THE EVOLVING GOVERNANCE OF DEFENCE-RELATED FINANCE: CONSIDERATIONS FOR CANADIAN FINANCIAL INSTITUTIONS

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1. INTRODUCTION

Recent geopolitical developments have prompted a reassessment of the role of defence and security within public policy, industrial strategy and capital markets. Russia's invasion of Ukraine heightened geopolitical tensions and renewed defence spending commitments across NATO members have underscored the importance of sustained investment in defence capabilities and related infrastructure. As defence finance has become more prominent, questions are emerging regarding how defence-related activities may be evaluated within existing sustainability, governance and disclosure frameworks.

This shift is relevant for Canada. Canada reached NATO's 2% of GDP defence spending benchmark in fiscal year 2025–26 and has committed to NATO's Defence Investment Pledge of 5% of GDP annually by 2035. This comprises 3.5% of GDP for core defence requirements and a further 1.5% for defence- and security-related investments, including critical infrastructure, resilience and dual-use capabilities.[1] The scale and breadth of this commitment are likely to expand the range of defence- and security-related activities requiring financing, increasing the exposure of Canadian financial institutions to associated governance, risk management, and disclosure considerations. This evolution also reflects broader changes in the nature of defence itself. Today, the private sector drives much of the innovation relevant to modern defence capabilities, with militaries increasingly relying on technologies originally developed for commercial applications.[2] As a result, these considerations may extend beyond traditional defence contractors, for example, dual-use technologies and infrastructure. Areas such as artificial intelligence, cybersecurity, quantum technologies, telecommunications, space technologies and critical infrastructure increasingly blur the distinction between civilian and defence applications, creating new questions regarding how related financing activities should be classified, governed and disclosed.

Regardless of differing views on whether defence-related activities should fall within sustainable finance frameworks, the governance concepts developed through sustainable finance—including the assessment of non-financial risks, enhanced due diligence, materiality, transparency, and disclosure—provide a useful foundation for addressing many of the governance questions emerging in defence finance. As financial institutions reassess their role in financing defence and security, these frameworks can offer established approaches for evaluating and communicating risks beyond traditional financial considerations.

As defence increasingly encompasses dual-use technologies, digital infrastructure and broader resilience capabilities, the governance challenge for financial institutions may shift from evaluating dedicated defence companies to developing governance, due diligence and disclosure frameworks capable of assessing defence-related activities across a much wider range of sectors.

Europe has been at the forefront of this discussion, with notable progress made in clarifying how conventional defence activities should be governed within existing sustainable finance frameworks. European policymakers have increasingly emphasized governance, transparency and due diligence, providing financial institutions with greater clarity regarding the treatment of defence-related activities.

Canada has not experienced the same degree of regulatory evolution. However, recent developments suggest that defence and security are becoming increasingly relevant within the Canadian financial system. In June 2026, OSFI lowered the Domestic Stability Buffer (DSB), noting that the resulting additional lending capacity could support Canada's economic adaptation to structural changes in areas including defence and security, critical infrastructure, resources and artificial intelligence. Canada has also been selected as the host country for the newly established Defence, Security and Resilience Bank (DSRB), a multilateral financial institution designed to mobilize public and private capital for defence, security and resilience projects, expected to be operational in 2027. Together, these developments indicate growing policy and institutional attention to defence, security and resilience financing in Canada. As public and private capital is mobilized in support of these objectives, Canadian financial institutions may increasingly encounter governance questions regarding how defence-related lending, investment and underwriting activities should be classified, governed and disclosed.

This paper examines how the international governance landscape for defence finance has evolved and considers the implications for Canadian financial institutions. It identifies the principal lesson from Europe as the increasing expectation that defence-related activities be supported by clear governance frameworks, documented policies and transparent disclosure.

2. HOW THE INTERNATIONAL LANDSCAPE HAS EVOLVED

Defence finance has undergone a notable shift in recent years. While defence-related investments have historically been viewed by many investors through the lens of ethical exclusions and reputational risk, evolving geopolitical developments have accompanied greater attention to the role of defence and security within broader capital allocation and risk management frameworks.

2.1 Changing context

Russia's invasion of Ukraine in 2022 marked a significant inflection point. Beyond its immediate humanitarian and geopolitical consequences, the conflict exposed weaknesses in defence industrial capacity across Europe[3] and highlighted the extent to which long-term security objectives depend on sustained access to long-term capital.[4] More broadly, heightened geopolitical tensions, growing concerns over strategic resilience, and renewed defence spending commitments among NATO members have reinforced the expectation that elevated security-related

investment is likely to remain an ongoing feature of the investment landscape rather than a temporary response to current conflict.[5] At the 2025 NATO Summit in The Hague, Allies agreed to a new long-term defence investment commitment of 5% of GDP by 2035, replacing the previous 2% benchmark. The new framework allocates 3.5% of GDP to core defence capabilities and a further 1.5% to broader security, resilience and defence-related infrastructure.[6]

In this evolving context, policymakers and market participants are increasingly seeking to clarify how conventional defence activities should be treated within existing regulatory, governance, and disclosure frameworks.[7] Sustainable finance frameworks provide well-developed approaches to assessing non-financial risks, due diligence, materiality and disclosure that may offer useful guidance for addressing these questions, irrespective of whether defence spending is ultimately considered sustainable.

2.2 Clarifying the Application of Sustainable Finance Frameworks

Before Russia's invasion of Ukraine, conventional defence was widely regarded by many European financial market participants as incompatible with sustainable finance, despite the absence of any general prohibition on financing the sector under the EU sustainable finance framework. This reflected a combination of evolving market practice, voluntary exclusion policies adopted by financial institutions, and uncertainty regarding the interpretation of existing sustainable finance rules. While early policy discussions—including the Platform on Sustainable Finance's advisory work on a possible Social Taxonomy—raised questions regarding the treatment of defence-related activities, many financial institutions went further by adopting broad exclusion policies for the sector.[8]

Russia's invasion of Ukraine in 2022 altered this policy context. As European governments reassessed defence readiness, industrial capacity and strategic resilience, policymakers increasingly clarified that existing sustainable finance legislation does not prohibit financing for conventional defence activities. Between 2022 and 2025, this message was reinforced through public statements by the European Commission, expanded financing by the European Investment Bank for security and defence projects, and targeted amendments to sustainable finance legislation.[9]

In December 2025, the European Commission published a Commission Notice (the Notice) on the application of the sustainable finance framework and the Corporate Sustainability Due Diligence Directive (CSDDD) to the defence sector. Issued amid renewed European defence investment and growing uncertainty regarding how conventional defence activities should be interpreted within existing sustainable finance legislation, the Notice did not introduce new legislation. Rather, it clarified how the European Union's existing sustainable finance framework applies to conventional defence activities and reaffirmed that defence companies remain subject to the same governance, disclosure and due diligence expectations as other sectors. The principal legislative components of the EU sustainable finance framework are summarized in Table 1.

Table 1: Principal Components of the EU Sustainable Finance Framework

	Primary purpose	Relevance to defence finance
Sustainable Finance Disclosure Regulation (SFDR)	Requires financial market participants to disclose how sustainability risks and sustainability characteristics are incorporated into investment products and decisions. Defines a "sustainable investment" (Article 2(17)).	Provides the mandatory disclosure and governance framework within which conventional defence-related investments are assessed
EU Taxonomy Regulation	Granular classification system identifying economic activities that are explicitly environmentally sustainable.	Conventional defence activities fall outside its primary scope, though defence firms can report alignment for auxiliary green spending.
Corporate Sustainability Reporting Directive (CSRD)	Establishes standardized corporate sustainability reporting requirements across European industries.	Improves the quality and availability of non-financial ESG data relevant to investors and financial institutions.
Corporate Sustainability Due Diligence Directive (CSDDD)	Requires companies to identify, prevent, and mitigate adverse human rights and environmental impacts across value chains.	Confirms that defence companies remain fully subject to the same strict due diligence expectations and compliance rules as other sectors.
EU Climate Benchmark Regulation (*and Delegated Regulation* (EU) 2020/1818)	Establishes minimum exclusion standards for climate-labeled and Paris-Aligned financial indexes.	Amended by Delegated Regulation (EU) 2025/1775 to replace vague "controversial weapons" bans with a more narrow "prohibited weapons" list, clearing conventional arms for index inclusion.

The Commission's central clarification was that the EU's sustainable finance framework does not place general limitations on financing any sector, including the defence sector. Rather than being treated as automatically excluded, conventional defence activities are expected to be assessed on a case-by-case basis within the existing regulatory framework. The Commission further notes that defence companies should not be treated as a de facto non-contributing sector when assessing sustainability. Under appropriate circumstances, activities that safeguard peace and security may contribute to social objectives, provided they do not significantly harm other sustainability objectives and the undertaking demonstrates good governance. This approach is also consistent with the Sustainable Finance Disclosure Regulation (SFDR). Under Article 2(17), a "sustainable investment" is one that contributes to an environmental or social objective, does no significant harm to any such objective, and is made in an undertaking that follows good governance practices. The Commission also clarified that the Corporate Sustainability Due Diligence Directive (CSDDD) applies equally to the defence sector.

Participation in defence-related activities does not exempt companies from undertaking appropriate human rights and environmental due diligence, reinforcing that the evolving European approach is one of regulatory clarification rather than regulatory exception.[10]

The Commission emphasized that the absence of conventional defence activities from the EU Taxonomy does not prejudge the sector's environmental performance or imply that such activities are excluded from financing under the broader EU sustainable finance framework. The EU Taxonomy is an environmental classification system that identifies economic activities making a substantial contribution to specified environmental objectives and is one component of the broader sustainable finance framework. Conventional defence activities generally fall outside that scope. Nevertheless, defence companies may still report taxonomy alignment for eligible horizontal activities—such as investments in energy efficiency, clean transport or building renovations—even where their principal business activities are not themselves taxonomy-aligned.[11, 12] For clarity, this discussion relates only to conventional defence activities. International prohibited weapons remain subject to separate legal restrictions and exclusion policies under the EU sustainable finance framework.

Taken together, these clarifications distinguish between activities that are not prohibited under the EU's sustainable finance framework and those that qualify as taxonomy-aligned environmentally sustainable activities. More importantly, they establish a common regulatory foundation upon which financial institutions can develop governance, investment and disclosure practices that reflect their own mandates, risk appetites and stakeholder expectations while still arriving at different conclusions regarding defence finance.

2.3 Institutional responses to evolving governance expectations

The Commission's clarification, together with related legislative amendments and broader policy signals, has been followed by a gradual evolution in market practice. Rather than relying on broad exclusion policies or implicit assumptions, financial institutions increasingly articulate how defence-related activities are assessed within existing investment, lending and disclosure processes.

Institutional responses have reflected differing mandates, risk appetites and stakeholder expectations. The European Investment Bank (EIB) has expanded the scope of its support for security and defence-related projects as part of its Strategic European Security Initiative, while maintaining its broader environmental, social and governance requirements, including the exclusion of weapons and ammunition.[13] This expansion reflects a notable evolution in the role of public finance in supporting Europe's defence industrial base while maintaining established governance standards.

Several European commercial banks have reviewed and updated existing defence sector policies to reflect evolving regulatory guidance and geopolitical realities. For example, BNP Paribas updated its Defence Sector Policy to distinguish more clearly between internationally prohibited weapons and conventional defence activities, while maintaining documented due diligence and governance requirements.[14] Rather than establishing blanket exclusions, the policy sets out due diligence expectations, eligibility criteria and governance processes, providing additional transparency around how defence-related financing decisions are made.

Institutional investors have likewise adopted differing approaches. Some European pension

funds have revised long-standing exclusion policies to permit investments in conventional defence companies, while others have retained more restrictive investment policies consistent with their mandates and stakeholder expectations. For example, AP Pension removed its long-standing exclusion on conventional defence investments following Russia's invasion of Ukraine, while maintaining its exclusions for the controversial weapons categories.[15] Although approaches vary, they also illustrate a common trend: decisions regarding defence finance are increasingly supported by documented governance frameworks, formal investment policies and more transparent public disclosure.

These developments have also begun to influence broader investment practice. According to Clarity AI, European Article 8 funds - which promote environmental and/or social characteristics under the Sustainable Finance Disclosure Regulation (SFDR) - increased their exposure to conventional defence companies by nearly 60%, from 0.9% of average portfolio weight in the last quarter of 2024 to 1.42% by the last quarter of 2025.[16] While institutions continue to adopt differing investment approaches, the data suggest that regulatory clarification, together with evolving geopolitical priorities, has contributed to a broader reassessment of conventional defence within parts of the European sustainable investment market.

2.4 Governance implications

These developments should not be interpreted as evidence of a European consensus on defence finance. Significant differences remain across jurisdictions and institutions, reflecting varying legal frameworks, investment mandates, stakeholder expectations and risk appetites. Investment outcomes continue to vary considerably, with some institutions expanding their exposure to conventional defence while others maintain more restrictive investment policies.

Underlying these developments is a broader shift from implicit market practice toward explicit governance. Rather than relying on broad exclusion policies or informal assumptions, financial institutions are increasingly expected to articulate how defence-related activities are classified, assessed, governed and disclosed. The European experience suggests that greater regulatory clarity need not prescribe investment outcomes. Instead, it can provide a common governance framework within which institutions exercise judgement consistent with their own mandates, fiduciary responsibilities and stakeholder expectations.

This shift from exclusion toward explicit governance provides a useful reference point for other jurisdictions confronting similar questions. As defence finance becomes more prominent within international capital markets, the experience in Europe demonstrates how regulatory clarification, documented governance frameworks and transparent disclosure can help institutions navigate evolving stakeholder expectations while preserving flexibility in investment decision-making.

3. THE CANADIAN CONTEXT

Compared with recent developments in Europe, Canada's sustainable finance architecture has largely developed around climate-related financial risk, sustainability disclosure and the transition to a net-zero economy rather than sector-specific guidance. While Europe has recently clarified how defence-related

activities may be considered within its existing sustainable finance framework, Canada's regulatory framework remains primarily focused on climate-related objectives.

3.1 Canada's regulatory framework remains focused on climate-related financial risk

Canada has made progress in developing regulatory expectations for climate-related financial risk. The Office of the Superintendent of Financial Institutions' (OSFI) Guideline B-15: *Climate Risk Management* establishes comprehensive expectations for federally regulated financial institutions (FRFIs) regarding the governance, management and disclosure of climate-related risks. These expectations include board oversight, integration of climate-related risks into enterprise risk management frameworks, climate scenario analysis and public disclosure of climate-related financial risks.[17] Similarly, the Canadian Sustainability Standards Board (CSSB) has introduced sustainability disclosure standards aligned with the International Sustainability Standards Board (ISSB), further strengthening expectations around sustainability-related governance and disclosure in Canada.[18]

Canada is also developing a made-in-Canada sustainable finance taxonomy through Business Future Pathways, overseen by the independent Canadian Taxonomy and Transition Planning Council, with technical research led by the Canadian Climate Institute. In October 2026, the Council released its final Methodology Report, establishing definitions for green and transition economic activities aligned with Canada's net-zero objectives. Sector-specific technical screening criteria remain under development, with completion targeted for the end of 2027. Unlike the recent European Commission guidance, however, the Canadian taxonomy remains focused on climate mitigation and does not provide guidance on how defence-related activities should be classified within sustainable finance or ESG frameworks.[19]

Table 2: Principal Components of Canada's Sustainable Finance Framework

	Primary purpose	Relevance to defence finance
OSFI Guideline B-15: Climate Risk Management	Establishes prudential expectations for climate-related governance, risk management, scenario analysis, and disclosure for federally regulated financial institutions (FRFIs).	Provides a governance framework for climate-related financial risk but does not address defence-related finance or ESG classification.
Canadian Sustainability Disclosure Standards (CSDS 1 & CSDS 2)	Establish sustainability-related and climate-related disclosure expectations modeled after the ISSB global baseline (IFRS S1 & S2), introduced by the Canadian Sustainability Standards Board (CSSB).	Strengthens corporate sustainability reporting but provides no guidance on the treatment of defence-related activities.
CSA Sustainability Disclosure Initiatives (optional)	Development of sustainability-related disclosure requirements for Canadian capital markets by the Canadian Securities Administrators.	Sustainability disclosure continues to evolve across provincial capital markets, but no defence-specific guidance has been issued..
Canadian Sustainable Finance Taxonomy (under development)	Voluntary classification framework defining Green and Transition economic activities to support Canada's net-zero transition. Final methodology released October 2026; sector-specific criteria under development.	Focused on climate mitigation and industry decarbonization; does not provide guidance on the classification of defence-related activities.
OSFI Capital & Prudential Framework (DSB, Capital Adequacy, etc.) *	Prudential supervision and financial system resilience.	Recent OSFI commentary has acknowledged defence and security as areas where lending capacity may support Canada's structural transition, but without providing sustainable finance guidance.

*Supports the defence finance discussion but not an actual component of Canada's Sustainable Finance Framework

To date, however, neither OSFI nor Canadian securities regulators have issued comparable guidance addressing how defence-related lending, investment or underwriting activities should be considered within prudential or sustainable finance frameworks. Unlike the recent clarification provided by the European Commission, there has been no comparable Canadian regulatory guidance regarding how defence finance should be classified, governed or disclosed. Accordingly, while Canada's sustainable finance framework continues to evolve, its development has remained centred on climate-related objectives rather than the broader social sustainability questions that have recently emerged in Europe.

Recent developments nevertheless suggest that defence and security are becoming increasingly relevant within Canada's financial and prudential landscape. In June 2026, OSFI lowered the Domestic Stability Buffer (DSB), noting that the additional lending capacity could support Canada's economic adaptation to structural changes in areas including defence and security, critical infrastructure, resources and artificial intelligence.[20] At the same time, the establishment of the Defence, Security and Resilience Bank (DSRB) reflects a broader international effort to mobilize public and private capital in support of defence, security and resilience objectives. On July 7, 2026, the Government of Canada announced further steps to advance the establishment of the DSRB following Canada's selection as the host country, reinforcing Canada's role in supporting the development of this new international institution for defence, security and resilience financing.[21] Together, these developments suggest that defence and security are becoming an increasingly important area of capital deployment for Canadian financial institutions. However, unlike the European Commission's recent guidance, these developments do not address how defence-related activities should be classified within sustainable finance frameworks or how associated governance and disclosure expectations should evolve.

3.2 The DSRB introduces new governance considerations

The establishment of the DSRB may create new channels through which Canadian financial institutions participate in defence, security and resilience finance. The Bank is intended to mobilize public and private capital by providing long-term financing and guarantees, supporting investment across defence and security supply chains and lending to member governments for priority investments. Canada and eight partner countries announced their shared intention to establish the DSRB in July 2026, following Canada's selection as host of its future headquarters, with operations targeted to begin as early as 2027. Canadian financial institutions have also been among the private-sector organizations supporting the development of the initiative. The DSRB's proposed financial architecture is intended to use mechanisms including loans, guarantees, credit enhancements and co-financing to mobilize commercial lenders and institutional investors, creating multiple potential channels through which Canadian financial institutions may engage with the Bank and DSRB-supported financing.[22]

While the DSRB's ultimate scale, operating model and market significance will depend on its final institutional design and the extent of market participation, it nevertheless provides a useful illustration of the types of governance questions that may arise as defence and security financing expands and increasingly mobilizes private capital. More broadly, the DSRB reflects an expectation that private capital will play an increasingly important role in financing defence, security and resilience priorities. This may create new opportunities for commercial banks, institutional investors and private credit providers, while also increasing the importance of governance frameworks that clearly articulate how defence-related financing decisions are assessed, approved and disclosed.

Should the DSRB develop as intended and become an important channel for defence and security financing, participation through the Bank may raise governance considerations that

differ from traditional bilateral defence lending or investment. Depending on the structure of an exposure, Canadian institutions could participate as lenders, co-financiers, investors or counterparties, requiring consideration of how their own eligibility criteria, due diligence requirements and risk appetite interact with those established by the DSRB. This may include determining the extent to which an institution can rely on the DSRB's assessment of an underlying transaction and where additional institution-level review remains appropriate. As the DSRB develops its initial policies and directives, similar questions may arise regarding the interaction between its environmental and social standards and those applied by participating institutions.

The experience of European institutions offers a useful reference point. As defence financing expanded, institutions such as the European Investment Bank, BNP Paribas and AP Pension evolved and clarified their governance frameworks, eligibility criteria, due diligence processes and disclosure practices. Canadian financial institutions participating in DSRB-supported financing may encounter similar governance considerations as they determine how the Bank's requirements interact with their own institutional policies and stakeholder expectations.

The DSRB's mandate also encompasses both lending to sovereign members and financing intended to mobilize private capital across defence and security supply chains, meaning that the underlying credit, due diligence and governance considerations may differ materially across DSRB-supported transactions.

The involvement of a sovereign-backed international institution may also alter—but does not eliminate—the governance and reputational considerations associated with defence finance. Guarantees, credit enhancement or co-financing may redistribute financial risk and facilitate private-sector participation, while participating institutions remain responsible for ensuring that individual transactions are consistent with their own mandates, risk appetites, governance frameworks and stakeholder expectations. Mechanisms designed to diversify or absorb risk at the system level can still generate institution-level concentration, correlation, governance and reputational considerations.[23] Whether through the DSRB or other emerging financing structures, if defence and security finance expands as expected, Canadian financial institutions may increasingly need to consider not only whether an exposure meets the requirements of the relevant financing arrangement, but also how such participation aligns with their own approaches to risk management, due diligence, governance and disclosure.

3.3 Governance approaches to defence finance remain largely institution-specific

In the absence of common regulatory guidance on defence finance, governance of defence-related activities has largely remained institution-specific. While OSFI Guideline B-15: Climate Risk Management[24] establishes prudential expectations for climate-related governance, risk management and disclosure, and the Canadian Sustainability Disclosure Standards (CSDS 1 & CSDS 2)[25] establish sustainability-related disclosure standards, neither framework provides guidance on how, or when, defence-related lending, investment or underwriting activities can be classified within sustainable finance approaches. Likewise, Canada's

proposed sustainable finance taxonomy remains focused on classifying green, transition and abatement activities, and does not currently provide guidance on the treatment of defence-related activities.[26]

This does not imply an absence of governance. Canadian financial institutions would generally be expected to assess defence-related activities through existing governance, risk management, legal, compliance and responsible investment frameworks, with governance approaches that reflect each institution's mandate, risk appetite, client base and stakeholder expectations. Consequently, governance practices may differ considerably across institutions despite operating within the same broader prudential and regulatory environment.

The boundaries of defence-related finance may also become increasingly difficult to define as capital is directed toward dual-use technologies and other activities with both commercial and defence applications. BDC's Strong North Fund illustrates this emerging complexity. The $300 million venture capital fund supports Canadian early-stage companies developing deep technologies with defence-focused or dual-use applications or strategies, including areas such as artificial intelligence, cybersecurity, quantum technologies and advanced communications. This illustrates how the defence financing landscape is extending beyond conventional defence companies and may raise classification and governance questions where defence applications overlap with commercial technologies, critical infrastructure or broader resilience objectives.[27]

This contrasts with the direction of travel in Europe, where regulators have recently focused on clarifying the governance framework within which institutions make these decisions.[28] The objective has not been to prescribe a single investment outcome, but rather to establish a common governance framework within which institutions can exercise judgement consistent with their mandates, fiduciary responsibilities and stakeholder expectations. The result is not necessarily greater consistency in investment decisions, but greater transparency regarding how those decisions are reached and communicated.

While Canada's regulatory context differs from Europe's, the experiences of institutions such as the European Investment Bank, BNP Paribas and AP Pension illustrate that governance responses need not converge on a single investment outcome. The emerging trend has been toward more explicit governance frameworks, documented policies and greater transparency regarding how defence-related financing decisions are made. These examples may provide useful reference points as Canadian institutions develop their own approaches.

3.4 Emerging governance questions

The Canadian context does not necessarily call for a single governance approach to defence finance. Rather, it raises questions regarding how existing governance frameworks may need to evolve as defence and security become increasingly prominent within financial markets. The European experience suggests that greater clarity need not prescribe investment outcomes. Instead, it can provide a common governance framework within which institutions can exercise judgement consistent with their mandates, fiduciary responsibilities and stakeholder expectations.

The European experience suggests that, regardless of differing views on whether defence-related activities should be financed or considered within sustainable finance frameworks, it is important to ensure that

the governance frameworks supporting those decisions are clearly articulated, consistently applied and appropriately disclosed. As defence finance continues to evolve within Canada, similar governance questions are likely to emerge across lending, investment, underwriting and sustainability reporting.

The following section considers several practical governance questions that Canadian financial institutions may increasingly need to address.

4. PRACTICAL GOVERNANCE CONSIDERATIONS

The preceding discussion does not suggest that Canadian financial institutions should adopt a common approach to defence finance. Rather, it highlights a series of governance questions that institutions may increasingly need to address as defence, security and resilience financing becomes more prominent within Canadian and international capital markets. The following questions are intended to support institutions in developing governance approaches that are transparent, well documented and consistent with their own mandates, fiduciary responsibilities and stakeholder expectations.

While Canada does not currently provide sector-specific guidance for defence finance, institutions are not starting from a blank slate. Existing international frameworks for human rights due diligence and environmental and social risk management—including the UN Guiding Principles on Business and Human Rights (UNGPs), the Equator Principles and the IFC Performance Standards—provide established reference points that may inform aspects of institutional practice. Elements of the EU sustainable finance framework discussed above may also offer useful points of reference, particularly where they address governance, due diligence and disclosure. These frameworks do not resolve the defence-specific classification and governance questions facing Canadian institutions, but they can help distinguish areas where established practices already exist from those where institutional judgement or further regulatory clarification may be required.

4.1 How might defence-related activities be classified within sustainability frameworks?

One of the first governance questions concerns classification. The European Commission has clarified that conventional defence activities are not inherently incompatible with the EU's sustainable finance framework, while distinguishing them from activities that qualify as environmentally sustainable under the EU Taxonomy. Recent amendments to the EU Climate Benchmark Regulation provide a further reference point by narrowing mandatory weapons-related exclusions from "controversial weapons" to four categories of internationally prohibited weapons—anti-personnel mines, cluster munitions, biological weapons and chemical weapons—for EU Climate Transition and Paris-aligned Benchmarks.[29] Within Canada, however, there is currently no comparable guidance regarding how defence-related lending, underwriting or investment activities should be reflected within sustainability, responsible investment or ESG frameworks. These questions may become more complex where technologies or infrastructure have both civilian and defence applications. As financing increasingly extends to dual-use technologies, institutions may need to consider whether existing classification frameworks adequately capture these activities or whether additional governance guidance is warranted.

As defence-related activities are increasingly not confined to companies traditionally considered part of the defence sector, and defence and security increasingly rely on technologies such as artificial intelligence, semiconductors, cybersecurity, communications infrastructure, cloud computing and advanced electronics, governance questions will arise across a broader range of sectors. This will create additional complexity where institutions adopt different approaches to indirect defence exposure, activity thresholds or component suppliers.

An initial question for Canadian financial institutions may be whether defence finance warrants a distinct governance approach. Some institutions may conclude that existing governance, risk management and responsible investment frameworks already provide an appropriate basis for evaluating defence-related activities. Others may determine that the sector's unique legal, geopolitical and reputational considerations justify more explicit governance through dedicated policies or classification frameworks.

As defence and security financing becomes more prominent, institutions may increasingly need to consider whether existing sustainability frameworks adequately explain how these activities are classified. This may include considering whether defence-related activities should be addressed within existing ESG or responsible investment policies, how they interact with emerging transition finance frameworks, and whether internal classifications remain consistent across lending, underwriting, investment management and public reporting. Clear internal classifications can help ensure that governance decisions, stakeholder communications and public disclosures remain aligned.

While these questions are evolving within defence finance, the underlying governance approaches are not new. Responsible investment and sustainable finance practices have long assessed companies at the activity level, recognizing that different activities within the same company may present materially different environmental, social or governance considerations. As defence and security activities become increasingly integrated across a broader range of sectors, financial institutions may benefit from building on these established approaches by adapting their application to reflect the evolving nature of defence and security activities, together with the associated due diligence, disclosure and stakeholder engagement considerations.

4.2 How should governance and due diligence for defence-related activities evolve?

The European experience demonstrates that greater recognition of defence finance has not been accompanied by weaker governance expectations. Rather, regulatory clarification has generally been accompanied by more explicit governance processes and documented due diligence. Institutions have increasingly documented how defence-related activities are assessed within existing governance frameworks, including due diligence processes, legal and regulatory compliance, prohibited weapons policies and broader responsible business practices. Governance frameworks also need to address the potential impacts arising from how defence-related products and services are developed, supplied and ultimately used, including considerations relating to applicable human rights standards and international humanitarian law. For Canadian institutions, the question will be whether existing governance processes sufficiently

address the unique legal, reputational and stakeholder considerations associated with defence-related activities. Similar questions may increasingly arise for dual-use technologies, where due diligence may need to consider not only the nature of the underlying technology, but also its potential defence-related applications and whether existing governance frameworks adequately address those uses.

Existing international frameworks provide useful starting points for this assessment. The UN Guiding Principles on Business and Human Rights (UNGPs) establish a broad framework for identifying, preventing, mitigating and accounting for adverse human rights impacts, including those directly linked to an institution's products or services through clients, investments and other business relationships.[30, 31] This approach also provides an important link to the European framework: the CSDDD explicitly builds on the UNGP concept of human rights due diligence, requiring covered companies to integrate due diligence into policies and risk management systems and to identify, assess and address adverse human rights and environmental impacts.[32] These considerations reinforce the importance of governance and due diligence processes that are capable of identifying, assessing and managing downstream human rights and international humanitarian law risks in a manner consistent with an institution's legal obligations, internal policies and stakeholder expectations.[33, 34]

More operational frameworks may provide additional reference points where relevant to the transaction. The Equator Principles provide a risk-based model for categorizing and assessing environmental and social risks in project-related financing, while the IFC Performance Standards provide established methodologies for environmental and social risk management, including labour and certain primary supply-chain risks. These frameworks do not apply to all defence-related financing and do not resolve defence-specific questions of eligibility or classification, but they illustrate established approaches to proportionate due diligence that institutions may be able to draw on within existing governance processes.

For Canadian institutions, this may include reviewing whether existing governance frameworks adequately address defence-related activities, whether responsibilities for oversight are clearly defined, and whether escalation processes exist for transactions that raise heightened legal, reputational or stakeholder concerns. Institutions may also need to consider whether existing prohibited weapons policies remain appropriately defined and whether due diligence processes adequately distinguish between conventional defence activities, dual-use technologies and internationally prohibited weapons.

4.3 What level of disclosure is appropriate?

As defence finance becomes more visible, investors, clients and other stakeholders may increasingly seek greater transparency regarding how institutions approach defence-related activities. This does not necessarily imply detailed public reporting on individual transactions or investment decisions. Rather, it raises broader questions regarding whether existing disclosures or governance documents adequately explain how defence-related activities are assessed, governed and communicated.

Existing frameworks provide some reference points for considering this question. The UNGPs identify communication regarding how adverse human rights impacts are addressed as part of the human rights due diligence process. The European experience also illustrates how existing disclosure frameworks can provide information relevant to defence-related governance without requiring defence finance itself to be classified as sustainable: the CSRD improves the availability of standardized sustainability information from companies, while the SFDR establishes disclosure requirements relevant to how financial market participants assess and communicate sustainability-related characteristics of investments. These frameworks do not establish a model for Canadian defence-finance disclosure, but may provide relevant inputs where defence-related activities intersect with existing human rights, sustainability or responsible investment obligations. Disclosure considerations may become particularly complex where investments involve dual-use technologies, for which civilian and defence applications may coexist within the same company, product or investment. Institutions may therefore increasingly need to explain not only whether they participate in defence-related financing, but also how such activities are identified, governed and disclosed within broader investment portfolios.

Institutions may therefore wish to consider whether existing sustainability reports, responsible investment policies, stewardship reports, governance frameworks or other public disclosures provide sufficient clarity regarding their overall approach. Greater transparency regarding governance processes may help institutions respond consistently to evolving stakeholder expectations while reducing ambiguity regarding how defence-related activities are considered within broader sustainability frameworks.

4.4 Navigating cross-jurisdictional expectations

Canadian financial institutions operating internationally may increasingly encounter differing regulatory and investor expectations regarding defence finance. European investors operating under the Sustainable Finance Disclosure Regulation (SFDR), for example, may seek greater clarity regarding how defence-related activities are classified within sustainability frameworks, even where Canadian regulatory expectations remain less prescriptive. More broadly, Canadian institutions may encounter European disclosure, due diligence or investment requirements through their own activities or through relationships with investors, clients and counterparties. The EU framework provides useful reference points for navigating these differences: SFDR establishes sustainability-related disclosure requirements for financial market participants and products, while the CSDDD establishes due diligence expectations for adverse human rights and environmental impacts for companies within its scope. As international capital markets become increasingly interconnected, institutions may therefore benefit from considering how governance approaches can remain consistent across jurisdictions while responding to differing regulatory and stakeholder expectations.

Rather than developing separate governance approaches for different jurisdictions, institutions may benefit from considering whether a single governance framework can accommodate differing regulatory expectations

while remaining consistent with their own mandates, fiduciary responsibilities and stakeholder commitments. A well-articulated governance framework may also provide greater flexibility as sustainable finance frameworks continue to evolve internationally.

Ultimately, these questions are not intended to prescribe a single approach to defence finance. Rather, they reflect the broader evolution of sustainable finance governance as financial institutions adapt to a changing geopolitical environment. The European experience demonstrates that greater regulatory clarity need not dictate investment outcomes. Instead, it can provide a governance framework that enables institutions to exercise judgement transparently and consistently while remaining aligned with their own mandates, fiduciary responsibilities and stakeholder expectations.

4.5 Emerging governance guidance and practical resources

As defence and security finance continues to evolve, practical implementation guidance is also beginning to emerge internationally. While regulatory frameworks remain at different stages of development across jurisdictions, a growing number of investor- and multistakeholder-led initiatives are developing practical approaches to governance, due diligence, disclosure and stakeholder engagement for defence-related financing and investment. These resources reflect an emerging recognition that governance questions surrounding defence finance extend beyond traditional financial risk considerations to include broader non-financial risks, including human rights, international humanitarian law, reputational risk and responsible business conduct.

Examples include the draft Guidance for Responsible Investment in Defence-related Companies (GRID),[35] formerly Principles for Responsible Defence Investment, an investor-led initiative currently under consultation that seeks to provide practical due diligence and governance guidance for investors engaging with defence-related companies. Related guidance has also emerged through the UN Working Group on Business and Human Rights' report Investors, Environmental, Social and Governance Approaches and Human Rights,[36] which examines the application of the UN Guiding Principles on Business and Human Rights to investors and provides guidance on integrating human rights considerations into investment decision-making, as well as the United Nations Development Programme's Heightened Human Rights Due Diligence for Business in Conflict-Affected Contexts guide.[37]

Many of these initiatives remain under development and are primarily directed toward institutional investors rather than the broader financial sector. Nevertheless, they may provide useful reference points for Canadian financial institutions as governance practices continue to mature. As Canadian institutions refine their own approaches to defence-related lending, investment and underwriting, these emerging resources may complement future domestic regulatory developments by illustrating how governance, due diligence and disclosure considerations can be operationalized in practice.

5. CONCLUSION

The evolving international approach to defence finance reflects a broader shift in how financial institutions are expected to govern complex sustainability-related decisions. While Europe has not reached a single view on the role of defence within sustainable finance, it has increasingly provided greater clarity regarding how defence-related activities should be assessed, governed and disclosed. In doing so, the focus has shifted away from broad exclusion policies and toward more transparent governance frameworks that enable institutions to exercise judgement consistent with their mandates and stakeholder expectations.

Canada is at an earlier stage of this evolution. The establishment of the Defence, Security and Resilience Bank (DSRB), together with recent prudential developments, suggests that defence, security and resilience finance is becoming an increasingly important feature of Canada's financial landscape. However, there remains limited public guidance regarding how defence-related activities should be considered within sustainable finance frameworks. As participation by Canadian financial institutions increases, they may increasingly encounter questions from boards, investors and other stakeholders regarding classification, governance, due diligence and disclosure.

Ultimately, the central challenge is likely to be whether institutions can clearly articulate the governance frameworks through which defence finance decisions are made. As sustainable finance continues to evolve beyond climate-related financial risk alone, financial institutions will increasingly be asked to navigate complex trade-offs across environmental, social, geopolitical and economic objectives. In that context, transparent governance may prove to be as important as the investment decisions themselves - not because it dictates outcomes, but because it provides confidence in the processes through which those outcomes are reached.

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GLOSSARY OF KEY TERMS

Conventional defence: For the purposes of this paper, conventional defence refers to activities, products and services primarily intended for military or national defence purposes that do not involve weapons prohibited under applicable international conventions. This may include conventional weapons and ammunition, military platforms and equipment, and related defence systems and services.

Dual-use: Products, technologies and services that have both civilian and defence or security applications. Dual-use activities may include technologies developed primarily for commercial purposes that also have defence applications, including cybersecurity, artificial intelligence, autonomous systems and advanced technologies.

Critical infrastructure: Assets, systems and networks that are essential to the functioning, security and resilience of society and the economy. These may serve primarily civilian purposes while also supporting defence and national security objectives, including energy, communications and transportation infrastructure.

Resilience: Activities and investments intended to strengthen the capacity of infrastructure, systems, institutions or supply chains to withstand, adapt to and recover from disruptions, including geopolitical and security-related disruptions. Resilience finance may therefore encompass activities with both civilian and defence or security relevance.

Prohibited weapons: For the purposes of this paper, prohibited weapons refers to the four categories identified under the EU Climate Benchmark framework: anti-personnel mines, cluster munitions, biological weapons and chemical weapons, whose use, possession, development, transfer, manufacture or stockpiling is prohibited under the relevant international conventions referenced by the EU framework.

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