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

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Re: Policy Submission on Strengthening the Climate Resilience and Sustainability of the Ontario Financial Services Sector

The Financial Services Regulatory Authority of Ontario (FSRAO) has a vitally important role in supervising the integrity of the financial system. FSRAO's objectives, pursuant to the *Financial Services Regulatory Authority of Ontario Act,* include a mandate to supervise the regulated sectors; to protect the rights and interests of consumers and contribute to public confidence; to promote transparency in disclosure of information and high standards of business conduct; and to foster strong, sustainable, competitive, and innovative financial services sectors.[1]

The Canada Climate Law Initiative (CCLI) is making this submission to request that FSRAO develop specific guidelines on management of climate-related risks for entities in the sectors it supervises. The CCLI submits that seven key recommendations have the potential to significantly enhance Ontario's oversight of financial services and fill some significant gaps that currently exist, clarifying existing standards as they apply to climate-related risks. Ontario faces growing, significant exposure to climate-related impacts, including increasing frequency and severity of flooding, heat waves, wildfires, and winter storms, and the resultant economic and financial harms.[2] Guidance to help entities under FSRAO's supervision become financially resilient to the impacts of climate change is critically important.

FSRAO's role in the safety and soundness of Canada's financial system is pivotal as it supervises entities with almost a trillion dollars of assets under management.[3] FSRAO supervises 58 credit unions in Ontario that are diverse in size, but collectively comprise 1.76 million members and $93

[1] *Financial Services Regulatory Authority of Ontario Act,* 2016, SO 2016, c 37, Sched 8, as amended, ss 3(1) and 3(2).
[2] Intergovernmental Panel on Climate Change (IPCC), *Climate Change 2023: Synthesis Report* (20 March 2023), IPCC_AR6_SYR_SPM.pdf; IPCC, *Sixth Assessment Report from the Intergovernmental Panel on Climate Change* (2021), IPCC_AR6_WGI_SPM_final.pdf; UNEP, *UNEP Emissions Gap Report* 2023 (20 November 2023), EGR2023.pdf (unep.org).
[3] FSRAO, Annual Business Plan 2024-27, (14 February 2024) at 21, Annual Business Plan 2024-27 (fsrao.ca).

billion in assets.[4] FSRAO licenses and supervises the conduct of 215 property and casualty (P&C) insurance companies, more than 12,000 agents and adjusters, and prudentially supervises 51 Ontario-incorporated insurance companies and reciprocals.[5] FSRAO licenses 93 life and health insurance companies, over 6,000 life insurance corporate and partnership agents, and over 57,000 individual life insurance agents.[6] Protection of depositors and policyholders includes ensuring that the prudential supervisor is providing baseline guidance on the climate-related financial risk management of these financial institutions.

FSRAO also regulates and supervises approximately 4,500 pension plans registered in Ontario, which are investing $871 billion of assets and providing pension benefits and retirement security to nearly 4.4 million members. Defined benefit pension plans under FSRAO's supervision have assets of approximately $838 billion; and defined contribution pension plans have $33 billion in assets.[7] As Canada's largest pension regulator, FSRAO can play a leadership role in protecting pension plan members and beneficiaries.

Given the importance of these financial institutions to both the provincial and national economies, it is critically important that FSRAO's guidance and supervision encourage investment in projects, activities, and sectors that will support the transition to a sustainable economy. The CCLI believes our recommendations will effectively amplify Ontario's protection of the safety and soundness of the financial system by offering guidance to Ontario-regulated financial institutions on managing climate-related financial risks and building financial resilience in the transition to a decarbonized economy.

The CCLI is a collaboration of the law faculties at the University of British Columbia and York University that analyses the legal obligations of corporate directors, pension fiduciaries, and asset managers to manage and report on climate-related financial risks and opportunities. It publishes guidance on effective climate governance, working closely with legal and accounting professionals and policymakers.[8] We have 15 affiliated research scholars from across Canada and more than 70 Climate Governance Experts, including in the financial services sector, who donate their time to help boards meet their climate governance obligations.

Our seven recommendations:

1. FSRAO should adopt a guideline on climate financial risk management for Ontario-regulated financial institutions aligned with the federal Office of the Superintendent of Financial Services (OSFI) Guideline B-15 Climate Risk Management.[9]

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[4] FSRAO, Annual Business Plan 2024-27, note 3.
[5] FSRAO, Annual Business Plan 2024-27, note 3 at 21,
[6] FSRAO, Annual Business Plan 2024-27, note 3 at 23,
[7] FSRAO, Annual Business Plan 2024-27, note 3 at 24-25.
[8] See for example, in financial services, Helen Tooze, *Canadian Credit Unions and Effective Climate Governance Cooperating for a Sustainable Future* (CCLI and Canadian Credit Union Association, 2023) (*Canadian Credit Unions*); Janis Sarra and Norie Campbell, *Banking on a Net-Zero Future: Effective Climate Governance for Canadian Banks* (CCLI 2022); Janis Sarra, *Life, Health, Property, Casualty: Canadian Insurance Company Directors and Effective Climate Governance* (CCLI 2021) (*Life, Health, Property, Casualty*); Janis Sarra, Roopa Davé, Meghan Harris-Ngae, and Ravipal Bains, *Audit Committees and Effective Climate Governance, A Guide for Boards of Directors* (CCLI, 2020).
[9] Office of the Superintendent of Financial Services, OSFI Guideline B-15 Climate Risk Management (March 2023), Climate Risk Management - Office of the Superintendent of Financial Institutions (osfi-bsif.gc.ca); updated 20 March 2024, to align Annex 2-2 align with the International Sustainability Standards Board's final IFRS S2 Climate-related Disclosures standard.

2. Disclosure required by FSRAO in respect of its regulated entities should align, to the extent possible, with the International Financial Reporting Standards (IFRS) Foundation International Sustainability Standards Board (ISSB) sustainability standard IFRS S2 Climate-related Disclosures and proposed Canadian Sustainability Disclosure Standard (CSDS) CSDS 2 Climate-related Disclosures.[10]

3. FSRAO should recognize climate-related risk as a transverse risk in its overall risk rating of Ontario-regulated financial institutions.

4. FSRAO should consider issuing market conduct rules in climate risk management guidance, similar to Québec's l'Autorité des marchés financiers (AMF) proposed Climate Risk Management Guideline.[11]

5. FSRAO should extend requirements under a climate financial risk management guideline to Ontario-regulated pension funds and their investment managers, including guidance for small pension plans as to how they can best meet their fiduciary duties in respect of climate change in their oversight of, and service agreements with, investment managers.

6. FSRAO should consider a time-limited safe harbour for duly diligent directors, trustees, and other fiduciaries in respect of meeting Scope 3 emissions targets, while maintaining the flexibility of FSRAO's prudential supervisory authority.

7. FSRAO should support the Sustainable Finance Action Council's (SFAC) Green and Transition Finance Roadmap and co-operate as a member of the proposed governmental stakeholder advisory group in advising the Taxonomy Council on developing the Green and Transition Finance Taxonomy.

The CCLI's detailed rationale for these recommendations is discussed below.

Recommendation 1:

FSRAO should adopt a guideline on climate financial risk management for Ontario-regulated financial institutions aligned with the federal Office of the Superintendent of Financial Services (OSFI) Guideline B-15 Climate Risk Management.[12]

A significant gap in oversight of Ontario-regulated financial institutions is specific guidance on expectations in respect of the management of climate-related risk. CCLI appreciates that FSRAO has proposed guidance on operational risks and resilience for Ontario-incorporated insurance companies, which has not yet been finalized or issued, including reference to environmental, social

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[10] IFRS S2, Sustainability Disclosure Standard, Climate-related Disclosures (June 2023, in force effective 1 January 2024) (IFRS S2 Climate-related Disclosures) and IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* (IFRS S1)((June 2023, in force effective 1 January 2024) (IFRS S1). The provisions in IFRS S1 apply broadly to all sustainability-related financial disclosures, including climate-related disclosures; IFRS S1.21. Canadian Sustainability Standards Board (CSSB), CSSB Exposure Draft – Proposed Canadian Sustainability Disclosure Standard (CSDS) 2, Climate-related Disclosures and CSSB Exposure Draft – Proposed Canadian Sustainability Disclosure Standard (CSDS) 1, General Requirements for Disclosure of Sustainability-related Financial Information (CSDS 2, CSDS 1).

[11] L'Autorité des marchés financiers, Climate Risk Management Guideline (November 2023), Draft Climate Risk Management Guideline (lautorite.qc.ca); AMF, Ligne directrice sur la gestion des risques liés aux changements climatiques (AMF, 2023).

[12] OSFI, "Guideline B-15 Climate Risk Management", note 9.

and governance (ESG) risk management.[13] While ESG is important, climate-related financial risks are urgent and immediate and need specific guidance. CCLI also appreciates that FSRAO has acknowledged that climate change has the potential to significantly impact the safety and soundness of the financial system and the entities it supervises.[14] As FSRAO has recognized:

> Physical and transition risks can also lead to liability risks, such as the risk of climate-related claims under liability policies, as well as litigation and direct actions against financial institutions for failing to manage their climate-related risks. They can drive financial risks, such as credit, market, insurance, and liquidity risks for Insurers. They can also lead to strategic, operational, and reputational risks. In severe instances, climate-related risks can threaten the long-term viability of an Insurer's business model and the stability of the sector.[15]

The importance of these risks is exactly why there is need for a guideline on climate risk management for Ontario-regulated financial institutions. Liability risk increases when directors and officers have to guess at specific steps and considerations that should underpin effective climate governance. This lack of a baseline can, in itself, create further litigation risk.

On the liabilities side of the balance sheet, P&C insurers are particularly exposed to physical risks through insurable catastrophic events resulting in increased claims for loss of property.[16] P&C insurers can model and appropriately price evolving risks because non-life insurance is renewed annually; however, over the long term, non-linear and unexpected large increases in claims may result in pricing/liability mismatches, and while P&C insurers and reinsurers benefit from a short-tail liability pattern, they need to be cognizant of risks to insurability and the viability of their business model over the longer-term horizon of 2030 to 2050.[17]

For life and health insurance companies, the most immediate climate-related risk is on the asset management side, in that such insurers are large investors with portfolios increasingly at risk due to climate-related regulatory risks, market risks, technological changes, and increasingly, reputational risks. Many life and health insurers have not yet embedded climate risk in their core business planning and financial reporting.[18] Life and health insurers invest in long-term assets that are aimed at ensuring that they have the capital available to meet long-term obligations to policyholders of the products they offer. Life insurance contracts involve payout patterns of 10 to 30 years, life insurers generally aiming to generate predictable and stable income to match cash flows of long-dated liabilities under life insurance contracts' lengthy duration periods.[19] Key to

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[13] FSRAO, Proposed Guidance: Operational Risk and Resilience for Ontario-incorporated Insurance Companies and Reciprocal Insurance Exchanges, Effective Date: [TBD] Identifier: No. PC0050INT (17 April 2024), Proposed Guidance: Operational Risk and Resilience for Ontario-incorporated Insurance Companies and Reciprocal Insurance Exchanges (fsrao.ca) (FSRAO, Proposed Guidance Insurers); Risk Based Supervisory Framework for Ontario-incorporated Insurance Companies and Reciprocals, which articulates FSRAO's supervisory approach for all Insurers, as well as the practices and processes for determining an Insurer's Overall Risk Rating (ORR), intervention level and level of FSRAO's supervisory activity under the *Insurance Act* , Regulations, and FSRAO Rules and Guidance; Minimum Capital Test Guideline for Property and Casualty Insurance Companies and Reciprocals - January 2023 **(**MCT Guideline**).**

[14] FSRAO, Proposed Guidance Insurers, note 13, at 11-12.

[15] FSRAO, Proposed Guidance Insurers, note 13, at 19.

[16] *Life, Health, Property, Casualty,* note 8 at 21-22.

[17] *Life, Health, Property, Casualty,* note 8 at 25.

[18] *Life, Health, Property, Casualty,*, note 8 at 40.

[19] *Life, Health, Property, Casualty,*, note 8 at 45-46.

sustainability is making climate-related risk a core business issue, building financial resilience to climate impacts and supporting the transition to a decarbonized sustainable economy.

Credit unions, particularly smaller credit unions, have always been exposed to concentration risk due to their close connection to local communities, risk that is now exacerbated by the impacts of climate change. Flooding, winter storms, and other acute climate-related events are causing damage to homes and industries, and Ontario credit unions cannot easily rely on a broader network across Canada or the province to offset the losses within a specific community.[20] Risks also include physical damage to credit union property and infrastructure, disrupting the credit union's ability to serve the community. Damage to collateral tied to existing debts can diminish its value and viability, thereby hindering the credit union's ability to enforce liens and cover unpaid debts, increasing risk within a credit union's portfolio.[21] Credit union boards face a delicate balance when deciding on capital allocation in respect of investing in projects that reduce emissions and address climate risks and the speed and extent to which they can shift funding from high carbon-emitting industries that are currently important to their local members, but are likely to result in stranded assets.[22]

Adopting a guideline on climate financial risk management for Ontario-regulated financial institutions would help create a baseline of expectations for financial institutions on managing climate risks, aligned with the Canadian Sustainability Standards Board (CSSB) proposed Canadian Sustainability Disclosure Standard 2 Climate-related Disclosures (CSDS 2).[23] It would directly support FSRAO’s core mandate to protect consumers and the stability of the financial system.

Climate-related financial risk has been recognized globally as a threat to the financial stability of financial institutions.[24] Although FSRAO states that it is progressing on risk-based supervision, promoting effective governance and risk management, and is closely monitoring the financial soundness of entities in its regulated sectors through its supervisory efforts,[25] the absence of clear standards in respect of climate-related risks is a significant gap that may impair the sustainability of regulated entities.

Part of FSRAO’s mandate is to cooperate and collaborate with other regulators where appropriate.[26] CCLI’s view is that OSFI’s Guideline B-15 Climate Risk Management offers insightful guidance to financial institutions in their efforts to manage climate-related financial risks and opportunities and to ensure that they are sustainable over the longer term. OSFI’s Guideline B-15 aligns with the framework recommended by the Financial Stability Board’s Taskforce on Climate-related Financial Disclosures (TCFD)[27] and the IFRS International Sustainability Standards Board (ISSB) S2 Climate-related Disclosures.[28] FSRAO’s adoption of a guideline aligning with Guideline B-15 will ensure Ontario keeps pace with regulatory developments for financial institutions both

[20] *Canadian Credit Unions,* note 8 at 11.
[21] *Canadian Credit Unions,* note 8 at 11.
[22] *Canadian Credit Unions,* note 8 at 19-20.
[23] OSFI B-15 Guideline, note 9; CSDS 2, note 10.
[24] World Economic Forum, Risk Report 2024 (10 January 2024), WEF_The_Global_Risks_Report_2024.pdf (weforum.org); United Nations Environmental Programme Finance Initiative (UNEP FI) (2020) Climate Risk Applications: Guidance and Practices – United Nations Environment – Finance Initiative (unepfi.org); OSFI, Navigating Uncertainty in Climate Change Promoting Preparedness and Resilience to Climate-Related Risks (2021), Navigating Uncertainty in Climate Change - Promoting Preparedness and Resilience to Climate-Related Risks (osfi-bsif.gc.ca)
[25] FSRAO, Annual Business Plan 2024-27, note 3 at 51.
[26] *Financial Services Regulatory Authority of Ontario Act,* 2016, SO 2016, c 37, Sched 8, as amended, ss 3(1) and 3(2).
[27] Financial Stability Board’s Task Force on Climate-Related Financial Disclosure (TCFD) Framework.
[28] IFRS S2 Climate-related Disclosures, note 10.

domestically and globally. The embedding of oversight and management of climate-related risks and opportunities in governance, strategic planning, risk management, targets, and metrics will reduce risks of credit union or other financial institution failure from the growing frequency and intensity of acute events and the longer-term risks of chronic impacts.

The sustainability of Ontario financial institutions is critically important because many Ontario residents place their savings in the hands of credit unions. For the life and health insurance sector, there are approximately $33.6 billion in direct written premiums for life and health insurance and wealth products like segregated funds and annuities.[29] Many of these policyholders cannot manage the climate risks of their own life and health policies in that, if their insurer becomes insolvent or financially distressed due to failure to effectively manage climate risks, they are unable to transfer life and health policies as they have aged or face health issues and have become uninsurable or are insurable at a cost beyond their financial means. It is a further reason that insurers need to effectively manage climate-related financial risks — to protect policyholders' continued life and health protection. Credit unions and insurers need to remain competitive in the Canadian market, and Ontario-regulated financial institutions should offer the same level of protection as consumers receive with OSFI's Guideline B-15.

We submit that FSRAO should adopt the five principles in Guideline B-15 to align the safety and soundness of the financial services sector, specifically:

> Principle 1: The financial institution should have the appropriate governance and accountability structure in place to manage climate-related risks; should disclose the board of directors' oversight of, and management's responsibility for, assessing and managing climate-related risks and opportunities.
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> Principle 2: The financial institution should develop and implement a "climate transition plan" incorporating climate risk management in its business plan and strategy to guide its actions to manage physical and transition risks from climate change and identify and understand the impact of climate-related risks on its short-term and long-term strategic, capital, and financial plans.
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> Principle 3: The financial institution should manage and mitigate climate-related risks in accordance with its risk appetite framework and enterprise risk management framework, monitoring and reporting relevant internal metrics, limits, and indicators to assess the effectiveness of its climate risk management.[30]
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> Principle 4: The financial institution should use climate scenario analysis to assess the impact of climate-related risks on its risk profile, business strategy, and business model.
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> Principle 5: The financial institution should maintain sufficient capital and liquidity buffers for its climate-related risks, incorporating climate-related risks into its internal capital adequacy assessment process.[31]

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[29] FSRAO, Annual Business Plan 2024-27, note 3 at 23.
[30] Guideline B-15, note 9 at 5-6.
[31] Life Insurance Capital Adequacy Test (2024); Capital Adequacy Requirements (CAR) (2024).

These principles offer meaningful guidance on how an Ontario-regulated financial institution can begin to ensure its longer-term sustainability in the face of climate-related challenges. It would also provide FSRAO with the information required to supervise financial institutions and intervene in a timely matter where there are risks to capital adequacy or liquidity.

FSRAO's guidance should require financial institutions to implement relevant tools to measure and assess their climate-related risks; and they should incorporate climate-related risks into their internal monitoring and reporting of business performance and risk management effectiveness. It is important that the financial institution monitor and report on relevant internal metrics, limits, and indicators to assess the effectiveness of its climate risk management; manage its portfolio of exposures (e.g., credit, market, operational, insurance, and liquidity) over appropriate time horizons; and have internal targets to assess progress in managing its physical risk exposures and risks associated with the transition towards a low-greenhouse gas (GHG) emissions economy, consistent with its climate transition plan.[32]

The CCLI submits that FSRAO should adopt OSFI's three expected outcomes, specifically, that Ontario-regulated financial institutions understand and mitigate against potential impacts of climate-related risks to their business model and strategy; should have appropriate governance and risk management practices to manage identified climate-related risks and opportunities; and that they remain financially resilient through severe, yet plausible, climate risk scenarios, and operationally resilient through disruption due to climate-related disasters.[33] The guideline should be clear that disclosure of climate-related risk management and transition plans must be embedded in financial reporting and subject to officer certification and independent third-party assurance. The financial institution should report information that is clearly defined, collected, and understandable.

FSRAO's guidance could also be informed by the AMF's proposed Climate Risk Management Guideline in terms of setting expectations for public disclosure of governance and integrated risk management. Climate-related financial disclosures contribute to public confidence in the financial system and enable consumers, depositors, policyholders, and others to understand the risks that the financial institution is exposed to, in turn, building confidence in financial institutions.[34] Disclosure should be pegged to what is appropriate for the financial institution's size, nature, and complexity.

The AMF Guideline recommends five principles for effective disclosure of climate risks, including that the financial institution should provide relevant, comprehensive information specific to the impact of climate-related risks and opportunities on such things as its markets, businesses, strategy and financial statements; the information should be clear, balanced, consistent, and understandable for the general public and sufficiently granular to inform more sophisticated stakeholders; disclosure should include reliable, verifiable, and objective information appropriate for the institution's size, nature, and complexity; and the level of detail of disclosure must be proportional to the financial institution's size compared to other participants in its market, the complexity of its operations, and its systemic importance.

[32] Guideline B-15, note 9 at 7.
[33] Guideline B-15, note 9 at 2.
[34] L'Autorité des marchés financiers, proposed Climate Risk Management Guideline, note 11 at 12.

Recommendation 2:

> **Disclosure required by FSRAO in respect of its regulated entities should align, to the extent possible, with the International Financial Reporting Standards (IFRS) Foundation International Sustainability Standards Board (ISSB) sustainability standard IFRS S2 Climate-related Disclosures and proposed Canadian Sustainability Disclosure Standard (CSDS) CSDS 2 Climate-related Disclosures.**

Disclosure required by FSRAO in respect of its regulated entities should align, to the extent possible, with the IFRS S2 Climate-related Disclosures (IFRS S2) and proposed CSDS 2 Climate-related Disclosures (CSDS 2).[35] IFRS S2 represents the most universally-accepted provisions for climate-related financial disclosure globally, based on the TCFD framework and enhancing existing IFRS accounting standards.[36]

FSRAO's Business Plan 2024-27 highlights the importance of the need to promote transparency in the disclosure of information by the regulated sectors; deter deceptive or fraudulent conduct and activities by the regulated sectors; protect the rights and interests of consumers; foster strong, sustainable financial services; promote good administration of pension plans; and protect and safeguard the pension benefits and rights of pension plan beneficiaries.[37] Requiring meaningful disclosure of climate-related risks and opportunities is essential to meeting these objectives. FSRAO's business plan states that it is currently monitoring how regulated entities have been exploring the use of ESG factors in how they assess their approach to risk and investing.[38] While all ESG factors may be significant, understanding and managing climate-related risks is an urgent imperative, given the existential threat to the planet, to humanity, and to our financial system.

The adoption of key requirements of IFRS S2 will facilitate a "level playing field" for Ontario-regulated financial institutions through comparable and consistent disclosure, and reduce the costs associated with reporting to multiple disclosure frameworks. Modern economies, including Canada's, rely on the flow of international capital; more than a third of all financial transactions occur across borders and that number is growing.[39] The IFRS standards provide high-quality, internationally recognized, accounting standards that bring transparency, accountability, and efficiency to financial markets.[40] A clear framework will reduce the risk of capital flowing out of Canada to jurisdictions where the rules are clear. IFRS S2 builds on and enhances the TCFD pillars of governance, strategy, risk management, and metrics and targets. It identifies and offers disclosure guidance on key aspects of managing climate-related physical and transition risks and allows for proportionality in reporting of information based on the size and complexity of entities. As you are aware, the CSSB proposed standards mirror IFRS S2, with an adjustment for the timing of implementation and transition.

By expressly incorporating the new standards into a guideline, FSRAO would be acknowledging the need for proportional treatment of different sizes and capacities of different financial institutions.

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[35] IFRS S2 Climate-related Disclosures, note 10. The provisions in IFRS S1 apply broadly to all sustainability-related financial disclosures, including climate-related disclosures; IFRS S1.21.

[36] Taskforce on Climate-related Financial Disclosures (TCFD), *Task Force on Climate-related Financial Disclosures Guidance on Metrics, Targets, and Transition Plans* (October 2021), at 38-45, 2021-Metrics_Targets_Guidance-1.pdf (bbhub.io).

[37] FSRAO, Annual Business Plan 2024-27, note 3 at 6-8.

[38] FSRAO, Annual Business Plan 2024-27, note 3 at 17.

[39] Financial Stability Board, *Progress Report on Climate-related Disclosures: 2023 Report* (October 2023), at 4, Progress Report on Climate-related Disclosures: 2023 Report - Financial Stability Board (fsb.org) (FSB).

[40] FSB, note 39.

Both IFRS S2 and proposed CSDS 2 build in a proportionality test, which protects smaller companies in their efforts to effectively manage and disclose. They state that in preparing disclosures about the anticipated financial effects of a climate-related risk or opportunity, an entity shall use all reasonable and supportable information that is available to it at the reporting date without undue cost or effort; and use an approach that is commensurate with the skills, capabilities, and resources that are available to the entity for preparing those disclosures.[41] Another proportional provision is that an entity "need not provide quantitative information about the anticipated financial effects of a climate-related risk or opportunity if the entity does not have the skills, capabilities or resources to provide that quantitative information".[42] These provisions allow a tailoring of climate risk management disclosure to the size and capacity of the particular insurance company or credit union.

As of January 2024, the IFRS Foundation reports that 24 regulators/standard setters have signed the declaration of support for IFRS S2, including 19 individual countries and three supranational bodies, comprising disclosure authorities in 63 countries.[43] For example, the United Kingdom (UK) government has stated its support for the IFRS Sustainability Disclosure Standards; the Australian government is in the process of implementing mandatory climate disclosures in annual financial statements based on IFRS S2; the Sustainability Standards Board of Japan has issued exposure drafts of IFRS sustainability disclosure standards; and Singapore is consulting on the introduction of IFRS sustainability-related disclosures.[44] The IFRS Foundation reports that in Canada, 33 organizations headquartered in Canada and 13 multinational organizations with subsidiaries headquartered in Canada have endorsed IFRS S2.

Recommendation 3:

> **FSRAO should recognize climate-related risk as a transverse risk in its overall risk rating of Ontario-regulated financial institutions.**

FSRAO has acknowledged international and domestic efforts at the sustainability of financial institutions and has encouraged insurers "to continue progress towards further incorporation of ESG goals and climate risk management into their corporate strategies and business activities".[45] While CCLI applauds its consideration of integrating ESG goals into its regulatory and supervisory frameworks, we are concerned that there is a growing gap in its supervision of climate risk management.

The CCLI urges FSRAO to consider adopting OSFI's approach in its new Supervisory Framework for Federally-regulated Financial Institutions, effective April 2024, which considers climate risk a "transverse risk" that affects all areas of financial risk.[46] The framework is aimed at capturing the impact of systemic risks in four risk categories – business risk, financial resilience, operational resilience, and risk governance. OSFI has observed:

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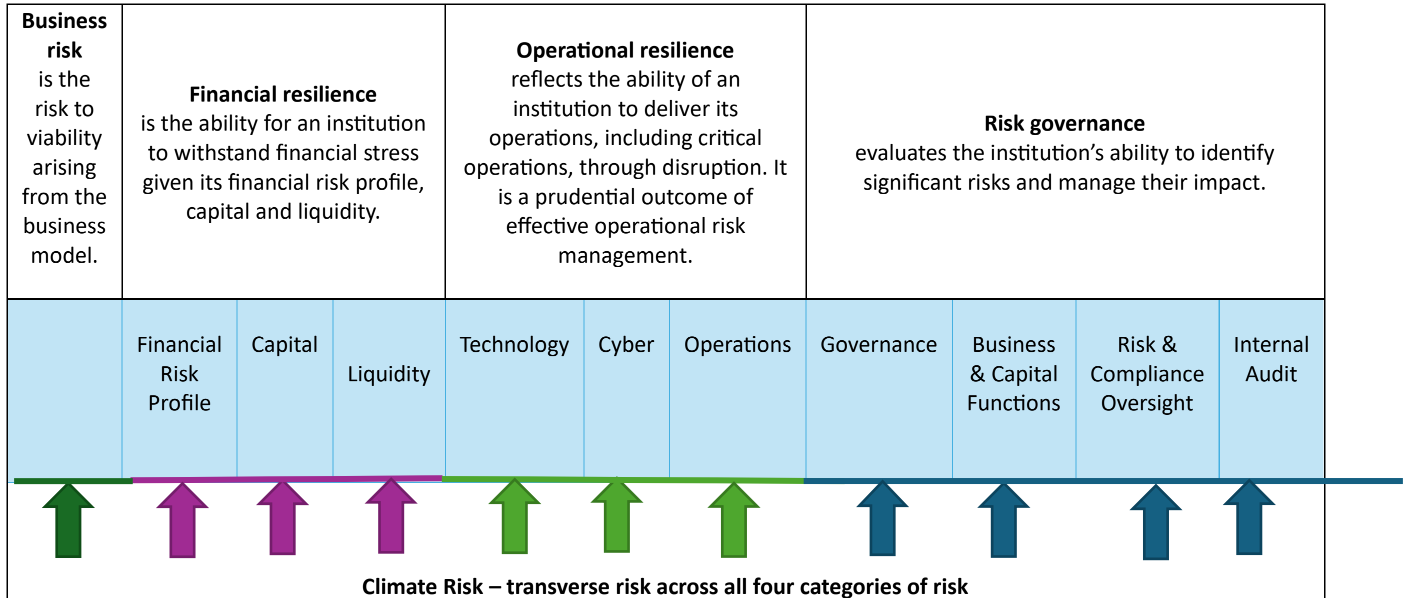
[41] IFRS S2 Climate-related Disclosures, note 10, para 18.
[42] IFRS S2 Climate-related Disclosures, note 10, para 20.
[43] IFRS, https://www.ifrs.org/ifrs-sustainability-disclosure-standards-around-the-world/cop28-declaration-of-support/further-statements-of-support/ .
[44] Australian Government, Treasury, Climate-related financial disclosure Consultation paper, (June 2023), Climate-related financial disclosure - consultation paper (treasury.gov.au); IFRS, IFRS - Progress towards adoption of ISSB Standards as jurisdictions consult.
[45] FSRAO, Proposed Guidance Insurers, note 13 at 20.
[46] Ben Gully, Deputy Superintendent OSFI, "Supervisory Framework Renewal – Briefing – Fall 2023, OSFI, (2023), Ben Gully – Supervisory Framework Renewal – Briefing – Fall 2023 (osfi-bsif.gc.ca). See also OSFI Notice, OSFI's New Supervisory Framework, (4 October 2023), https://www.osfi-bsif.gc.ca/en/news/supervisory-framework-renewal-briefing-fall-2023.

> Climate risk is an important area of focus and we've developed the new framework to support this work. Climate risk considerations can impact all of the new rating categories. We therefore show climate as a transverse risk. Significant climate-rated risks will be reflected in our rating of the relevant category. When we communicate with institutions it will be clear when climate risk is an issue.[47]

The chart below demonstrates the importance of climate risk to OSFI's entire supervisory framework.

OSFI Overall Risk Rating (ORR), effective April 2024



Created by CCLI based on OSFI framework[48]

Currently, FSRAO assesses insurers' climate risk initiatives under the umbrella of ESG in its Risk Based Supervisory Framework for Ontario-incorporated Insurance Companies and Reciprocals (RBSF-I) as part of their resilience rating.[49] We recommend the climate resilience be embedded as part of FSRAO's determination of overall risk rating, as it is a transverse risk.

Recommendation 4:

> **FSRAO should consider issuing market conduct rules in climate risk management guidance, similar to Québec's l'Autorité des marchés financiers (AMF) proposed Climate Risk Management Guideline.**

The AMF Climate Risk Management Guideline sets out market conduct rules. Under the umbrella of "fair treatment of clients", a financial institution must be proactive in offering its products, providing climate-related information at all stages of a product's life cycle, particularly with respect to clients' needs and interests.[50] The AMF proposed Guideline expects the financial institution to

[47] Gully, note 46.
[48] Gully, note 46.
[49] FSRAO, Proposed Guidance Insurers, note 13, at 21.
[50] AMF, Climate Risk Management Guideline, note 11.

take changes in climate-related risks into account when designing, marketing, and advertising new products or altering existing ones, so that its products deliver the benefits and features reasonably expected by the different client groups.[51]

Whether products are offered through intermediaries or directly, the financial institution must ensure that clients are aware of their actual risk environment; clients must be made aware of the increased frequency and consequences of climate-related physical and transition risks, and understand the features of the products offered. Directors must take the necessary steps to ensure that any product advertising is accurate, clear, and not misleading in relation to climate-related risks.[52] The AMF expects disclosure to clients before, when, and after a product offered by the financial institution is purchased. The Guideline states that the complexity of certain financial products can interfere with clients' ability to clearly understand them and clients should not be encouraged to acquire a product if they don't understand every aspect of it from the viewpoint of climate-related risks or extreme weather events.[53]

The CCLI appreciates that FSRAO could locate market conduct protection regarding climate in its Public Warning Guidance.[54] However, that guidance appears to be aimed more at cautioning consumers against improper dealings with FSRAO-regulated products and services and doing business with an unlicensed individual or entity. This Guidance supports FSRAO's mandate and statutory objects, in particular, to contribute to public confidence in the regulated sectors; promote public education and knowledge about the regulated sectors; deter deceptive or fraudulent conduct, practices and activities by the regulated sectors; promote high standards of business conduct; and protect the rights and interests of consumers. If this guidance is used, there should be explicit reference to market conduct and climate risk. However, a better approach might be to include fair treatment of clients as part of a guideline on climate risk management, as in Québec.

Recommendation 5:

> **FSRAO should extend requirements under a climate financial risk management guideline to Ontario-regulated pension funds and their investment managers, including guidance for small pension plans as to how they can best meet their fiduciary duties in respect of climate change in their oversight of, and service agreements with, investment managers.**

Ontario has become a two-tiered pension regime. There are pension plans that are proactively managing climate related risks and securing the sustainability of pension benefits for current and future generations through comprehensive investment strategies aimed at long-term sustainability. Examples include the University Pension Plan of Ontario and the Ontario Teachers' Pension Plan.[55] Yet many other pension plans have no climate action plan and/or lag in identifying and managing climate-related financial risks and opportunities. Many smaller pension funds have their investments managed by service providers, but are not providing effective oversight of their pension funds and direction to their investment managers to ensure that they are effectively managing climate-related risks and opportunities. This lacuna will hinder the sustainable delivery

[51] AMF, Climate Risk Management Guideline, note 11 at 9.
[52] AMF, Climate Risk Management Guideline, note 11 at 9, 11.
[53] AMF, Climate Risk Management Guideline, note 11 at 11.
[54] FSRAO, Public Warning Notices, Effective date 1May 2024 Identifier: No GR0017APP, Public warning notices Guidance | Financial Services Regulatory Authority of Ontario (fsrao.ca).
[55] University Pension Plan Ontario, *Climate Action Plan* Climate action plan - My UPP; OTPP, *Annual Responsible Investing and Climate Strategy Report*, Annual Responsible Investing and Climate Strategy Report (otpp.com).

of the pension promise. There is a lack of clear, specific guidance by FSRAO on the duties of pension investment managers in respect of managing climate-related risks. The gap created by lack of specific guidance may result in future capital adequacy issues for pension plans; and it is their beneficiaries that will suffer the harms associated with poor investment returns and perhaps even solvency risk. FSRAO's oversight should include clear guidance on climate risk management.

The Ontario *Pension Benefits Act* requires the administrator of a pension plan to ensure that the pension plan and the pension fund are administered in accordance with the *Act* and the regulations.[56] The administrator of a pension plan, including a board of trustees, must exercise the care, diligence, and skill in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person.[57] In the administration and investment of the pension fund, the administrator must use all relevant knowledge and skills that the administrator possesses or, by reason of the administrator's profession, business or calling, ought to possess.[58] An administrator or, if the administrator is a pension committee or a board of trustees, a member of the committee or board, shall not knowingly permit the administrator's interest to conflict with the administrator's duties and powers in respect of the pension fund.[59] Although the administrator is able, where it is reasonable and prudent in the circumstances, to employ one or more agents to carry out any act in the administration and investment of the pension fund,[60] the administrator remains the fiduciary.

As fiduciaries, administrators are responsible for prudently managing risks in their pension plans, making decisions in the best interest of pension plan beneficiaries, and administering the plan in accordance with the filed plan documents and all applicable laws.[61]

The duty of impartiality requires trustees and fund managers to balance intergenerational interests in determining short-, medium-, and long-term investments. In order for pension fiduciaries to fulfill their fiduciary duty to act prudently, clear baseline standards with respect to climate governance and risk management are required, including identification, oversight, and management of climate-related risks and opportunities material to the financial risk-return profile of the pension fund's investments in the transition to a decarbonized economy.

CCLI supports FSRAO's Proposed Guidance — Pension Plan Administrator Roles and Responsibilities, particularly the clarification of the fiduciary obligations of administrators in respect of both the common law and statutory duties. We also appreciate that FSRAO participates in setting practice guidance of the Canadian Association of Pension Supervisory Authorities (CAPSA), although our view is that consensus building in CAPSA has led to the lowest common denominator of consent on pension plan oversight, rather than aspiring to global standards. CCLI believes that there continues to be a gap in guidance of what is required in climate risk management and how administrators fulfill their duties to act in good faith and in the best interests of multigenerational plan members and beneficiaries.

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[56] Ontario *Pension Benefits Act,* RSO 1990, c P 8, s 19(1).
[57] Ontario *Pension Benefits Act,* RSO 1990, c P 8, s 22(1), (3).
[58] Ontario *Pension Benefits Act,* RSO 1990, c P 8, s 22(2)..
[59] Ontario *Pension Benefits Act,* RSO 1990, c P 8, s 22(4).
[60] Ontario *Pension Benefits Act,* RSO 1990, c P 8, s 22(5).
[61] Proposed Guidance: Pension Plan Administrator Roles and Responsibilities Guidance, Interpretation No. PE0296INT, at para 1.2, Proposed Guidance: Pension Plan Administrator Roles and Responsibilities Guidance | Financial Services Regulatory Authority of Ontario (fsrao.ca) Consultation closed September 28, 2023.

While the guidance is clear that sections 22(1) and (2) of the *Pensions Benefits Act* require the administrator to exercise the care, diligence, and skill in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person and that administrators must be knowledgeable about their responsibilities and the standard of care they must meet, these broad provisions on statutory duties do not provide specific guidance on meeting these duties in respect of climate risk management. Given the universal acknowledgement of the urgent risk that climate change poses to financial stability, FSRAO should be offering clear guidance.

That guidance needs to include specific insights as to how small pension plans can meet their fiduciary obligations in respect of climate change. It should set out principles and expectations that trustees can use in negotiating service agreements with their investment managers, and in turn, guide investment managers, which, currently, are fiduciaries both to the plan for their investment activities, but also to their own company. Guidance on climate risk management would reduce the potential for conflict of interest in decisions that benefit the investment manager in the short term but place pension funds at longer-term risk.

While some may be concerned that a requirement to manage climate-related risk may increase the likelihood of litigation, should the investment returns of a pension plan underperform the plan's target returns, this concern seems misplaced. Given the fact that climate-related risks are material and have financial impacts, pension administrators and their service providers that ignore these risks are much more likely to face litigation for a failure to employ the prudence the *Pension Benefits Act* requires they exercise.

We also recommend that FSRAO encourage the Minister to amend Regulation 909 under the *Pension Benefits Act (PBA*) to require that the pension plan administrator's written statement of investment policies and procedures (SIPP) includes a statement on how its policies and procedures address climate-related financial risks, including the plan's climate resilience (mitigation and adaptation), and how it weighs the risks and benefits in decisions with respect to its portfolio of investments and loans in light of the impending transition to a net-zero emissions economy. Ontario already has a provision regarding ESG and SIPP. Under section 78(1) of Regulation 909, the SIPP must include a statement about whether ESG factors are incorporated into the plan's investment policies and procedures, and if so, how they have been incorporated. If there is a plan to consider ESG, it is the administrator's responsibility to establish the processes to monitor and report on compliance. The CCLI's view is that the Minister should make disclosure of climate transition plans a requirement under the SIPP provisions.

Recommendation 6:

> **FSRAO should consider a time-limited safe harbour for duly diligent directors, trustees, and other fiduciaries in respect of meeting Scope 3 emissions targets, while maintaining the flexibility of FSRAO's prudential supervisory authority.**

The CCLI submits that FSRAO guidance should require financial institutions to disclose Scope 1, 2, and 3 GHG emissions on a phased-in basis, as required by OSFI's Guideline B-15.[62] We appreciate that Scope 3 data will initially be challenging to assess and may initially have to be estimated; however, considering that Scope 3 emissions comprise the majority of end-to-end carbon

[62] Guideline B-15, note 9 at 16.

emissions, it will be important to collect the data, particularly for projects in which the credit union provides debt or equity financing. The common law already recognizes that if directors and other fiduciaries act in good faith and with a view to the best interests of the company, duly diligent directors are protected from liability.[63]

For pension fiduciaries, there is a due diligence defence embedded in the *Pension Benefits Act* and common law. It is accepted that climate risk is a material factor in investment decisions and the fact that a fund takes climate risk into account should not be the basis for litigation. The defences available under section 22 of the *Pension Benefits Act* and at common law are that if pension fiduciaries exercise the care, diligence, and skill in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person; and ensure the administrator is using the relevant knowledge and skills,[64] the fact that they have applied this standard of care means that there is no basis for litigation.

That said, given that it will take some time to obtain fully accurate information on Scope 3 emissions in the value chain, a time-limited safe harbour may alleviate concerns that fiduciaries have about litigation risk for information largely derived from third parties. One option is to offer a time-limited safe harbour from civil liability for Scope 3 emissions disclosure, for example, two or three years at most, so that fiduciaries can work diligently, reasonably, and on a timely basis towards accurate disclosure. A safe harbour for Scope 3 emissions disclosure would create a time-limited period in which directors and pension fiduciaries need not worry about lawsuits.

If fiduciaries meet their duties, including relying on expert knowledge and advice and ensuring accuracy of their public statements and disclosures, they need not worry about litigation risk. However, without specific guidance from FSRAO, they are left to determine the scope of these duties in respect of climate risk management. It also means that there is no baseline guidance against which investors, policyholders, depositors, and pension plan members can assess actions, which may increase litigation risk. Clear guidelines on climate risk management will serve a preventive role, both in terms of fiduciaries understanding expectations of them and their clients understanding the scope and limits of what is expected of them from the supervisor. With clear guidance in place, including the proportionality provisions of IFRS S2, if a pension fund, for example, made good faith, duly diligent, and prudent efforts to mitigate climate-related risks but the results vary from expected investment returns, there would be no grounds for litigation. Similarly, if an insurance company or credit union failed to meet their emissions reductions targets for the period, any legal challenge to their decisions would be assessed by a court based on evidence of their exercise of skill, care, and due diligence, not the actual failure to meet a target. In both examples, if the fiduciary does not have the knowledge or skills to make informed reasonable decisions, they can rely on outside expertise in accordance with FSRAO's guidance and the statute.

A safe harbour allows FSRAO to retain its ability to enforce the relevant legislation in respect of its regulated entities; however, it could signal that for a time-limited period, it will work with directors and administrators that are acting diligently and in good faith to meet the Scope 3 disclosure requirements and monitor their efforts to comply. This approach would not be protection from regulatory sanction, but does recognize that there is a continuum of regulatory and enforcement

[63] *Peoples Department Stores Inc (Trustee of) v Wise,* 2004 SCC 68, [2004] 3 SCR 461 (SCC); *BCE Inc v 1976 Debentureholders*, [2008] 3 SCR 560 (SCC)).
[64] Ontario *Pension Benefits Act,* RSO 1990, c P 8, s 22(1), (3).

strategies that encourage transparency in disclosure and the evolving nature of Scope 3 emissions data collection/calculation.

Where disclosure of Scope 3 emissions is not possible, FSRAO should require the financial institution to disclose the efforts made to obtain the information about its value chain, the reasons why that information could not be obtained, and its plan to obtain such information in the future. This accommodation aligns with IFRS S2. It is also the approach taken in the European Union, which has included a three-year grace period in the Corporate Sustainability Reporting Directive (CSRD) specifically for value chain disclosures.[65]

Recommendation 7:

> **FSRAO should support the Sustainable Finance Action Council's (SFAC) Green and Transition Finance Roadmap and co-operate as a member of the proposed governmental stakeholder advisory group in advising the Taxonomy Council on developing the Green and Transition Finance Taxonomy.**

A green and transition finance taxonomy is key to Canada's transition to sustainable finance, as it will set standards for climate-related financial instruments and benchmarking climate risk management. FSRAO can take a leadership role in endorsing the SFAC's Green and Transition Finance Roadmap.[66] Several Ontario financial institutions such as Ontario Teachers' Pension Plan and Co-operators Insurance participated on the council and its working groups to develop the taxonomy principles, and their input has helped make the roadmap practical and feasible.

A taxonomy is primarily a classification system — it outlines a common set of definitions and criteria to create clarity and agreement on what constitutes a "green" or "transition" investment. Taxonomies are a critical tool for solving two urgent and interrelated challenges within Canada's financial system: the ability to attract global capital to invest in Canada's transition and to reduce the risk of "greenwashing".[67] Investors need transparency and certainty in order to make strategic investment decisions. A taxonomy does not dictate investors' or companies' investment or capital expenditure choices.

A science-based taxonomy will create the market integrity, clarity, and interoperability necessary to accelerate global capital investment in Canada's decarbonization transition. The SFAC recommendations need to be implemented to facilitate company-level net-zero target setting, transition planning, and effective climate disclosure; evaluate projects against framework criteria to determine whether they are green or transition; and assess projects against "do no significant harm" criteria. The proposed Taxonomy will flow capital to decarbonization opportunities across all major emitting sectors and help with Canada's positioning in global capital and financial markets. Ontario has an important role in helping to develop the Taxonomy in a manner that protects the safety and soundness of the financial system.

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[65] EU, Corporate Sustainability Reporting Directive, Directive - 2022/2464 - EN - CSRD Directive - EUR-Lex (europa.eu) at para 34. See also Deloitte, "Frequently Asked Questions About the E.U. Corporate Sustainability Reporting Directive" (17 August 2023) Heads Up — #DeloitteESGNow — Frequently Asked Questions About the E.U. Corporate Sustainability Reporting Directive (August 17, 2023) | DART – Deloitte Accounting Research Tool.

[66] Sustainable Finance Action Council (SFAC) Taxonomy Roadmap Report (2022) (hereafter Taxonomy Roadmap).

[67] Taxonomy Roadmap, note 66.

The federal government in its 2023 Fall Economic Statement and 2024 budget announced that the Department of Finance will work in consultation with regulators, the financial sector, industry, and independent experts to develop a taxonomy that is aligned with reaching net-zero emissions by 2050.[68] FSRAO should participate as a member of the proposed Taxonomy Council's Indigenous, Provincial, and Territorial Government Stakeholder Advisory Group in advising the Taxonomy Council as it moves forward.

Conclusion

Implementing the CCLI's seven key recommendations would align FSRAO's supervision of its regulated sectors with OSFI's Guideline B-15, IFRS S2 Climate-related Disclosures, and proposed CSDS 2 Climate-related Disclosures. FSRAO could, in the future, consider the global sustainability accounting standards, including biodiversity and natural capital risks and opportunities, but we submit that climate risk management is the most immediate concern that should be addressed.

Thank you for considering our submission. The CCLI looks forward to discussing these recommendations with you.

Sincerely,

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[68] Deputy Prime Minister Freeland, "2023 Fall Economic Statement" (21 November 2023), at 63, FES-EEA-2023-en.pdf (canada.ca); Canada, "Budget 2024" at 198, Budget 2024 (canada.ca).