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OSFI Eyes Climate-Related Risks: Releases Discussion Paper and Announces Three Month Consultation

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On January 11, 2021, the Office of the Superintendent of Financial Institutions (OSFI) launched its three-month consultation on climate-related risks in the Canadian financial sector with the publication of a discussion paper called *Navigating Uncertainty in Climate Change: Promoting Preparedness and Resilience to Climate-Related Risks* (the Discussion Paper).

The objective of the Discussion Paper is to engage Federally Regulated Financial Institutions (FRFIs), Federally Regulated Pension Plans (FRPPs) and other OSFI stakeholders in a dialogue on climate risks in relation to FRFI business strategies and FRPP investment strategies and to use stakeholder feedback to inform OSFI's development of climate risk guidance and supervisory expectations. Although OSFI's current guidance does not specifically address climate-related risks (outside of, perhaps, the Earthquake Risk Exposure guidance), the existing guidance includes principles and expectations applicable to the management of such risks.

In brief, the Discussion Paper: (i) identifies and categorizes climate-related risks, and how these risks could impact the safety and soundness of FRFIs and FRPPs (collectively, entities); (ii) explores how entities could prepare for, and build resilience to, climate-related risks; and (iii) provides an overview of climate-related financial disclosure as well as OSFI's ongoing work on climate-related risks. We have summarized these discussion points in greater detail below:

1. Climate Related Risks and Their Impact on FRFIs and FRPPs

The Discussion Paper categorizes climate-related risks into physical risks, transition risks and liability risks and provides examples of how such risks may affect deposit-taking institutions, insurance companies and pension plans. Physical risks refer to damage caused by wildfires, floods and other climate events. Transition risks refer to risks associated with the increased regulation of greenhouse gas industries, such as credit risk (e.g., higher cost of borrowing). Liability risks relate to potential exposure to climate-related litigation, which could impact entities directly or indirectly. Given the uncertain outlook and longer-term horizon associated with climate related-risks, OSFI indicates that entities should be prepared for persistent economic uncertainty. The Discussion Paper also demonstrates how climate-related risks may affect an entity's business and/or investment strategies. OSFI notes that building resilience to these risks requires a holistic approach that includes the development of a climate-related risk appetite and strategy and implementation of governance and risk management practices that are commensurate with an entity's

specific circumstances.

2. Ways FRFIS/FRPPs Could Prepare for, and Build Resilience to, Climate-Related Risks

The Discussion Paper sets out a number of practices related to risk appetite and strategy, governance and risk management which Canadian entities are beginning to implement, as well as the approaches taken by regulators in other jurisdictions. OSFI expects FRFIs to take a forward-looking approach to identify and understand how material risks affect an FRFI's business and/or investment strategy, risk profile and capital management. The Discussion Paper highlights the existence of "data challenges," such as the changes that may be necessary to the underlying assumptions used in a FRFI's financial risk modeling as climate-related risks evolve. OSFI expects FRPPs to consider a wider range of factors affecting their ability to prudently administer their plans, including risks that could impact long-term investment performance.

3. Climate-Related Financial Disclosure and OSFI's Ongoing Work on Climate-Related Risks

The Discussion Paper provides a summary of the various climate-related financial disclosures currently in place and confirms that OSFI is continuing to advance its understanding of climate-related risks relevant to entities. OSFI notes that, in 2019, the Expert Panel on Sustainable Finance recommended that the Government of Canada require a mandatory phased "comply or explain" implementation of the Financial Stability Board Task Force on Climate-related Financial Disclosures' Recommendations for Canadian companies, including financial institutions and pension plans. OSFI is closely following the Government of Canada's response to these recommendations as it could have implications for how OSFI fulfills its mandate. As well, OSFI is collaborating with the Bank of Canada on a pilot program to assess the transition risk for financial institutions related to the transition to a lower-greenhouse gas economy using scenarios that are relevant to Canada. OSFI regularly participates in various international and domestic fora which allow it to gauge the approaches taken in other jurisdictions. For instance, the Climate Financial Risk Forum, established jointly by the Prudential Regulatory Authority and the Financial Conduct Authority in 2019, published a guide to climate-related financial risk management on June 29, 2020 to assist financially regulated entities in the UK.

Based on the nature of OSFI's consultation questions in Annex A to the Discussion Paper, OSFI appears to be receptive to suggestions from regulated entities and other stakeholders as to the overall design and approach for the management of climate-related risks.

Conclusion

Climate-related risks can affect an entity's safety and soundness by contributing to financial, strategic and operational risks and by affecting a FRFI's reputation. OSFI appears to be motivated to modify its guidance, supervisory processes and reporting requirements, to the extent required, to address climate-related considerations.

OSFI has invited comments to be submitted on the Discussion Paper, including any responses to the consultation questions in Annex A, by email at Climate-climat@osfi-bsif.gc.ca by April 12, 2021. Feedback from entities and other interested stakeholders on climate-related risk management would inform any climate-related guidance OSFI decides to publish for the entities it regulates. OSFI confirmed that public consultation(s) will precede any proposed changes to OSFI's regulatory guidance.

We encourage entities to submit their comments to OSFI with respect to the Discussion Paper and we would be pleased to assist with any such submissions.

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