NEI

September 30, 2022

Mr. Peter Routledge
Superintendent of Financial Institutions
Office of Superintendent of Financial Institutions
255 Albert Street
12th Floor
Ottawa, Ontario
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Re: Comments on Draft Guideline B-15: Climate Risk Management

Submitted by email to: ClimateRisks-RisquesClimatiques@osfi-bsif.gc.ca

Dear Mr. Routledge:

With approximately C$10 billion in assets under management, NEI Investments' approach to investing incorporates the thesis that companies can mitigate risk and take advantage of emerging business opportunities by integrating best environmental, social and governance (ESG) practices into their strategies and operations. We commend the Office of Superintendent of Financial Institutions (OSFI) for the opportunity to provide comment on the Draft Guideline B-15: Climate Risk Management (the Guideline), which sets out expectations related to federally regulated financial institutions (FRFIs). As an investor with direct exposure to several FRFIs, the proposed guideline is a material development given the significant impacts that climate-related risks could have not only on those financial institutions but also on the financial system more broadly.

We appreciate the comprehensive nature of the draft Guideline. We have focused our comments on a limited set of principles-based expectations where we sought to provide input.

As a principle-based guideline, the language in the draft document is at times vague and we worry that it could be subject to different interpretations. This may lead to challenges regarding the quality, usefulness and completeness of the information disclosed by the FRFIs. It is in this context that we encourage OSFI to be more specific on the disclosure elements expected under the principles, wherever possible, and avoid the use of overly broad guidance such as "sufficient details" and "appropriate processes and controls".

Chapter 1- Governance and Risk Management Expectations

I. 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.

We agree that FRFIs should develop and implement a Climate Transition Plan and appreciate that OSFI refers to the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) Guidance on Metrics, Targets, and Transition Plans for the elements to be considered. To promote consistency and ensure the information being disclosed by FRFIs is complete and useful, we believe the key elements that make a climate transition plan credible should be explicitly highlighted in the Guideline. We recognize that the expectations for what constitutes a credible transition plan are continually evolving but we would highlight the following key aspects based on the TCFD Guidance and Glasgow Financial Alliance for Net Zero ("GFANZ") publication: "Expectations for Real-economy Transition Plans" : Whether the FRFI's transition plans or stated emissions reduction targets have been validated by a third-party; whether the FRFI has set medium term and long-term targets within an appropriate timeframe and frequency; whether the targets and management oversight are aligned; whether the business strategies and activities support the targets; whether the FRFI has an engagement strategy within its value chain and whether the FRFI has set an appropriate financing strategy to execute its transition plan.

Principle 2: The FRFI should have the appropriate governance, policies, and practices in place to manage climate-related risks.

We note that the Guideline mainly focuses on the role of Senior Management. While we acknowledge that OSFI's Corporate Governance Guideline sets out the expectations for FRFIs boards of directors, we strongly encourage OSFI to articulate expectations that directly address the various elements of climate risk oversight in the Guideline. For instance, given the complexity of addressing climate risks, the FRFI should disclose how both its board and Senior Management continuously build the skills and capacity to respectively ensure an effective oversight and management of climate-related risks.

Furthermore, while we note that independent external assurance is not required at this time, we believe the Guideline should address the evolving role of the Audit Committee of the board regarding the integration of climate risk considerations in the auditor's mandate when determining the scope and terms of audit engagements. While it would be premature to get external assurance on the financial implications of climate risks given that scenario analyses are still developing, as an investor, we see value in auditors reviewing and validating, initially, the existence and quality of processes and controls the FRFI has in place to assess climate-related risks.

II. Risk Management

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.

A. Risk Identification, Measurement, and Management

We fully agree that FRFIs should have appropriate processes and controls to identify and measure the potential impact of climate-related risks on their portfolio over appropriate time horizons. However, we are concerned that this expectation does not provide much guidance on what constitutes "appropriate processes and controls". We suggest specifying the various elements that FRFIs should be considering within their processes and controls, which may include but are not limited to regular internal auditing, ongoing climate-related trainings, and tracking and reporting on performance metrics.

We support the expectation that FRFIs should consider alternative data sources or reasonable proxies to bridge data gaps. In this context, we recommend adding an expectation that the FRFI should work with its clients and other stakeholders to enhance data availability and quality over time. We see value in asking FRFIs to disclose the percentage of their current climate risk data that relies on estimated versus actual data and how they work towards improving their data quality.

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.

We support the expectation that FRFIs should use climate scenario analysis. Our experience in talking with companies, is that the process of undergoing a scenario analysis exercise provides valuable insights and increased understanding across the business of the impacts of climate-related risks and opportunities. The Guideline sets out reasonable expectations on how scenario analysis should be used, but we note it does not speak to the need to provide some level of transparency on the process or results – except in the case of the requirement to disclose to OSFI the results of the standardized scenario. We believe the use of scenario analysis (and the results it provides) is material information for investors and should be disclosed.

Regarding the creation of a standardized scenario exercise that OSFI can use to aggregate and compare FRFIs exposures, it does seem like it would provide valuable insights to OSFI and moreover could be quite helpful for smaller institutions that might not have the resources to pursue bespoke or multiple different scenario exercises. However, there could be a tension between this proposal and the guidance provided earlier in Principle 5 that states companies should consider a range of plausible scenarios. We would not want to see a situation where FRFIs choose to only perform the standardized scenario exercise, as we worry this could paradoxically increase the risks for these institutions by creating collective blind spots. Considering the uncertainty involved with all scenario analysis exercises, we continue to believe that the greatest value of scenario exercise is the process itself and the ability to consider multiple “what if?” situations. The Guideline should ensure that FRFIs do not rely solely on the standardized scenario provided by OSFI.

Principle 6: The FRFI should maintain sufficient capital and liquidity buffers for its climate-related risks.

As capital requirements for climate-related risks are a significant component of managing a FRFI’s financial position, we agree that this section should be developed into a separate chapter of the Guideline.

We support the expectation that climate-related risks should be included into a FRFI’s capital planning horizon to account for severe, yet plausible, climate-related scenarios. As climate-related risks pose systemic risks to the financial system, such risks should be considered by a FRFI in determining liquidity and capital adequacy requirements. These risks should be factored into minimum capital requirements, on a risk-adjusted basis, along with the provisioning for an adequate capital buffer for such severe climate-related scenarios.

Chapter 2- Climate-Related Financial Disclosures

Principle 1: The FRFI should disclose relevant information.

We support the expectation that a FRFI should present disclosures in *sufficient* detail to enable users to assess its exposure and approach to addressing climate-related issues. Given that there is not much guidance on what constitutes "sufficient detail", we believe the Guideline could be more explicit. As an investor, we would value detailed disclosure of the FRFI's climate-related exposure including a discussion of risk concentration (e.g. geographies, sectors, products, business lines or counterparties). This is currently stated as only an internal expectation for FRFIs under Chapter A – Principle 3 – Point B: Risk Monitoring And Reporting. We believe this information is decision-useful for investors and should be disclosed publicly.

Principle 2: The FRFI should disclose specific and complete information

In disclosing the FFRI's governance, strategy, and processes for managing climate-related risks, we suggest adding the specific expectation that the FRFI should disclose the climate-related expectations it sets for its clients. To be most useful, this information should be broken down by sector. The FRFI should also disclose the extent and scope of its client engagements to mitigate climate risks. We would expect the FRFI to focus its engagement on sectors where its risks are most concentrated and materially significant.

Given the state of current data limitations when it comes to adequately measuring climate-related risks and impacts (such as the lack of reliable emissions data), the FRFI should also disclose how it works with its clients and other stakeholders to enhance data availability and quality over time.

Principle 4: The FRFI should disclose reliable, verifiable, and objective information.

While we note that independent external assurance is not required at this time, in line with our earlier comment on the role of auditing in attesting the accuracy of information, the FRFI should work towards integrating climate risk considerations into its audit engagements. This could initially cover an assurance on climate-related processes, followed by an assurance on climate-related financial impacts. It is worth highlighting that a number of investors have started to engage audit firms on this matter. There is an emerging expectation that the Audit Committee should be incorporating climate-related risk considerations in audit engagements. Investors have also started to consider the potential implications that that expectation could have on their proxy voting decisions.

IV. Implementation Date

We hope that the expected implementation date for the Guideline will not be delayed beyond the fiscal periods ending on October 1, 2023. After reviewing the conceptual roadmap to the full complement of OSFI climate-related financial risk disclosure expectations (Annex 2-3), we suggest updating the implementation of the below elements as follows:

- ***ISSB Cross-Industry Metrics – Remuneration***: We believe that all FRFIs should be disclosing how climate-related considerations are integrated into executive management remuneration by 2024, no later than one year following the initial implementation date of the Guideline and not 2025. Given the urgency in addressing climate-related risks, remuneration and other incentives should be aligned with the climate strategy today, and we note that the disclosure of the FRFI's climate strategy is already considered as a minimum disclosure expectation effective in 2023.

- ***Scope 3 emissions for category 2 and 3 banks and Other Federally Regulated Insurers:*** We recognize that smaller sized financial institutions may need more time to build capacity and resources to fully assess their financed emissions. And we also acknowledge the complexity of measuring scope 3 emissions. However, we believe an incremental disclosure expectation should be set out to incentivize early action rather than deferring to 2027. Scope 3 emissions are a necessary input for climate scenario analysis, target setting and for developing strong climate strategies. As an investor, we value disclosure on the steps a financial institution is taking to track and measure its scope 3 emissions and how it works with its clients to improve data availability and quality. We see more value in being able to assess partial disclosures that will improve over time over a delayed yet full disclosure in 2027. The incremental disclosure expectations could be prioritized based on asset types and sectors. As an example, the FRFI could start measuring and disclosing the financed emissions associated with its clients in high emitting sectors such as in the oil, gas and mining sectors and gradually add sectors over time; this is an approach that is currently followed by financial institutions supporting the Partnership for Carbon Accounting Financials (PCAF) methodology.

V. Location and Timing of Disclosures

While we appreciate the benefits of giving FRFIs the discretion to determine the location of the disclosures expected by the Guideline, we believe that specific disclosures related to the financial impacts of climate-related risks on the FRFI and the discussion on whether the latter judges these financial impacts to be material or not, should be presented in the notes to the financial statements to ensure their verifiability over time.

Conclusion

We thank OSFI for the opportunity to comment on the draft Guideline on climate risk management for FRFIs. We hope our investor perspective is helpful. Please do not hesitate to contact us if you believe further dialogue on any of the issues raised in this letter would be helpful.

Sincerely,

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