CADWALADER

Canada's Proposed Green Taxonomy Framework Follows Global Trends, With Some Notable Differences

April 21, 2023

By Duncan Grieve
Special Counsel | White Collar Defense and Investigations

By Jayshree Balakrishnan
Associate | Global Litigation

Last month, Canada's Department of Finance published the Sustainable Finance Action Council (SFAC) recommendations for the development of a green taxonomy for sustainable investment, as the country moves toward its goal of net zero greenhouse gas emissions by 2050. "**The Taxonomy Roadmap Report**," developed by the Taxonomy Technical Experts Group (TTEG) of the SFAC, in partnership with the **Canadian Climate Institute**, sets out emissions-based criteria for categorizing financial investments or assets into one of two investment categories—"green finance" and "transition finance." The TTEG has designed the taxonomy with the objective of encouraging the issuance of both green and transition financial instruments in a way that is consistent with Canada's Paris-aligned commitment to limit global warming to 1.5° C.

Under the recommendations set out in the SFAC Report, projects and activities within the green category must be low or zero-emitting (low or zero scope 1 and 2 emissions, low or zero downstream scope 3 emissions), and produce goods or services with expected significant demand growth in the global low-carbon transition. The report listed a number of specific examples for these type of projects: green hydrogen production, afforestation projects, zero-emissions vehicle manufacturing (with low-emissions supply chains), and electricity transmission infrastructure.

Projects and assets in the transition category must substantially decrease scope 1, 2 and 3 emissions from carbon-intensive sectors, without the use of carbon offsets. These activities must also have concrete and limited lifespans, and not impact negatively (in terms of difficulty and cost) the future transition to net zero.

The SFAC Report includes a recommendation that Canada's taxonomy should include "do no significant harm" (DNSH) criteria to ensure that included projects are not detrimental to other ESG priorities, including environmental, labor and indigenous right protections under Canadian law, noting that the DNSH criteria was pioneered in the EU taxonomy.

Taking the Temperature: Canada's proposed green taxonomy as set out in the SFAC report varies in certain significant respects from those in place or being considered in other regions. The inclusion of the transition category is one of the most notable differences; neither the EU taxonomy for sustainable activities nor the proposed UK green taxonomy have this category. As we have previously reported, the current draft of the proposed Singapore taxonomy does include a transitional category in its "traffic light" categories: green (helpful), amber (transitionary), and red (harmful) activities as they relate to the net zero goal.

Another area that has garnered significant commentary is the question of whether nuclear power should be considered a green energy sector. As we reported last month, the UK announced that it would include nuclear power as a sustainable form of energy, a decision that, while controversial, is in line with the EU's similar determination from February 2022. According to statements from the SFAC, while nuclear power is currently excluded from the taxonomy (along with fossil fuels, firearms, alcohol and tobacco, and gambling) as proposed, future inclusion is possible.

As we have previously noted, taxonomies are essential in allowing investors and companies to understand what industries, businesses and projects will be considered sustainable. The development of regional taxonomies with varying approaches and rubrics underscores not only the difficulty in defining a sustainable activity or project, but also increases the regulatory and practical burdens investors and financial market participants will likely face in making investment decisions. Differences in categories and criteria will also impact the flow of investments across countries and regions. Canada reportedly has an estimated annual investment gap of $115 billion in order to reach the country's stated climate goals. As some commentators have observed, the SFAC report suggests that the lack of development of any climate-related sustainable investment taxonomy by the U.S. authorities may result in "potential competitiveness implications."