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Comments from the Honourable Rosa Galvez on the Office of the Superintendent of Financial Institutions' draft methodology for a Standardized Climate Scenario Exercise (SCSE)

Mandate

The consultation starts with this statement: "The mandate of the Office of the Superintendent of Financial Institutions Canada (OSFI) is to protect the rights and interests of depositors, policyholders, financial institution creditors, and pension plan members and beneficiaries while allowing financial institutions to compete and take reasonable risks. OSFI fulfills its mandate by focusing on the safety and soundness of federally regulated financial institutions (FRFIs) and federally regulated pension plans (FRPPs)."

Allowing financial institutions to fund emissions in excess of what experts consider relatively safe for the climate constitutes an unreasonable risk, including for the safety and soundness of financial institutions, that cannot be taken for all of society. A real, deep understanding of the climate crisis, its tipping points, and the cascading effects contributing to a potential future state of polycrises logically leads to the conclusion that the only way to manage the financial risks of climate change, which are severely affecting the economy of many Canadian regions, in particularly those hit repeatedly by the same or a variety of extreme weather events, as well as the economy of specific sectors producing high emissions, is to align financial flows with our last remaining chance to ensure a climate safe world.

As my updated White Paper shows, many legislators and regulators are moving in that direction internationally. The Commissioner of the Environment and Sustainable Development invited OSFI to take an expanded view of its mandate[1], to truly ensure the ultimate stability of the financial system it supervises. OSFI's interpretation of its mandate is fundamental to the SCSE. There may be some gain in getting a very rough estimate of the economic damages and financial risks of futures where we exceed the temperature goal of the Paris Agreement and reach 4 degrees of warming, which scientists warn would threaten the very survivability of the planet for future generations and most life on earth, however, this information is not germane to ensuring damages and risks are averted. At this point information and data have been collected and experience has been gained around the world and Canada must integrate this knowledge to recoup the time we

[1] Including under the Federal Sustainable Development Act (https://laws-lois.justice.gc.ca/eng/acts/F-8.6/page-1.html)

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have lost by starting late in the process. Moreover, if the numbers are wrong, as a growing number of experts are saying, OSFI's SCSE exercise could actually be detrimental by not sufficiently incentivizing financial actors, including regulators, to contribute to the already ongoing, necessary and inevitable transition. The financial sector is the enabler and catalyzer of a successful transition to a low-carbon economy and without its active role in this endeavor, Canada will not attain its net zero goal which will be disadvantageous to Canada's competitiveness.

Economic models of climate change

Indeed, a global theme emerging from other jurisdictions specifically addresses the inherent limitations of economic models of climate change for financial regulation and economic policy. This literature summary surveys these limitations and how they dangerously lead to underestimating the damages and overestimating the costs of transition while this piece explains what this means for OSFI's SCSE exercise and whether it will truly serve to ensure the safety and soundness of the Canadian financial sector.

Focus on rigorously constrained 1.5°C scenario

From a financial risk perspective, the 1.5°C scenario is most relevant as scientists warn it is the only scenario that will allow us to avert catastrophe. It is also the one nations across the globe, including Canada, committed to in the Paris Agreement. However, the main interest of this exercise should not be attempting to measure acute transition risks, but about deriving ideas about pathways that can minimize transition risks and physical risks in line with the necessary action.

The *Climate-Aligned Finance Act* (CAFA) would support Canada's alignment with the Paris Agreement as well as move our nation in the same direction as other jurisdictions. OSFI would be specifically tasked to supervise the disclosures of FRFIs against only one scenario, therefore simplifying their own processes to focus on the only scenario that matters, the one proposing emissions[2] reduction on a pathway that respects a global carbon budget that ensures a high probability (66% or greater[3]) of limiting global temperature increase to 1.5˚C above pre-industrial levels with no or low overshoot based on the best available science and precaution. The longer we wait, the more restrictive future legislation will need to be because we will find ourselves addressing the impacts of climate change on the economy from a position of damage control rather than from a position focused on prevention. A 1.5°C maximum temperature increase is the most appropriate temperature goal to avoid dangerous climate change under the UNFCCC

[2] Emissions refer to all lifecycle emissions, including scopes 1 to 3, covering both upstream and downstream.

[3] The IPCC calculates global carbon budgets for 50% and 66% probabilities of limiting warming to 1.5 ˚C. The broader scientific community also models a global carbon budget at 83% probability of limiting warming to the same extent.

according to the IPCC Special 1.5°C report and we must do all we can to ensure we align our actions with this goal.

Global carbon budgets are a rapidly evolving science and a depleting absolute quantity. The definition in CAFA ensures the global budget is based on the best and latest science. The reference to precaution also means other relevant factors, such as the influence of other greenhouse gases beyond CO_2, must be included in the calculation.[4] To date, the scenario exercises undertaken by OSFI and the Bank of Canada lacked details about these important constraints. OSFI's final scenario methodology should include the above safeguarding constraints and transparently disclose them.

Conclusion

CAFA would make the above considerations and many others mandatory, however, OSFI can do most, if not all, the actions contemplated under the bill under an updated and expanded interpretation of its mandate which is warranted by the unprecedented climate crisis we are collectively facing. OSFI doesn't need CAFA to become law, it could adopt several of the best practices described in it to assist the financial sector in fulfilling its imperative role in the transition. In time, OSFI will be obliged to travel along the same path that Canada's peers, commercial partners, and other G7 and OECD countries are already walking.

[4]For more information see : *Canada's Fair Share of Emissions Reductions under the Paris Agreement* as well as White Paper p. 31.

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