NEI

December 20, 2023

Office of the Superintendent of Financial Institutions
255 Albert Street, 12th Floor
Ottawa, ON K1A 0H2

Email: ClimateScenario-ScenarioClimatique@osfi-bsif.gc.ca

Re: Comments on Draft Standardized Climate Scenario Exercise

Dear Superintendent of Financial Institutions:

NEI Investments is a Canadian asset manager specializing in responsible investing, with approximately $11 billion in assets under management. We are part of Aviso Wealth's asset management business - Aviso being one of the largest Canadian financial services providers with over $110 billion in assets under administration and management. NEI's approach to investing incorporates the thesis that companies can mitigate risk and take advantage of emerging business opportunities by integrating best environmental, social and governance (ESG) practices into their strategies and operations. As part of our investment process, we utilise sustainability-related financial information to better inform our investment decisions and guide our corporate proxy voting and engagement activities.

We appreciate the opportunity afforded by OSFI to provide input to this consultation as it looks to both increase its own understanding of systemic risks and better inform federally regulated financial institutions (FRFI) of their potential exposures to climate-related risks. Our feedback is only provided to the indicated numbered sections aligning to the Standardized Climate Scenario Exercise (SCSE) draft for consultation, and labelled as such in our letter.

1. Introduction

We have assumed that the standardized exercise is meant to provide guidance to FRFIs in assessing the potential risks of climate change. We agree that climate scenario analysis is in its nascency and our understanding of climate-related risks is constantly shifting. Combined with the expected increase in the quantity and quality of climate-related data due to the increased focus on standardization and regulation of climate-related financial disclosures, this shifting landscape will require flexibility in the application and methodology of the SCSE.

We are fully supportive of the emphasis on risk discrimination and exposure assessments in light of what is most practical in today's environment. We agree with not focusing on the sizing of risks at this stage as it is more critical for OSFI to understand the potential risks on the economy in aggregate, as well as for the FRFI to be aware and understand risk exposures and the impact on business resiliency.

Finally, while the draft consultation indicates that results will be submitted to OSFI on a periodic basis, depending on the frequency of reporting, we recommend that an adjusted or new scenario analysis be conducted when there is a significant change to the FRFI that may modify the business model or operations, such as an acquisition or corporate action. We also believe that the frequency of reporting should be defined by OSFI. It is our belief that annual reporting would not be informative while reporting every 5 years or more would be too long of a gap.

2.1 Objectives

We largely agree with the objectives as presented in the draft. We would like to clarify that the intent of obtaining comparable results is not to compare or rank one FRFI to another but to allow for the aggregation of results that were analysed by the FRFIs in a standardized framework or consistent manner. This comparability may also highlight the different risk profiles of FRFIs that have differing operating models, regional exposures or balance sheet compositions.

We have assumed that the second objective "*Encouraging the building of FRFIs' capacity to assess the impact of climate related catastrophic events and policies and to conduct climate scenario analysis exercise*" applies to the real estate lending and investment portfolios as indicated in section 4 rather than the FRFI's own real estate footprint. We appreciate the use of proxies if heating and energy sources are too difficult to obtain or if it represents a significant burden on the FRFI to identify. We also understand the challenges that may be present with residential real estate data availability and collection, and again emphasize that the individual data points are not the focus of the exercise but are instead a means to assess and understand the magnitude or nature of the exposure.

3. Climate transition risk for commercial exposure

We agree with the risk drivers and parameters outlined in this section. We provide additional feedback in the subsections listed below.

3.1. Balance sheet assumptions: We are unclear of the assumption of no growth of the balance sheet at 5 year intervals. Assuming that the balance sheet runs-off or that the lending and investment portfolios do not change does not reflect a realistic scenario. While SCSE recognizes the constraint of this, there may be an underestimation of the risks since we know that banks target annual growth rates in lending and/or earnings. We recommend that a growth rate be provided, which may reference an economic baseline, and assumes the balance sheet composition stays constant.

3.2.1 Selected scenarios and narratives: We appreciate OSFI listing the four scenarios identified to provide consistency in the analysis. We assume that the Bank of Canada will generally follow available industry scenarios and update or modify as necessary.

3.3 Industry sector classification: We agree with the approach of using industry sector level classifications for the use of proxies to provide an improved level of analysis. However, we note that the focus should not be on the numerical data output itself but on understanding sector-specific risks and the potential impact to the FRFI.

3.4 Credit risk: While we acknowledge that OSFI will be using the results of the scenario analysis for its internal assessments, we encourage OSFI to disclose the overall findings on an aggregated basis. The aggregated results may include how the FRFIs fair with respect to understanding the climate-related risks presented, and not necessarily the detailed quantitative metrics. We also encourage that if material risks are identified by an FRFI during the scenario analysis process, the FRFI discloses relevant information to investors, which may include qualitative information or assumptions used in determining expected loss. We also acknowledge that a scenario analysis is not a forecast but used at a point in time and trust that OSFI will manage public disclosures appropriately.

4. Real estate transition risk exposure assessment

4.4 Dimensions and aggregated amounts: We support the objective of encouraging the FRFIs to build capacity in collecting relevant data to provide a useful analysis of climate-related risks. To enhance this process, we encourage the FRFIs to enhance their due diligence process and KYC questionnaire to start properly gathering data as required.

151 Yonge Street, Suite 1200
Toronto, ON M5C 2W7

5. Physical risk exposure assessments

We understand that the physical risk exposure assessment will be limited to physical hazards in Canada. As Canadian FRFIs may have lending and investment portfolios outside of Canada, we believe it would be beneficial to require them to disclose the proportion of real estate exposure in Canada versus international markets if material.

We note that the remainder of the draft provides detailed guidance on assumptions, formulas and exposures, which are all very helpful to the FRFI in performing the scenario analysis and to OSFI for ensuring consistency in the method employed by the various FRFIs. The draft provides the necessary transparency needed to understand the overall results, where risks and exposures may exist in parts of the financial system and economy and how these risks need to be addressed.

As a final note, we strongly recommend that when the Canadian Sustainability Standards Board (CSSB) releases its Canadian standard on climate-related disclosures (aligned to IFRS S2), OSFI looks to align the SCSE with the standard. We believe it is important to support a global baseline in sustainability reporting and its adoption by the CSSB to provide the consistency and reliability needed by all users of these standards. We recognize that OSFI is supportive of this initiative.

Thank you again for the opportunity to respond to the draft methodology. We would be pleased to discuss any of our comments in further detail as is helpful. We look forward to the final issue of the SCSE in 2024.

Sincerely,

Adelaide Chiu, CPA CA CFA
Vice President, Head of Responsible Investing
NEI Investments

Hasina Razafimahefa
Senior Manager, Evaluations & Proxy Voting
NEI Investments

cc: Jamie Bonham, Head of Stewardship

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