can short stocks, lend shares, use leverage and use more complex derivative strategies that mutual funds

---

online: <https://www.thebalance.com/how-and-when-to-rebalance-your-portfolio-2466529>.

[41] Government of Canada, "Registered Retirement Savings Plan" (December 14, 2018), online: <https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/rrsps-related-plans.html>; Shaun Pfeiffer, "Tax Efficiency of Mutual Funds and Exchange-Traded Funds" (2016) J Financial Services Professionals 19.

[42] NI 81-102, *supra* note 38, Part 2.3.

[43] John Adams, et al., "Are mutual fund fees excessive?" (2012) 36 J Banking & Finance 2245at 2258; James Cox & John Payne, "Mutual Fund Expense Disclosures: A Behavioral Perspective" (2005) 83 Wash University L Quar 907.

[44] Martijn Cremers, et al., "Indexing and active fund management: International evidence" (2016) 120 J Financial Economics 539.

[45] Rob Russell, "ABCs of Investing, Alpha, Beta and Correlation", Forbes (July 14, 2014), online: <https://www.forbes.com/sites/robrussell/2014/07/15/abcs-of-investing-for-experienced-investors/#13077bc7393f>.

[46] Aye Soe & Ryan Poirier, *SPIVA® Canada Scorecard* (S&P Global, 2016); Jeff Cox, "Bad times for active managers: Almost none have beaten the market over the past 15 years", CNBC News (April 12, 2017), online: <https://www.cnbc.com/2017/04/12/bad-times-for-active-managers-almost-none-have-beaten-the-market-over-the-past-15-years.html>; Owen Walker, "Active fund managers beat market by just 16p for every »100 invested", Press Release (January 28, 2018) via ProQuest database.

[47] Indrani De, & Michelle Clayman, "The benefits of socially responsible investing: An active manager's

perspective" (2015) 24:4 J Investing 49 at 50.

[48] Martin Lettau & Ananth Madhaven, "Exchange-Traded Funds 101 for Economists" (2018) 32:1 J Economic Perspectives 135.

[49] Azhar Mohamad, Aziz Jaafar & John Goddard "Short selling and exchange-traded funds returns: evidence from the London Stock Exchange" (2016) 48:2 Applied Economics 152; James Chong, Monica Hussein, & Michael Phillips, "S&P 500 ETFs and Index Funds: Are Fees All There Is to It" (2011) 14:2 J Wealth Management at 59; Joanne Hill, "The Evolution and Success of Index Strategies in ETFs" (2016) 72:5 Financial Analysts J 8; Gary Gastineau, *The Exchange-Traded Funds Manual*, 2nd ed.

cannot.[50] US investors in ETFs have tax advantages and can defer capital gains tax until the entire ETF is sold, whereas with mutual funds, investors must claim capital gains tax every time assets in the fund are sold.[51] ETFs have played a major role in passive investing.[52] ETFs evolved from complex structures like bull/bear structures and are thus believed (wrongly) that they are more complex (but not necessarily riskier) than mutual funds, even if most ETFs created today are simple index structures.[53] It is this wide range of strategies and low cost which may make ETFs better suited for RI.

Retail investors use bonds as part of the fixed income component of their portfolio.[54] Green bonds pass certification processes to ensure that the projects funded have environmental/social benefits.[55] Legally speaking, there is nothing unique about a green bond, with most being "asset-linked" instruments.[56] Carney notes ". . . the transition . . . provides an annual opportunity worth trillions of dollars for companies and financiers."[57] Green and other RI bonds are a potentially valuable source for RI investments.

Community Economic Development Investment Funds (CEDIF)[58] allow for raising capital to invest in not-for-profit entities within a defined community.[59]

(Hoboken, NJ: John Wiley & Sons. 2010); Anna Agapova, "Conventional Mutual index funds versus Exchange Traded Funds" (2011) 14 J Financial Markets 323 at 324.

50 Mohamad, Jaafar & Goddard, *ibid.*; *see also* Joseph Engleberg, et al., "Short-selling Risk" (2018) LXXIII:2 J Finance 755; Christopher Nicholls, *Corporate Finance and Canadian Law*, 2nd ed. (Toronto: Carswell, 2013) ch.5.

51 Mark Kennedy, "ETF Tax Advantages over Mutual Funds", Balance (June 16, 2018), online: <https://www.thebalance.com/etf-tax-advantages-over-mutual-funds-1215121>; Fidelity Investments LLC, "Benefits of ETFs", online: <https://www.fidelity.com/learning-center/investment-products/etf/benefits-of-etfs>.

52 Cremers et al, *supra* note 44 at 540; Ananth Madhaven, *Exchange Traded Funds and the New Dynamics of Investing* (Oxford Scholarship Online, 2016) Caitlin Dannhauser, "The impact of innovation: Evidence from corporate bond exchange-traded funds" (2017) 125 J Financial Economics 537.

53 Hill, Evolution of ETFs, *supra* note 49.

54 Vasile Dedu & Dan NitÇescu, "Use of fixed income products within a company's portfolio" (2012) 10:10 Theoretical and Applied Economics 5 at 7; SIFMA, *2017 Fact Book* (New York: SIFMA Research Department, 2017) at 4.

55 Amelie Labbe, "PRIMER: green bonds" (2017) Int Fin L Rev London 1; International Capital Markets Association, "Social Bonds Principles" (June 2018), online: <https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/SocialBondsBrochure-JUNE2017.pdf>.

56 Michael Flaherty et al., "Financing climate policies through climate bonds — A three stage model and empirics" (2017) 42 Research in International Business and Finance 468 at 471-472; Thiam Ng & Jacqueline Tao, "Bond financing for renewable energy in Asia" (2016) 95 Energy Policy 509 at 514.

57 CTV, "Companies need to come clean about climate change risk, Mark Carney says", CTV News (July 15, 2016), online: <http://www.ctvnews.ca/business/companies-need-to-come-clean-about-climate-change-risk-mark-carney-says-1.2987976>.

58 *Community Economic-Development Corporations Regulations*, NS Reg 79/98, Sch A

Social enterprises often emerge in geographies where the market and state have failed to provide adequate responses to social, economic, and environmental challenges.[60] Local communities are unlikely to have many locally-based investors who are sophisticated and locally focused, and those who are sophisticated are likely using networks to look outside the area for investment opportunities.[61] A CEDIF is small by nature.[62] Advantages include investing locally in a small business and favourable tax treatment.[63] Wind4all Communities III Inc. is an example of a CEDIF with a Mi'kmaq partner highlighting positive Indigenous rights/economic development opportunities.[64] One of these Mi'kmaq partners, the Pictou Landing First Nation,[65] is a historically disadvantaged community that has suffered human rights abuses.[66]

Thus, mutual funds, ETFs, bonds and CEDIFs are all potential RI structures. Unfortunately, licensing provisions, as illustrated in the next section, prevent most Mass Affluent retail investors from accessing these vehicles. Also, of significant note, the issues detailed in this section regarding RI are the same issues that regulators are reviewing for the industry as a whole.[67]

(i) Licensing

Securities in Canada, including advisor licensing, are regulated provincially, and are designed to protect "investors from unfair, improper or fraudulent practices; and to foster fair and efficient capital markets."[68] The securities

---

[CEDIF Regs]; Michael Friedman, *Budget 2016: Labour-Sponsored Venture Capital Corporations Tax Credit Re-Introduced* (Toronto: McMillan LLP, 2016).

59 NSSC, "Community Economic-Development Investment Funds (CEDIFs)", online: <https://nssc.novascotia.ca/corporate-finance/community-economic-development-Investment-funds>; NSSC, *CEDIF*, NSSC Policy 45-601 (January 17, 2014), Blanket Order No. 45-521.

60 Douglas Lionais, "Social Enterprise in Atlantic Canada Canadian" (2015) 6:1 J Nonprofit Social Economy Research 25.

61 Harvey Johnstone, "Business model innovation: a case study of venture capital in a depleted community" (2013) 15:1 Venture Capital 77.

62 CEDIF Regs, *supra* note 58, ss. 10-12, 17.

63 *Equity Tax Credit Act*, S.N.S. 1993, c. 3, s. 11; *Equity Tax Credit Regulations*, N.S. Reg. 18/94; Government of Nova Scotia*, Equity Tax Credit, Equity Tax Credit Application* (January 22, 2019), online: <https://www.novascotia.ca/finance/en/home/taxation/tax101/personalincometax/equitytaxcredit/default.aspx>.

64 Assante Wealth Management Hydrostone, "Wind4all Communities III Inc.", online: <http://www.assantehydrostone.com/wind4all/>, s. 28.

65 *Ibid.* at 41.

66 Joan Baxter, *The Mill: Fifty Years of Pulp and Protest* (Pottersfield Press, 2017).

67 Status Report on CSA Consultation Paper 33-404 Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients, CSA Staff Notice 33-319 (June 1, 2017).

68 Christopher Nicolls, *Securities Law*, 2nd ed. (Toronto: Irwin Law, 2018), OSA, *supra* note 32, ss. 1.1, 143(13); *Securities Act*, R.S.N.S. 1989, c. 418 [NSSA] ss. 1A(a), 1.2; CSA,

commissions delegate to self-regulatory organizations (SROs) retail advisor licensing and educational requirements, with two primary categories of registration; investment dealers and mutual fund dealers.[69] The two main SROs are the Mutual Fund Dealers Association (MFDA)[70] and the Investment Industry Regulatory Organization of Canada (IIROC).[71] The representatives of each category are limited in terms of the products about which they can provide advice. An investment dealer may act as a dealer in respect of any security; whereas a mutual fund dealer may only act as a dealer in respect of any mutual fund.[72] Mutual funds are regulated by the MFDA and most bank financial advisors are mutual fund licensed.[73] Mutual fund advisors cannot provide advice on stocks, bonds, ETFs and non-mutual fund-based index funds. There are currently approximately 79,800 licensed mutual fund advisors in Canada, which makes funds the most widely available type of structure available.[74]

Investment advisors are regulated by IIROC.[75] There are fewer IIROC advisors as compared to MFDA advisors currently licensed.[76] There are approximately only 8,200 licensed advisors of the big Canadian banks and large independent firms.[77] IIROC advisors also have higher minimum thresholds, with some firms maintaining a "posted" $250,000 investment minimum; however, in personally speaking with several brokers, the actual minimum is closer to $500,000,[78] with seasoned IIROC advisors having minimums of $1 million.[79] These minimums stem from fee structures, as most

"A Provincial/Territorial Memorandum of Understanding Regarding Securities Regulation" (2004), online: < https://www.securities-administrators.ca/aboutcsa.aspx?id = 77 > .

[69] *Registration Requirements, Exemptions, and Ongoing Registrant Obligations*, OSC NI 31-103 (December 4, 2017) para. 7.1(1) [NI 31-103]; OSA, *supra* note 32, s. 21.1; Gary Gassman & Perry Granof, "Global Issues Affecting Securities Claims at the Beginning of the Twenty-First Century" (2007) 43 Tort Trial & Ins. Prac. L.J. 85 at 88.

[70] *Ibid.* at para. 9.2.

[71] *Ibid.* at para. 9.1.

[72] *Ibid.* at para. 7.2.

[73] MFDA, "Membership statistics", online: < http://mfda.ca/members/membership-statistics/ > .

[74] *Ibid.*

[75] IIROC, "About IIROC, Know Your Advisor", online: < http://www.iiroc.ca/about/Pages/default.aspx > .

[76] *Ibid.*

[77] Staff Report, "The Firms with the Biggest Books, the Most Assets and the Largest Rosters" Advisor Magazine (May 4, 2016), online: < http://www.advisor.ca/news/industry-news/the-firms-with-the-biggest-books-the-most-assets-and-the-largest-rosters-205346 > .

[78] For example, Schultz Group has a minimum threshold of $500,000. Scotia Wealth Management, "The Schultz Group", online: < http://www.schultzgroup.ca/Services/Fee-Based-Investing.html > .

IIROC brokers are compensated via sales commissions and trailer revenue. Only investors with at significant investable assets can access an IIROC broker.[80] Most Mass Affluent investors will not meet these minimum thresholds, they will not be able to access an IIROC broker and will be limited to accessing only mutual fund products. Thus, if a retail investor wishes to purchase an RI ETF or individual bond, they must either use an IIROC broker or use an online brokerage and trade themselves.[81]

In the US, the Securities & Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), and state securities commissions govern adviser licensing.[82] Canadian and US licensing are similar in that both separate the two roles of investment adviser and, in the US case, a limited service adviser.[83] FINRA is authorized by SEC to protect investors and ensure the fair and honest operation of markets.[84] It does not regulate funds but regulates the broker-dealers and approximately 629,525 registered securities representatives that sell funds.[85] There was movement by Congress to separate the regulatory environment for mutual funds and investment advisers, similar to the Canadian experience; however, this has not yet occurred.[86]

The Australian Securities and Investment Commission (ASIC) regulates the fund industry in Australia.[87] Australia has moved to a centralized federal government securities regulatory regime, like the US to oversee its 25,379 advisors.[88] Australia and Canada are similar in that retail investors are more

---

79 Mathieu Storrier, Scotia McLeod, online: <http://crescoadvisorygroup.ca/second-opinion/>; David Aston, "A Perfect Fit", MoneySense (May 12, 2011), online: <http://www.moneysense.ca/magazine-archive/a-perfect-fit/>.

80 Edwin Weinstein, *Mutual Fund Fee Research*, Paper submitted to CSA per RFP OSC 201314M -93 (OSC/Brondesbury Group, 2015) at 49 [Weinstein].

81 Online brokers are for the do-it yourself investor. These channels do not provide any advice or guidance on product suitability, nor require a duty of care. If the client requires advice, the only channel for ETFs or stocks is the broker/IIROC channel.

82 *Investment Advisers Act of 1940 15 U.S.C. § 80b-1 through 15 U.S.C. § 80b-21*, s. 203A. ø80b—3a & SEC. 222 ø80b—18a [IAA].

83 *Ibid.*

84 *Securities Exchange Act of 1934*, Pub. L. No. 94-29, sec. 3(6), § 3(a)(26), 89 Stat. 97, 100 (1975) (codified as amended at 15 U.S.C. § 78c(a)(26) (2012)), 15 U.S.C. § 78o-3. Barbara Black, "Punishing Bad Brokers: Self-Regulation and FINRA Sanctions" (2013) 8 Brook J. Corp. Fin & Com. L. 23.

85 FINRA, "About Us", online: <http://www.finra.org/about>; *Exchange Act Release No. 55495*, 2007 WL 1260858 (March 20, 2007) at 9; FINRA, "Statistics", online: <https://www.finra.org/newsroom/statistics>.

86 Barbara Black, "Are Retail Investors Better Off Today?" (2008) 2 Brook J. Corp. Fin & Com. L 303 at 319-20.

87 Australia, *Corporations Act of 2001 (Cth) No. 50, 2001*, Part 7.6 [Australia *Corporations Act*].

88 Pamela Hanrahan & Ian Ramsay, "Regulation of mutual funds in Australia", to be published in *Research Handbook on Mutual Funds,* William Birdthistle and John Morley

likely to retain the services of a financial advisor/financial planner rather than an investment advisor, which means that funds will be the more prominent products being sold.[89] The responsible entities that operate as advisors must be licensed under the Australian Financial Services (AFS) licensing regime.[90] The Australian *Corporations Act* provides that "a financial services licensee may give the authorized representative a written notice authorizing the person, for the purposes of this Chapter, to provide a specified financial service or financial services on behalf of the licensee."[91] The financial services specified may be some or all of the financial services covered by the licensee's licence.[92] Thus, not all licensed individuals will deal in both securities and mutual funds.

All three countries separate mutual fund advisors from the broader securities brokers. The treatment of mutual funds as distinct from other securities creates a potential for systemic bias and suggests a need for a more extensive regulatory review. This separation would affect Australians in much the same manner as Canadians.

(ii) Advisor duties

Investor protection depends on the unique relationship between financial advisor and client. Canadian advisors owe a duty to act fairly, honestly and in good faith with their clients.[93] This obligation, unfortunately, does not amount to a fiduciary duty or even a best interest standard.[94] A fiduciary duty requires fiduciaries to make complete disclosure of all material information.[95] There are

---

(eds) (Edward Elgar Publishing, 2017); see also ASIC, *Annual Report 2016-2017* (Sydney: ASIC, 2017).

89 *Ibid.* at 8.

90 *Ibid.* at 12.

91 Australia *Corporations Act*, *supra* note 87, s. 916A.

92 *Ibid.*, s. 921B (2)-(4).

93 OSA, *supra* note 32, ss. 25(1), 36(1), NSSA, *supra* note 68, s. 39A; *Securities Act* (Alberta), R.S.A. 2000, C. S-4, s. 75.2.

94 *Hunt v. TD Securities Inc.*, 2003 CarswellOnt 3141, 66 O.R. (3d) 481, 36 B.L.R. (3d) 165, 39 C.P.C. (5th) 206, 229 D.L.R. (4th) 609, 175 O.A.C. 19, [2003] O.J. No. 3245 (Ont. C.A.); additional reasons 2003 CarswellOnt 4971, 40 B.L.R. (3d) 156, 43 C.P.C. (5th) 211, [2003] O.J. No. 4868 (Ont. C.A.); leave to appeal refused 2004 CarswellOnt 1610, 2004 CarswellOnt 1611, 330 N.R. 198 (note), 196 O.A.C. 399 (note), [2003] S.C.C.A. No. 473 (S.C.C.); *Varcoe v. Sterling*, 1992 CarswellOnt 888, 7 O.R. (3d) 204, [1992] O.J. No. 60 (Ont. Gen. Div.); affirmed 1992 CarswellOnt 976, 10 O.R. (3d) 574, [1992] O.J. No. 1501 (Ont. C.A.); leave to appeal refused (1992), [1992] 3 S.C.R. viii (note), 10 O.R. (3d) xv, 145 N.R. 390 (note), 60 O.A.C. 74 (note), [1992] S.C.C.A. No. 440 (S.C.C.); however, see *Andrews v. Keybase Financial Group Inc.*, 2014 NSSC 287, 2014 CarswellNS 582, 349 N.S.R. (2d) 1, 1101 A.P.R. 1, [2014] N.S.J. No. 418 (N.S. S.C.), and *Industrial Alliance Insurance and Financial Services Inc. v. Brine*, 2015 NSCA 104, 2015 CarswellNS 913, 367 N.S.R. (2d) 108, 54 C.C.L.I. (5th) 1, 392 D.L.R. (4th) 575, 1157 A.P.R. 108, 2015 C.E.B. & P.G.R. 8157 (headnote only), [2016] I.L.R. I-5827, [2015] N.S.J. No. 486 (N.S. C.A.); additional reasons 2016 NSCA 3, 2016 CarswellNS 45 (N.S. C.A.); leave to appeal refused 2016 CarswellNS 399, 2016 CarswellNS 400 (S.C.C.).

limited circumstances where advisors can hold "discretionary" investment accounts, which allow the advisor to make decisions and trades without the clients express consent, and there is full trust and confidence and discretion, then there may be fiduciary duties attached to the advisor.[96] However, this is the exception, not the norm, as most advisors are "order-takers" and the Supreme Court of Canada has ruled that fiduciary duties do not attach to order takers, who offer little to no advice.[97]

The Canadian Securities Administrators (CSA) has been investigating the need to enhance the obligations of advisors, dealers, and representatives toward a best interest standard for their clients.[98] Through the Fund Facts delivery (Point of Sale)[99] and Client Relationship Model Phase 2 (CRM2)[100] initiatives, the CSA has introduced regulatory reforms to make mutual fund fees, registrants' compensation, and clients' investment performance more transparent.[101] Adding a best interest standard and "leveling the playing field" by equalizing compensation structures would be a positive step to all mutual funds, with RI being an unintended beneficiary. The CSA has identified five issues that could be solved by a best interest standard, including rates of returns

---

[95] Leonard Rotman, "Understanding Fiduciary Duties and Relationship Fiduciarity" (2017) 62:4 McGill L J 1 at 10, 16.

[96] *Kent v. May*, 2001 CarswellAlta 721, 298 A.R. 71, [2001] A.J. No. 552 (Alta. Q.B.) at paras. 51-53; affirmed 2002 ABCA 252, 2002 CarswellAlta 1311, 317 A.R. 381, 284 W.A.C. 381, [2002] A.J. No. 1327 (Alta. C.A.) at para. 55; additional reasons 2002 ABCA 306, 2002 CarswellAlta 1626, [2002] A.J. No. 1554 (Alta. C.A.) [Kent v. May]; *Varcoe v. Sterling*, *supra* note 94 at paras. 234-236, Eric Dolden & Tom Newnham, *Legal Liability for Financial Advisors in Canada* (Vancouver: Dolden, Wallace, Folick LLP, 2015) at 19 [Dolden & Newnham].

[97] *Hodgkinson v. Simms*, 1994 CarswellBC 438, 1994 CarswellBC 1245, EYB 1994-67089, [1994] 3 S.C.R. 377, 97 B.C.L.R. (2d) 1, 16 B.L.R. (2d) 1, 22 C.C.L.T. (2d) 1, 57 C.P.R. (3d) 1, 117 D.L.R. (4th) 161, 5 E.T.R. (2d) 1, [1994] 9 W.W.R. 609, 49 B.C.A.C. 1, 6 C.C.L.S. 1, 95 D.T.C. 5135, 171 N.R. 245, 80 W.A.C. 1, [1994] S.C.J. No. 84 (S.C.C.) at para. 33 [Hodgkinson v. Simms], Leonard Rotman, "Fiduciary Law's Holy Grail: Reconciling Theory and Practice in Fiduciary Jurisprudence" (2011) 91:921 Boston University L Rev 921 at 965-966.

[98] OSC, *Consultation Paper OSC 33-404* (April 28, 2016), online: <http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20160428_33-404_proposals-enhance-obligations-advisers-dealers-representatives.htm>.

[99] *Implementation of the Final Stage of Point of Sale Disclosure for Mutual Funds: Pre-Sale Delivery of Fund Facts,* CSA Notice of Amendments to NI 81-101 Mutual Fund Prospectus Disclosure and to Companion Policy 81-101CP Mutual Fund Prospectus Disclosure (2014) 37 OSCB 10985.

[100] CSA *Notice of Amendments to National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations* and to Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations (Cost Disclosure, Performance Reporting and Client Statements*) (2013) 36 OSCB 3173.

[101] Rudy Luukko, "The days are numbered for embedded fund commissions", Morningstar (June 29, 2016), online: <http://cawidgets.morningstar.ca/ArticleTemplate/ArticleGL.aspx?id=758402&culture=en-CA>.

and fees (i.e. value for money), misplaced trust, conflicts of interest, information asymmetry, and outcomes based on the regulatory regime.[102] Moving to a best interest standard would alleviate (at least in theory) some of these issues as advisors would need better skill sets to meet their duties.

The duty of care, on the other hand, differs in the US from Canada. Under the *Investment Advisers Act of 1940* (IAA), it is unlawful for any investment advisor to directly or indirectly defraud, deceive, or engage in a deceptive or manipulative practice.[103] It is also illegal for any person willfully to make any untrue statement of a material fact in any registration application or willfully to omit to state in any such application or report any material fact which is required to be stated therein.[104] In the US, the above legislation has been interpreted to be a fiduciary duty standard, and would pose greater obligations on the advisor than their Canadian counterparts.[105]

Like the CSA, the SEC is mandating increased reforms and disclosures for advisors.[106] This reform is characterized as the "fiduciary duty" versus suitability standard of care.[107] As fiduciaries, investment advisors owe their clients a duty to provide only suitable advice, which takes into account the client's financial situation, investment experience, and investment objectives.[108] The disclosures or lack thereof, and the lack of training around RI may not amount to a breach of fiduciary duty, but it could impact a client's purchasing decision, especially if a best interest standard was imposed.[109] Presumably, this fiduciary duty standard should lead to increased and more complete disclosures of RI materials in US than in Canada. Unfortunately, the legislation seems doomed for repeal.[110]

The United Kingdom, European Union, and Australia already mandate a best interest standard.[111] Dealer and advisors in Australia have a fiduciary duty

---

[102] *Ibid.* at para. i.

[103] IAA, *supra* note 82, ss. 206, 207, SEC. 206 ø80b—6.

[104] *Ibid.*, s. 207. ø80b—7.

[105] *Securities & Exchange Commission v. Capital Gains Research Bureau Inc.*, 11 L.Ed.2d 237, 84 S.Ct. 275, 375 U.S. 180 (U.S. Sup. Ct., 1963).

[106] SEC, *Commission Guidance on Disclosures*, Securities Act Release No. 33-9106, Exchange Act Release No. 34-61469, 75 Fed. Reg. 6289 (February 2, 2010).

[107] James Wrona, "The Best of Both Worlds: A Fact-Based Analysis of the Legal Obligations of Investment Advisers and Broker-Dealers and a Framework for Enhanced Investor Protection" (2012) 68:1 Business Lawyer 1.

[108] SEC, Investment Advisers Act Release No. 1406 (March 16, 1994).

[109] Joseph Goertz, Swarn Chatterjee & Brenda Cude, "Suitability vs Fiduciary Standard: The perceived impacts of changing one's standard of care" (2014) 27:2 J Financial Planning 20.

[110] *Financial Choice Act* (US), H.R.10 — 115th Congress (2017-2018) [FCA].

[111] Australia *Corporations Act*, *supra* note 87, Part 7.7A, Division 2, Subdivision B, s. 961B; *Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients*, OSC CSA Consultation Paper 33-403 (2012) 35 OSCB 9558 at 3.

to their clients. A duty of care, diligence and honesty includes a "best interests" standard,[112] which is more akin to US standards and is more onerous than Canadian requirements. The Australian Statement of Advice[113] contains even more information and requires a more thorough review of client circumstances than Canada requires, which should uncover more environmental and ethical preferences than Canadian advisors can under current suitablility requirements.

(iii) Suitability/Know Your Client

Despite the differences in advisor standards of care, all three jurisdictions use the KYC rule as one of the most important rules an advisor must follow.[114] KYC obligations mandate that advisors select investments that are suitable for their client's investment needs, time horizons, purpose of investment, and risk tolerances.[115] Breaches of KYC and suitability, while not amounting to a breach of fiduciary duties, do amount to breach of contract and potentially negligence.[116] In Canada, and the US, there are currently no KYC requirements for an advisor to ask about a client's preference, inclination or desire for RI. This lack of such a requirement is a problem as RI, on one hand, may pose diversification risks due to screens limiting assets available for investment, while on the other hand, RI may limit downsize risk on a client's portfolio.[117] Obligations of advisers must be enhanced by adding ESG factors to the KYC.[118]

In the US, FINRA Rule 2111 states that a

> member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile.[119]

Suitability should encompass a client's willingness, desire, aptitude and appetite for RI investments.[120] There are forces that may dissuade an advisor from

---

[112] FCA, *supra* note 110, s. 601FC(1).

[113] Australia *Corporations Act*, *supra* note 87, Part 7.7, Division 3, Subdivision C, s. 946A.

[114] NI 31-103, *supra* note 69, s 13.2. *Kent v. May*, *supra* note 96 at para. 65, Dolden & Newnham, *supra* note 96 at 22-25.

[115] *Suitability Obligation and Know Your Product*, CSA Staff Notice 33-315 (2009) 32 OSCB 6890.

[116] *Kent v. May*, *supra* note 96 at 65.

[117] Ick Jin, "Is ESG a systemic risk factor for US equity mutual funds" (2018) 8:1 J Sustainable Finance and Investment 72 at 73, 75.

[118] RIA, *Comments Regarding CSA Consultation Paper 33-404: Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives toward their Clients* (September 26, 2016).

[119] FINRA, *Suitability* Rule 2111; *Know your Customer*, FINRA Rule 2090, R-FINRA-2010-039 and amended by SR-FINRA-2011-016 eff. (July 9, 2012).

discussing these investment vehicles, including fee structures, advertising, and educational requirements, the same forces that affect advice in Canada.

The Australian best interest standard ensures that advisors recommend financial products that are suitable, having regard to each client's objectives, financial situation, and needs.[121] However, unlike Canada and the US, there is specific guidance for environmental, social and ethical considerations. Australian guidance states that

> Advice providers must form their own view about how far s961B requires inquiries to be made into the client's attitude to environmental, social or ethical considerations. Advice providers may need to ascertain whether environmental, social or ethical considerations are important to the client and, if they are, conduct inquiries about them.[122]

(iv) Retail document disclosure

Clients cannot make informed, meaningful investment choices unless they obtain all necessary information. Advertising issues complement the problems with disclosures, as advertising includes all sales material provided to the investor.[123] The Fund Facts must be provided to clients for any sales of mutual funds.[124] The Fund Facts contains a description of the purpose of the fund and the appropriate investor, which will indicate whether the fund is intended to be an RI fund.[125] It describes relevant fund elements, including historical rates of return, fees, top holdings, investment mix, and risk rating. The "marketing pitch" from this document needs to be credible in that it should better illustrate how and why the underlying companies and assets are included. This shows the interlink between lack of material disclosures and the need for enhanced KYC and regulatory documents provided to retail investors. This applies to all advisors, regardless of the licensing body.

---

[120] FINRA, "Suitability: What Investors Need to Know", online: < http://www.finra.org/investors/suitability-what-investors-need-know >.

[121] Australia *Corporations Act*, *supra* note 87, Part 7.7, s. 961B; see also ASIC, RG 175, (November 2017), ss. RG. 175.254, RG 175.309.

[122] *Ibid.* at RG 175.311.

[123] OSA, *supra* note 32, s. 50(2).

[124] *Mutual Fund Prospectus Disclosure*, *supra* note 38, *Point of Sale for mutual funds and segregated funds*, OSC Framework 81-406, (2008) 31 OSCB 10479; *Implementation of the Final Stage of Point of Sale Disclosure for Mutual Funds: Pre-Sale Delivery of Fund Facts — CSA Notice of Amendments to NI 81-101 Mutual Fund Prospectus Disclosure and to Companion Policy 81-101CP Mutual Fund Prospectus Disclosure* (2014) 37 OSCB 10985 [OSC 81-406]; *ETF Facts: Filing and Delivery Requirements for a Summary Disclosure Document for Exchange-Traded Mutual Funds*, OSC Framework (2016) 39 OSCB 9948; CSA Notice of Amendments to National Instrument 41-101 General Prospectus Requirements Form 41-101F4 *Information Required in an ETF Facts Document* (Form 41-101F4) (2017) 40 OSCB 1585

[125] *Ibid.*

Advertising regulations in the US is another potential issue of RI misrepresentation. FINRA Rule 2210 governs US rules around advertising and client communications.[126] RI is manifestly misunderstood in general, so it is not improbable that advisor communications may not reflect the true nature, intent and performance of RI. More importantly is the lack of communication and advertising for RI. A dearth of communication may be seen as indifference, or apathy towards RI. Lipton notes, "sharing sustainability information, corporate responsibility initiatives and progress publicly on the company's website and bringing them to these investors' attention are significant actions in the new paradigm."[127]

Continuous disclosure obligations in Australia are conducted via a Product Disclosure Statement, much like the Fund Facts in Canada.[128] The regulations contain "Good Disclosure Principles" which require timely, relevant and complete disclosure that promotes product understanding and facilitates product comparison all with regard to consumers' needs.[129] Content requirements include "fees payable in respect of a financial product; risks of a financial product; benefits of a financial product; and significant characteristics of a financial product."[130]

(v) Fee structures

NI 81-105 provides for permitted compensation structures, marketing practices, and other concerns.[131] Fees are usually taken as a percentage of assets, and so the higher the fees, the lower the returns and thus are directly related to performance. Fees are also tied to commissions via trailer revenue, which impacts advisor behaviour.[132] Advisors will often sell to clients the product that gives them the largest commission payment, whether or not this is in a client's best interest.[133] If an advisor is paid 60 bps on a "fund of fund" mutual fund, but only 50 bps on a standalone fund, there is a disincentive to provide advice on that standalone fund, especially if it is an RI fund.[134] Advisors will sell what is easy to sell, not necessarily what is in the client's long-term best interests.

---

[126] FINRA, Rule 2210 — *Advertising Regulation* (January 9, 2017).

[127] *Martin Lipton, Wachtell, Lipton et al.*, "Succeeding in the New Paradigm for Corporate Governance", Harvard Law School Forum on Corporate Governance and Financial Regulation (2018), online: <https://corpgov.law.harvard.edu/2018/01/23/engagement-succeeding-in-the-new-paradigm-for-corporate-governance/>.

[128] Australia *Corporations Act*, *supra* note 87 at part 7.9; ASIC, RG 168 *Disclosure: Product Disclosure Statements (and other disclosure obligations)* (October 28, 2011).

[129] *Ibid.* at RG 168.4.

[130] *Ibid.* at RG 168.38.

[131] *Mutual Fund Sales Practices*, OSC NI 81-105 (2013) 36 OSCB (Supp-3).

[132] *Investment Fund Continuous Disclosure,* OSC NI 81-106 (2018), 41 OSCB #40 (Supp-2), ss. 15.1, 17.1; see also Weinstein, *supra* note 80 at 16, 26, 28.

[133] Weinstein, *supra* note 80 at 47, 75, 79.

The CSA is currently investigating the need to amend fee arrangement structures.[135] A recent CSA study found that funds that pay commission underperform other funds, with distribution costs raising expenses and lowering investment returns.[136] The study found advisors push investors into riskier funds, with compensation influencing the flow of money.[137] Larger embedded commissions stimulate sales, with recommendations being sometimes biased in favour of products that generate more commission for the advisor.[138] The evidence is clear: fee structures impact advice and product recommendations.

Commission is only one form of inducement that influences sales. Other inducements (advancement, recognition, etc.) can also influence sales.[139] Compensation affects the effort made by advisors to overcome investor behavioural biases, including biases that may lead to sub-optimal returns. It is not yet known if banning commission-based products in favour of asset or fee-based structures will result in a net improvement in the overall return to the investor.[140] Selling investments based on an improper match between risk propensity and the risk of the investment will not be eradicated by a change of compensation regime, but it will likely be diminished.[141] In jurisdictions that have moved to fee-based compensation, people with less wealth and less income find it harder to get advisory service than others.[142]

Like the CSA, FINRA has noted that the fee structure of certain products incents advisors to increase their sales.[143] Advisors employed by firms with proprietary funds tend to sell a higher proportion of their most profitable fund classes. Captive advisors are more likely to recommend in-house products.[144] Underlying licensure shapes the focus of advice.[145] Commission-only advisors sell individual equities in greater numbers and asset sizes than others, while ETFs are sold more by fee-only advisors.[146] Similar to the Canadian experience, there

---

[134] The author experienced this reality as an investment advisor for one of the large financial institutions.

[135] *Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives*, OSC CSA Staff Notice 33-318 (2016) 39 OSCB 10115; CSA Discussion Paper and Request for Comment 81-407, *Mutual Fund Fees* (2012) 35 OSCB 11233.

[136] Weinstein, *supra* note 80 at 15.

[137] *Ibid*. at 25.

[138] *Ibid*. at 17.

[139] *Ibid*. at 26.

[140] *Ibid*. at 6.

[141] *Ibid*. at 7.

[142] *Consultation on the Option of Discontinuing Embedded Commissions*, CSA Consultation Paper 81-408 (January 10, 2017) at 76; IFIC, *IFIC Submission Re: Consultation Paper 81-408* (June 9, 2017) at 4.

[143] FINRA, "Report on Examination Findings" (December 6, 2017), online: <http://www.finra.org/industry/2017-report-exam-findings/product-suitability> at 6.

[144] Weinstein, *supra* note 80 at 35.

[145] *Ibid*. at 34.

is an inherent potential conflict of interest for suitability of investments due to compensation structures. This has repercussions for the entire industry but could have profound implications for RI products.

Fee structures have been studied in Australia.[147] Unlike Canada and the US, Australia has made the proactive choice to regulate commission structures. These regulations could curtail the potentially conflicting methods advisors use to artificially inflate their commission payments. Unfortunately, a recent amendment rolls back many of these amendments.[148] The ban on embedded commissions remains.[149]

(vi) Education

While commission and compensation are issues with all mutual fund products, not just RI, a more serious concern prejudicing RI uptake is the lack of knowledge of the advisor on RI. The educational requirements to be licensed under MFDA are simple and straightforward. There is only one required course, the Investment Funds of Canada (IFIC) course and exam.[150] There are no current educational requirements dealing with either ESG or RI issues. It is difficult to understand how MFDA representatives can accurately and materially recommend (or not recommend) RI investments if they have no education or knowledge on the subject.[151] Like MFDA advisor education, the importance of advisor education on IIROC advisors cannot be understated. The Canadian Securities Course (CSC) is currently the mandatory course to become an IIROC licensed advisor.[152] Like the mutual funds' exam, the CSC does not have an RI/ESG education component. It is thus doubtful that many IIROC advisors have the knowledge to understand and recommend RI products.

A broker-dealer agent ("Agent") in the US must complete the Series 7,[153] Series 63,[154] Series 66[155] and the new Securities Industry Essentials[156] (SIE)

---

146 *Ibid.* at 38.

147 Australia, *Corporations Amendment, (Future of Financial Advice Act) 2012*, No 67, 2012 and *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012*, No 68, 2012.

148 *Corporations Amendment (Financial Advice Measures) (Australia) Bill, 2016*, No. 22, 2016.

149 Herbert Smith, "ASIC's new 'fees for service' model: impact on takeovers and schemes", Lexology, online: <https://www.lexology.com/library/detail.aspx?g=828ba0b4-09ea-4715-bc27-c65a8862048f>.

150 IFIC, "IFIC exam" (Course list, 2017), online: <https://www.ifse.ca/courselist/canadian-investment-funds-course-cifc/>; Canadian Securities Institute offers *Investment Funds in Canada* (Course, CSI, 2017), online: <https://www.csi.ca/student/en_ca/courses/csi/ifc_info.xhtml>.

151 The certified financial planner is a designation only.

152 CSI, "Canadian Securities Course" (Course, CSI, 2018), online: <https://www.csi.ca/student/en_ca/courses/csi/csc.xhtml>.

153 FINRA, *Series 7 Exam - General Securities Representative Exam (GS)* [Series 7].

exams. The Agent must then register with the Central Registration Depository maintained by FINRA.[157] A candidate who passes the Series 7 exam is qualified for the solicitation, purchase and/or sale of all securities products, including corporate securities, municipal fund securities, options, direct participation programs, investment company products and variable contracts.[158] Thus, this includes stocks, bonds, mutual funds, ETFs. Series 7 is an equivalent to the CSC, and licensing would be similar to that of IIROC.[159] Series 65[160] are necessary to become a full independent Investment Advisor. Series 6 exams, on the other hand, are similar to MFDA requirements, in that the Series 6 exam assesses the competency of entry-level representatives to perform their job as investment company and variable contracts products representatives.[161] There is no mention of ESG criteria in either the Series 6 or Series 7 exams, or in the SIE.

ASIC has set the minimum training standards for all financial product advisors, not just investment advisors.[162] The type of training depends upon which products are advised.[163] However, qualifications in Australia are much more robust and onerous. Australian financial advisors must have a relevant bachelor or higher degree, or equivalent qualification.[164] These qualifications, plus the suitability requirements noted above, make if much more likely that advisors will have some familiarity with RI products.

---

[154] FINRA, *Series 63 - Uniform Securities Agent State Law Examination* (Course, FINRA, 2018).

[155] FINRA, *Series 66 — Uniform Combined State Law Examination* (Course, FINRA, 2018), online: <http://www.finra.org/industry/series66>.

[156] As of October 1, 2018, FINRA Rule 1210.03 was updated to the new Series 7 and the Securities Industry Essential Exam, see "Securities Industry Essentials Exam", online: <http://www.finra.org/industry/essentials-exam>. There is still no ESG requirements for either exam. FINRA, "Securities Industry Essential Examination — Content Outline", online: <http://www.finra.org/sites/default/files/SIE_Content_Outline.pdf>; FINRA, *EC Approves Consolidated FINRA Registration Rules, Restructured Representative-Level Qualification Examinations and Changes to Continuing Education Requirements,* Regulatory Notice 17-30 (October 2017).

[157] E.g. *New Hampshire Securities Act*, Ch. 421-B Uniform Securities Act, at (B)9.

[158] Series 7, *supra* note 153.

[159] Financial Planner World, "Becoming a Financial Advisor in Canada", online: <https://www.financialplannerworld.com/canadian-advisor/>.

[160] FINRA, "Series 65 - Uniform Investment Adviser Law Examination" (Course, FINRA, 2018), online: <http://www.finra.org/industry/series65>.

[161] FINRA, "Series 6 Investment Company and Variable Contracts Products Representative Exam (IR)", online: <http://www.finra.org/industry/series6>. (Also amended October 1, 2018 per FINRA Rule 1210.03).

[162] ASIC, *Regulatory Guide 46, Licensing: Training of financial product advisers* (July 2012).

[163] *Ibid.* at RG 146.7.

[164] ASIC, "Professional standards for financial advisers", online: <https://asic.gov.au/regulatory-resources/financial-services/professional-standards-for-financial-advisers-reforms/>.

(b) Summary Conclusions

Current advisor licensing requirements create significant limitations for RI investment uptake. Mutual fund advisors should be able to provide advice on ETFs, bonds or CEDIFs, structures that as shown in the next section are more likely to be RI. Weinstein found that in the US, there are three other reasons for lower ETF sales:

1. Many financial advisors are not allowed to sell ETFs.
2. Some clients and advisors view "stock-picking" as the focus of their relationship.
3. Advisors may not be willing to expend the time and effort to get clients comfortable with a new product.[165]

Advisors, in both Canada and the US, have commission and compensation structures that favour some products over others which may limit promotion of RI funds. Fee structures that bias advice towards a current product or class of products should be banned. Poor investment decisions by investors around type and style of investment products appear to be the result of a "lack of financial awareness and education, better advertising of active-styled products, and more enthusiastic promotion of actively managed funds by intermediaries perhaps due to sales commissions, and overconfidence biases of investors and advisors and fund managers."[166] Fee structures need to be updated to ensure that RI funds are promoted as enthusiastically as higher commission paying funds.

Current KYC obligations do not mandate any RI-type questions, and it is highly recommended that suitability requirements be updated to incorporate ESG issues. Updating KYC requirements without updating education requirements would be ill advised, as advisors would not be able to provide the advice to satisfy their duty of care. Currently advisors do not have the training or education required for RI promotion. Mandating ESG factors as part of both a mutual fund and an investment advisor's education requirements would aid in RI uptake: "Overcoming these issues requires a mixture of regulation, education, overcoming misconceptions about ESG integration and toolkits for investment practice."[167]

Thus, all areas of advice in Canada contribute to a lack of RI uptake. It is inconceivable that an advisor can recommend the proper products for their clients without understanding either the client or the product.[168] US advisors,

---

[165] Weinstein, *supra* note 80 at 38.

[166] Bollen, *supra* note 22 at 234.

[167] UNEP FI, *Fiduciary Duty in the 21st Century — Canada Roadmap* (New York: UNEP FI, 2017) at 5.

[168] FINRA, Rule 2111; Lawrence Ritcie, Louis Tsilivis & Marleigh Dick, "CSA publishes harmonized response to concerns regarding client-registrant relationship", Osler LLP (June 22, 2018) online: < https://www.osler.com/en/blogs/risk/june-2018/csa-publishes-harmonized-response-to-concerns-regarding-client-registrant-relationship. >

like their Canadian counterparts, may conflict due to compensation structures, and also like Canadian advisors, do not have the training required to provide advice on RI.

Australia has moved to a best interest standard, unlike Canada, and has already mandated fee structure changes to limit compensation conflicts. This best interest standard specifically includes mandates to ask clients about their environmental, social and ethical interests. Canada should implement Australia's enhanced duty of care standards, KYC ESG questions, and limits on fee compensation. This best interest standard would elevate the obligations of all advisors while still not becoming a fiduciary standard.[169] The June 2018 proposal would put the client's interest first when making a suitability determination.[170] Unfortunately, the CSA is backtracking on its reforms and RI, which could have been an unintended beneficiary, is an unintended casualty.[171]

3. ANALYSIS

The Mass Affluent, generally speaking, can only access MFDA advisors. IIROC advisors focus on high net worth and accredited investors, mainly due to fee and commission structures.[172] Mutual funds may not be the best vehicles to construct RI portfolios; however, they have been the default product for the Mass Affluent. Unfortunately, there is a paucity of RI mutual funds available to most Canadians.[173] There is especially a lack of accessibility to RI for clients of big banks, as only two banks offer funds with RI mandates.[174] Bank sales representatives must, generally, exclusively sell proprietary products from their FI and thus clients will not be able to access RI funds. Many independent

---

169 Michelle Schriever, "Best Interest Standard Could be Fiduciary Duty in Disguise: Expert", Advisor.ca (October 3, 2016), online: <http://www.advisor.ca/news/industry-news/best-interest-standard-could-be-fiduciary-duty-in-disguise-expert-212984>; David Hodges, "Provincial Regulators Raise concerns about best interest standard for advisers", Canadian Press (May 11, 2017).

170 CSA, "Canadian securities regulators align to publish harmonized response to concerns with the client-registrant relationship" (June 21, 2018), online: <https://mailchi.mp/osc/canadian-securities-regulators-publish-harmonized-response-to-concerns-with-the-client-registrant-relationship?e=dcff75c17d>.

171 *Proposed Amendments to National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations*, CSA Notice (2018), 41 OSCB (Supp-1); Barbara Schecter, "OSC drops push for 'best interest' standard as regulators propose narrower reforms", Financial Post (June 21, 2018), online: <https://business.financialpost.com/news/fp-street/osc-drops-push-for-best-interest-standard-as-regulators-propose-narrower-reforms>.

172 Weinstein, *supra* note 80 at 74.

173 RIA, *Responsible Investment Funds in Canada* (December 31, 2017) (Toronto: RIA, 2018); State Street Advisors, "SPDR SSGA Gender Diversity Index ETF" online: <https://www.bloomberg.com/quote/SHE:US>; *BMO*, "Invest with Impact, Invest in Women", Release (February 16, 2017).

174 *Ibid.*

investment managers, insurance companies, and credit unions, also do not offer RI funds.[175] In other words, no firm provides access an RI investor would expect, and most funds are derivative offerings, with high fees.[176] US funds offer the potential to be more diversified than Canadian funds, given the larger number of companies based in the US, and it should be theoretically "easier" to construct a US equity fund that complies with the tenets of RI.[177] However, several of these funds have large minimum investments, so these were would cater to the accredited investor. Like Canada, none of the major US financial institutions (Wells Fargo[178] or JP Morgan Chase) or the large investment firms (such as Fidelity) create RI mutual fund products.[179] Wells Fargo Private Bank offers custom RI solutions, but only to accredited investors.[180] There are a few funds that specialize in water issues[181] or in women's rights[182] but, like in Canadian context, they are small niche funds. Thus, mutual funds do not currently offer true RI selection.

Licensing restrictions limit the availability of ETFs, as ETFs require similar prospectus disclosure as public companies.[183] Yet, there is much greater selection of RI ETFs, with ETFs constructed for environmentally responsible technologies, such as water, alternative energy, or green technology.[184] Global

---

[175] Investors Group, "Socially Responsible Investing", online: < https://www.investors-group.com/en/investments/products/socially-responsible-investing-sri; > Manulife, "Responsible Investment", online: < http://www.manulifeam.com/ca/About-Us/Responsible-Investment-at-Manulife-Asset-Management/ > ; Desjardins, "Responsible Investment", online: < https://www.desjardins.com/ca/personal/wealth-management/our-solutions/responsible-investement/index.jsp > ; IA Clarington, *IA Clarington Inhance Canadian Equity SRI Class* (March 31, 2018); Desjardins, "Desjardins SocieTerra Cleantech Fund, Fund Facts", online: < https://www.fondsdesjardins.com/information/00168_adf_a_en.pdf > ; NEI, *NEI Canadian Equity RS Fund, Fund Facts* (July 12, 2018).

[176] Hawken, *supra* note 30.

[177] SIF, "Sustainable, Responsible and Impact Mutual Fund and ETF Chart", online: < https://charts.ussif.org/mfpc/ > [SIF].

[178] Wells Fargo, "Mutual Fund Screener", online: < https://mutualfunds.wellsfargo.com/mutual-fund-center/mfScreener.aspx?#:L = N-T:AF = T:SO = T:MRC = 0:p = 1:c = NM:d = up > .

[179] SIF, *supra* note 177.

[180] Wells Fargo, "Social Impact Investing", online: < https://www.wellsfargo.com/the-private-bank/solutions/social-impact-investing/ > .

[181] Calvert Research, "Calvert Water Fund", online: < https://www.calvert.com/Calvert-Global-Water-Fund-CFWAX.php > .

[182] Impax Asset Management, "Pax Ellevate Global Women's Leadership Fund", online: < https://paxworld.com/pax-ellevate/ > .

[183] OSA, *supra* note 32, s. 1.1; *Amendments to National Instrument 81-101 Mutual Fund Prospectus Disclosure*, OSC NI 81-101 (2017) 40 OSCB 1584.

[184] Investopedia, "Going Green with Exchange Traded Funds", online: < http://www.investopedia.com/articles/exchangetradedfunds/11/going-green-with-etfs.asp#ixzz4Eu5X0yXO > ; Blackrock Inc., "iShares Sustainable ETFs Investing for a Sustainable

water demand is increasing with the SDGs mandating access to water and sanitation.[185] There are no Canadian mutual funds that invest in water or water infrastructure but there is one Canadian ETF and two US ETFs that focus on water.[186] There are ETFs that focus on low carbon technologies,[187] clean technologies,[188] infrastructure,[189] battery technologies,[190] electric vehicles,[191] and Sustainable Development Goals (SDGs).[192] This contrasts with the mutual fund industry, which, save for one fund, offers no such opportunities. In short, ETFs offer a potential solution to the construction of RI.

Mass Affluent investors can only use bond mutual funds as part of their fixed income.[193] High net worth clients can access individual bonds. Green bonds offer the greatest opportunity for RI; however, they are generally not available to the Mass Affluent. In Canada, individual bonds are only available via an IIROC advisor. The 2017 TD green bond was available only through the TD Wealth Management IIROC network.[194] Ontario green bonds were issued via

---

Future", online: <https://www.ishares.com/us/strategies/sustainable-investing/sustainable-etfs-product-overview>; iShares, "Jantzi Social Index ETF", online: <https://www.blackrock.com/ca/individual/en/products/239574/ishares-jantzi-social-index-etf>.

[185] United Nations, *Transforming Our World: The 2030 Agenda for sustainable development. Draft resolution referred to the United Nations summit for the adoption of the post-2015 development agenda*, UN General Assembly, 2015, 69th session. UN Doc. A/70/L.1 of (September 18, 2015), SDG 7; UNESCO, *The United Nations World Water Development Report 2015 Water for a Sustainable World* (France: UN, 2015); Lady Justice Arden, "Water for all? Developing a Human Right to Water in National and International Law" (2016) 65 Int Comparative L Quar 771 at 787.

[186] Blackrock Inc., "iShares Global Water Index ETF, Fund Facts", online: <https://www.blackrock.com/ca/individual/en/products/239755/ishares-sp-global-water-index-fund>; Invesco, "Invesco S&P Global Water Index ETF", online: <http://etfdb.com/etf/CGW/>.

[187] iShares, "MSCI ACWI Low Carbon Target ETF (CRBN), Fund Facts", online: <https://www.ishares.com/us/products/271054/ishares-msci-acwi-low-carbon-target-etf>; SPDR MSCI ACWI Low Carbon Target ETF (LOWC).

[188] Invesco, "Invesco Cleantech EFF, Fund Facts", online: <https://www.invesco.com/portal/site/us/investors/etfs/product-detail?productId=PZD>.

[189] First Trust Advisors LP, "First Trust NASDAQ Clean Edge Smart Grid Infrastructure Index Fund" (GRID), online: <https://www.ftportfolios.com/retail/etf/etfsummary.aspx?Ticker=GRID>; NASDAQ OMX, "Clean edge Smart Grid Infrastructure", online: <https://cleanedge.com/indexes/stock-index/qgrd>.

[190] Global X Funds, "Lithium & Battery Tech ETF", online: <https://www.globalxfunds.com/funds/lit/>.

[191] Global X Funds, "Autonomous & Electric Vehicles ETF", online: <https://www.globalxfunds.com/funds/driv/>.

[192] *iShares MSCI Global Impact ETF* (MPCT).

[193] Green bond funds do not yet exist in Canada. US, Calvert Investments, "Calvert Green Bond Fund (A)", online: <https://www.calvert.com/Calvert-Green-Bond-Fund-CGAFX.php>.

prospectus, so only IIROC advisors have access.[195] Government documents state that the province may examine opportunities to sell Green Bonds directly to retail investors, but only if it is cost effective and after the domestic market has matured.[196] Both bonds were oversubscribed, so it was a missed opportunity to allow retail investors the ability to purchase this vehicle, stimulating interest in green bonds. It is this questionable line of thinking that prevents RI uptake from hitting the mainstream.

US and international investors have similar problems as Canadian retail investors. Many issuers in the US fear a green bond issuance due to potential litigation due to claims of misrepresentation, leaving large organizations to issue green bonds to which mass affluent investors cannot access.[197] Access in Australia to green bonds is also very limited. National Australia Bank launched Australia's first green mortgage bond in 2018.[198] It had pricing similar to a non-green bond, (i.e. no greenium), yet the bond was oversubscribed.[199] The largest investor has been asset managers and individual investors cannot purchase these bonds.[200] The World Bank has issued green bonds but investors in these bonds are almost solely institutional investors,[201] with few issuances available to

---

[194] TD Bank, "TD Bank Green Bond DNV GL Eligibility Assessment", online: < https://www.td.com/document/PDF/Verification_Statement.pdf > .

[195] Ontario, "Green Bonds", online: < http://www.ofina.on.ca/greenbonds/ > ; Sean Kidney, "Ontario issues long-awaited inaugural green bond", CBI (October 6, 2014), online: < https://www.climatebonds.net/2014/10/ontario-issues-long-awaited-inaugural-green-bond-cad-500m-4481m-175-4yrs-aa2e-mixed > .

[196] Ontario, "Ontario Green Bond Q&A's" (January 26, 2017), online: < http://www.ofina.on.ca/greenbonds/ > .

[197] Kate Allen, "Strict US market rules limit corporate sellers of green bonds", Financial Times (February 20, 2018), online: < https://www.ft.com/content/baa217c4-157c-11e8-9376-4a6390addb44 > ; Cicero, '*Second Opinion' on Fannie Mae Multifamily Green Bond Framework* (June 8, 2018); Alicia Jones, "Fannie Mae Wins Recognition as Largest Issuer of Green Bond by the Climate Bonds Initiative", Press Release (March 20, 2018); BoA, "Bank of America Issues Its Third and Largest Green Bond", Press Release (November 10, 2016).

[198] NAB, *NAB Climate Bonds*, online: < https://capital.nab.com.au/information/green-and-sri-bonds > .

[199] Paulina Duran, "Australia green bond market muzzled by policy uncertainty", Reuters (February 5, 2018), online: < https://www.reuters.com/article/us-australia-bonds-green/australia-green-bond-market-muzzled-by-policy-uncertainty-idUSKBN1FP0OS > .

[200] Cole Latimer, "Climate bonds market to hit a new benchmark in 2018", Sydney Morning Herald (January 10, 2018), online: < https://www.smh.com.au/business/banking-and-finance/2018-the-year-of-the-green-bond-20180109-p4yycb.html > ; Oliver Yates, "Australia's budding green bond market", Clean Energy Finance Corp. (June 2015), online: < https://www.cefc.com.au/media/feature-articles/files/australias-budding-green-bond-market/ > .

[201] World Bank, *Green Bond Impact Report* (Washington, DC: World Bank Treasury, 2017) at 7; World Bank, "Green Bonds Attract Private Sector Climate Finance", Press Release (June 10, 2015), online: < http://www.worldbank.org/en/topic/climatechange/brief/

Accredited Investors.[202] There are no World Bank green bonds for the Mass Affluent. In sum, the ability of any Mass Affluent retail investor to procure a green bond is extremely limited. A green bond ETF is the only current method to invest in these vehicles.[203]

Institutional investors have an advantage as they are able to purchase investments inaccessible to the retail investor.[204] The Greening Canada Fund (GCF) invested directly in carbon credits and is an example of an alternative model mandated to combat climate change.[205] The advantages/disadvantages of offsets are outside the scope of the article.[206] The GCF followed a private equity model, rather than a mutual fund structure.[207] The offering was by a private placement and was unavailable to the public.[208] Ironically, despite the lack of a prospectus, investors had more information available to them prior to purchase than an investor would normally have.[209] Securities law thus may have it wrong. It is not the complexity or structure of the product that should warrant public

---

green-bonds-climate-finance >; World Bank, "Green Bonds", online: < http://treasury.worldbank.org/en/about/unit/treasury/ibrd/ibrd-green-bonds >.

[202] World Bank, World Bank Launches First Kangaroo Green Bond, Press Release (April 16, 2014); World Bank, "World Bank Green Bonds for Merrill Lynch Wealth Management Investors", Press Release (June 8, 2011), online: < https://www.worldbank.org/en/news/press-release/2011/06/08/the-world-bank-and-bank-of-america-merrill-lynch-announce-world-bank-green-bonds-for-merrill-lynch-wealth-management-investors >.

[203] S&P Dow Jones, "A Look Inside Green Bonds: Combining Sustainability With Core Fixed Income" (May 2018), online: < https://ca.spindices.com/indices/fixed-income/sp-green-bond-index >; *iShares*, "ESG USD Corporate Bond ETF", online: < http://etfdb.com/etf/SUSC/ >.

[204] S. Kaplan & A Schoar, "Private equity performance: returns, persistence, and capital flows" (2005) 60 J Finance 1791, Keith Black, "Defining Liquid Alternative Investments" (2015) 17:3 J Alternative Investments 6 at 8; UN PRI, *Integrating ESG in Private Equity: A Guide for General Partners* (New York, PRI, 2014); Patricia Crifo, Vanina Forget & Sabrina Teyssier, "The price of environmental, social and governance practice disclosure: An experiment with professional private equity investors" (2015) 30 J Corporate Finance 168 at 169.

[205] Greening Canada Fund LP., *Amended and Restated Limited Partnership Agreement* (September 30, 2009), S. 3.1.

[206] Kathy Dhanda & Laura Hartman, "The Ethics of Carbon Neutrality: A Critical Examination of Voluntary Carbon Offset Providers" (2011) 100 J Business Ethics 119; Shi-Ling Hsu, "International Market Mechanisms" in *The Oxford Handbook of International Climate Change Law*, Cinnamon Carlarne, Kevin Gray, and Richard Tarasofsky (eds) (Oxford University Press, 2016) at 249; Brianne Riehl et al., "Lessons Learned in Mandatory Carbon Market Development" (2017) 10:3-4 Int Rev Env and Resource Economics 227.

[207] Greening Canada Fund LP, *Limited Partnership Interests, Confidential Offering Memorandum* (September 17, 2009).

[208] *Ibid.*

[209] Marcelo Labbe & Colin Atkinson, "On the pricing of Emission Reduction Purchase Agreement contracts" (2010) 3:2 J Energy Markets 69.

access; rather it is the amount of information that could allow investors to make informed decisions. Had a prospectus offering been made, the fund could have been made available to IIROC-based retail investors. Structured as a mutual fund, the fund could have been marketed to the Mass Affluent.

Given their local focus, CEDIFs should be a valuable tool to use for RI and could be structured to provide tangible ESG benefits, but accessibility by most Mass Affluent investors is precluded.[210] A purchaser must use an IIROC advisor, yet not all IIROC advisors can access this vehicle.[211] A mutual fund of several CEDIF entities should be created to offer diversification to reduce the inherent risks in a CEDIF.[212] Jurisdictions could use this as a true model of a unique legal structure to "incent" investors to incorporate using this structure.

(a) Summary Conclusions

ETFs show more evidence of "RI-ness" as there are ETFs that invest in low carbon, alternative energy, water, solar, and cleantech. ETFs are not riskier than funds and precluding investors from accessing vehicles due to structure rather on complexity fails to protect investors from risk. There does not seem to be a solid justification for preventing greater access to these products. Green bonds also hold great promise but are not made readily available to the Mass Affluent. They are not structurally different from other bonds, so there is no justification for why they are not part of a fixed income mutual fund. To access ETFs, bonds, and CEDIFs only two options currently exist. The first is to go to an IIROC licensed investment advisor, but as noted, most of these advisors have large minimum investment assets making this not an option for the Mass Affluent. The second option is to use an online brokerage account, but most clients do not have the time, energy or ability to undertake "do it yourself" investing. Most Mass Affluent investors need the services of an advisor. The unfortunate reality is that there is an inherent lack of accessibility for the Mass Affluent. At the retail level, access, not theory is what is needed. MFDA and Series 6 licensed representatives need to be allowed to sell a wider array of products, including ETFs and green bonds.

New regulations around the licensing of MFDA advisors are required. New structures of fixed income investments that are available to the Mass Affluent are required. FIs must eliminate propriety offerings, or at the very least, allow their advisors access to the universe of investments within their licensing.

---

210 Cedif.ca, "Community Economic Development Investment Funds", online: <http://cedif.ca/funds/bca-investment-co-operative-limited/>.

211 CEDIF Regs, *supra* note 58, s. 3(4) *CEDIF Application Process FAQs*, para. 12, C*ommunity Economic Development Investment Funds*, NSSC CP 45-601 (January 17, 2014) ss. 1.2, 3(4) Wind4all Communities III Inc., *Offering Memorandum* (January 14, 2016) at 29.

212 *Ibid.* at 13.

4. CONCLUSION

Securities laws are designed to "protect" Mass Affluent investors against loss due to complex structures, creating a system whereby most investors do not have access to all investment vehicles. Retail investors need RI products. MFDA advisors should be able to access all types of mutual funds, granting access to specialized products and certain CEDIFs. A better method of "mainstreaming" RI is required. This article is not advocating for all products be available to all advisors, as any specific investment must be reviewed to determine suitability, and this article is not advocating for its use as a valid or "good" investment option. Rather, regulators must look at broadening the options available for RI investments.

Secondly, standards for retail advisors must improve. Implementing a best interest standard, along with enhanced pay structures and education requirements on RI is necessary. More informed advisors with knowledge of potential RI options would encourage investment. Aligning pay and commission structures would help RI uptake and it would stop the disincentive of promoting products that pay the advisor better, rather than the client preference.

Timing could not be better for change, as there are many other issues that securities regulators are dealing with for mutual funds and advisors. However, CSA backtracking makes this unlikely, which is cause of concern for RI going forward.

Reproduced with permission of copyright owner. Further reproduction prohibited without permission.