



# Federal **FINANCIAL SECTOR** Review

November 2016



## Introduction

Mobilizing Canada's financial sector to enable the transition to a sustainable, low-carbon, climate-resilient society is essential. Canada's current federal financial sector legislative and regulatory framework is not designed to support that transition. The review of the framework is a crucial opportunity to reflect on the purpose of Canada's financial sector and make substantive improvements that will enable Canada to become more prosperous and inclusive in the future.

Focusing on incremental legislative and regulatory adjustments to address some of the trends identified in The Department of Finance's consultation document, *“Supporting a Strong and Growing Economy: Positioning Canada's Financial Sector for the Future”* will not suffice due to the magnitude of the required transition and relative infrequency of the government's review.

The Co-operators supports the government's reflection on the purpose of Canada's financial sector and wishes to provide feedback on how Canada's financial sector can help position Canada strategically to seize future opportunities and create sustainable economic growth. We must effectively identify and leverage the mitigation and adaptation efforts and the business opportunities associated with 21<sup>st</sup> century risks. There is no choice to be made between the environment and the economy.

The consultation paper notes “Canada's financial sector is entering this review from a position of strength, after weathering the 2008 financial crisis well relative to international peers”. While this may be true, much has changed in the world since 2008. The crisis accelerated global momentum behind sustainable finance. The *United Nations' Inquiry into the Design of a Sustainable Financial System* report noted that, “recognition has grown that the financial system must be not only sound and stable, but also sustainable in the way it enables the transition to a low-carbon, green economy.”

## About The Co-operators

The Co-operators is a group of Canadian companies focusing on insurance and financial services. As a co-operative, our 43 member-organizations include co-operatives and credit union centrals representing a combined membership of millions of Canadians.

We have over \$35.1 billion in assets under administration, employ 4,632 individuals and 2,513 licensed insurance representatives, while serving more than 350 credit unions with nearly 5.3 million members.

We insure approximately 36,000 farms, 128,000 businesses, 722,000 homes, and one million vehicles. Through Addenda Capital Inc. we are responsible for investing more than \$28 billion in

assets for pension funds, insurance companies, foundations, endowment funds and third party mutual funds of major financial institutions.

Addenda's approach to sustainable investment focuses on integrating environmental, social and governance issues into investment processes. Our mission is to add value through independent research, active management, innovation, discipline and integrity and to nurture genuine partnerships with our clients. We became a signatory to the United Nations-supported Principles for Responsible Investment in 2012 and to the Montréal Carbon Pledge in 2015.

Below is The Co-operators Group Ltd. feedback specific to the questions posed in the consultation document.



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

An overriding theme that appears to be absent from the consultation paper is the emerging global discussion regarding the role society sees for the financial sector in the future. There appears to be an increasing realization that the financial sector must be harnessed as a means to achieve a transition to a sustainable, low-carbon, climate-resilient society. Societal desire to achieve this transition should be expected to have a significant influence on the financial sector in the future and Canada's legislative and regulatory framework should support that desire.

While the specific trends and challenges identified in the consultation paper are important, below are additional issues, trends and opportunities we believe will significantly impact the financial sector in the future and should be addressed in the government's policy review moving forward.

1. **Inequality of outcomes and opportunity** can have a negative impact on economic growth and prosperity. Inequality has also been associated with financial crises and social conflicts;
2. **Technological changes in society**, not just financial technologies, will have drastic changes on society and in turn on the financial sector. From artificial intelligence to self-driving cars, there will be impacts on insurance and banking;
3. Changing attitudes and values on incorporating **ESG (environmental, social & governance into financial decisions;**

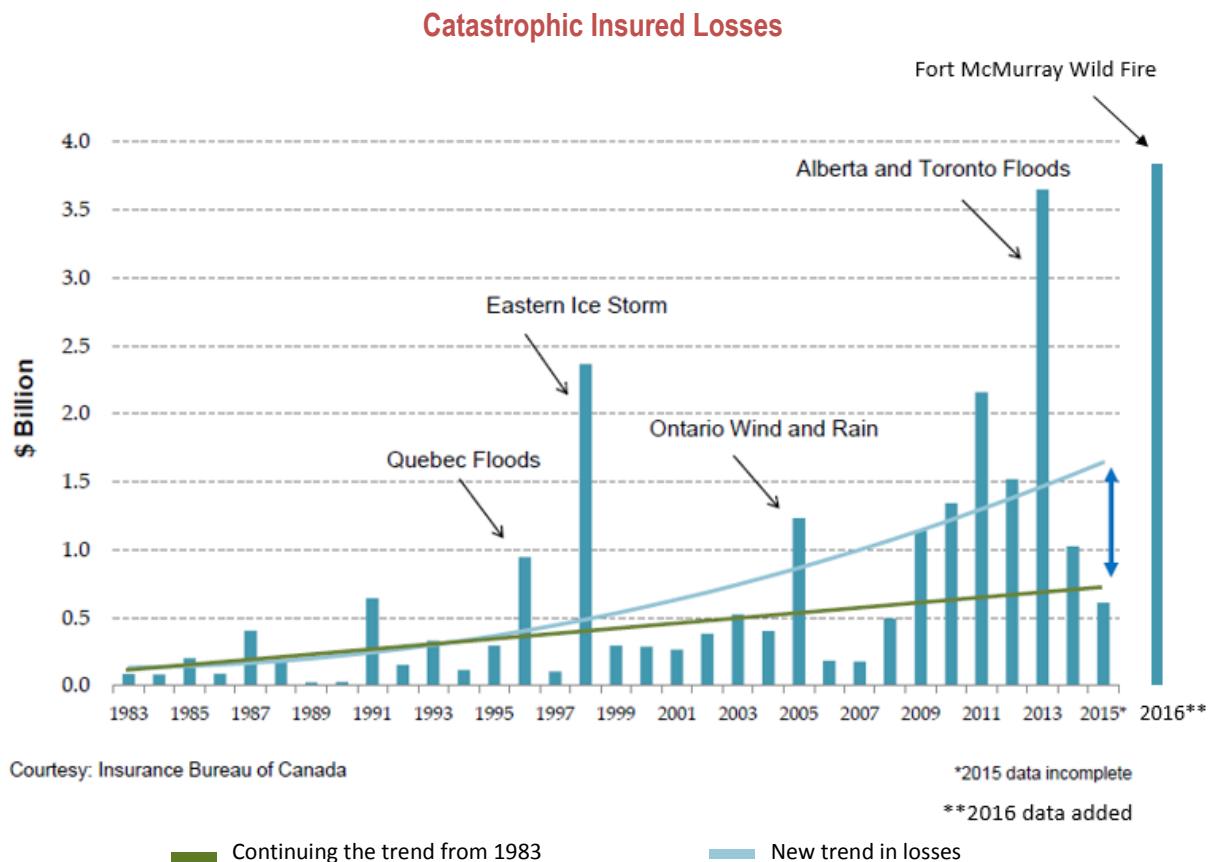
4. The **nature of financial market participation has been changing**, such as an increasing role for pension funds and other large institutional investors and a decreasing role for brokers;
5. **Diversity on boards** and senior management positions is improving slowly in Canada and appears to be a subject of renewed focus;
6. **Climate Change** is set to have large scale impacts on Canada's economy through efforts to both mitigate the change and adapt to the physical impacts; and
7. Parts of the developing world are emerging as leaders in aligning financial systems with sustainable development, with China becoming a global champion of green finance. No longer just a question of consumer preference, **green finance** is impacting overall system performance, shifting toward the core of the future of world capital markets. Innovations such as green bonds, green infrastructure investment, carbon-efficient and sustainable indexes and exchange-traded funds are growing to mobilize the capital needed for a low-carbon economy.

Insurers are exposed to all three types of risk climate change poses to finance: physical risks, liability risks, and transitional risks.<sup>1</sup> In Canada, the cost of damage from extreme weather has been increasing dramatically over several decades with flooding becoming the most common type of natural disaster in Canada, and is getting worse.

Up until 2008, on average, there were \$400 million of insurable losses in Canada per year as a result of weather-related events. Since 2008, those losses have exceeded \$1 billion per year. This is the impact of climate change and it is important that we protect our homes, business and critical infrastructure as climate change takes hold. Otherwise, our cities will become less safe and resilient.

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<sup>1</sup> "The impact of climate change on the UK insurance sector", Bank of England Report, September 2015



We recognize catastrophic events and the impact on property insurance is a problem that is bigger than insurance and requires a solution that is broader than insurance. All three levels of government must be engaged as well as the academic community and various industries (banking, asset managers, insurers etc.) in order to develop a complete solution for our communities.

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

Utility, in terms of the role the financial sector must play in the development of a sustainable, low-carbon, carbon-resilient society should be paramount in the government's financial sector framework. However, the focus on utility, as well as stability and efficiency as outlined in the consultation paper appears to be rooted in an incremental approach to reviewing and revising Canada's federal financial sector legislative and regulatory framework. It fails to address the magnitude of the required transition and the relative infrequency of the government's review.

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

There are many lessons to be learned from other jurisdictions and indeed from prior work in Canada that could inform how to address emerging trends and challenges.

In 2015 the **Financial Stability Board (FSB)** established an industry-led **Task Force on Climate-related Financial Disclosures**. The Task Force is currently developing recommendations for voluntary, consistent, comparable, reliable, and clear disclosures around climate-related financial risks to enable companies to provide information to stakeholders such as lenders, insurers, and investors.<sup>2</sup>

While the recommendations will be voluntary, many support them becoming mandatory to be effective and to truly embed climate information into financial decision making. This will enable companies to better understand what and how to report and enable investors to better access information needed to assess portfolio risks. The Task Force's Final report is expected in early 2017.

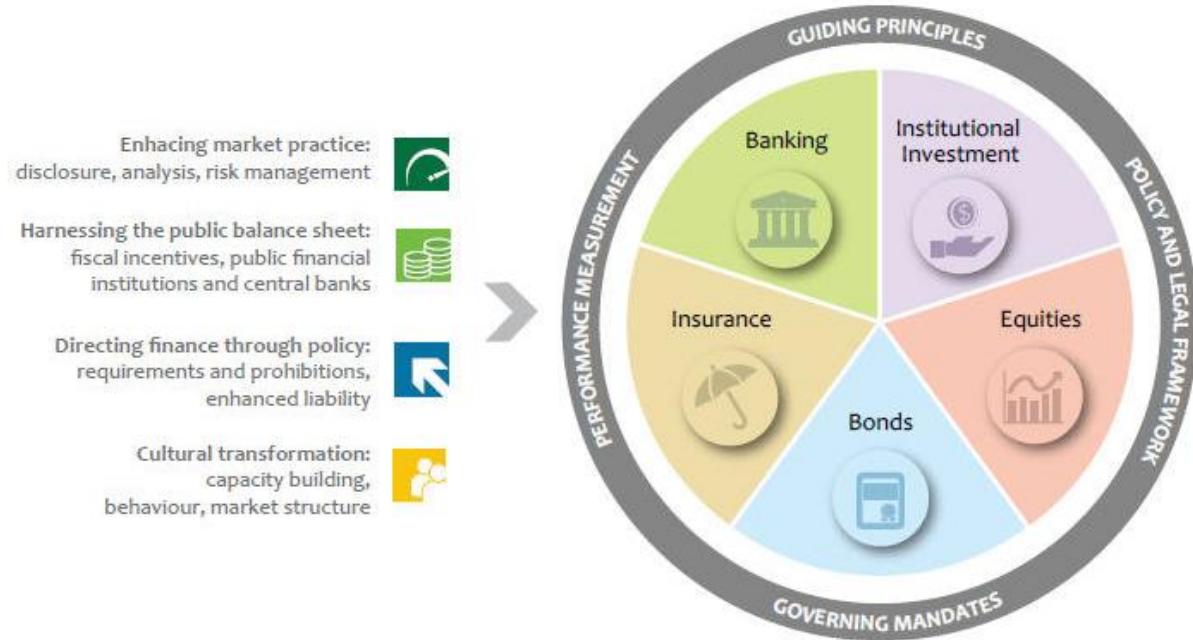
The United Nations Environment Programme inquiry into the *Design of a Sustainable Financial System* was established in 2014 to advance policy options to “deliver a step change in the financial system’s effectiveness in mobilizing capital towards a green and inclusive economy”.<sup>3</sup>

The Inquiry calls for a **realignment of the financial system** and identifies short termism as an issue and suggests government and governance structures be re-calibrated to align with long-term outcomes. Financial policy makers and regulators need to take steps to integrate sustainable development such as guiding principles, regulator mandates, and performance measurement.

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<sup>2</sup> “*Resolving the climate paradox*”, Speech by Mark Carney, Governor of the Bank of England, Chair of the Financial Stability Board, September 22, 2016

<sup>3</sup> “*The Financial System We Need*”, UNEP Inquiry Report, October 2015



*"The Financial System We Need", UNEP Inquiry Report, October 2015*

Another example is the work of Canada's National Roundtable on the Environment and the Economy. Reports such as **"Framing the Future: Embracing the Low-Carbon Economy"** include a host of policy recommendations worthy of further review.

Moving forward, the government's policy paper should include recommendations on climate change disclosure for insurance companies. In the United States, the National Association of Insurance Commissioners (NAIC) has begun to do so as six states – California, Connecticut, Minnesota, New Mexico, New York, and Washington – require insurers operating in these states, and who represent the largest share of premium in the US, to disclose their climate-related risks.

The Bank of England's Prudential Regulation Authority published a report, **"The Impact of Climate Change on the UK Insurance Sector"** and the Bank of England now states that, **"We are now actively considering the financial impact of systemic environmental risks on our statutory objectives."** There are likely lessons to be learned from this work. Other initiatives and research worth reviewing includes:

- Research and recommendations on green finance prepared by the G20;
- OECD research on green growth and sustainable development; and
- IMF work in this area: From Ambition to Execution: Policies in Support of Sustainable Development Goals.

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

**Diversity within Senior Executives and Boards: require companies of a certain size to have women represent at least the largest of 3 board positions or 30% of board positions**

There is a strong business case for higher levels of gender diversity on boards of directors and among executive officers than currently exists. Gender diversity, along with diversity in professional experience, education, and ethnicity can enhance board effectiveness and corporate decision-making. As such, we encourage increasing many types of diversity on the boards of directors and in executive officer positions.

The Co-operators supports a minimum 30% representation of women on boards and within senior management. In fact, we have committed ourselves to this by 2020.

Our President and CEO, past Chair and current Board Member of the International Cooperative and Mutual Insurance Federation (ICMIF), participated in a report entitled *“Women in Leadership Positions”*; a report following a survey of women CEOs, Chairs and Presidents in co-operative and mutual insurers.

Insurance has often had the reputation of being a conservative industry, run in a “*time-honoured*” way by men. However, as the report notes, in the co-operative and mutual insurance sector, women are taking a more significant role. Today, 29 of the 214 (13.5%) co-operative and mutual member organizations within the ICMIF are led by a female.

The anecdotal survey explores various questions including whether or not co-operatives and mutual businesses are more inclined to appoint female leaders, views regarding monitoring of the gender composition of workforces, and whether obligatory quotas or targets are necessary to help achieve greater representation of women in management.

**Climate-related Financial Disclosures: Consider requiring disclosure recommended by the Task Force on Climate-related Financial Disclosures**

In 2015 the **Financial Stability Board (FSB)** established an industry-led **Task Force on Climate-related Financial Disclosures**. The Task Force is currently developing recommendations for voluntary, consistent, comparable, reliable and clear disclosures around climate-related financial risks to enable companies to provide information to stakeholders such as lenders,

insurers, and investors.<sup>4</sup> While the recommendations will be voluntary, we support them becoming mandatory to be effective and to truly embed climate information into financial decision making. This will enable companies to better understand what and how to report and enable investors to better access information needed to assess portfolio risks. The Task Force's final report is expected in early 2017.

**Pension fund disclosures: Require federally registered pension plan administrators to disclose to their members and publicly whether, and if so how, the consideration of environmental, social and governance factors is reflected in the plan's investment policy and practice**

Canada lags behind other countries in terms of national regulation on ESG (environmental, social, governance) disclosure for pension funds. The United Kingdom, Australia, France, Sweden and Germany, among others, require ESG disclosure by pension administrators. Federal policy on ESG disclosure has not kept abreast with changes at the provincial levels. In 2014, Ontario adopted regulations requiring ESG disclosure by pension administrators. Federal leadership on ESG disclosure could prompt action among those provinces that have thus far been slower to act.

**Executive compensation: Introduce mandatory and binding shareholder votes on executive compensation for companies of a certain size**

Jurisdictions such as Switzerland and the United Kingdom have adopted binding compensation related votes for public companies - Canada should follow. While this review is focused on companies overseen by the Office of the Superintendent of Financial Institutions, corporate governance improvement would benefit the financial sector if applied to all public companies due to the significant role Canadian financial institutions play in investing in Canadian public companies for their clients.

**Canada Business Corporations Act: Apply improvements to Canada Business Corporations Act proposed through Bill C-25 to companies overseen by the Office of the Superintendent of Financial Institutions**

Many of the corporate governance improvements proposed for the Canada Business Corporations Act such as annual and individual election of directors, majority voting of directors and diversity disclosure, should also apply to companies overseen by the Office of the Superintendent of Financial Institutions.

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<sup>4</sup> "Resolving the climate paradox", Speech by Mark Carney, Governor of the Bank of England, Chair of the Financial Stability Board, September 22, 2016

### **Investor stewardship: Introduce a stewardship code for institutional investors in Canada**

Jurisdictions such as the United Kingdom, Japan, and Malaysia have introduced investor stewardship codes that are intended to enhance the quality of engagement between investment managers and companies to help improve long-term risk-adjusted returns to shareholders. Investors should apply the code on a “comply or explain” basis.

### **Green finance: Introduce regulatory and policy mechanisms to encourage sustainable and green finance activity in Canada**

The many reports and associated research referenced in our response to Question 3 above include policy recommendations for governments wishing to encourage sustainable and green finance activity.

### **National securities regulator: Continue efforts establish a national securities regulator**

In the words of the Canadian Coalition for Good Governance, “Canada needs a national securities regulator and a national securities act to ensure that uniform rules, focusing on investor protection and keeping pace with international best practices, govern our capital markets. If these rules are broken, a national securities regulator can ensure that enforcement is swift, effective and coordinated across the country.”<sup>5</sup>

### **Statement of Investment Policy for the Government of Canada: Consider Including a preference for investments that promote a sustainable, low-carbon, climate-resilient society and require sustainable investing practices**

The Statement of Investment Policy for the Government of Canada guides how the government invests its money and consideration should be given to how those investment practices could support financial sector policy objectives or promote a sustainable, low-carbon, climate-resilient society. One approach may be to require the adoption of sustainable investing best practices and provide regular reporting on adherence to those practices.

### **Canada Infrastructure Bank: Consider Including a preference for investments that promote a sustainable, low-carbon, climate-resilient society and require sustainable investing practices**

The Canada Infrastructure Bank, as announced in the 2016 Fall Economic Statement, may play a significant role in financing a large portion of government infrastructure development in the future. As many large infrastructure projects - that may be financed by the Canada Infrastructure Bank - will be physical in nature, provide essential services and have long

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<sup>5</sup> [http://www.cccg.ca/site/cccg/assets/pdf/New\\_formated\\_Statement\\_Regarding\\_the\\_National\\_Regulator.pdf](http://www.cccg.ca/site/cccg/assets/pdf/New_formated_Statement_Regarding_the_National_Regulator.pdf)

economic lives. Therefore, it is essential that the bank have a strong governance framework that will ensure investments promote a sustainable, low-carbon, climate-resilient society for Canadians. One approach to support that alignment would be to require the bank to adopt sustainable investing best practices and provide regular reporting on its adherence to those practices.

### **Consumer protection: Require financial sector companies to act in their clients' best interests**

Many Canadians, and likewise Canadian companies, believe financial sector companies are required to provide advice that is in their best interest as a client. This is a reasonable belief that should be made a requirement.

## **5. What other actions should be taken to ensure the financial sector framework remains modern and technically sound?**

*"Financial policymakers will not drive the transition to a low-carbon economy. Governments will establish the frameworks, and the private sector will make the investments. Nonetheless, financial policymakers do have a clear interest in ensuring the financial system is resilient to any transition hastened by those decisions. Our role is to help develop the frameworks for markets to adjust efficiently."<sup>6</sup>*

In order to better anticipate and position Canada to leverage systemic change and ensure we are masters of our own destiny, we need to define a vision of a sustainable Canadian financial system. Key federal officials, provincial regulators, the Bank of Canada, as well as the banking, asset management and insurance sectors should be engaged in this undertaking.

The United Nations' Inquiry has researched financial and monetary policies, regulations, standards, disclosure requirements, credit ratings, listing requirements and indices, analyzing the effectiveness of each in helping to align financial systems with sustainable development. Canada can benefit from this work to assess the policies best suited to support the government's mandate and meet its climate commitments.

We call on the government to bring together a small group of key government and business leaders, sustainable finance experts, and the heads of the UN Inquiry to explore the development of a roadmap for Canada as a positive first step.

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<sup>6</sup> "Resolving the climate paradox", Speech by Mark Carney, Governor of the Bank of England, Chair of the Financial Stability Board, September 22, 2016

## Concluding Remarks

On behalf of The Co-operators group of companies, thank you for the opportunity to participate in the review of Canada's federal financial sector legislative and regulatory framework.

Please do not hesitate to contact our Director of Government Relations, Maya Milardovic at [xxx](#) for any further feedback or clarification.



A handwritten signature in black ink that reads "Kathy Bardwick".

Kathy Bardwick  
President and CEO  
The Co-operators Group Ltd.