Municipal Pension Board of Trustees

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BC Financial Services Authority

Via online survey

Subject: Feedback to BCFSA's 2023 Consultation on Natural Catastrophes and Climate-Related Risks

Demographics

1. Which financial services segment are you affiliated with? (choose one)

Pension plans

2. Which area of the province best describes where you live and work? (select one)

Vancouver Island (including Gulf Islands)

General Questions

3. Has BCFSA **identified the key risks and issues** for financial services providers and consumers, or are there any elements or issues that have not been identified that should be considered, keeping in mind BCFSA's mandate and regulatory authority? Yes/No (please provide comments)

Yes.

4. Is the proposed approach appropriate for the financial services sector in B.C. **given our mandate and strategic imperatives**? Yes/No (please provide comments)

The consultation paper indicates BCFSA intends to monitor NCCR on a proactive basis and build observations and lessons into its prudential supervisory approach. We would like to emphasize the importance of ensuring clarity between the differing roles of the regulator and pension plan administrator in monitoring NCCR risks so they can both be as effective as possible.

We also note that BCFSA intends to develop its guidelines/guidance regarding NCCR risks management across a number of documents, including adding to existing ones. This makes sense given the holistic nature of NCCR risks. However, we would caution against

guidance/guidelines being distributed/duplicated/cross-referenced across too many documents. This could impede the clarity of the guidelines/guidance provided by BCFSA.

5. Are there any **unique characteristics** that BCFSA needs to consider that would necessitate BCFSA modifying its approach from other regulators? No/Yes (please provide comments)

No.

6. How should BCFSA **apply proportionality** when developing its approach?

Consistent with CAPSA's draft Pension Plan Risk Management Guideline, plan administrators should be encouraged to adapt their risk management practices to reflect their plan's specific circumstances and the risks being assumed to ensure the appropriateness and effectiveness of their management of NCCR risks and the fulfillment of their fiduciary obligations.

Following the existing supervisory framework, proportionality should continue to be anchored to size, scale, complexity and risk profile. In practice, additional requirements should remain principles-based and not result in disproportionate and unsustainable costs for participants.

The differing implications of NCCR across institutions should also be considered in determining how to apply proportionality. Example 1: A pension plan's sector may be more susceptible to NCCR than the pension plan's investments. This is perhaps unique to pension plans. The adopted approach should ensure risk management continues to focus on the pension plan's risk, rather than taking on those of the sector. Example 2: Local NCCR events arguably pose a more immediate and systemic risk to credit union and insurance companies compared to pension plans whose NCCR are more uniquely a function of its investments. The adopted approach should reflect the systemic nature of NCCR varies across institutions.

7. From a **consumer's perspective**, are there additional areas that BCFSA should focus that fit with our mandate? No/Yes (please provide comments)

No.

Pensions

First section – Risks and scenario analysis

BCFSA is proposing that pension plan administrators should identify, measure, and manage physical and transition risks to their investment portfolios. BCFSA proposes that for transition risk, the standardized scenarios developed by OSFI/BoC could be used to help inform the scenario analysis conducted by B.C. pension plan administrators to ensure comparability, with necessary modifications that reflect unique characteristics of the B.C. environment.

BCFSA acknowledges that not all pension plans have the internal capacity to conduct a full analysis.

a. What are the key considerations and challenges for pension plans to identify, measure, and manage physical and transitions risks?

Pension plans need to identify, manage and monitor climate risk to the pension fund.

The capacity for plan administrators to measure physical and transition risks and to conduct scenario analysis and stress testing should be carefully considered by BCFSA and should not be overestimated. We understand that most pension plans have minimal in-house investment resources and may rely on multiple external investment managers and consultants to invest their assets in a variety of asset classes. The adopted approach should consider the current capacity of pension plans to identify and measure physical and transition risks and ensure additional requirements do not result in disproportionate and unsustainable costs.

Limitations to scenario analysis and stress testing should also be considered when establishing guidelines: 1) scenarios are not forecasts and cannot be used to predict what will happen; rather they provide a range of potential outcomes; 2) expertise and judgement are required in interpreting results—all models have idiosyncrasies in their assumptions and can lead to inconsistencies in components (e.g., sectors) where data is lacking; 3) modelling and research continues to evolve which requires scenarios to be continuously reviewed as well.

While conditions for climate-related disclosures are improving, there are still significant data gaps, especially in illiquid assets where often only poor and unverifiable data is available. Estimation methodologies for carbon emissions can be inconsistent and opaque, and there are competing taxonomies.

It is unclear how non-climate-related physical risks, such as earthquakes, can be or should be included in climate-related scenario analysis and stress testing. In contrast, local natural catastrophes may be taken into account in business continuity planning.

b. What are your views on scenario analysis and stress testing to assess a pension plan's exposure to physical and transition risks in its investment portfolio?

We recognize that climate change poses significant financial risks and opportunities for pension plans. The risks are both physical and transitional in nature. For this reason, we have incorporated scenario analysis as a critical tool for both our risk management and strategic planning. We instruct our agent on the scenarios we would like to see modelled.

In alignment with TCFD recommendations, our investment agent uses climate change scenario analysis to identify how climate-related risks and opportunities may affect portfolio performance. The results of this analysis are used for detailed assessments and to prioritize

existing and new investments. Our agent assesses climate risks during due diligence and throughout the investment life cycle. This ensures climate change is an ongoing consideration in investment decisions, asset management and stewardship activities.

Our investment agent provides us with the outputs from their models, highlighting potential impacts to our portfolio under several climate change scenarios. These portfolio climate stress tests help us understand the plan's resilience to climate risks in a range of potential outcomes and how the plan's resilience may change over time. Descriptions of the scenarios employed for this modelling may be found in our agent's TCFD report.

The focus of scenario analysis and stress testing of the pension fund should be on key financial impacts associated with physical risks from climate change (e.g., extreme weather events and fires) and transition risks (e.g., policy change, technology shifts). As mentioned above, it is unclear how non-climate related physical risks, such as earthquakes, can be or should be included in climate-related scenario analysis. In contrast, local natural catastrophes may be taken into account in business continuity planning.

Assessing various climate change scenarios ensures that a range of potential outcomes are understood. Commonly used global warming scenarios include 3 degrees, 2 degrees and 1.5 degrees (net zero).

However, as mentioned previously, it is also important to understand the limitations of scenario analysis: 1) scenarios are not forecasts and cannot be used to predict what will happen; rather they provide a range of potential outcomes; 2) expertise and judgement are required in interpreting results—all models have idiosyncrasies in their assumptions and can lead to inconsistencies in components (e.g., sectors) where data is lacking; 3) modelling and research continues to evolve which requires scenarios to be continuously reviewed as well.

c. What should BCFSA consider as part of our approach to scenario analysis and stress testing for pension plan administrators?

As mentioned above, the capacity for plan administrators to conduct scenario analysis and stress testing should be carefully considered by BCFSA and should not be overestimated. Most pension plans have minimal in-house investment resources and rely on multiple external investment managers and consultants to invest their assets in a variety of asset classes. The adopted approach should consider the current capacity of pension plans to identify and measure physical and transition risks and ensure additional requirements do not result in disproportionate and unsustainable costs.

Any requirements for pension plans in general, including requirements related to climate risk, should remain principles-based.

Second section – Disclosures

BCFSA is proposing that pension plan administrators increase disclosures in alignment with each of the Task Force on Climate-related Financial Disclosures ("TCFD") pillars of governance, strategy, risk management and metrics and targets. These disclosures should be reliable, verifiable, and objective which will may eventually require third-party assurance.

a. Should disclosures be voluntary or mandatory? Why?

We are comfortable making disclosures in alignment with the TCFD pillars, and have been doing so since our 2019 Annual Report. We see that as consistent with our accountability to the beneficiaries of the pension plan.

As mentioned previously, most pension plans have minimal in-house investment resources and rely on multiple external investment managers and consultants to invest their assets in a variety of asset classes. We expect it could be extremely challenging for these administrators to develop and report out aggregated climate metrics and targets as recommended by the TCFD.

We believe it is reasonable to expect plan administrators to transparently share with their beneficiaries the plan's climate-related approach to governance, strategy, risk management and what they expect from their asset managers in this regard.

We do not support the use of mandatory third-party assurance of climate-related disclosures, as this will only increase the cost of managing the plan without adding value to the plan.

b. Should disclosures be standardized, or should pension plans have discretion to decide for themselves how to report?

As mentioned above, we believe it is reasonable to expect plan administrators to transparently share with their beneficiaries the plan's climate-related approach to governance, strategy, risk management and what they expect from their assets managers in this regard. It would be challenging for most administrators to report out aggregated climate metrics and targets.

IFRS S2 incorporates the TCFD recommendations, however it does not specify which scenarios must be used and enables organizations flexibility to determine which climate-related approach and scenarios are most applicable to their circumstances. We would recommend that this discretion be maintained for plan administrators in British Columbia.

We do not support the use of mandatory third-party assurance of climate-related disclosures, as this will only increase the cost of managing the plan without adding value to the plan. We believe it could be reasonable to allow plan administrators to reference their investment

agent/manager's TCFD disclosures to fulfill any reporting requirements on this topic, rather than independently repeating the exercise on their own.

Any requirements for pension plans in general, including requirements related to climate risk, should remain principles-based.

c. What are the challenges associated with meeting disclosure requirements in alignment with TCFD?

Any climate-related metrics disclosed by pension plans will only be as good as the disclosure that comes from the entities in which they invest, or the plan's capacity to either purchase additional data or develop adequate methodologies to do estimations themselves. Not all pension plans may have the capacity and resources to complete this exercise.

While conditions for climate-related disclosures are improving, there are still significant data gaps, especially in illiquid assets where often only poor and unverifiable data is available. Estimation methodologies for carbon emissions can be inconsistent and opaque and there are competing taxonomies.