Canada Climate Law Initiative | L'Initiative canadienne de droit climatique

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To:
Peter Routledge
Superintendent of Financial Institutions
Office of the Superintendent of Financial Institutions
ClimateRisks-RisquesClimatiques@osfi-bsif.gc.ca

Dear Superintendent Routledge,

Re: Draft Guideline B-15: Climate Risk Management

The Canada Climate Law Initiative (CCLI)[1] applauds the Office of the Superintendent of Financial Institutions (OSFI) for its draft Guideline B-15 Climate Risk Management.[2] The proposed Guideline is important recognition that climate-related risks can significantly affect the safety and soundness of federally-regulated financial institutions (FRFI), in turn affecting the integrity of the Canadian financial system. The proposed Guideline marks the first time in Canada that regulatory authorities are adopting a leadership role in respect of management of climate-related risks in the financial sector and the need to build resilience in the transition to a decarbonized economy. The CCLI strongly supports the work of OSFI and the vast majority of the content of the proposed guideline. That said, the CCLI has five recommendations that we believe are particularly important in enhancing it further.

As OSFI has observed, building financial resilience in respect of climate-related risks requires FRFI to address vulnerabilities in their business model and requires "forward-looking approaches that are holistic,

[1] The CCLI is a collaboration of the faculties of law at the University of British Columbia and York University that examines the legal basis for corporate directors, officers, pension fiduciaries, and asset managers to manage and report on climate-related financial risks and opportunities, publishing guidance on effective climate governance and working closely with the accounting profession to publish a guide for audit committees. The CCLI is the Canadian partner of the global Commonwealth Climate and Law Initiative, founded at Oxford University, United Kingdom.
[2] OSFI draft Guideline B-15 Climate Risk Management, Part A, (May 2022), Climate Risk Management (osfi-bsif.gc.ca) (hereafter Guideline B-15).

integrated, and built on reliable empirical data and sound analyses".[3] OSFI has recognized that most FRFI are in the early stages of building climate-related risk assessment capabilities.[4] Few of the 400 FRFI over which OSFI has supervisory authority are on a pathway to net-zero greenhouse gas (GHG) emissions that aligns with Canada's commitments domestically and internationally. A key part of OSFI's mandate is to protect depositors and policyholders; thus, it is vital that in meeting their prudential obligations, FRFI identify and manage climate-related risks and opportunities and undertake ambitious efforts to move to net-zero emissions.

The CCLI supports OSFI's three expected outcomes for FRFI to achieve pursuant to the guideline:

- The FRFI understands and mitigates against potential impacts of climate-related risks to its business model and strategy.
- The FRFI has appropriate governance and risk management practices to manage identified climate-related risks.
- The FRFI remains financially resilient through severe, yet plausible, climate risk scenarios, and operationally resilient through disruption due to climate-related disasters.[5]

The CCLI supports a prudential framework that recognizes the importance of FRFI building financial resilience against intensifying climate-related risks in each aspect of their business plans. In particular, CCLI supports the close alignment of proposed Guideline B-15 with the framework recommended by the Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TCFD)[6] and the International Financial Reporting Standards (IFRS) Foundation's International Sustainability Standards Board (ISSB) S2 Exposure Draft on Climate-related Disclosures,[7] which will ensure Canada keeps pace with regulatory developments for financial institutions globally. The proposed mandatory disclosure requirements will assist in creating transparency for the Canadian public, enhancing confidence in the financial system. The embedding of oversight and management of climate risks and opportunities in governance, strategic planning, risk management, targets, and metrics will reduce risks of financial institution failure from the growing frequency and intensity of acute events and the longer term risks of chronic impacts. CCLI also applauds statements made by Superintendent Routledge regarding the importance of integrating climate-related risks in its regulatory and supervisory activities and its recognition that climate-related risks manifest over varying time horizons and can drive financial risks, including credit, market, insurance, and liquidity risks.

The CCLI supports the Guideline's objective of ensuring that the FRFI understands and mitigates against potential impacts of climate-related risks to its business model and strategy; that it has appropriate governance and risk management practices to manage identified climate-related risks; and that the FRFI remains financially resilient by considering severe, yet plausible, climate risk scenarios. We believe our five recommendations will enhance the guideline, and we offer a rationale for suggesting each of them in this submission:

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[3] Office of the Superintendent of Financial Institutions (OSFI), "OSFI consults on expectations to advance climate risk management", OSFI News Release, (26 May 2022), OSFI consults on expectations to advance climate risk management (osfi-bsif.gc.ca) (hereafter OSFI News Release); Guideline B-15 Climate Risk Management, note 2, Part A.

[4] OSFI News Release, note 3.

[5] Guideline B-15, note 2, Part A3.

[6] Financial Stability Board's Task Force on Climate-Related Financial Disclosure (TCFD) Framework.

[7] International Financial Reporting Standards (IFRS) Foundation, International Sustainability Standards Board (ISSB) Exposure Draft on Climate Related Disclosures.

CCLI recommendation 1: Amend Guideline B-15 principles 1 and 2 to embed transition to net-zero emissions:
Principle 1: In incorporating identification and management of climate-related risks and opportunities into its business model and strategy, the FRFI must have a plan to transition to net-zero GHG emissions, with short-, medium- and long-term objectives for decarbonization with the goal of the FRFI contributing to keeping the average rise in temperature to 1.5°C above pre-industrial levels and with the FRFI adopting sound methodologies to annually measure and report progress in meeting targets and objectives. Principle 2: The FRFI should have the appropriate governance, policies, and practices in place to manage climate-related risks and to transition to net-zero GHG emissions.

CCLI recommendation 2: OSFI should adopt capital-based measures to protect FRFI financial soundness
OSFI should use its supervisory capital planning process to require FRFI to hold higher capital and liquidity buffers to weather climate-related transition and management of physical and transition risks; and OSFI should consider whether to change its risk weightings to encourage FRFI to allocate capital in a manner that allows them to remain financially sound in the transition.

CCLI recommendation 3: Embed disclosure requirements in financial reporting
The proposed Guideline should be clearer that disclosure for climate-related risk management and transition plans must be embedded in financial reporting and subject to officer certification and independent third-party assurance.

CCLI recommendation 4: Require all FRFI to disclose the reporting standards used
All FRFI should be required to disclose the reporting standard used to disclose their emissions and to establish that the reporting standard used is comparable to the GHG Protocol and the Partnership for Carbon Accounting Financials' (PCAF) Global GHG Accounting and Reporting Standard if they are not being used.

CCLI recommendation 5: FRFI board of directors education must be enhanced
OSFI should support considerably more education of boards of directors of FRFI in respect of meeting their climate governance obligations and the requirements of proposed Guideline B-15; and OSFI should require FRFI to demonstrate that the board is actively and competently identifying, overseeing, and managing climate-related risks and the capital and liquidity needed to transition to a net-zero economy.

1. GOVERNANCE

Proposed Guideline B-15 contains two principles in respect of climate governance:

Principle 1: The FRFI should incorporate the implications of climate change and the transition to a low-greenhouse gas (GHG) economy to the FRFI in its business model and strategy.
Principle 2: The FRFI should have the appropriate governance, policies, and practices in place to manage climate-related risks.

The CCLI supports OSFI's direction that the FRFI should identify and understand the impact of climate-related risks on the FRFI's short-term and long-term strategic, capital, and financial plans, recognizing

that climate-related risks can affect FRFI through micro- and macro-economic transmission channels. CCLI particularly applauds the requirement that the FRFI should develop and implement a Climate Transition Plan, in line with its business plan and strategy, that guides the FRFI's management of increasing physical risks from climate change and the transition towards a low-GHG economy, aligned with the TCFD's *Guidance on Metrics, Targets, and Transition Plans*.[8] The proposed Guideline specifies that in developing the transition plan, the FRFI should assess the achievability of its plan under different climate-related scenarios, and how it would measure and assess its progress, including tracking internal metrics and targets such as GHG emissions.[9]

OSFI's second principle is equally important. OSFI has stated that it expects the FRFI to integrate climate-related risks into its Risk Appetite Framework and Internal Control Framework, and should reflect climate-related risks in its Enterprise Risk Management (ERM) framework, policies, and practices.[10] It also requires the FRFI to articulate the roles and responsibilities of different business lines and oversight functions in managing climate-related risks, and to recognize that senior management has overall accountability for the FRFI's climate risk management and thus senior management compensation should take into account effective management of climate-related risks.

However, the CCLI believes that the expression "transition to a low-greenhouse gas (GHG) economy" allows too much room for FRFI to determine their transition goals and does not align with Canada's stated commitment to net-zero emissions; nor does it align with global regulatory developments in respect of financial institutions. For example, the UK government is requiring financial institutions to have a robust firm-level transition plan setting out how they will decarbonize to net-zero emissions.[11] We recommend that principles 1 and 2 be amended as follows:

> **CCLI recommendation 1: Amend Guideline B-15 principles 1 and 2 to embed transition to net-zero emissions:**
> Principle 1: In incorporating identification and management of climate-related risks and opportunities into its business model and strategy, the FRFI must have a plan to transition to net-zero GHG emissions, with short-, medium- and long-term objectives for decarbonization with the goal of the FRFI contributing to keeping the average rise in temperature to 1.5° C above pre-industrial levels and with the FRFI adopting sound methodologies to annually measure and report progress in meeting targets and objectives. Principle 2: The FRFI should have the appropriate governance, policies, and practices in place to manage climate-related risks and to transition to net-zero GHG emissions.

OSFI's Corporate Governance Guideline[12] sets out OSFI's expectations with respect to corporate governance of FRFI, including that boards have effective oversight of the FRFI's short-term and long-term business plan and strategy. The board should be satisfied that the decisions and actions of senior management are consistent with the board-approved business plan, strategy, and risk appetite of the FRFI, and that the corresponding internal controls are sound. These guidance requirements apply to climate governance.

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[8] TCFD's *Guidance on Metrics, Targets, and Transition Plans.*
[9] Guideline B-15, note 2, Chapter 1.
[10] OSFI, Corporate Governance Guideline (2018), Corporate Governance (osfi-bsif.gc.ca).
[11] UK Government, HM treasury, "Guidance Fact Sheet: Net Zero-aligned Financial Centre" (November 2021), Fact Sheet: Net Zero-aligned Financial Centre - GOV.UK (www.gov.uk); UK Government, Policy paper, "Greening Finance: A Roadmap to Sustainable Investing" (2020), Greening Finance: A Roadmap to Sustainable Investing - GOV.UK (www.gov.uk).
[12] OSFI, Corporate Governance Guideline, note 10.

The 196 Parties to the United Nations Framework Convention on Climate Change that signed the Paris Agreement in 2015 and then updated their commitments at COP26 in 2021, including Canada, have committed to the common goal of holding the increase in the global average temperature to 1.5°C above pre-industrial levels and to work towards net-zero emissions. OSFI should be aligning its governance requirements to align with the target of achieving net-zero emissions. It is not sufficient to suggest that only FRFI that have made commitments to net zero through the Net-Zero Banking Alliance[13] or Net-Zero Insurance Alliance[14] need their transition plans to be aimed at the net-zero emissions goal.

2. RISK MANAGEMENT

CCLI supports OFI's four-prong approach to risk management, specifically risk identification, measurement, and management; risk monitoring and reporting; operational preparedness and resilience for climate-related disasters; and awareness and capabilities building. The third principle in the proposed Guideline is critically important: "*Principle 3*: The FRFI should have processes in place to adequately price climate risk-sensitive assets and liabilities and manage these exposures in accordance with the FRFI's Risk Appetite Framework."

OSFI's Corporate Governance Guideline sets out OSFI's expectations that FRFI boards have effective oversight of the FRFI's risk management, its risk appetite framework, internal control framework, and significant policies, plans, and strategic initiatives related to the management of the FRFI or that materially impact, capital, and liquidity. Here again, the board should be satisfied that the decisions and actions of senior management are consistent with the board-approved risk appetite and that the corresponding internal controls are sound.[15] These risk management duties are particularly appropriate for climate risk management.

In particular, CCLI supports the requirement that the FRFI have appropriate processes and controls to identify and measure the potential impact of climate-related risks on its portfolio of exposures, including credit, market, operational, insurance, and liquidity, over appropriate time horizons; and that the FRFI collect and use reliable, timely, and accurate climate risk data on emissions, geophysical location of exposures ,and other data relevant to its business activities to inform its risk management and decision-making.[16] The CCLI also supports the Guideline's recommendation that the FRFI implement relevant tools and models, including climate scenario analysis, to assess its climate-related risks, and where it uses third-parties tools to support its assessment, the FRFI should sufficiently understand the embedded data, methodology, and assumptions.[17]

OSFI has recognized that each FRFI should incorporate climate-related risks into its internal monitoring and reporting of risk management effectiveness, including monitoring and reporting on relevant internal metrics, limits, and indicators to assess the effectiveness of its climate risk management; and internal targets to assess the FRFI's progress in managing its physical risk and transition risks.[18] As part of their prudential obligations, FRFI should develop capabilities to identify risk concentrations by sector, product, counterparty or region and ensure that internal reporting systems can produce timely,

[13] Net-Zero Banking Alliance, Principles for Responsible Banking – United Nations Environment – Finance Initiative (unepfi.org).
[14] Net-Zero Insurance Alliance.
[15] OSFI, Corporate Governance Guideline, note 10.
[16] Guideline B-15, note 2, Chapter 1, part II.
[17] Guideline B-15, note 2, Chapter 1, part II.
[18] Guideline B-15, note 2, Chapter 1, part II.B

accurate, independent, and objective reporting on these risks to support strategic planning and risk management.

OSFI's principles 4 and 5 address operational preparedness and resilience for climate-related disasters. They recognize that the frequency and severity of acute physical events and range of transition risks require different types of preparedness, depending on the sector and markets in which the FRFI operates: "*Principle 4:* The FRFI should mitigate the impact of climate-related disasters on its critical operations. *Principle 5:* The FRFI should use climate scenario analysis to assess the impact of climate-related risk drivers on its risk profile, business strategy, and business model."

The CCLI supports Guideline B-15's requirement that the FRFI include climate scenario analysis as a part of its Stress Testing Framework,[19] including considering severe, yet plausible, climate-related disaster scenarios in its decision-making regarding operations, business continuity, and disaster recovery planning processes, and also including scenarios where the material third party could fail to continue providing service. We agree that the FRFI should use results as an input into its capital and financial planning processes; and that the FRFI consider the range of scenarios over short-, medium- and long-term time horizons where climate-related risks can materialize and drive risks. We agree that such scenarios should include both physical and transition risks and their potential interplay, and we applaud OSFI's announcement that it will develop standardized climate scenario analysis exercises to assess aggregate exposures to physical and transition risks, requiring FRFI to report their results to OSFI.

We understand that there may be resistance by some FRFI to undertake such analysis, but effective strategic planning and risk management can only occur by considering a range of potential scenarios over different time frames, given that climate risk is not in control of the FRFI or domestic governments. The phase-in schedule for all institutions, which ideally should be shortened, nonetheless offers a full response to these concerns, as it allows smaller FRFI time to develop tools and capacity as non-internationally active FRFI have a longer period over which to phase in the full complement of disclosure requirements.

3. CAPITAL AND LIQUIDITY ADEQUACY

The CCLI supports Principle 6 of Guideline B-15, specifically, that the FRFI should maintain sufficient capital and liquidity buffers for its climate-related risks. It is critically important that FRFI incorporate climate-related risks into their Internal Capital Adequacy Assessment Process (ICAAP) or Own Risk and Solvency Assessment (ORSA) process. Key is that the FRFI consider its capital requirements under severe, yet plausible, climate-related scenarios and risks that could materialize beyond the FRFI's standard capital planning horizon.[20] The CCLI supports OSFI's recommendation that the FRFI should incorporate the impact of climate-related drivers on its liquidity risk profile and integrate a range of FRFI-specific and market-wide severe, yet plausible, climate-related stress events when assessing the adequacy of its liquidity buffers.[21] In addition to expectations of what FRFI will do internally, OSFI should

[19] Aligned with Guideline E-18: *Stress Testing*, which sets out OSFI's expectations on the use of stress testing for senior management to use in making business strategy, risk management and capital management decisions.

[20] OSFI Guideline E-19: *Own Risk and Solvency Assessment* (ORSA), (2017),which sets out OSFI's expectations of an insurer's own assessment of its risks, capital needs and solvency position, and for setting Internal Targets, based on an insurer's ORSA. Guideline E-19: *Internal Capital Adequacy Process for Deposit-Taking Institutions* (ICAAP), which sets out OSFI's expectations of federally regulated deposit-taking institutions' own assessment of the adequacy of their capital.

[21] See OSFI Guideline E-18: *Stress Testing.,* note 19.

consider whether it needs to adjust its supervisory process to further enhance its prudential oversight of FRFI.

> CCLI recommendation 2: OSFI should adopt capital-based measures to protect FRFI financial soundness
> OSFI should use its supervisory capital planning process to require FRFI to hold higher capital and liquidity buffers to weather climate-related transition and management of physical and transition risks; and OSFI should consider whether to change its risk weightings to encourage FRFI to allocate capital in a manner that allows them to remain financially sound in the transition.

OSFI uses its Supervisory Framework to assess the safety and soundness of financial institutions and to identify issues/areas of concern early in order that timely corrective actions may be taken. OSFI's assessment of capital is made in the context of the nature, scope, complexity, and risk profile of an institution. The draft guideline already has the principle that FRFI should maintain sufficient capital and liquidity buffers for its climate-related risks; however, OSFI should enhance current capital requirements and proactively set a baseline for capital that recognizes and embeds capital buffers sufficient to prevent capital and liquidity deficiencies as climate-related risks grow in frequency and intensity. OSFI has a wide range of powers to assess the level and quality of capital and to intervene where the combination of the institution's overall net risk and its capital and earnings compromises the institution's resilience.[22] However, FRFI would benefit from clear requirements on climate-related capital and liquidity expectations and their investors and other stakeholders would have greater confidence in the ability of the FRFI to manage transition and prevent risks to the safety and soundness of the institution. OSFI should recalibrate its capital requirements to better capture the impact of systemic climate-related risks on the risk profile of FRFI and order enhanced capital requirements. It should be prepared to intervene early where it identifies deficiencies in a FRFI meeting these requirements.

Another issue to consider is adjust the risk weighting of assets that are carbon-intensive to recognize the growing financial risks, and/or update its risk weightings to positively value capital directed towards sustainable finance; however, any adjusted risk weighting must be fundamentally linked to OSFI's prudential mandate to protect the safety and soundness of Canada's financial system through capital and liquidity requirements and to protect the public interest by ensuring that FRFI build resilience to climate-related financial shocks.

Risk weightings under standardized Basel models do not recognize long-term risks from climate change, and there is growing discussion regarding how supervisory oversight of the capital framework may be able to mitigate climate-related risks in the financial system. The International Monetary Fund (IMF) has noted that macroprudential policy could incorporate climate-related risks though exposure or concentration limits to 'brown' sectors of the economy with elevated environmental risk, as well as by considering climate-based factors in the designation of systemically important financial institutions.[23]

OSFI should consider adjusting risk weights through a both a 'green supporting factor' that gives recognition to the need to finance transition and a 'brown negative weighting factor' that recognizes the growing financial risks of lending to carbon-intensive industries. Such an approach would enhance Basel III capital

[22] OSFI, Guide to Intervention, Guide to Intervention for Federally Regulated Deposit-Taking Institutions (osfi-bsif.gc.ca).
[23] Dimitri G. Demekas and Pierpaolo Grippa, "Financial Regulation, Climate Change, and the Transition to a Low-Carbon Economy: A Survey of the Issues", IMF Working Paper WP/21/296, (December 2021), International Monetary Fund, Washington DC.

requirements, which currently embed a lower risk weighting for short-term corporate loans (1-3 years) and a higher risk weighting to capital and liquidity requirements to longer term loans (7 years or more), the latter of which arguably serves as a barrier to FRFI financing sustainable projects going forward.[24] Although the Basel Accord does encourage banks to calculate regulatory capital for credit and operational risk exposures to borrowers in violation of environmental regulations, it merits considering whether regulatory capital risk weights should be adjusted to expressly include climate risks. Key is that any adjusted risk weighting supports the objectives of capital adequacy and liquidity requirements, specifically, the safety and soundness of the financial system.

This issue of risk weighting may require some further study before standards are set. Alexander and Lastra observe that as long as Basel capital and liquidity requirements are not relaxed for long-term projects, the financing of environmentally sustainable economic activities will remain very limited.[25] They note that the potential for a green supporting factor or a brown penalizing factor has been criticized as creating regulatory arbitrage opportunities for banks to create complex financing structures involving 'green' assets that could undermine regulatory capital objectives, and suggest that there is lack of evidence that lower capital requirements will encourage greater green lending and investment.[26] Alexander and Lastra also argue that lending to green assets may not be any less risky than implied by existing risk weights and what is more likely is that the extra risk of lending to unsustainable activities adds risk to the system overall, which suggests that 'brown' assets justify a higher risk weight, not lower risk weighting for green assets.[27] They recommend that the whole range of supervisory instruments from licensing to sanctioning and crisis management should be adapted to address environmental sustainability challenges, including internal audits, ICAAP stress tests, loan classification, and independent external audits.[28] The Bank of England has stated that Basel III provides adequate flexibility for bank supervisors to work with banks in identifying sustainability risks material to the stability of the banking sector; and that supervisors can intervene on a firm-by-firm basis if they consider a bank's assessment of capital needs inadequate.[29]

4. CLIMATE-RELATED FINANCIAL DISCLOSURES

Climate-related financial risk disclosures help OSFI meet its mandate of protecting depositors, policyholders, and creditors. Disclosure contributes to public confidence in, and resilience of, the Canadian financial system by ensuring appropriate information is publicly available to enable understanding of FRFIs' financial condition and the risks to which they are exposed. By providing all stakeholders and the public with key risk and risk management information, these disclosures can build confidence in FRFI management, and enable FRFI to attract and maintain access to capital and liquidity channels. Internationally, central banks and supervisors in the Network for Greening the Financial System are promoting a scenario-based approach to the disclosure of climate-related financial risks, recognizing that climate change could result in the next global financial crisis.[30]

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[24] K Alexander, 'Are environmental risks missing in Basel III?' (2015) 30 *Butterworths Journal of International Banking and Financial Law* 67.
[25] Kern Alexander and Rosa Lastra, "Banking regulation and Environmental Sustainability", at 22 (working paper, forthcoming 2022, cited with permission of the authors).
[26] Alexander and Lastra, note 25 at 30.
[27] Alexander and Lastra, note 25 at 25.
[28] Alexander and Lastra, note 25 at 26.
[29] Alexander and Lastra, note 25 at 23. Bank of England, Implementation of Basel standards (21 March 2022), Implementation of Basel standards | Bank of England.
[30] Bank for International Settlements, *The Green Swan,* 2020.

The CCLI supports all of the principles set out in the Guideline for disclosure and the guidance on achieving high-quality and decision-useful disclosures that enable users to understand the financial impact of climate change on FRFI. In particular, the CCLI supports the requirement to provide complete, reliable, and verifiable information specific to the potential impact of climate-related risks and opportunities on a FRFI's markets, businesses, corporate, and investment strategy, financial statements, and future cash flows; a statement explaining why a particular risk or issue is not significant, where appropriate; and information from the perspective of the potential impact of climate-related issues on value creation, considering and addressing the different time frames and types of impacts; disclose exposure to potential nature and size of climate-related impacts; the FRFI's governance, strategy, and processes for managing climate-related risks; performance with respect to managing climate-related risks and opportunities,[31] including future-oriented information on possible future financial implications, with an explanation of the definition, assumptions, and scope applied to arrive at quantitative information; and to use data that is consistent with what is used in its investment decision-making and risk management. The FRFI should explain any data limitations it faces and the impact of those data limitations on disclosure.

However, we believe that OSFI should reconsider its decision not to require climate-related disclosures to form part of financing reporting and to require independent external assurance at this time. The current draft states that the FRFI has discretion regarding the location of the disclosures. In CCLI's view, this approach is inadequate, and institutional investors have long been pointed out that disclosures in separate standalone reports suffer from lack of rigour brought to financial disclosures and leave too much room for data not being comparable year over year or company to company.

> **CCLI recommendation 3: Embed disclosure requirements in financial reporting**
> The proposed Guideline should be clearer that disclosure for climate-related risk management and transition plans must be embedded in financial reporting and subject to officer certification and independent third-party assurance.

The FRFI should report information that is clearly defined, collected, recorded, and analyzed in such a way that the information reported is verifiable to ensure it is high quality. Any scenario analyses should be based on data used by the FRFI for investment decision-making and risk management. The CCLI supports principles 3 to 6 under the disclosure chapter that the FRFI should disclose clear, balanced, and understandable information;[32] the FRFI should disclose reliable, verifiable, and objective information;[33] the FRFI should present disclosures that communicate financial information that serves the needs of a range of users, with appropriate balance between qualitative and quantitative information; give fair and balanced narrative explanations that provide insight into the meaning of quantitative disclosures, including the changes over time; and straightforward explanations of issues in its disclosures;[34] the FRFI should disclose information appropriate for its size, nature, and complexity;[35] and the FRFI should disclose information consistently over time to enable users to understand the development and/or evolution of the impact of climate-related issues on the FRFI's business and allow for inter-period comparisons.[36] To the extent possible, the FRFI should base its disclosures on objective data and use best-in-class measurement methodologies. The CCLI also supports use of the GHG

[31] Guideline B-15, note 2, Chapter 2.
[32] Guideline B-15, note 2, Chapter 2, Principle 3.
[33] Guideline B-15, note 2, Chapter 2, Principle 4.
[34] Guideline B-15, note 2, Chapter 2, Principle 3, paragraphs 15 and 16.
[35] Guideline B-15, note 2, Chapter 2, Principle 5.
[36] Guideline B-15, note 2, Principle 6, paragraph 23.

Protocol[37] and regarding calculation and disclosure of the portion of Scope 3 GHG emissions associated with the FRFI's loans and investments, the FRFI are expected to use the Partnership for Carbon Accounting Financials' (PCAF's) Global GHG Accounting and Reporting Standard for the Financial Industry.[38]

The CCLI supports OSFI's requirement for disclosure of climate-related information under the TCFD pillars; specifically that all categories of FRFI must describe:

> *Governance:* the board of directors' oversight of climate-related risks and opportunities, and describe management's role in assessing and managing climate-related risks and opportunities.
>
> *Strategy:* all FRFI must describe the climate-related risks and opportunities the FRFI has identified over the short, medium, and long term; and describe their impact on the FRFI's businesses, strategy, and financial planning.
>
> *Risk Management:* all FRFI are to describe the FRFI's processes for identifying and assessing climate-related risks; processes for managing climate-related risks; and for identifying, assessing, and managing climate-related risks are integrated into the FRFI's overall risk management.
>
> *Metrics and Targets:* Depending on the type of FRFI, they are required to disclose the metrics used by the FRFI to assess climate-related risks and opportunities in line with its strategy and risk management process and to describe the targets used by the FRFI to manage climate-related risks and opportunities and the issuer's performance against these targets applies to D-SIB,[39] Category 1 SMSB,[40] and Internationally Active Insurance Groups (IAIG) headquartered in Canada.[41] These requirements do not apply to category 2 or 3 SMSB or all other federally-regulated insurers other then IAIG headquartered in Canada.[42]

The CCLI applauds the requirement that all FRFI will be required to disclose their Scope 1 and Scope 2 GHG emissions and the related risks,[43] and that D-SIB, Category 1 SMSB, and IAIG headquartered in Canada are required to disclose the FRFI's Scope 3 GHG emissions and the related risks; the reporting standard used by the FRFI to calculate and disclose the Scope 1, 2, and 3 emissions; and if the reporting standard referred is not the GHG Protocol, disclose how the reporting standard used by the FRFI is

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[37] Greenhouse Gas Protocol, GHG Protocol.
[38] Global GHG Accounting and Reporting Standard for the Financial Industry (the PCAF Standard).
[39] OSFI identifies domestic systemically important banks (D-SIB) as Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, National Bank of Canada, Royal Bank of Canada, and Toronto-Dominion Bank. Guideline B-15, note 2, Annex 2-2 - Minimum Climate-Related Financial Risk Disclosure Expectations, by FRFI Category.
[40] SMSB Category (i.e. Category 1, 2 or 3) as defined in OSFI's SMSB Capital and Liquidity Requirements Guideline.
[41] Internationally Active Insurance Groups (IAIG) headquartered in Canada refers to Sun Life Assurance Company of Canada, Manufacturers Life Insurance Company, Canada Life Assurance Company, and Intact Financial Corporation. Guideline B-15, Annex 2-2 - Minimum Climate-Related Financial Risk Disclosure Expectations, by FRFI Category (hereafter Guideline B-15, Annex 2-2).
[42] OSFI notes that the term federally-regulated insurer includes life insurers and property and casualty insurers (P&C), domestic insurance companies and foreign insurance companies in respect of their insurance business in Canada, registered reinsurers, and fraternal benefit societies, Guideline A - Life Insurance Capital Adequacy Test and the P&C-1 Annual Return Instructions and include federally approved provincial / territorial reinsurers. Category 1, 2 or 3 SMSB are defined in OSFI's SMSB Capital and Liquidity Requirements Guideline.
[43] Guideline B-15, note 2, Annex 2-2.

comparable with the GHG Protocol.[44] By 2027, Category 2 and 3 banks and other federally-regulated insurers will be required to disclose Scope 3 GHG emissions and all FRFI will be required to disclose physical and transition risk scenario analysis.

We understand why the disclosure of Scope 3 emissions requirement does not apply to smaller entities in the first round, but see no reason why these entities do not have to disclose the reporting standard used to disclose their Scope 1 and 2 emissions and to disclose how the reporting standard used is comparable to the GHG Protocol if it is not being used. Therefore, the CCLI recommends that OSFI require transparency in how emissions targets and reductions are being calculated. We believe that 2026 is a more responsive timeframe to require such disclosures, given the rapidly closing window on shifting the trajectory of global warming.

> **CCLI recommendation 4: Require all FRFI to disclose the reporting standards used**
> All FRFI should be required to disclose the reporting standard used to disclose their emissions and to establish that the reporting standard used is comparable to the GHG Protocol and the Partnership for Carbon Accounting Financials' (PCAF) Global GHG Accounting and Reporting Standard if they are not being used.

The CCLI also applauds the requirement for D-SIB, Category 1 SMSB, and IAIG headquartered in Canada being required to disclose ISSB Cross-Industry Metrics,[45] including the amount and percentage of assets or business activities vulnerable to physical risks and transition risks; and the proportion of revenue, assets or other business activities aligned with climate-related opportunities, expressed as an amount or as a percentage.[46]

By 2025, all FRFI will be required to disclose Incremental ISSB Cross-Industry Metrics, specifically, capital deployment: the amount of capital expenditure, financing or investment deployed toward climate-related risks and opportunities; internal carbon prices: the price per metric tonne of GHG emissions used internally by an entity, including how the entity is applying the carbon price in decision-making (for example, investment decisions, transfer pricing, and scenario analysis), expressed in Canadian dollars per metric tonne of CO_2 equivalent; and remuneration: the proportion of executive management remuneration affected by climate-related considerations in the current period, expressed in a percentage, weighting, description, or amount in Canadian dollars.[47]

By 2026, banks and insurance companies will be required to disclose ISSB Industry-Specific Metrics (Banks)[48] and (Insurers)[49] limited to climate-related risks; specifically, commercial, industrial, and residential credit exposure to climate risks, by industry, and description of approach to incorporation of climate risk factors in credit analysis.[50] Also by 2026, issuers will be required to disclose limited to climate-related risks, specifically, for Investment Management: total invested assets, by industry and asset class, and a description of approach to incorporation of climate risk factors in investment management processes and

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[44] Guideline B-15, note 2, Annex 2-2.
[45] International Sustainability Standards Board's (ISSB) Exposure Draft on Climate Related Disclosures.
[46] Guideline B-15, note 2, Annex 2-2.
[47] Guideline B-15, note 2, Annex 2-3 Conceptual Roadmap to Full Complement of OSFI Climate-Related Financial Risk Disclosure Expectations.
[48] ISSB Industry-Specific Metrics (Banks).
[49] ISSB Industry-Specific Metrics (Insurers).
[50] Guideline B-15, note 2, Annex 2-3 Conceptual Roadmap to Full Complement of OSFI Climate-Related Financial Risk Disclosure Expectations.

strategies; and in respect of Climate Risk Exposure: probable maximum loss (PML) of insured products from weather-related natural catastrophes, the total amount of monetary losses attributable to insurance payouts from modeled natural catastrophes and non-modeled natural catastrophes, by type of event and geographic segment (net and gross of reinsurance), and a description of approach to incorporation of environmental risks into (1) the underwriting process for individual contracts and (2) the management of firm-level risks and capital adequacy; and in respect of policies designed to incentivize responsible behavior: net premiums written related to energy and net premiums written related to energy efficiency and low carbon technology.

5. DIRECTOR EDUCATION

The experience of the CCLI and its 67 Canadian Climate Governance Experts across Canada, as well as some of CCLI's affiliated institutional investors, is that the boards of FRFI still do not have sufficient expertise to effectively oversee climate risk management and the transition to a net-zero emissions economy. OSFI should support implementation of Guideline B-15 by creating expectations for board education that will help achieve effective implementation of the guideline.

Some boards of FRFI view climate change as purely a shareholder issue, given the growing number of shareholder proposals at annual meetings. Not only is climate change a systemic financial risk that has been recognized by scientists, governments, central banks, and appellate courts, this narrow shareholder view runs contrary to both statutory and common law in respect of the scope of directors' duties in Canada. The constating legislation of FRFI states that directors are to act honestly and in good faith with a view to the best interests of the FRFI, and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.[51] The clear direction by the Supreme Court of Canada is that in fulfilling these duties, directors are to have regard to all relevant considerations, and that where conflict arises between the interests of various stakeholders, it falls to the directors to resolve them in accordance with their fiduciary duty to act in the best interests of the corporation viewed as a "good corporate citizen".[52] Directors acting in the best interests of the company, includes, but is not confined to, considering the need to treat affected stakeholders in a fair manner, commensurate with the corporation's duties as a responsible corporate citizen.[53]

> **CCLI recommendation 5: FRFI board of directors education must be enhanced**
> OSFI should support considerably more education of boards of directors of FRFI in respect of meeting their climate governance obligations and the requirements of proposed Guideline B-15; and OSFI should require FRFI to demonstrate that the board is actively and competently identifying, overseeing, and managing climate-related risks and the capital and liquidity needed to transition to a net-zero economy.

In its oversight of capital of FRFI, OSFI already assesses the extent to which the board provides oversight, advice and guidance to senior management with respect to management of capital and liquidity; and assesses the extent to which board approval is required for significant policies, plans and strategic initiatives related to the management of, or that materially impact, capital and liquidity.[54] This assessment must

[51] See, for example, Section 158(1), *Bank Act* SC 1991, c 46, as amended 2022.
[52] *BCE Inc v 1976 Debentureholders*, [2008] 3 SCR 560 (SCC) at paras 36–8 (hereafter *BCE*). See also *Peoples Department Stores Inc (Trustee of) v Wise,* [2004] 3 SCR 461 (SCC) at 491.
[53] *BCE*, note 52 at para 82.
[54] OSFI, "Capital", Capital (osfi-bsif.gc.ca).

include assessment of climate governance and boards should be providing evidence of their competence in effectively overseeing implementation of Guideline B-15.

Given OSFI's important role in supervising FRFI, it could provide many more opportunities for the boards of FRFI to upskill in respect of all aspects of climate-related governance, strategic planning, and risk management. There are a growing number of programs designed to support directors in developing their climate governance capacity, including *pro bono* programs that provide helpful guidance to boards in meeting changing regulatory requirements and designing effective climate governance mechanisms.[55] OSFI could work with FRFI and institutional investors and other external stakeholder groups to facilitate knowledge sharing and effective governance best practices.

Thank you for the opportunity to communicate our views and congratulations again on a very important guideline. Please do not hesitate to contact CCLI if we can be of further assistance.

Sincerely,
on behalf of the Canada Climate Law Initiative

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[55] For example, CCLI's 15 affiliated research scholars from universities across Canada and 67 Canadian Climate Governance Experts have made presentations to more than 100 corporate and pension boards in Canada on effective climate governance and disclosure.