



OSFI Consultation: Climate-related risks in the financial sector

Submissions from Shift: Action for Pension Wealth and Planet Health, Environmental Defence Canada, and Ecojustice Canada

Executive Summary

Thank you for this opportunity to provide input on OSFI's January 2021 paper, *Navigating Uncertainty in Climate Change*¹ (the "Discussion Paper") to discuss how OSFI can fulfill its responsibility for prudential and regulatory oversight of federally-regulated pension plans ("FRPPs") and federally-regulated financial institutions ("FRFIs") regarding climate-related risks.

We are writing as a coalition of organizations with expertise and interest in reducing the risks of climate change through law and policy—including the impacts of climate change on the financial sector as well as the impacts of the financial sector in exacerbating or addressing climate change. We do not see these risks as separable, as over the long-term, financial institutions that exacerbate climate change also increase the financial risks of climate change. Financial institutions must play a key role in aligning financial flows with emissions trajectories that are consistent with the limiting the global temperature increase to 1.5°C by mid-century.

We are writing to encourage OSFI to create mandatory and prescriptive rules for climate risk assessment, disclosure, and management for FRPPs and FRFIs. Although this submission focuses primarily on climate risk and FRPPs, most of these recommendations, especially those detailing the key criteria for climate risk disclosure, should also apply to FRFIs.

These submissions address the following issues: 1) how climate risks should be addressed in Statements of Investment Policies and Procedures ("SIPPs") and OSFI Guidelines; 2) why mandatory climate risk disclosure is necessary for FRPPs; 3) the key criteria for mandatory climate risk disclosure, including stress testing and credible net-zero targets; and 4) the key criteria for selection and monitoring of investment managers regarding climate risk. Under each of these sections we have identified the questions in the Discussion Paper to which we are responding.

We also note that mandatory climate risk assessment and disclosure are only the starting points for dealing with the risks of climate change on financial systems. As OSFI is responsible for the prudential

¹ OSFI, *Navigating Uncertainty in Climate Change: Promoting Preparedness and Resilience to Climate-Related Risks* (January 2021), online: <https://www.osfi-bsif.gc.ca/Eng/Docs/clmt-rsk.pdf>.

regulation and supervision of FRPPs and FRFIs, OSFI must also provide guidance on how these risks are to be prudently managed, not just disclosed.

We have made the following recommendations, which are explained further below:

Question 8: What are the key considerations for incorporating climate-related risks into the FRPP's Statement of Investment Policies and Principles?

OSFI should require that FRPPs include climate-related risks as material risks explicitly in their SIPPs. SIPPs should acknowledge climate-related risks, commit to conducting a climate change risk assessment, set targets to manage those risks, and explain the tools that the FRPP will use to meet those targets, including both engagement and divestment as potential strategies.

OSFI should also develop prudential exposure limits for climate-related risk, which should be included as guidance in the development of SIPPs. These could take the form of recommended limits on the exposure of a fund to the economic sectors most exposed to climate-related risks, such as the fossil fuel sector, given the transition risks and volatility associated with those sectors.

Question 9: For FRPPs where the administrator directly invests in assets, are scenario analysis and stress testing used to assess the pension plan's exposure to climate-related risks? If so, how useful are they? What are some other risk measurement tools that FRPP administrators should consider?

OSFI should require FRPPs to stress test their portfolio and report on the results to OSFI, beneficiaries, and the public. Specifically, OSFI should develop or adopt a "climate success" 1.5°C scenario. It should require that FRPPs (as well as FRFIs) test their portfolio against a "climate success" 1.5°C scenario as well as a "climate failure" scenario as part of their climate risk disclosure obligations. The 1.5°C scenario should take a precautionary, limited approach to carbon removal technology and carbon credits.

Question 10: whether FRPPs should consider an investment manager's climate-related risk management when selecting risk managers and, if so, the criteria they should use?

OSFI should provide guidance stating that FRPPs must consider an investment manager's approach to climate-related risk as part of their duty of prudence when selecting and monitoring investment managers. The criteria should include commitments by the investment manager to reduce climate risk through exclusions or screens and a detailed policy of engagement and escalation if the investment manager uses engagement to manage climate-related risks.

Question 13: Given OSFI’s role as the prudential regulator and supervisor of FRFIs and FRPPs, what other work do you think OSFI should consider in relation to climate-related risks; and

Question 16: What factors should OSFI consider in designing its guidance, supervision process and reporting requirements to promote FRPP preparedness and resilience to climate-related risks?

As a prudent regulator and supervisor, OSFI should develop mandatory public climate-risk disclosure standards for FRPPs and FRFIs based on the recommendations of the Task Force on Climate-related Financial Disclosures. These standards can be informed by the United Kingdom and New Zealand consultation reports, which underscore the need for urgent, standardized mandatory climate risk disclosure for pension plans.

As part of this work OSFI should develop a 1.5°C “climate success” scenario with a precautionary approach to carbon removal and offsetting, as well as guidance on reporting on scenario analysis.

OSFI should also require that FRPPs and FRFIs disclose emissions targets and credible plans to meet those targets as part of their mandatory climate risk disclosure. OSFI should develop guidance for Paris-aligned targets and plans, requiring these targets to address the full scope of emissions in portfolios.

Table of Contents

Executive Summary.....	1
Introduction	4
Financial risks of climate change	4
OSFI’s role in the regulation of climate-related risk	5
Who we represent	6
Climate-related risks addressed in SIPPs	7
Why we need mandatory and prescriptive climate risk disclosure for federally-regulated pension plans10	
International movement towards mandatory prescriptive climate risk disclosure	11
Criteria for a mandatory, standardized disclosure regime	13
Criteria for mandatory stress testing	13
Requiring standardized Paris alignment for targets and metrics	18
Disclosure should be made public	20
Criteria for selecting investment managers.....	20
Conclusion.....	22
Contact information.....	24

Introduction

Financial risks of climate change

Climate change is an “existential challenge” and a “threat of the highest order to the country, and indeed to the world.”² In order to prevent catastrophic economic and social consequences from climate change, nearly 200 governments, including Canada, signed on to the *Paris Agreement* and committed to holding the increase in the global average temperature to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5°C.³ To meet this 1.5°C target, carbon dioxide emissions must decline by 45% from 2010 levels by 2030 and reach net zero by 2050.⁴ Meeting these targets requires a significant and urgent financial shift by public and private actors around the world.⁵

Climate change creates material financial risks that can affect investment returns, as noted by the industry-led Task Force on Climate-Related Financial Disclosures (“TCFD”).⁶ OSFI notes in its Discussion Paper that evidence suggests that the financial toll of climate change is increasing.⁷ As stated by Mark Carney, former governor of the Bank of Canada and Bank of England:

Changes in climate policies, technologies and physical risks in the transition to a net zero world will prompt reassessments of the value of virtually every asset. The financial system will reward companies that adjust and punish those who don't.⁸

These risks cannot be ignored until 2030 or 2050, they must be acted on now. Sudden market shifts and re-pricing to align with the *Paris Agreement* goals can happen suddenly and have already begun to

² Reference re *Greenhouse Gas Pollution Pricing Act*, 2021 SCC 11, at para 167.

³ *Paris Agreement*, being an Annex to the *Report of the Conference of the parties on its twenty-first session, held in parties from 30 November to 13 December 2015--Addendum Part two: Action taken by the Conference of the parties at its twenty-first session*, 12 December 2015, UN Doc FCCC/CP/2015/10/Add.1, 55 ILM 740 (entered into force 4 November 2016) [*Paris Agreement*], Article 2.1(a).

⁴ Intergovernmental Panel on Climate Change, “Summary for Policymakers” in *Global Warming of 1.5°C. An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development and efforts to eradicate poverty* (2018) <https://www.ipcc.ch/site/assets/uploads/sites/2/2019/05/SR15_SPM_version_report_LR.pdf>, at 12.

⁵ *Paris Agreement*, *supra* note 3, Article 2.1(c); *Final Report of the Expert Panel on Sustainable Finance: Mobilizing Finance for Sustainable Growth* (Gatineau: Environment and Climate Change Canada, 2019) <http://publications.gc.ca/collections/collection_2019/eccc/En4-350-2-2019-eng.pdf>, at 1-2 [Expert Panel on Sustainable Finance Report].

⁶ Task Force on Climate-related Financial Disclosures, *Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures* (June 2017), online: <<https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf>> at ii-iii [TCFD Report].

⁷ Discussion Paper, *supra* note 1, at para 2.2.

⁸ Mark Carney, *Remarks given during the UN Secretary General's Climate Action Summit 2019* (23 September 2019), online: <https://www.bankofengland.co.uk/-/media/boe/files/speech/2019/remarks-given-during-the-un-secretary-generals-climate-actions-summit-2019-mark-carney.pdf>, at 7.

occur.⁹ These shifts can create risks of fossil fuel reserves becoming “stranded assets”, if the world meets the Paris Goals.¹⁰ An analysis in the *Financial Times* estimated that around \$900 billion, or one-third of the current value of oil and gas majors, would evaporate if the 1.5°C *Paris Agreement* goal is met.¹¹ A rapid energy transition can create risks for companies and infrastructure involved in extracting, producing, transporting, and refining fossil fuels.

Some companies are starting to recognize their stranded assets: in February 2021, Imperial Oil confirmed a loss of \$1.1 billion last quarter because it is no longer planning to develop “a significant portion” of its unconventional assets in Alberta.¹² Similarly ExxonMobil, Total, British Petroleum (BP) and Shell have also written off the value of some of their assets in the last year.¹³

OSFI’s role in the regulation of climate-related risk

As you are aware, pension administrators have fiduciary and statutory obligations when designing investment strategies and making investment decisions.¹⁴ They have a duty of care to invest prudently and a duty of loyalty to invest in the best interests of beneficiaries.¹⁵ Although pension administrators undoubtedly have a fiduciary duty to inform themselves of climate-related risks and manage this risk, these legal obligations are not presently clear enough to effectively protect beneficiaries from the financial impacts of climate-related risks. As noted by the federal Expert Panel on Sustainable Finance, “widely used interpretations of fiduciary duty and materiality are lagging the evolving reality of climate change and its financial implications”.¹⁶ Therefore, OSFI must provide clear guidance on what is required to assess, disclose and manage climate-related risks prudently—it cannot rely on pension administrators to prudently manage climate-related risks on their own.

⁹ Mark Carney, Governor of the Bank of England, *Breaking the Tragedy of the Horizon - climate change and financial stability* (29 September 2015), online: <https://www.bankofengland.co.uk/-/media/boe/files/speech/2015/breaking-the-tragedy-of-the-horizon-climate-change-and-financial-stability.pdf?la=en&hash=7C67E785651862457D99511147C7424FF5EA0C1A>.

¹⁰ Christopher McGlade and Paul Ekins, “The geographical distribution of fossil fuels unused when limiting global warming to 2°C” (2015) 517 *Nature* 187, at 187; Andrew Grant and Mike Coffin, *Breaking the Habit: Why none of the large oil companies are “Paris-aligned”, and what they need to do to get there* (Carbon Tracker, 2019) online: <https://carbontracker.org/reports/breaking-the-habit/>, at 10.

¹¹ Alex Livsey, “Lex in Depth: the \$900bn cost of ‘stranded energy assets’” (3 February 2020), online: <https://www.ft.com/content/95efca74-4299-11ea-a43a-c4b328d9061c>.

¹² Sarah Rieger, “Imperial Oil to write down up to \$1.2B, no longer plans to develop ‘significant portion’ of Alberta assets” *CBC News* (30 November 2020), online: <https://www.cbc.ca/news/canada/calgary/imperial-oil-1.5822984>; https://financialpost.com/commodities/energy/after-massive-writedown-imperial-oil-says-no-big-projects-in-coming-years?utm_medium=Social&utm_source=Twitter#Echobox=1612303603.

¹³ Yadullah Hussain, “Posthaste: Imperial Oil’s massive write-off suggests the era of stranded Canadian assets is already here” *Financial Post* (1 December 2020), online: <https://financialpost.com/executive/executive-summary/posthaste-imperial-oils-massive-write-off-suggests-the-era-of-stranded-canadian-assets-is-already-here>.

¹⁴ *Burke v Hudson’s Bay Co*, 2010 SCC 34, at para 41; *Pension Benefits Standards Act, 1985*, RSC 1985, c 32 (2nd Supp), s 8.

¹⁵ Ari Kaplan and Mitch Frazer, *Pension Law*, 2nd ed (Irwin Law: Toronto, 2013), at 318-21; *Pension Benefits Standards Act, 1985*, s 8(4)-(5); *Cowan v Scargill*, [1984] 2 All ER 750, at 760.

¹⁶ Expert Panel on Sustainable Finance Report, *supra* note 5, at 20.

As the regulator of more than 1,200 private pension plans in federally regulated areas of employment, representing 1.15 million active members and assets of about \$215.5 billion,¹⁷ OSFI has a responsibility to provide clear direction to FRPPs to disclose and reduce their climate-related risks immediately. OSFI's powers include:

- 1) As Superintendent under the *Pension Benefits Standards Act*, OSFI has the authority to require FRPPs to file information concerning the investments of the fund and the solvency and funding status of a pension plan and to direct the plan to disclose any of this information to pension plan members, former members or any other people entitled to pension benefits under the plan.¹⁸ OSFI is well-positioned to introduce mandatory climate risk disclosure for FRPPs in order to allow for OSFI and pension beneficiaries to determine whether their pension plans are resilient to climate risks and sufficiently aligned with the *Paris Agreement* goals.
- 2) OSFI can provide guidance on how climate-related risks should be addressed in SIPPs which set investment strategy for FRPPs, and to set guidelines for exposure limits to climate-related risks.
- 3) OSFI can continue to develop the technical expertise and modelling regarding climate scenarios to enable FRPPs and FRFIs to conduct effective and informative climate stress testing.¹⁹
- 4) OSFI can recommend legislative and regulatory changes to the Department of Finance to improve regulation of financial climate-related risk beyond the current mandate of OSFI. Although our submissions focus on what OSFI can do to regulate climate-related risk under its current mandate, we encourage OSFI to make recommendations to the Minister of Finance to further advance climate risk regulation across federally-regulated parts of the economy, including broad standardized climate risk disclosure, safe harbour regulation for institutions that divest from climate risk-exposed sectors, and clarifications of the fiduciary duties of directors and administrators to consider climate-related risks.

Given the urgency of the climate crisis, OSFI should be using all of the tools available to it to ensure that climate-related risks do not threaten the integrity and soundness of FRPPs and FRFIs in the short, mid and long-term. As federal regulator, OSFI not only has broad regulatory authority, but also should take a leadership role in setting the standard for other pension regulators across the country.

Who we represent

This submission is being made by three organizations: Shift: Action for Pension Wealth and Planet Health ("Shift"), Environmental Defence, and Ecojustice. Collectively, we have expertise and interest in reducing the risks of climate change through law and policy—including the impacts of climate change on the financial sector and the impacts of the financial sector in exacerbating and averting climate change.

¹⁷ OSFI Annual Report 2019-2020, online: <https://www.osfi-bsif.gc.ca/Documents/WET5/AR/eng/1920/AR1920-index.html>.

¹⁸ *Pension Benefits Standards Act, 1985*, ss 12-13; *Pension Benefits Standards Regulation, 1985*, SOR/87-19, s 15(1)(d) and (e).

¹⁹ OSFI, "Bank of Canada and OSFI launch pilot project on climate risk scenarios" (16 November 2020), online: <https://www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/Pages/20201116-nr.aspx>

Shift is an organization that monitors the fossil fuel investments of Canadian pension funds and works to protect pensions and the climate by bringing together beneficiaries and their pension funds to engage on the climate crisis. Shift meets with pension administrators, engages with beneficiaries, and researches and writes reports regarding Canadian pension funds' exposure to climate-related risks.

Environmental Defence is a leading Canadian advocacy organization that works with government, industry and individuals to defend clean water, a safe climate and healthy communities. More than 250,000 Canadians support the organization's work to end fossil fuel subsidies, ensure a just transition, and increase investment in a clean economy.

Ecojustice is Canada's largest environmental law charity with a history of developing game-changing litigation to build a case for a better, more stable climate. Ecojustice is aligned with international efforts to regulate climate-related risk and is seeking to ensure that Canada's climate finance regulation keeps up with countries that are taking leadership on regulating climate-related risk, including the United Kingdom and New Zealand.

We are making these submissions from the perspective of organizations that are working to ensure that climate-related financial risks are regulated to reflect the realities and urgency of climate change. We know that addressing climate-related risks cannot just be a box to be ticked on a SIPP or in an annual report, instead it requires substantive regulation to ensure that financial institutions and pensions are sufficiently prepared for the sudden economic shocks and uncertainties inherent with climate-related risks.

Climate-related risks addressed in SIPPs

Response to Question 8: What are the key considerations for incorporating climate-related risks into the FRPP's Statement of Investment Policies and Principles?

OSFI's SIPP Guideline should be amended to require that SIPPs state the degree of climate-related risks, climate-related risk tolerance, and tools to be used to reduce this risk. This Guideline already states that, in order to meet the legislated requirements for a SIPP, a plan administrator should determine the degree of risk and risk tolerance that a plan is able to sustain.²⁰ Currently, the SIPP Guideline lists five key risks to be considered in SIPPs: credit risk, mismatch risk, currency risk, price risk, and interest rate risk. The guideline does not mention climate-related risks, even though the OSFI Discussion Paper acknowledges that climate-related risks are systemic risks that can drive these listed financial risks.²¹

²⁰ OSFI, "Guideline for the Development of Investment Policies and Procedures for Federally Regulated Pension Plans" (April 2000), online: <https://www.osfi-bsif.gc.ca/Eng/pp-rr/ppa-rra/inv-plc/Pages/penivst.aspx#mozToclid86742> [SIPP Guideline].

²¹ Discussion Paper, *supra* note 1 at paras 3.1-3.4.

At a minimum, OSFI should require in its guideline that SIPPs acknowledge climate-related risks and explain how climate-related risks will be addressed in the FRPP's investment strategy. As noted in the Discussion Paper, climate-related risks and transition risks in particular can materially change the investment environment over time.²² However, contrary to what is suggested in para 5.5 of the OSFI Discussion Paper, we disagree that climate-related risks should be addressed similarly to other environmental, social and governance ("ESG") factors. Although we support OSFI also creating guidance regarding how SIPPs should include other ESG factors, climate-related risks should be treated separately given the financial and systemic risks that climate change creates and the specific standards and science that inform responses to climate-related risks.

As described above, we have already seen evidence of transition risks from stranded assets arise in the last few months as large oil companies have begun to write down the value of their fossil fuel assets.²³ The systemic risks posed by climate change require a specific targeted regulatory response by OSFI, including guidance on how SIPPs should address climate risks. SIPPs are especially important for providing guidance to internal and external investment managers who will use the SIPP to direct their investment decisions.

Canada currently has limited requirements for pension plans to describe how climate-related risks, or ESG factors more broadly, are integrated in their investment strategies. Only Ontario currently requires pension funds to disclose whether or not they consider ESG factors in their SIPP.²⁴ However, OSFI should not simply adopt the Ontario approach, as it has limited utility, especially in addressing material climate-related risks.

Although the Ontario approach is helpful in confirming that pension funds certainly *can* consider ESG factors for ethical or financial reasons, it does not help inform beneficiaries regarding *how* material ESG risks, like climate-related risks, are being managed by the pension administrator. Nor does it require that funds actually integrate climate-related risks into their investment strategy. Pension funds only have to mention in their SIPP whether or not they integrate ESG factors in their investment strategy, they do not have to explain why they choose not to incorporate ESG factors.

In 2017, 64% of funds in Ontario stated that they did not integrate ESG factors in their investment strategy.²⁵ As of 2020, approximately 86% of plans in Ontario do not integrate ESG factors.²⁶ For those funds that state that they do not integrate ESG factors into their investment strategy, beneficiaries are left completely in the dark regarding how their pension might be exposed to climate-related or other

²² Discussion Paper, *supra* note 1 at para 5.3.

²³ Yadullah Hussain, "Posthaste: Imperial Oil's massive write-off suggests the era of stranded Canadian assets is already here", *supra* note 13.

²⁴ *General Regulation, Pension Benefits Act*, RRO 1990, Reg 909, s 78(3).

²⁵ Financial Services Commission of Ontario, *2017 Report Ontario Pension Plan Filings of Statement of Investment Policies and Procedures Information Summaries*, online:

<https://www.fSCO.gov.on.ca/en/pensions/investment/Documents/2017-sipp-report.pdf> at 27. For plans with over \$1 billion assets under management, 67% of plans integrate ESG factors in some way.

²⁶ FOI Request AF-20-37, December 28, 2020.

material risks. Those funds that do consider ESG factors have discretion as to which factors they consider and are given little guidance regarding what further information they have to disclose.²⁷ The Ontario approach does not provide effective or consistent guidance for the disclosure of climate-related risks and does not reflect the urgency and rapidly changing industry standards for assessing and disclosing climate-related risks.

Given the urgency of addressing climate risks, OSFI should provide detailed guidance on prudential approaches to managing climate risk. OSFI should go beyond the Ontario disclosure requirements for ESG factors in SIPPs. For climate-related risks, which OSFI has noted may have an impact on the security and soundness of the fund, the prudent approach is to require funds to consider climate change as a relevant material factor in their long-term investment strategy.

We propose that SIPPs and the OSFI guidelines should address climate-related risks in four key ways:

- 1) SIPPs should have to acknowledge climate-related risks as a key material risk. The SIPP should set out how the FRPP is assessing and determining its risk tolerance for climate-related risks. This should include a requirement that the FRPP will conduct a climate change risk assessment.
- 2) Funds should be required in their SIPPs to set out their targets for reducing their climate risk and aligning with the *Paris Agreement* goals. Those targets should apply to all emissions from all assets under management. As described further, setting targets is a key element of climate risk disclosure. By including the time-bound emissions target in the SIPP, all investment managers and pension administrators must work to meet the target in their investment strategy.
- 3) FRPPs should have to describe what tools they will use to meet these targets in their SIPP. If the FRPP is going to engage with portfolio companies to reduce climate-related risks, they should have an engagement and escalation policy to ensure that engagement will actually be effective in reducing climate risks over a reasonable time frame. OSFI should also clarify that screens or exclusions on high-carbon investments, such as coal, oil, and gas-related investments, are an effective and prudent tool for funds to reduce climate-related risk. These exclusions or screens should be included and described in the SIPP.
- 4) OSFI should develop prudential limits for both FRPPs and FRFIs for exposure to economic sectors that are most exposed to climate-related risks, such as the fossil fuel sector, given the long-term decline and volatility of those sectors. This would inform the climate risk tolerance in SIPPs. A group of experts have made a similar recommendation to bank and non-bank regulators in the United States.²⁸

²⁷ Financial Services Commission of Ontario, “Environmental, Social and Governance Factors” (November 2017), online: <https://www.fSCO.gov.on.ca/en/pensions/policies/active/Documents/IGN-004-2017.pdf>.

²⁸ Public Citizen and Americans for Financial Reform, “Climate Roadmap for U.S. Financial Regulation” (March 2021), online: <https://www.citizen.org/wp-content/uploads/Climate-Financial-Reg-Report.pdf> at 10-11.

Why we need mandatory and prescriptive climate risk disclosure for federally-regulated pension plans

Response to:

- *Question 13: Given OSFI's role as the prudential regulator and supervisor of FRFIs and FRPPs, what other work do you think OSFI should consider in relation to climate-related risks; and*
- *Question 16: What factors should OSFI consider in designing its guidance, supervision process and reporting requirements to promote FRPP preparedness and resilience to climate-related risks?*

The current state of pension regulation in Canada does not clearly require pension funds to adequately address, manage or disclose climate risk. As noted by the Expert Panel on Sustainable Finance, although there is increasing interest in climate risk disclosure, there is a need for greater certainty and guidance so that climate risk disclosure is useful and comparable.²⁹ This need for greater standardization of climate-related disclosure across the economy was recently echoed by the CEOs of the eight largest pension funds in Canada, noting the need for transparency from companies for pension funds to be able to fully disclose and integrate climate change and other ESG factors into their investment strategies.³⁰

A growing number of large Canadian public pension plans now acknowledge their significant climate risk exposure, but do not fully disclose these risks.³¹ At the same time, many pension fund managers have yet to acknowledge climate risks or even describe processes by which they are working to understand their climate risk exposure.

Therefore, OSFI should be moving towards mandating and prescribing climate-related disclosure for all funds, whether or not they may voluntarily consider ESG risks in their investment strategy. Climate-related risks have moved from a non-financial factor that investors *may* consider for moral reasons, to a financial risk that prudent investors *must* consider.

²⁹ Expert Panel on Sustainable Finance Report, *supra* note 5, recommendation 5.2.

³⁰ British Columbia Investment Management Corporation, "CEOs of eight leading Canadian pension plan investment managers call on companies and investors to help drive sustainable and inclusive economic growth" (25 November 2020), online: <https://www.newswire.ca/news-releases/ceos-of-eight-leading-canadian-pension-plan-investment-managers-call-on-companies-and-investors-to-help-drive-sustainable-and-inclusive-economic-growth-844608554.html>.

³¹ For example, the Ontario Teachers' Pension Plan has acknowledged climate change as a systemic risk and made a commitment that its investments will be net-zero by 2050. However, so far, this commitment does not apply to all emissions or all aspects of its portfolio, nor do they fully disclose their exposure to climate risks through investments in companies involved in the extraction, processing, combustion, or transportation of fossil fuels.

International movement towards mandatory prescriptive climate risk disclosure

Around the world, countries leading the way in climate regulation are adopting mandatory climate risk disclosure and rules for the integration of climate risks into investment strategies. The United Kingdom (UK) and New Zealand provide two key examples, as they have both made commitments to mandatory climate risk disclosure for large pension funds.

In the UK, the Department of Work and Pensions announced in summer 2020 a proposal to require occupational pension schemes to comply with the recommendations of the TCFD by having effective governance, strategy, risk management and accompanying metrics and targets for the assessment and management of climate-related risks. In New Zealand, the Cabinet announced in fall 2020 that it would introduce economy-wide mandatory climate-risk disclosure according to TCFD recommendations.

Although the current proposals in the UK and New Zealand differ in terms of scope and timing, both countries' processes emphasize the following themes, which are also relevant in Canada:

- **Disclosure must be mandatory, not voluntary.** New Zealand's Cabinet paper noted that mandatory disclosure was needed to promote business certainty, provide higher quality comparable information, raise expectations for disclosure, create a level-playing field and accelerate progress in the quality of data.³² Similarly, the UK Department of Pension and Work concluded that they did "not believe that the quality of climate change governance and reporting will significantly improve until the requirements are made mandatory" and stated that voluntary phase-in of disclosure ran the risk of lowering expectations regarding rigorous standardized disclosure.³³
- **Flexibility in disclosure requirements may be needed as pension funds rely on adequate disclosure from portfolio companies, but pension funds must show they are using their influence to obtain and push for better disclosure.** There are two elements of flexibility that have been considered in the UK and New Zealand as well as by the Canadian Expert Panel on Sustainable Finance:
 1. Flexibility to address the lack of availability of information to pension funds until climate risk disclosure is mandated for all portfolio companies. To address this, the UK is proposing that pension funds must take all steps to comply with disclosure and stress testing requirements "as far as they are able". This standard will be further described in

³² New Zealand, *Cabinet paper: Climate-related financial disclosures* (September 2020), online: <https://www.mfe.govt.nz/more/briefings-cabinet-papers-and-related-material-search/cabinet-papers/cabinet-paper-climate-0>, at paras 23-24.

³³ UK Department for Work & Pensions, *Taking action on climate risk: improving governance and reporting by occupational pension schemes* (January 2021), online: <https://www.gov.uk/government/consultations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes-response-and-consultation-on-regulations> at 31-32, 42 [UK Consultation Report"].

guidance, but includes an expectation that trustees will prioritize engagement to fill material data gaps in their ability to assess climate risk.³⁴

2. Flexibility to not disclose climate risks if pension funds explain how climate risks are not material. We would not support this type of flexibility. Although the Expert Panel on Sustainable Finance and the New Zealand Cabinet proposal recommends this “comply or explain” approach, the UK proposal does not allow for funds to avoid disclosure by claiming that climate risk is not material. As explained by the UK consultation paper, this is because climate risk assessment and disclosure are the mechanisms by which investors determine whether they are exposed to a significant climate risk.³⁵ We would argue that the UK rejection of this comply or explain approach demonstrates a better understanding of the purpose of mandatory climate risk assessment and disclosure.

- **Climate risk disclosure requirements can be phased in based on the size of the pension funds.** The largest pension funds (in the UK, those with more than £1 billion assets under management and in New Zealand, those with more than \$1 billion NZ) will be required to meet climate risk disclosure requirements first. The UK has also said it will conduct a review of whether to expand these requirements in 2023.
- **Despite uncertainties, disclosure must be made mandatory as soon as possible.** The UK report emphasized that “climate change is an urgent risk” that requires action now to effectively integrate climate change risk into pension scheme decision making.³⁶ Therefore, although there may need to be some flexibility to allow for a lack of information provided by companies, pension funds must also start disclosing and considering climate risk now with the information available.
- **Standardized climate risk disclosure requires regulators to create additional guidance for disclosure.** Although the TCFD recommendations are a good starting point for climate risk disclosure, regulators must prescribe and provide binding statutory guidance on disclosure in order to ensure it is adequately standardized. In New Zealand, they have an External Reporting Board that will be developing disclosure standards. In the UK, climate risk disclosure requirements will be set out in a mix of regulation and guidance materials. Importantly, the UK has adopted key measures that will be mandatory such as a requirement for pension funds to select and report on at least two metrics consistently, one which measures absolute emissions in the portfolio and one which is an intensity-based metric, and they must set a target based on one of those metrics. As we describe further, in Canada, this target should be based on absolute emissions and should align with Canada’s commitments under the *Paris Agreement*.

³⁴ UK Consultation Report, *supra* note 33, at 80-81.

³⁵ UK Consultation Report, *supra* note 33, at 31.

³⁶ UK Consultation Report, *supra* note 33, at 42.

When considering whether to implement mandatory and prescriptive rules regarding the disclosure of climate risk for FRPPs and FRFIs, OSFI should be guided by these themes that have arisen in similar consultations in the UK and New Zealand. Although some flexibility may be needed while mandatory disclosure is adopted across the rest of the economy, these countries have concluded that mandatory prescriptive climate risk disclosure should be adopted urgently for pension funds, allowing pension plans to push for better disclosure from portfolio companies. OSFI, as Canada's federal pension regulator, should follow suit.

Criteria for a mandatory, standardized disclosure regime

In addition to our view that climate risk assessment and disclosure aligning with the TCFD recommendations must be made mandatory for all pension funds regulated by OSFI, we have also set out several key criteria for any mandated climate risk assessment and disclosure for FRPPs:

- Mandatory stress-testing (also called scenario analysis) must require pension funds to test the resilience of their investment strategy to climate success scenarios (where warming is kept below 1.5°C) and climate failure;
- Pension plans must set a target or targets to align with the *Paris Agreement* goal of net-zero emissions by 2050;
- OSFI should develop guidance regarding what will be considered Paris-aligned targets and metrics that cover the full scope of emission sources; and
- Climate risk disclosure must be made publicly available.

Criteria for mandatory stress testing

Response to Question 9: For FRPPs where the administrator directly invests in assets, are scenario analysis and stress testing used to assess the pension plan's exposure to climate-related risks? If so, how useful are they? What are some other risk measurement tools that FRPP administrators should consider?

A key element of TCFD-aligned climate risk disclosures is the need to assess an organization's resilience to climate-related scenarios, especially a 2°C or lower scenario. We recommend that OSFI provides detailed guidance on how stress testing should be conducted to ensure that FRPPs and FRFIs are fully and accurately assessing their resilience to climate risks.

Central bankers have warned that accelerating climate-related financial risk poses a threat not only to individual finance institutions, but also for the integrity of the global financial system.³⁷ In particular,

³⁷ Guidance to Assess the Systemic Importance of Financial Institutions, *Markets and Instruments: Initial Considerations Report to the G-20 Finance Ministers and Central Bank Governors* (2009), online: <https://www.imf.org/external/np/g20/pdf/100109.pdf#page=4>; Mark Carney, *Breaking the Tragedy of the Horizon*, *supra* note 9.

experts worry that leveraged exposure to rapid and unprecedented re-pricing events driven by changes in technology and policy, as well as physical risks, could lead to a reassessment of the value of assets and destabilize the global financial system. As a result, a growing number of central banks and regulators, including the Bank of Canada and OSFI, are undertaking projects and policies to stress-test the resilience of finance institutions to climate risks associated with a range of future climate scenarios, and the financial system's wider exposure more broadly to climate-related risk.³⁸

While stress-tests are an essential tool for managing climate risk exposure, their value is often limited by the choice of the scenarios used for analysis. It is critical that the outlooks chosen to test institutional portfolio alignment and broader financial stability are sufficiently stressful to provide an accurate picture of the range or possible futures and associated system risks. Many scenarios chosen do not meet this standard by modelling futures with assumptions based on business-as-usual baselines. As a result, stress-tests often downplay the scale of climate risk exposure.

Effective scenario analysis should test against bookend outlooks which assume climate success and climate failure, not business as usual pathways. It is especially important that models are chosen which reflect an assumption that the world will be successful in achieving the goal of the *Paris Agreement*, limiting warming to 1.5°C, compared to pre-industrial levels. Few global economic models to date however actually achieve this standard, leading many scenarios to significantly underreport transition risk exposure.

Helpfully, two new 'Paris-aligned' outlooks are now expected in 2021: the International Renewable Energy Agency's ("IRENA") Energy Transitions Outlook: 1.5°C pathway³⁹ (see Figure 1) and a highly anticipated new 1.5°C outlook promised from the International Energy Agency ("IEA") to be unveiled this spring and included in its flagship World Energy Outlook report in the fall. Previous IEA outlooks are not considered Paris-aligned by experts, and a growing list of major institutional investors have called on them to publish a complete 1.5°C scenario for this reason.⁴⁰

While the Network for Greening the Financial System ("NGFS") published a guide to assist central banks and supervisors in their use of scenario modelling, the recommendations do not address climate risk sufficiently or realistically.⁴¹ The report guides users towards slower and riskier decarbonization pathways, selects scenarios which prioritize unrealistic carbon removal technologies over the

³⁸ OSFI, Bank of Canada and OSFI launch pilot project on climate risk scenarios, *supra* note 19.

³⁹ International Renewable Energy Agency, *World Energy Transitions Outlook: 1.5°C Pathway* (March 2021), online: <https://www.irena.org/publications/2021/March/World-Energy-Transitions-Outlook>.

⁴⁰ Susanna Rust, "Net-zero asset owner group calls for 'fully developed' IEA 1.5°C scenario" (8 January 2021), online: <https://www.ipe.com/news/net-zero-asset-owner-group-calls-for-fully-developed-iea-15c-scenario/10049938.article>.

⁴¹ NGFS, *Climate Scenarios for central banks and supervisors* (June 2020), online: https://www.ngfs.net/sites/default/files/medias/documents/820184_ngfs_scenarios_final_version_v6.pdf.

requirement to phase-out fossil fuels, and does not caution over the limitations of Integrated Assessment Models (“IAMs”) and the need for a precautionary approach.⁴²

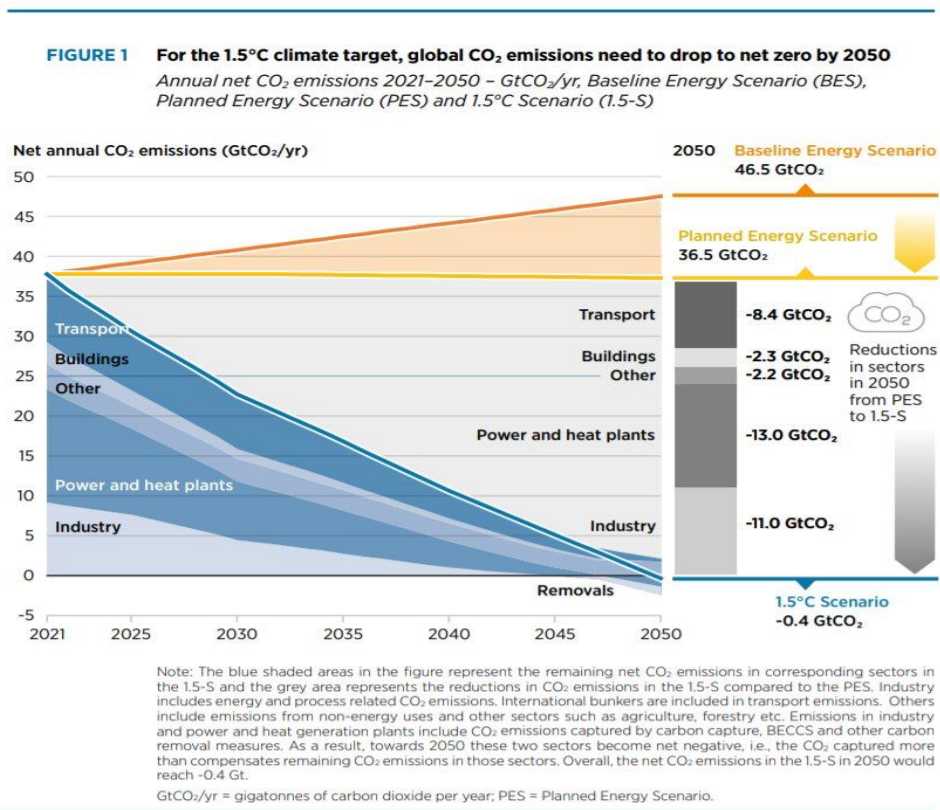


Figure 1. IRENA’s Energy Transitions Outlook: 1.5°C pathway.

Carbon removal technologies are often heavily relied upon in climate scenarios. And yet, carbon removal technologies face myriad deployment barriers and raise a number of environmental, economic, and social concerns. Carbon removal technologies are currently expensive to deploy, may not result in substantially lower or negative emissions, and raise significant sustainability and environmental justice concerns in light of their potential energy, water, land use, and other resource demands. We would therefore recommend that any scenarios developed by OSFI and the Bank of Canada take a highly precautionary and conservative approach towards carbon removal.

Outlined below are the main reasons why those developing climate-safe scenarios should limit or avoid the use of carbon removal in their projections and scenario analyses in order to accurately model climate risks:

⁴² Oil Change International, *NGFS Scenarios: Guiding Finance Towards Climate Ambition Or Climate Failure?* (February 2021), online: <http://priceofoil.org/content/uploads/2021/02/NGFS-scenarios-final.pdf>.

- **Carbon capture and storage (CCS) at scale remains largely unproven and its potential to deliver significant emission reductions by mid-century is currently limited.** Current evidence supporting CCS as an effective and scalable climate mitigation tool is largely theoretical, and still under debate. For CCS to play a significant role in achieving the *Paris Agreement* goal, gigatonnes (Gt) of CO₂ would need to be captured and permanently stored. This would require the financing and construction of CO₂ transport infrastructure roughly equivalent in scale to today’s oil and gas pipeline and marine transport networks. The political, social, economic, and technical barriers to achieving this cannot be understated. Equity, cost-effectiveness, and abatement potential are all important factors in determining whether CCS should be considered a technology solution.
- **Enhanced oil recovery is at odds with climate action,**⁴³ and will not lower emissions in comparison to renewable energy and energy efficiency.
- **CCS is not needed in the power sector.** Faster, cleaner, safer, more efficient, and cheaper means exist to reduce CO₂ emissions, such as phasing out fossil fuels and replacing them with renewable energy, energy efficiency, and energy conservation.⁴⁴
- **A suite of strategies and technologies already exist to cut emissions in the industrial sector, without CCS.**⁴⁵ There is no definitive evidence that CCS is the fastest, cheapest, cleanest and most durable way to decarbonize the industrial sectors, including the cement, iron ore-based steel and other metals, and chemical industries. Emissions in the industrial sector can be significantly reduced by increasing process efficiency. For some of these industries, zero-carbon technologies and processes already exist and should be rapidly deployed, replacing fossil fuels with renewable energy, increasing recycling rates, and designing alternative materials with lower emission footprints than steel, conventional cements, plastics and aluminum.
- **Safe, permanent, and verifiable storage of CO₂ is difficult to guarantee.**⁴⁶
 - For CCS to serve as a safe, effective mitigation tool, captured carbon must be injected and stay underground permanently. Significant uncertainty remains in estimates of potential leakage risk.⁴⁷
 - Aside from compromising climate mitigation efforts, depending on volume and concentration, CO₂ leakage also has the potential to contaminate ground and surface waters, impact soil ecology and the marine environment, and harm human health.⁴⁸

⁴³ European Environment Agency, “Carbon capture and storage could also impact air pollution”, last modified 10 December 2019, see: <https://www.eea.europa.eu/highlights/carbon-capture-and-storage-could>

⁴⁴ See, e.g., Center for International Environmental Law, *Fuel to the Fire: How geoengineering threatens to entrench fossil fuels and accelerate the climate crisis* (February 2019), online: <https://www.ciel.org/reports/fuel-to-the-fire-howgeoengineering-threatens-to-entrench-fossil-fuels-and-accelerate-the-climate-crisis-feb-2019/>.

⁴⁵ Climate Action Network International, *Position: Carbon Capture, Storage and Utilisation* (January 2021), online: https://climatenetwork.org/wp-content/uploads/2021/01/can_position_carbon_capture_storage_and_utilisation_january_2021.pdf

⁴⁶ Climate Action Network International, *ibid*.

⁴⁷ S. T. Anderson, “Risk, Liability, and Economic Issues with Long-Term CO₂ Storage—A Review” (2017) 26 *Natural Resources Research* 89, <https://doi.org/10.1007/s11053-016-9303-6>.

⁴⁸ Climate Action Network International, *supra* note 45.

- The implications for climate mitigation as well as other environmental and public health risks makes governance and the risk of leakage, even at very low rates, a serious concern.
- **Long-term CO₂ storage creates financial, liability, and climate risks that are highly likely to be transferred from the private sector to the public sector.**
 - Another barrier to CCS deployment is the question of who is liable for CO₂ once it is stored underground. The answer to this question determines who is likely responsible for monitoring a CO₂ storage site, remediating CO₂ leaks to the extent possible, providing financial security, and paying for any “harm” to the climate, private property, environment, human health, etc. in the event something goes wrong.
 - Long-term CO₂ storage over hundreds or even thousands of years hands over our climate responsibility to future generations.
 - Industry actors are often unwilling to invest in CCS unless they are protected from the risks associated with long-term CO₂ storage. In some countries, efforts to limit the liability of those engaged in CCS have included liability caps, federal indemnity programs, and a complete transfer of liability from the private to public sector,⁴⁹
 - Liability questions for CO₂ storage have yet to be answered in many places, and most countries lack a governance structure to maintain and ensure the long-term fiscal integrity of CO₂ storage sites. Some proponents of CCS have sought to relieve private sector parties engaged in CCS of financial and legal liability by transferring risk to governments and/or incorporating liability limits into law. Even with strong financial security mechanisms in place, there is a risk that governments will ultimately be responsible for the long-term monitoring, management, and remediation of CO₂ storage sites.
- **The climate impact of CCS should consider all emissions and costs from concomitant processes.** The costs and emission of greenhouse gases and some pollutants from processes associated with CCS need to be carefully factored into scenario analysis. Power plants and industries intended to sequester CO₂ will use additional energy to compress, transport to suitable reservoirs, and pump into the ground the captured CO₂. Studies calculate that 15-25% more energy would be required, depending on the particular CCS technology used.⁵⁰

We also caution that scenarios should limit their reliance on carbon credits or offsetting, as it runs into similar issues as carbon removal. Carbon offset programs have a history of failure.⁵¹ Scenarios that rely heavily on carbon credits outside of Canada put the burden of emission reductions on lower income

⁴⁹ I. Havercroft and R. Macrory, *Legal Liability and Carbon Capture and Storage: A Comparative Perspective* (2014), online: https://sequestration.mit.edu/pdf/GHGT8_deFigueiredo.pdf.

⁵⁰ European Environment Agency, *supra* note 43.

⁵¹ Greenpeace UK (Jan 2021) *Net Expectations: Assessing the role of carbon dioxide removal in companies' climate plans*, online: <https://www.greenpeace.org.uk/wp-content/uploads/2021/01/Net-Expectations-Greenpeace-CDR-briefing.pdf>, at 9.

countries, impacting local biodiversity and local communities.⁵² So far, there is little regulation of carbon credits internationally or nationally to help limit double counting of emissions or ensure that carbon credits are useful in reducing emissions.⁵³

Therefore, OSFI should require that FRPPs and FRFIs stress test against a 1.5°C scenario which takes a precautionary approach towards carbon removal technology and offsetting. The scenarios being developed by the Bank of Canada and OSFI should similarly include a scenario that aligns with Canada meeting its net-zero targets and which limits overreliance on undeveloped and unproven carbon technology. FRPPs and FRFIs should have to disclose the results of these stress tests to OSFI and to the public and explain what actions they are taking to ensure that they remain resilient to this climate success scenario.

Requiring standardized Paris alignment for targets and metrics

Response to Question 16: What factors should OSFI consider in designing its guidance, supervision process and reporting requirements to promote FRPP preparedness and resilience to climate-related risks?

Another key element of climate risk disclosure under the TCFD recommendations is the setting of an emissions target to manage climate-related risks and opportunities and reporting on metrics relevant to that target. As part of its climate-risk disclosure requirements, we encourage OSFI to require that FRPPs and FRFIs set targets that are “Paris-aligned” (aligned with the 1.5°C goal of the *Paris Agreement*). Further, OSFI should develop guidance defining Paris-aligned targets and the metrics that should be used to report on performance towards these targets. We have further described key criteria for Paris-aligned targets below.

As mentioned above, the *Paris Agreement*, signed by nearly 200 countries, represents a global ‘bottom up’ political consensus on the requirement to stabilize global temperature increases at levels that avoid the most harmful and dangerous harm for societies and ecosystems by keeping the rise in global average temperature to well below 2°C above pre-industrial levels; and to pursue efforts to limit the increase to 1.5°C. In order to meet this 1.5°C target, carbon dioxide emissions must decline by 45% from 2010 levels by 2030 and reach “net zero” by 2050.⁵⁴

Subsequently, governments, institutions and industry have used ‘net-zero’ as a form of short-hand for Paris-alignment. However the definition of the term is often intentionally or accidentally misinterpreted in ways which would make ‘Paris-alignment’ in line with global climate goals impossible. In particular,

⁵² A. Skelton et al, “10 myths about net zero targets and carbon offsetting, busted” (11 December 2020) *Climate Home News*, online: <https://www.climatechangenews.com/2020/12/11/10-myths-net-zero-targets-carbon-offsetting-busted/>.

⁵³ Ecofiscal Commission, *Bridging the Gap: Real Options for Meeting Canada’s 2030 GHG Target* (November 2019), online: <https://ecofiscal.ca/wp-content/uploads/2019/11/Ecofiscal-Commission-Bridging-the-Gap-November-27-2019-FINAL.pdf>, at 7.

⁵⁴ IPCC, *Summary for Policymakers*, *supra* note 4.

the lack of timelines for action and reliance on assumptions of non-additional offsets or unrealistic carbon removal assumptions that would allow companies, institutions and governments to continue polluting the climate, delaying the rapid decarbonization required. Empty ‘net-zero’ promises from Canadian companies and institutions are becoming widespread in Canada.

In response to growing net-zero greenwashing, leading climate scientists recently published a guide for assessing if net-zero targets are meaningful. Perhaps most critically, they ask: ‘Would the global climate goal be achieved if everyone did this?’ as part of a Check-List for Rigorous and Clean Net-Zero Plans. This report should form a foundation for OSFI’s guidance on Paris-alignment.⁵⁵ The three key elements for Paris-aligned targets from this report are:

- 1) The targets specify which emission sources and which gases are covered, when net zero will be reached, and whether the intent is to reduce, remove or offset emissions. This also means that targets should cover all emission sources, commonly referred to as Scope 1, Scope 2, and Scope 3 emissions.⁵⁶ A target or metric that does not report on Scope 3 emissions will miss out on the key climate risks, especially for fossil fuel companies, as transition risks mostly arise from the Scope 3 emissions produced when fossil fuels are consumed.⁵⁷ In addition, a Paris-aligned target must describe if and how it is relying on carbon removal and/or credits to reach its net zero target. The target should not rely on unrealistic or unfeasible carbon removal technologies or ineffective carbon credit schemes for the same reason that stress testing scenarios should not include assumptions of unrealistic technology – unrealistic assumptions will not address the real financial risks of climate change.
- 2) The target should capture the required adequacy, fairness and equity considerations. For an investor based in Canada, its target should, at minimum, align with Canada’s net zero target and revised nationally determined contribution. It should adopt a target based on cutting emissions locally rather than relying on international offsets.
- 3) The target should include a measurable roadmap that spells out measurable short-term, medium-term and long-term actions, including interim targets between now and 2050.

⁵⁵Rogelj et al. “Net-zero emissions targets are vague: three ways to fix. To limit warming, action plans from countries and companies must be fair, rigorous and transparent” *Nature* (March 2021), online: <https://www.nature.com/articles/d41586-021-00662-3>.

⁵⁶ Scope 1 emissions are direct emissions from a company’s activities. Scope 2 emissions are indirect emissions from the company’s consumption of electricity, heat or steam. Scope 3 emissions are all other indirect emissions, such as the emissions resulting from the use of the company’s products, like the burning of fossil fuels for a fossil fuel company, see: <https://ghgprotocol.org/calculation-tools-faq>.

⁵⁷ Task Force on Climate-related Financial Disclosures, *Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures* (June 2017), online: <https://assets.bbhub.io/company/sites/60/2020/10/FINAL-TCFD-Annex-Amended-121517.pdf>, at 54 [TCFD Implementation Report]; UNEP Finance Initiative, *Changing Course: A comprehensive investor guide to scenario-based methods for climate risk assessment in response to the TCFD* (May 2019), online: <https://www.unepfi.org/wordpress/wp-content/uploads/2019/05/TCFD-Changing-Course-Oct-19.pdf>, at 32.

Not only does the proliferation of meaningless or deceitful net-zero promises significantly increase the exposure of companies and institutions to climate risk, but they undermine the ability of OSFI regulated institutions and Canada more broadly to meet its required obligations under the *Paris Agreement*.

Disclosure should be made public

OSFI should require that FRPPs publish their climate risk disclosure report to the public through a website. This should include the results of their stress testing and their emission metrics. As noted in the UK's consultation process, "this approach has the essential merits of increased accountability and opportunity for scrutiny. This is vital, given the significant financially material risk that climate change poses to occupational pension schemes and their beneficiaries."⁵⁸

It is important that beneficiaries are able to see not only their pension plan's climate risk disclosure, but also the disclosure of other pension plans. This will allow for beneficiaries to understand if their pension plan is truly keeping up with industry standards in managing climate risk. Given that the assessment and management of climate risk is rapidly changing, beneficiaries must be allowed to hold their pension plans to account if they fall behind industry standards, exposing the beneficiaries to risk.

Criteria for selecting investment managers

Response to Question 10: whether FRPPs should consider an investment manager's climate-related risk management when selecting risk managers and, if so, the criteria they should use?

Pension administrators must consider an investment manager's climate-related risk management as part of their duties as a prudent investor to oversee and supervise investment managers.⁵⁹ This duty applies both when selecting investment managers and when monitoring their performance. OSFI should not just provide guidelines on selection criteria for investment managers, but also provide criteria for monitoring performance of investment managers with regards to climate risk. The obligation does not end at the selection of an investment manager.

Prudent supervision of investment managers' responses to climate risk is critical given the large number of pension plans that rely on investment managers for implementing all or part of their investment strategy. As climate change presents a material financial risk to pension fund investments, pension administrators have an obligation to ensure that pension funds manage their exposure to these risks, including through decisions made by investment managers.

⁵⁸ UK Consultation Report, *supra* note 33, at 106.

⁵⁹ Pension administrators as fiduciaries have duties to monitor the portfolio and supervise the performance of investment managers, see *Ermineskin Indian Band and Nation v Canada*, 2006 FCA 415, at para 239 (Sexton, JA, in dissent summarizing prudent investing principles); *Fales v Canada Permanent Trust Co*, [1977] 2 SCR 302, at 317.

Investment managers themselves also owe fiduciary duties to pension administrators when making investment decisions.⁶⁰ Although investment managers may owe duties to beneficiaries as well,⁶¹ it is the pension administrators who will be ultimately responsible for setting the investment strategy and acting in the best interests of beneficiaries. Therefore, pension administrators must set out criteria related to the management of climate risks for selecting and monitoring the performance of investment managers.⁶²

A review of 30 asset owners in OECD countries (excluding the United States) found that robust climate risk governance included clearly defined climate-related responsibilities for external managers as well as internal managers.⁶³ A key part of risk management was to create climate-related reporting requirements for external investment managers who are responsible for asset allocation, risk management or engagement with companies on climate-related activities.⁶⁴

Similarly, the TCFD also noted the important role that pension funds and other asset owners play in encouraging better disclosures along the investment chain, including by investment managers. The TCFD recommends that investment managers disclose climate risks to a similar standard as asset owners, including conducting stress testing to climate scenarios, disclosing the fund's exposure and integration of climate risks into risk management, disclosing GHG emissions, and setting climate-related targets.⁶⁵ The UK organization ShareAction has also recently released a list of best practices for investment managers in addressing ESG risks, including climate risks specifically, which should also inform the criteria for selection and monitoring of investment managers.⁶⁶

Based on the fiduciary duties of pension administrators, alignment with TCFD recommendations, and ShareAction's best practices report, we propose the following criteria for pension administrators selecting and monitoring investment managers:

- Investment managers should disclose climate risks according to the TCFD recommendations, including disclosing scope 1, 2, and 3 emissions and conducting and disclosing stress testing that meets the criteria for disclosure and stress testing for pension funds set out above;

⁶⁰ TCFD Implementation Report, *supra* note 57, at 38.

⁶¹ Law Commission, *Fiduciary Duties of Investment Intermediaries* (Law Com No 350, 2014), online: <https://www.lawcom.gov.uk/project/fiduciary-duties-of-investment-intermediaries/>, at 10.21-10.28.

⁶² The OSFI Guideline already note that an investment policy should document how investment managers will be chosen, compensated and replaced and that as part of this, the plan administrator should determine the degree of risk and risk tolerance the plan can sustain, *supra* note 20.

⁶³ Sustineri, *Market standards on climate-related risk by asset owners* (August 2018), online: <https://www.documents.clientearth.org/library/download-info/market-standards-on-climate-related-risks-by-asset-owners-report-by-clientearth-and-sustineri/>, at 7 [Sustineri Report].

⁶⁴ Sustineri Report, *supra* note 63, at 11.

⁶⁵ TCFD Implementation Report, *supra* note 57, at 37-42.

⁶⁶ ShareAction, *Point of No Returns Part V - Leading Practice: A guide to current leading practices by asset managers on responsible investment* (March 2021), online: <https://shareaction.org/wp-content/uploads/2021/02/ShareAction-Leading-Practice-2021.pdf>, at 53-55.

- Investment managers should have exclusions for new investments in coal, oil and gas, and exit plans for current investments;
- Investment managers should have a plan for decarbonization of all assets under management by 2050;
- Investment managers should have a public stewardship and engagement policy that includes:
 - a voting policy with a presumptive commitment to vote for resolutions that will increase climate risk disclosure and reduce climate risk exposure;⁶⁷ and
 - a publicly available escalation strategy setting out steps, timelines and triggers if companies do not respond to engagement.
- Investment managers must regularly and publicly report back to the pension administrator describing their efforts and outcomes in reducing climate risk through engagement with portfolio companies, including:
 - a list of companies and topics of engagement;
 - details of engagement progress and real-world outcomes;
 - next steps and targets for engagement;
 - contribution and activity related to collaborative shareholder initiatives to reduce climate risk;
 - explaining how the escalation strategy for unsuccessful engagement has been applied, if needed; and
 - providing the details of any other engagement activities for assets beyond public equity.

In addition to requiring investment managers to have escalation strategies to ensure that engagement with portfolio companies is effective and timely, pension funds should similarly have escalation strategies in the event that investment managers fail to disclose or manage climate risks according to the criteria set out by the pension fund. Only through careful monitoring and supervision of investment managers can pension administrators meet their fiduciary and prudential obligations to manage climate risk.

Conclusion

We recommend that OSFI mandate climate risk disclosure for all FRPPs and FRFIs as a first step to address climate-related financial risks. In response to the questions set out in the Discussion Paper, we have made the following recommendations:

Question 8: What are the key considerations for incorporating climate-related risks into the FRPP's Statement of Investment Policies and Principles?

OSFI should require that FRPPs include climate-related risks as material risks explicitly in their SIPPs. SIPPs should acknowledge climate-related risks, require a climate change risk assessment, set targets to

⁶⁷ See recommendation from Share Action report, *supra* note 66, and from UNPRI, *Fiduciary Duty in the 21st Century: Canada Roadmap*, at 11, online: <https://www.unpri.org/download?ac=1387>.

manage those risks, and explain the tools that the FRPP will use to meet that target, including both engagement and divestment as potential strategies.

OSFI should also develop prudential exposure limits for climate-related risk, which should be included as guidance in the development of SIPPs. These could take the form of recommended limits on the exposure of a fund to the economic sectors most exposed to climate-related risks, such as the fossil fuel sector, given the transition risks and volatility associated with those sectors.

Question 9: For FRPPs where the administrator directly invests in assets, are scenario analysis and stress testing used to assess the pension plan's exposure to climate-related risks? If so, how useful are they? What are some other risk measurement tools that FRPP administrators should consider?

OSFI should require FRPPs to stress test their portfolio and report on the results to OSFI, beneficiaries, and the public. Specifically, OSFI should develop or adopt a "climate success" 1.5°C scenario. It should require that FRPPs (as well as FRFIs) test their portfolio against a "climate success" 1.5°C scenario as well as a "climate failure" scenario as part of their climate risk disclosure obligations. The 1.5°C scenario should take a precautionary, limited approach to carbon removal technology and carbon credits.

Question 10: whether FRPPs should consider an investment manager's climate-related risk management when selecting risk managers and, if so, the criteria they should use?

OSFI should provide guidance stating that FRPPs must consider an investment manager's approach to climate-related risk as part of their duty of prudence when selecting and monitoring investment managers. The criteria should include commitments by the investment manager to reduce climate risk through exclusions or screens and a detailed policy of engagement and escalation if the investment manager uses engagement to manage climate-related risks.

Question 13: Given OSFI's role as the prudential regulator and supervisor of FRFIs and FRPPs, what other work do you think OSFI should consider in relation to climate-related risks; and

Question 16: What factors should OSFI consider in designing its guidance, supervision process and reporting requirements to promote FRPP preparedness and resilience to climate-related risks?

As prudent regulator and supervisor, OSFI should develop mandatory public climate-risk disclosure standards for FRPPs and FRFIs based on the TCFD recommendations. These standards can be informed by the UK and New Zealand consultation reports, which underscore the need for urgent, standardized mandatory climate risk disclosure for pension plans.

As part of this work OSFI should develop a 1.5°C "climate success" scenario with a precautionary approach to carbon removal and offsets. It should develop guidance on reporting on scenario analysis.

OSFI should also require that FRPPs and FRFIs disclose emissions targets and credible plans to meet those targets as part of its mandatory climate risk disclosure. OSFI should develop guidance for Paris-aligned targets and plans, requiring these targets to address the full scope of emissions in the portfolio.

If OSFI's ability to mandate climate risk disclosure and prudently regulate climate risk is limited by its legislated mandate, we ask that the Superintendent report to the Minister on what legislated changes should be made to ensure that OSFI can fulfill its role as prudential regulator with regard to climate-related risks.

Thank you for the opportunity to participate in this important conversation. If there are further opportunities to discuss OSFI's approach to the regulation of climate-related risks we would be happy to participate.

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