Vancity's response

to Navigating Uncertainty in Climate Change: Promoting Preparedness and Resilience to Climate-Related Risks

The climate emergency is the next major crisis on Canada's doorstep, and a problem of unprecedented risk for the country's financial system.

Risk management is the basis of health and stability for any financial institution (FI), and the interests of investors, borrowers and the broader economy can only be served within the context of a robust and comprehensive risk management framework.

As such, until climate-related risks are integrated into capital and regulatory frameworks, a destructive feedback loop of climate-related risks could begin to undermine the strength and resilience of Canada's financial system. Climate-related risks are inextricably linked with other risks—including credit, market and underwriting risks—and poised to be a major driver of risks for many decades to come.

In order to facilitate FIs' preparedness and resilience to these risks, Vancity is supportive of OSFI integrating climate-related considerations into the existing capital framework, requiring FIs to integrate climate-related risks into their risk assessment processes including governance, operational risks and Internal Capital Adequacy Assessment Plans, and mandating public climate-risk disclosures. Steps should also be taken to avoid boilerplate disclosures, including minimum requirements to ensure the information shared is relevant, clear, understandable and FI-specific.

We believe these are necessary steps in serving the interests of depositors, creditors, shareholders and policyholders.

Canada's peers, including the United Kingdom, the United States, the Netherlands, Spain and France, have already taken steps or publicly stated their intention to regulate the climate-risk exposure of their financial systems. Canada must stay in step with our global peers.

Vancity is a supporter of the Task Force on Climate-Related Financial Disclosures (TCFD), and will generate our second disclosure report this year. We are part of the Partnership for Carbon Accounting Financials (PCAF), and we represent North America on the Board overseeing the implementation of the UN's Principles for Responsible Banking.

The need for regulators such as OSFI to integrate climate risks into capital and regulatory frameworks is urgent. Without a view of climate risks, current frameworks are modeled around two mutually exclusive predictions of the future: Little-to-no rise in global temperatures, and a steady rise in demand for fossil fuels.

At the same time, a lack of recognition of climate-related risks is leading to the over-valuation of unsustainable assets and the under-valuation of green and sustainable assets. This misallocation of funds is undermining Canada's ability to harness transition opportunities and escalating the level and complexities of risks that threaten the stability of our financial system in the long-term.

Overall, Vancity is supportive of the considerations of climate risk outlined in OSFI's discussion paper.

Our recommendations are as follows:

1. OSFI should take immediate steps to integrate climate-related risks into its capital and regulatory framework, and undertake a review of relevant legislation to ensure regulatory alignment.

2. OSFI should require financial institutions and pension plans to report publicly about climate risk according to the methods and standards outlined by the TCFD, and include requirements that avoid boilerplate disclosure.

3. FIs should be required to meet a minimum standard of data tracking in order to support scenario analysis, including adjusting risk framework timelines to incorporate the longer-term impacts of climate-related risks.

4. OSFI should establish an agreed-upon business-as-usual baseline scenario that can be widely applied in the development of risk metrics.

5. OSFI should convene and lead a working group with provincial regulators to inform Canada's approach to integrating climate risk into capital and regulatory frameworks, and guide the development of better databases and analytical tools to support this work.

6. OSFI should develop a set of measurements and standards that can be applied to establish a clear definition of green or sustainable financing, and ensure that FIs bring products to market that reduce carbon emissions and align with the new climate risk framework.

More detailed rationale to support these recommendations is outlined in the responses to the discussion questions.

Annex A

Discussion questions

Climate-Related Risks and their Impact on FRFIs and FRPPs

Question 1:

What are your views on the characterization of climate-related risks as drivers of other risks? How do climate-related risks affect FRFIs and FDPPs? Do you have other views on the characterization of climate related risks set out in this paper?

Vancity answer:

Climate-related risks are drivers of financial risks, including credit, liquidity, market, operational and insurance risks. Given the growing frequency of severe weather events, and the trend toward GHG-reductive policies and markets persuasion, climate-related risks are poised to become an increasingly important driver of other financial risks.

Understanding climate risk is essential to prudential management of FIs, and Vancity supports efforts to better understand and account for the climate risk exposure of Canada's financial system.

Vancity is also supportive of the characterization of climate-related risks set out in the consultation paper, but with clarification on OSFI's view of why and how liability risk should be calculated separately for FIs. Vancity supports the TCFD's risk framework for FIs, which contemplates physical and transition risks, and embeds liability risk within the latter.

Question 2:

What steps can FRFIs and FRPPs take to improve their definition, identification and measurement of climate-related risks and the impact of these risks?

Vancity answer:

Canadian FIs have taken different steps to improve their definition, identification and measurement of climate-related risks and their impacts. What is most needed is a standardized approach that will give FIs a fixed set of standards, a way to gauge how they compare to peers, and give regulators a view of the overall exposure of the Canadian economy.

The TCFD outlines a set of 11 recommendations that can be helpful first steps in getting started in this work. They fall into four categories – governance, strategy, risk management and metrics and targets – and include a review of how climate-risks are integrated into the organization's overall risk management.

There are also steps that should be taken to understand the exposure of an FI's lending or investment portfolio at a high-level, such as heat mapping.

FIs need to begin expanding data sets, and collecting information related to physical and transition risks on their lending and investments, and OSFI should have a view to a minimum standard of data required, and the extent of related supply chain considerations that need to be integrated into scenario analysis and climate risk assessment.

More broadly, risk frameworks will need to be adjusted to consider longer timeframes, to account for the extended timelines that shape climate-related risks.

Ways FRFIs Could Prepare for, and Build Resilience to, Climate-Related Risks

Question 3:

Does your organization have, or plan to develop, a climate-related risk appetite and strategy? How does your organization approach setting its risk appetite and strategy?

Vancity answer:

Vancity's investment group, Vancity Investment Management (VCIM) incorporates a four-part climate risk strategy of divestment, decarbonization, reinvestment and engagement to investment decisions. VCIM has divested from companies that are primarily involved in the production, processing and distribution of fossil fuels.

Vancity Community Investment Bank (VCIB) has a subsidiary that provides investment through bonds and financing of Clean Energy projects. The determination of what kinds of projects to finance is based on a set of categories defined by Clean Energy standards from places like Corporate Knights and Climate Bonds Taxonomy.

Vancity currently does have a climate-related risk strategy, does not lend to the fossil fuel sector, and we will be completing our second TCFD disclosure report this year.

Climate is one of the ten risk dimensions our organization monitors, and we revise our metrics and thresholds annually. Our Operational Risk Management Committee meets monthly and has, as a standing item, a discussion on climate risks, including what they are, where they exist, and what mitigating steps are being taken or recommended. This committee reports into the Risk Management Committee (RMC).

At this stage, the climate risk metrics Vancity tracks are basic, and continuing to mature as we develop our climate strategy more fully.

Question 4:

What new or adapted governance structures, policies or processes should FIs consider to effectively manage their climate-related risks?

Vancity answer:

The implementation of new policies, structures and processes will be necessary to support most FIs in beginning to effectively manage climate-related risks.

This includes marrying evolving science on climate to business operations. Collective knowledge and understanding of climate-related risks is evolving, and new information is emerging constantly. FIs will need to create a centralized body within their organizations charged with adapting and aligning business decisions to emerging science.

Informed by this centralized body, clear policies should be developed that define the type of investments that exacerbate climate-related risks, and should be avoided, and those that mitigate climate-related risks, and should be encouraged.

FIs should be building their internal capacity to understand, track, and test scenarios for local climate trends and their impact on local market dynamics. This includes climate-related supply chain risks. FIs will need guidance from OSFI on how far downstream their analyses should go, and how to contemplate climate-related supply chain risks, including an inventory of factors to consider, such as geography and degrees of commoditization.

FIs should begin generating databases and building them out with statistics that can help illuminate key risk indicators (KRIs). Part of this work includes tracking exposure to fossil fuels, and establishing portfolio limits, or a carbon budget.

Finally, the five Cs of credit – character, capacity, capital, collateral and conditions – need to be expanded to become the six Cs, and include climate-related risks.

At Vancity, climate-related risks are part of our Enterprise Risk Management framework, which is monitored by our Risk Committee of the Board of Directors. The Board is currently exploring ways that oversight of our recent Climate Commitments can be integrated into our governance systems.

In practice, for example with our Socially Responsible Investment (SRI) portfolio, we look for companies capable of generating superior financial performance. Then we apply social, environmental and governance criteria. This approach provides a framework for achieving better long-term investment returns and more sustainable markets by considering both an investor's financial needs and an investment's impact on climate, and on society.

Question 5:

What are the key considerations and challenges related to embedding climate-related risk management in an FIs three lines of defense (lines of business, risk management/compliance, internal audit)?

Vancity answer:

Climate risk needs to be treated as any other risk and embedded across Canada's financial system. The greatest challenges are the availability, quality and standardization of data, and the timeframes contemplated in existing risk frameworks.

As long as disclosure is voluntary, progress in this area will lag behind the macro prudential consequences of global warming. This is why leadership by regulators such as OSFI is so essential – Canada's financial system needs a standardized approach to climate risk metrics in order to begin to understand our exposure to the risks of the climate crisis.

An example of where standardization is imperative to scenario analysis and climate-related risk management is in understanding the extent of the supply chain that should be considered in these calculations. For example, from construction to ongoing heating and cooling, FIs need a defined beginning and end point at which they should measure the carbon impact of a single mortgage. OSFI has an important role to play in delineating those bounds, and ensuring they are consistent across organizations. When left to individual FIs, there is a competitive incentive to limit the outer bounds of supply chain considerations, and to underestimate climate-related risks.

Another challenge with data is the mismatch between the short- and medium-term nature of financial risk management frameworks and longer-term climate-linked frameworks. It is necessary to recognize these divergent timeframes in order to fully integrate quantitative climate-risk measurement methodologies within traditional frameworks of financial risk management.

Disclosure mandated through legislation is the best way to drive integration of climate-related risk. Transition risk in Canada remains lower than in other jurisdictions due to the slower pace of legislation and dependance on resources. With the introduction of the new Net Zero Emissions Accountability Act OSFI should work with the Bank of Canada to push the financial sector to keep ahead of the coming transition to minimize risk – particularly because the risk borne of delay will drive the need for more drastic and economically disruptive actions in the future.

Question 6:

Is the description of the data challenges presented by OSFI in this discussion paper complete or are there other data challenges that need to be considered? What is the relative importance you would assign to each of these challenges?

Vancity answer:

Vancity is supportive of the description of data challenges to integrating climate-related risk outlined in the discussion paper. As OSFI has outlined, it is our experience that uncertainty and the extended timeline for outlook render traditional risk management approaches and stress testing tools insufficient for contemplating climate-related risks.

There is a particular challenge to understanding climate-related risks, in that historical data are not predictive of future trends. This problem underscores the need for an agreed-upon widely-applied business-as-usual baseline scenario to help inform risk metrics. An agreed-upon baseline could also support and inform the research that is needed to better understand risk in financial sectors including commercial banking, private equity, real estate and infrastructure.

Further, Vancity shares concerns articulated in the *Final Report of the Expert Panel on Sustainable Finance* that internationally-accepted taxonomies for green investments exclude opportunities for GHG emissions reductions, and are at risk for becoming diluted. OSFI should develop a set of metrics that can be used to define sustainable investments.

Question 7:

If your organization has started to include climate-related considerations in its risk management approaches and tools, please share your experience, including the usefulness and challenges associated with climate-related scenario analysis and stress testing.

Vancity answer:

Vancity was one of the first FIs in North America to include climate-related considerations in its risk management approaches, and we will be completing our second TCFD disclosure report this year.

Vancity's finance division works with both internal and external stakeholders such as CUMIS insurance to design and test plausible climate risk related scenarios. This work has been essential to our integration of climate risk, and cross functional team engagement in scenario analysis has helped our Internal Capital Adequacy Assessment Process (ICAAP) to improve climate risk assessment over time.

As part of identifying our pathways to net-zero across all our loans and mortgages by 2040, Vancity is investigating new underwriting criteria and financing terms to stimulate low-carbon commercial and residential building renovations. In addition to meeting criteria for financial risk, it is our intention that projects will need to meet a set of criteria around operational carbon, embodied carbon, and climate resilience. We assess climate resilience as a building's ability to continue to avoid or withstand climate impacts such as extreme heat, flooding, and wildfire.

We have experienced challenges in our work on climate-related scenario analysis, including insufficient granularity to our data sets, and a lack of industry resources and models we could learn from. These are both areas we expect could be improved greatly if more Canadian FIs were engaged in this work, and especially if they were required through regulatory oversight to do so.

Climate-Related Financial Disclosure

Question 11:

How does your organization currently disclose climate-related risk information? What are the drivers for any voluntary disclosure?

Vancity answer:

Vancity has a longstanding practice of engaging in open dialogue with our members, and transparency forms the basis of the commitment to be net-zero by 2040 we announced in January.

This includes a pledge to members that Vancity will encourage change within the financial services sector by accurately measuring and openly reporting on how our own actions are improving the well-being of people, communities and the environment. This includes implementing, testing, and helping to improve emerging standards for climate and impact reporting.

Vancity includes a TCFD-aligned disclosure in our annual report. We declared our support for TCFD in 2020, and in 2019 we signed the Global Alliance for Banking on Values' Climate Change Commitment and joined the Partnership for Carbon Accounting Financials (PCAF), committing to measure and disclose the climate impact of our loans and investments. Vancity is also a signatory to the United Nations Environment Programme Finance Initiative's Collective Commitment to the Climate Action, which requires signatories to set and publish targets for aligning their portfolios to strive for a 1.5 degree Celsius trajectory, based on scientifically established climate scenarios.

More recently, we piloted newly adapted methodology for accounting the carbon impact of our residential and commercial mortgages for PCAF.

Vancity has made these commitments because we believe that vigorous accounting and transparent disclosure are also critical in ensuring companies are making real, fundamental changes. Without them, it is all too easy for a company – or a financial institution – to avoid reducing its high-emissions activities by promoting climate-positive ones as an offset.

OSFI's Ongoing Work on Climate-Related Risks

Question 12:

A challenge OSFI has identified is lack of a universal climate-related taxonomy. Please describe the climate-related risk taxonomy, if any, your organization has developed or adopted?

Vancity answer:

Vancity has adopted the TCFD's framework and taxonomy for climate-related risk, and support regulators such as OSFI doing the same. The TCFD's framework has strong international support, and is being adopted by key economic partners, including the United Kingdom.

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?

Vancity answer:

In addition to the work outlined in the discussion paper, OSFI should undertake a legislative review to ensure regulatory harmonization in the recognition of climate risks.

As part of this review, OSFI should consider where climate-related considerations are embedded in financial decision making and oversight more broadly. Vancity is a supporter of the COP26 Private Finance Agenda put forward by the Bank of England, which suggests that all professional finance decisions should be required to take climate into account.

Question 14:

What are your views on the relative importance of using (1) OSFI's capital framework, (2) supervisory review process, and (3) market discipline to promote FI preparedness and resilience to climate-related risks? What factors should OSFI consider when making changes to the design and approach to each of these areas?

Vancity answer:

Though we support mandatory public disclosure, market discipline alone will be insufficient in driving preparedness in meeting climate-related risks. Though investments slowed in 2020 in response to the pandemic, Canada's largest FIs remain some of the world's top investors in fossil fuel projects.

This world-leading level of investment in fossil fuels raises urgent questions about Canada's exposure to climate-related risks, particularly transition risks. Until these are understood and quantified, the safety and soundness of Canada's financial system cannot be guaranteed.

It also underscores how government policy is needed to incent consumer and business behaviour that reduces our exposure to climate-related risks, and how policy and markets must work together to protect Canada's long-term interests.

OSFI should use its capital framework and supervisory powers to ensure Canadian FIs are prepared and resilient to climate-related risks. This leadership should include a working group with all the provincial regulators, to support them in adapting their capital frameworks and supervisory review process to incorporate climate-risk, and to share insights and develop best practices.

Conclusion

Thank you for the opportunity to respond to the consultation document ***Navigating Uncertainty in Climate Change: Promoting Preparedness and Resilience to Climate-Related Risks*** by the Office of the Superintendent of Financial Institutions (OFSI). Vancity welcomes this discussion document, and offer our ongoing to support to OSFI's efforts to integrate climate-risk into the regulatory framework that guards the health and resilience of Canada's financial system.

We're grateful for the opportunity to respond and to share our perspective on the important topic of climate-related risks. Please reach out if there are any questions regarding Vancity's feedback. We look forward to OSFI's leadership and next steps on this important issue.

About Vancity

Vancity is a values-based financial co-operative serving the needs of its more than 550,000 member-owners and their communities, with offices and 54 branches located in Metro Vancouver, the Fraser Valley, Victoria, Squamish and Alert Bay, within the unceded territories of the Coast Salish and Kwakwaka'wakw people.

With $30.5 billion in assets plus assets under administration, Vancity is Canada's largest community credit union. Vancity uses its assets to help improve the financial well-being of its members while at the same time helping to develop healthy communities that are socially, economically and environmentally sustainable.

We support the Task Force for Climate-Related Financial Disclosures, the Partnership for Carbon Accounting Financials, and represent North America on the Board overseeing the implementation of the UN's Principles for Responsible Banking.

Vancity is regulated both by the BC Financial Services Authority (BCFSA), and by OSFI, through the credit union's Toronto-based subsidiary, Vancity Community Investment Bank (VCIB).

About Vancity Community Investment Bank (VCIB)

VCIB is an Ontario-based schedule 1 federally chartered bank and a subsidiary of Vancouver City Savings Credit Union. As Canada's first values-driven bank, VCIB provides banking, investing, and financing solutions to help purpose-driven businesses and organizations thrive, grow, and foster change. Additionally, VCIB offers specialized financing solutions for social purpose real estate and clean energy projects. VCIB is a certified B Corporation and a member of the Global Alliance for Banking on Values.