Climate finance, Canada's new imperative: From nice-to-have to need-to-have

By Keren Perla & Chad Park | Opinion | December 7th 2022

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On the heels of COP27, where a landmark agreement was reached to create a "loss and damage" fund for the most vulnerable, countries continue to grapple with the future direction of climate finance. Photo via UNFCCC / Flickr (CC BY-NC-SA 2.0)

Our global financial system has reached a tipping point on tackling climate change, and Canada's economic future hangs in the balance.

Over the last year, record-breaking commitments affirmed that climate is taking its place centre stage. When 450 firms from 45 countries collectively pledged $130 trillion at COP26 in Glasgow in 2021 to align with a net-zero future, it sent the financial community a seismic signal. With the Glasgow Financial Alliance for Net Zero (GFANZ) now topping $150 trillion, moves like this make the trajectory of responsible investment difficult to deny.

On the heels of COP27, where a landmark agreement was reached to create a "loss and damage" fund for the most vulnerable, countries continue to grapple with the future direction of climate finance. Deals were struck promising to accelerate the energy transition, and investment commitments, still firmly on the table, got a little nudge forward.

While the 11th-hour adjustments to the cover decision language are still being hotly debated, it highlights that “a global transformation to a low-carbon economy is expected to require investment of at least US$4-6 trillion per year” *and* “that delivering such funding will require a transformation of the financial system and its structures and processes, engaging governments, central banks, commercial banks, institutional investors and other financial actors.” In other words, no small feat.

With increasing urgency, these actors are determining who is already on the future-fit track versus who is at risk of being left behind in an antiquated business model; it's a Netflix versus Blockbuster scenario. Climate finance is having a watershed moment, but one in which the debate on financing fossil fuels is far from settled.

Let’s be clear about why: embracing climate isn’t just a moral act for financial institutions. To put it another way, this is not — or is no longer — about virtue signalling. Rather, these commitments are the logical and strategic upshot of the existential risks of climate change and the massive opportunities arising from a transition economy.

The bottom line? Climate transition is on track to be a historic multitrillion-dollar investment opportunity and a business disruption that will reshape whole economies — Canada’s included.

Why does this matter for Canada?

To ensure the country's position in a net-zero future, both the public and private sectors are seeking avenues for economic diversification and transformation. Climate-smart investments like hydrogen, carbon capture, electrification and critical minerals and metals refining are already reflected in the federal government's funding priorities. The national climate adaptation strategy spells out further needs and opportunities in climate resilience.

The good news? There are many paths to decarbonization and plenty of opportunities to adopt new technologies and business models. The bad news? It won't be free. Transitioning high-emitting sectors and making communities more resilient to climate change will take significant investment. It's one thing to sign an agreement, announce net-zero plans or publish adaptation strategies, but quite another to deliver on them. It's time for action, not words.

While public funding is *an* avenue, it can't tackle the unprecedented challenges required to meet climate targets alone. Private investment must play a critical role: to expedite climate action, for companies transitioning their operations, in launching projects which impact low-carbon markets and in building climate-resilient infrastructure.

Yet, it's no secret that investments in Canada's resource-based economy are increasingly perceived as risky, and the sector is far from tone-deaf in this regard. As investors seek to align portfolios with emissions reductions targets, financing fossil fuels will get exponentially harder, and nowhere is this more of an existential challenge than in Canada's oil and gas industry, where significant reductions are needed to achieve the country's crucial emissions targets.

So, on one hand, we have climate-concerned investors deciding where to deploy their capital; on the other hand, industries needing massive investment in shifting to sustainable activities. It seems a perfect fit — assuming energy companies that have enthusiastically adopted net-zero plans prioritize projects to meet these pledges versus reverting to business as usual in a high-price environment. But the question remains: What will it take to make the companies of today attractive to those investing in tomorrow?

The case for transition investment

Despite supply and demand for climate finance increasing globally, transition-aligned projects still face challenges in attracting investment. The European Union's sustainable finance taxonomy, for example, specifies investment priorities for low-emission technologies and sectors, but provides considerably less clarity for the transition of high-emitting sectors.

This tension is very real in Canada. The federal government launched the Sustainable Finance Action Council (SFAC) to form the much-needed architecture of climate financing, but the story is still being written on how investor markets will ultimately respond. Influential global investor coalitions like the Net Zero Asset Owners Alliance and GFANZ are honing their methodologies and protocols to guide investors on the net-zero path; it remains to be seen how Canadian resource industries fit into investors' plans.

With climate finance rules taking shape globally and here at home, the moment is now for Canada to position itself competitively and build market trust for industries in transition.

Climate finance as a policy priority

Policymakers at national and provincial levels need solid frameworks grounded in climate science that reflect a new investment reality.

Investment flows will increasingly hinge on access to information and data to clarify climate-related risks. The information ecosystem needs to modernize and align with rapidly evolving international standards. These should serve as a baseline for transition-focused taxonomies to address the unique factors facing Canadian natural resource sectors.

While Canada needs a national declaration of transition strategies and priorities, it’s also poised to galvanize transition investment vehicles and drive private sector buy-in. According to a report by the Energy Futures Lab, “Alberta is well-positioned to kickstart this process and ensure that transition finance gains broader market acceptance."

Finally, policy will be vital to ensuring a just transition and creation of an inclusive economy. Emissions-intensive sectors support workers, consumers, and communities, for whom the social risks and opportunities of climate action are very real. Forging equitable public-private partnerships with Indigenous communities that prioritize collaboration should be foundational to these efforts, and these factors should be woven into strategic policy action at all levels of government.

Private capital is coming to the table, and that bodes well for the collective effort to address climate change. Whatever the motivation of finance industry actors, the transition to a net-zero economy will have profound impacts on virtually every sector in the decades ahead, as will efforts to reduce exposure to physical climate risk.

The new imperative for Canadian policymakers is to ensure all our sectors, including our resource sectors, are positioned to attract the investment and opportunities being created by the emergence of climate finance.

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