Natural Catastrophes and Climate-Related Risks

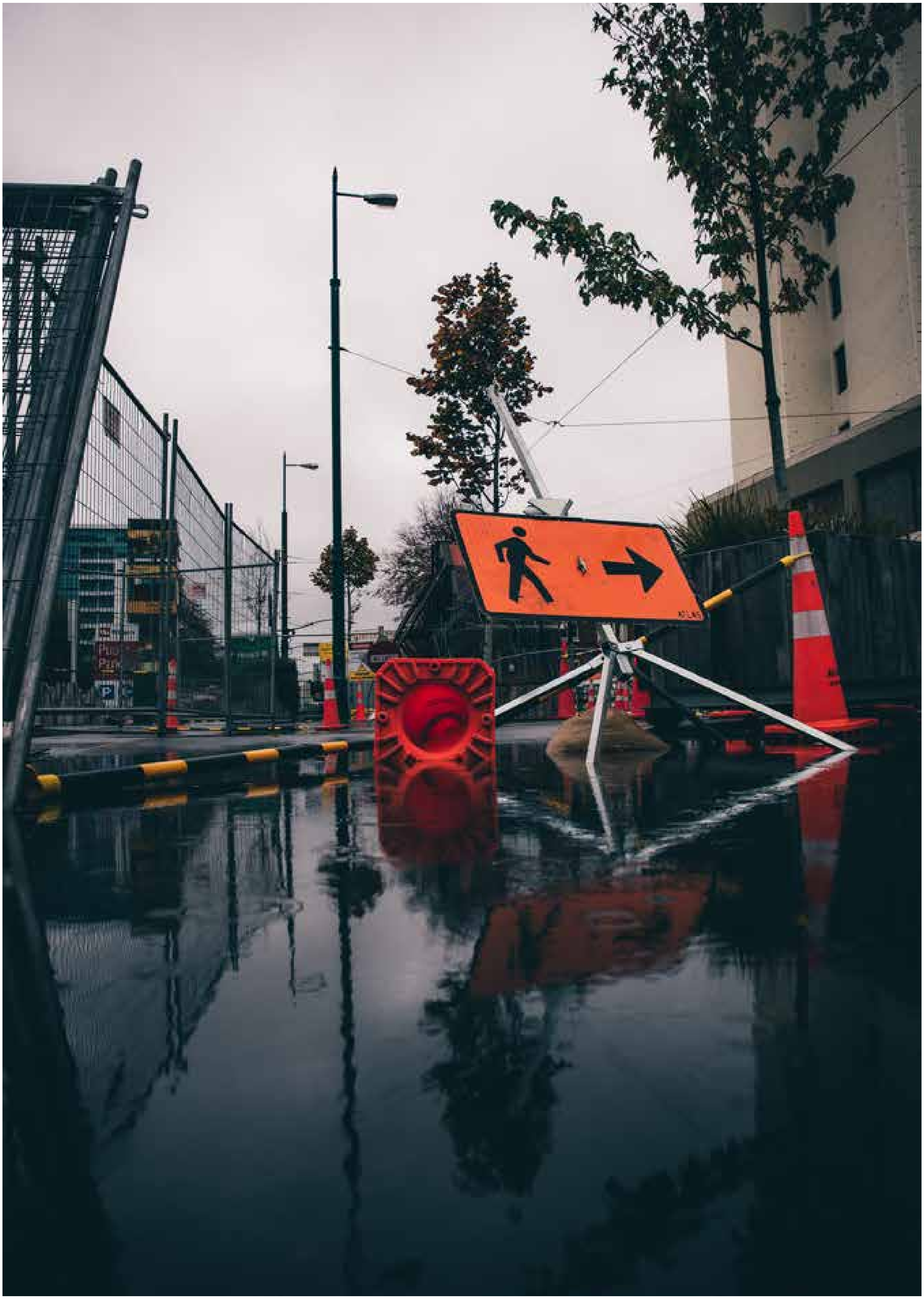
Managing Uncertainty and Building Resilience in the B.C. Financial Services Sector

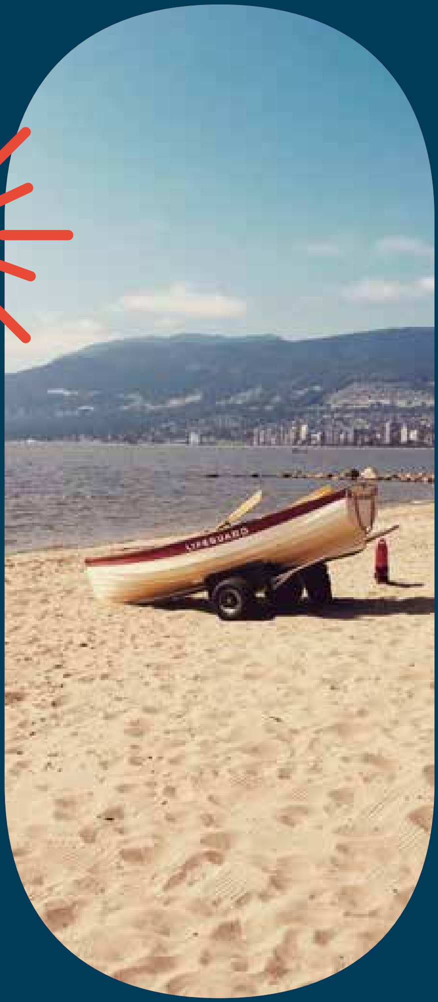
2023 Discussion Paper

JULY 2023

BCFSA

Contents





Executive Summary

This discussion paper outlines the proposed approach of B.C. Financial Services Authority ("BCFSA") towards natural catastrophes and climate-related risks ("NCCR"). In releasing this paper, we want to initiate a conversation with B.C.'s financial services sector participants and those that depend on these organizations and individuals for services.

Have Your Say

BCFSA is inviting our regulated entities and individuals, stakeholders, and members of the public to read the paper and provide their feedback on the discussion questions in Part 5. Feedback should be provided in our consultation feedback form by November 30, 2023.

The paper outlines how NCCR impacts each of the segments BCFSA regulates and poses a material risk to the financial services sector, and to consumers in British Columbia ("B.C."). The risks and impacts to the financial services sector are driven by B.C.'s significant exposure to natural hazards, including flooding, heat waves, wildfires, wind, winter storms, and earthquakes. The level of risk is expected to increase with the growing frequency and severity of natural catastrophes resulting from climate change. The financial services sector will not only have to adapt to these changes but will increasingly be relied upon as a source of information, advice, products, and services that empower consumers to be better able to protect themselves and their assets. Although earthquakes are not a result of climate change, earthquakes have the potential to cause damages and disruption at a scale much larger than any climate-related natural catastrophes.

At the same time, meeting climate targets that have been set by the provincial and federal governments will lead to significant structural changes for the Canadian and global economies. This transition to a lower-emissions economy will be more challenging in countries like Canada that have large carbon-intensive sectors and could impact financial institutions and pension plans with material exposures to carbon-intensive assets.

Given this assessment, BCFSA's position is that we should act to ensure the entities and individuals we regulate exercise prudent risk management, and that they help ensure consumers are protected and continue to be treated fairly. BCFSA is aware that some financial services providers have implemented measures to mitigate the impacts of NCCR on their business and the consumers they serve. However, regulatory guidance can ensure a consistent and comprehensive approach across the financial services sector. We propose an integrated and proportionate approach that prioritizes sector-wide solutions that consider the size, scale, and complexity of affected financial services providers. Our approach will encourage financial services providers to consider NCCR holistically, which means considering the impacts of NCCR on both their business and the consumers they serve rather than considering each of these in isolation. We specifically consider the real estate market, given its outsized impact on B.C.'s economy and its importance to our regulated segments and to consumers.

BCFSA's proposed approach has two pillars.

1. Ensuring financial services providers identify, measure, and manage NCCR, commensurate with the level of risk to both their business and to consumers.
2. Ensuring financial services providers disclose sufficient information to consumers so that they can understand the products and services they are being offered and/or have received.

BCFSA's Regulatory Objectives

BCFSA's objective is to instil confidence in the financial services sector by focussing on the safety and soundness of regulated entities and protecting consumers. BCFSA must safeguard the interests of consumers such as depositors, policyholders, beneficiaries, pension plan members, and home buyers while at the same time allowing the financial services sector to take reasonable risks and compete effectively.

The first pillar of our approach includes the following potential actions:

- Issuing NCCR-specific guidance for financial institutions and pensions plan administrators;
- Applying an NCCR lens to several planned guidance documents in BCFSA's Regulatory Roadmap to ensure NCCR are considered;
- Strengthening brokerage governance requirements to ensure real estate and mortgage brokerages are resilient to NCCR and that they can continue to provide products and services to their customers and clients through potential disruptions;
- Monitoring NCCR on a proactive basis and building observations and lessons learned into our prudential supervisory approach; and
- Overseeing the conduct of financial services providers to ensure they comply with regulatory requirements and fiduciary responsibilities, treat consumers fairly, and provide consumers with the information and advice they need to make an informed decision.

The second pillar includes two types of disclosures:

1. Market Transparency NCCR Disclosures: for the purposes of improving transparency by reducing uncertainty and allowing consumers and investors to understand the exposure of financial services providers to NCCR and strategies they employ to address these risks.
2. Property-Specific NCCR Disclosures: disclosures in relation to real estate to improve consumers' awareness of the risks to them and their assets (e.g., homes and businesses), ensuring they have the information they need to make informed decisions.

BCFSA recognizes the importance of high quality and accessible qualitative and quantitative information in measuring NCCR. As part of our approach, we will explore ways to help ensure financial services providers and consumers have access to data and information needed to determine NCCR exposures.

We acknowledge that the issues posed by NCCR require a "whole of society" approach. This means that our approach will complement the work of other stakeholders to address the causes of climate change, mitigate risk drivers, and build resilience. While other actors are primarily responsible for encouraging the transition to a low carbon economy and for broader climate adaptation efforts, our role as a regulator is to conduct ongoing surveillance of the financial services sector to identify material risks and potential consumer protection issues, and to intervene as necessary with regulatory expectations to ensure safety and soundness and protect consumers.

Part 01

Purpose

The purpose of this discussion paper is to outline how natural catastrophes and climate-related risks ("NCCR") are material and why a comprehensive approach across the financial services sector is needed. Following a review of the risks to the financial services sector and consumers in B.C., we outline potential regulatory actions along with estimated timelines for those activities.

BCFSA uses a risk-based approach to identify business practices or activities that are imprudent, unsafe, or unfair, and intervenes on a timely basis as required. Risk assessment is forward-looking. It allows us to identify issues or problems early on, and to take corrective actions when needed, so there is a greater likelihood of a satisfactory resolution of issues. A risk-based approach assesses the impact of the risks and the likelihood of their occurrence.

B.C.'s Financial Services Sector

BCFSA regulates financial services providers across seven financial services segments, including: credit unions; trust companies; insurance companies; pension plans; mortgage brokers; real estate service providers; and real estate development marketing.

BCFSA's analysis indicates that NCCR are material and potentially systemic for the B.C. financial services sector. NCCR can directly affect consumers, particularly their most significant assets – their homes and businesses. NCCR may also drive financial services providers to implement strategies and make decisions that reduce the level of financial protection available to consumers. Given this assessment, our position is that BCFSA should act to ensure the entities and individuals we regulate exercise prudent risk management, and that they help ensure consumers are protected and continue to be treated fairly.

At its core, BCFSA's proposed approach will require all financial services providers to review how their business and the consumers they serve could be impacted by NCCR. Our approach emphasizes the need for financial services providers to identify, measure, and manage material NCCR in a way that is proportionate to the risk posed to their business and to consumers. It also emphasizes the need for financial services providers to treat consumers fairly and to help ensure they have access to information, advice, and financial products and services that help protect them against NCCR.

Part

02

Key Terms

The terminology used in discussing NCCR can be technical. Below are definitions of key terms we use throughout this report.

Consumer: for the purposes of this discussion paper, we use the term "consumer" to broadly refer to individuals using or thinking of using the services or products offered by financial services providers. While consumer is a generic term, we recognize that terminology varies across each of our regulated segments (e.g., customers, members, clients, or policyholders).

Natural hazards: the potential occurrence of a natural or human-induced physical event or trend or physical impact that may cause loss of life, injury, or other health impacts, as well as damage and loss to property, infrastructure, livelihoods, service provision, ecosystems, and environmental resources. This includes such hazards as extreme weather, wildfires, and earthquakes.

Natural catastrophe refers to the actualization of a natural hazard where the damages exceed a certain threshold.

Earthquake risk: some earthquakes pose a material physical risk to financial services providers and consumers. Earthquakes are not caused or exacerbated by climate change.

Climate-related risks: in this discussion paper, we follow the approach to climate-related risk widely acknowledged in the financial services community established by the Financial Stability Board's Task Force on Climate-related Disclosures ("TCFD") and followed by Canadian federal and provincial financial regulators. In alignment with TCFD, we distinguish two major categories of climate-related risks: (1) physical risk and (2) transition risk.

1. **Physical risk** relates to the physical impact of climate change and includes:
    - The increasing frequency and severity of climate-related physical events, such as flooding, heat waves, wildfires, wind, and winter storms;
    - Indirect effects of climate change such as loss of ecosystem services (e.g., desertification, water shortage, degradation of soil quality or marine ecology); and
    - Longer term gradual shifts in climate conditions (e.g., sea level risk, ocean acidification).
2. **Transition risk** refers to the risks associated with transitioning to a lower-carbon economy, such as current or future government policies to reduce emissions, technological advancements, and changes in investor or consumer sentiment.

Climate-related risks are **complex** and **systemic**:

- **Complex:** the impacts of climate change are difficult to predict as the physical effects of greenhouse gases ("GHGs") emerge years after emission. This is further complicated by the interplay of physical and transition risks, which makes climate-related risks difficult to assess, measure, and manage using historical data and traditional approaches to risk analysis.
- **Systemic:** systemic risk can be defined as "a risk of disruption to financial services that is caused by an impairment of all or parts of the financial system and has the potential to have serious negative consequences for the real economy"[1]. All economic sectors are exposed to physical risk. For transition risk, while the disruption to some sectors is direct, it can also lead to indirect disruptions to other sectors, which can create instability and lead to severe knock-on effects.

Prudential supervision is primarily concerned with the solvency of individual firms (micro-prudential) and sector safety and soundness (macro-prudential). Through our ongoing prudential supervision, BCFSA monitors and assesses whether financial institutions and pension plans are in sound financial condition, whether they are complying with their governing laws, and meeting expectations established in regulatory instruments (rules, regulatory statements, and guidelines). This helps ensure the safety and soundness of the financial services sector.

Market conduct oversight: An important part of consumer protection is market conduct oversight, which ensures financial services providers comply with regulatory requirements and fiduciary responsibilities, treat consumers fairly, and provide consumers with the information and advice they need to make an informed decision.

Financial services providers is a broad term that covers entities and individuals in all the financial services segments we regulate, including credit unions, trust companies, insurance companies, pension plans, mortgage brokers, real estate service providers, and real estate development marketing.

Financial institutions includes credits union, insurance companies, and trust companies.

Consumer vulnerability: A condition, or set of conditions, which can change over time, determined by physical, social, economic, and environmental factors or processes that increases the susceptibility of a consumer to the impact of NCCR, particularly when a financial services provider is not acting with appropriate levels of care.

1 Bank for International Settlement, Systemic risk: how to deal with it? (bis.org), 2010

Part

03

Risk Identification and Measurement

BCFSA has identified NCCR as a material and potentially systemic risk. As a risk-based regulator, our focus is on ensuring that financial services providers are prepared, they exercise prudent risk management, and they help ensure consumers are protected and continue to be treated fairly.

Rather than representing a new type of risk to the financial services sector, our view is that NCCR may amplify conventional prudential risks, including credit, market, operational, reputational, liquidity, strategic, and insurance risks. This is consistent with the approach taken by national and international regulators. BCFSA takes a similar position with respect to market conduct risks. Although categories for market conduct risks are less developed internationally and nationally, BCFSA's view is that NCCR amplifies the risk that consumers could be treated unfairly, primarily through a lack of transparency, mis-selling, or poor product suitability and availability.

PHYSICAL RISK

B.C. is highly exposed to natural hazards including flooding, heat waves, wildfires, wind, winter storms, and earthquakes. It has experienced several natural catastrophes in recent years that have resulted in loss of human life, significant damage to physical assets, and disrupted economic activities.

Through their business operations, financial services providers may be directly or indirectly impacted by natural catastrophes. Credit unions and other financial services providers engaged in lending activities can see increased credit risk as natural catastrophes can impact collateral values and the debt repayment capacity of borrowers. Property and casualty insurers are likely to see increased claims following a natural catastrophe. Both financial institutions and pension plans are exposed to natural catastrophes through their investment portfolios. Also, real estate consumers are exposed to the same events and have traditionally relied on financial services providers to help explain their exposure and help protect them.

The level of risk is expected to increase with increasing frequency and severity of natural catastrophes as a result of climate change.[2] The financial services sector will not only have to adapt to these changes, but it will increasingly be relied upon as a source of information, advice, products, and services that help empower consumers to be better able to protect themselves and their assets.

Although earthquakes are not a result of climate change, some earthquakes could potentially cause damages and disruption at a scale much larger than any climate-related natural catastrophes.

Some earthquakes also pose a significant threat to the safety and soundness of B.C.'s financial sector and to B.C. residents. Several recent studies have estimated damages from a major earthquake approaching or exceeding $100 billion, which would far exceed the damages from any previous natural catastrophe in Canadian history.

An earthquake of this magnitude could result in significant damage to property and human life and poses a systemic risk to the financial system. It could trigger the default of multiple property & casualty insurance companies, potentially increase credit risk to lenders and lead to multiple failures. Consumers and businesses may have difficulty accessing funds and credit from lenders. It is estimated that economic growth would be significantly reduced following such an earthquake.

2 Retrieved from IBC 2021 Fact Sheet: Whereas the average annual insured losses from natural catastrophes totaled $446 million between 1983 to 2009, the annual average increased to $2.0 billion in insured losses between 2010 to 2020 (author's calculations in 2020 dollars based on reported losses plus loss adjustment expenses; note, figures for 2019 and 2020 are preliminary estimates that include only the two largest events in the year and annual totals)

Natural Catastrophes in 2021

The natural catastrophes of 2021 have demonstrated the impact that a changing climate can have on B.C. According to a November 2022 study[3] from the Canadian Centre for Policy Alternatives that was commissioned by VanCity Credit Union, the 2021 June heat wave, summer wildfires, and the November floods resulted in between $10.6 billion – $17.1 billion in total economic losses.

Heat Wave: The heat wave that hit B.C. in June and July of 2021 is believed to have contributed to hundreds of sudden deaths. According to the BC Coroners Service, there were 619 heat-related deaths in the province during the week of the heat wave.[4] The likelihood of such an event occurring was very low prior to 2021. This event was unprecedented in B.C.'s recorded history in terms of temperature and duration. According to the Insurance Bureau of Canada, the insured losses from the heat wave are estimated to be around $450 million.[5] Total economic losses are expected to be much higher.

Wildfires: The wildfires that followed the June heat wave burned over 1.2 million hectares (3 million acres) of land and forced thousands of people to evacuate their homes. The likelihood of wildfires occurring in B.C. is high due to the province's dry climate and forested areas.

The 2021 wildfires are among the largest and most destructive in B.C.'s history. Insured losses are estimated to be around $1.2 billion, including the June 30, 2021 wildfire that destroyed the town of Lytton ($102 million in insured losses) as well as the White Rock Lake wildfire on August 2, 2021 ($77 million in insured losses).

Floods: In November 2021, floods caused major damage to infrastructure and homes in British Columbia, and many communities were left without power and clean water. The insured losses from the floods are estimated to be around $675 million according to estimates from Catastrophe Indices and Quantification Inc. ("CatIQ"), with the total economic losses estimated to exceed $3 billion. The likelihood of flooding occurring in B.C. varies depending on the region, but it is generally considered to be moderate to high. The 2021 floods are among the most significant in B.C.'s history, particularly in terms of damage to infrastructure and disruption of communities.

Overall, the 2021 natural catastrophes were unusual and historic in terms of their severity and impact. They serve as a reminder of the growing risks and challenges associated with climate change.

3 Available at: https://policyalternatives.ca/sites/default/files/uploads/publications/BC%20Office/2022/11/ccpa-bc_Climate-Reckoning_web.pdf
4 Available at: https://www2.gov.bc.ca/assets/gov/birth-adoption-death-marriage-and-divorce/deaths/coroners-service/death-review-panel/extreme_heat death_review_panel_report.pdf
5 Insured loss estimates for 2021 extreme weather events retrieved from IBC 2021 Fact Sheet

Real Estate as a Focus Area

In addition to BCFSA's unique jurisdiction, given B.C.'s risk profile and the structural importance of real estate to the B.C. economy, impacts in this area could be particularly significant. The following are significant potential impacts BCFSA has identified:

- Property values could decrease (or increase) depending on exposure to natural hazards;
- The number of properties considered high(er) risk may increase due to changing climate conditions;
- Ongoing development in hazard prone areas is expected to put more homes in harms way, which could further increase the number of consumers exposed to natural hazards (i.e., more homes in high-risk areas);
- Construction and reconstruction costs will likely increase over time;
- Insurance and reinsurance costs could increase (abruptly) to correspond to the increasing frequency, intensity, and severity of natural catastrophes;
- Insurers could restrict homeowners' insurance coverage in high-risk areas; and
- Lenders could restrict or place conditions on mortgages for higher risk properties.

TRANSITION RISK

Transition risks could also affect the safety and soundness of B.C. financial institutions and pension plans. The B.C. and Canadian governments' legislative commitments to achieve net-zero greenhouse gas "GHGs" emissions by 2050 and the transition to a lower-emissions economy could impact financial institutions and pension plans with material exposures to carbon-intensive assets. Mispricing of transition risks could expose financial institutions and pension plans to sudden and large losses, with potential implications for financial viability.[6] Meeting climate targets will lead to significant structural changes for the Canadian and global economies, and this transition will be more challenging in countries like Canada that have large carbon-intensive sectors.

6 A recent pilot project led by the Bank of Canada and Office of the Superintendent of Financial Institutions on climate scenario analysis explored how different economic sectors are impacted by the transition to a low-carbon economy and the linkages to credit and market risk for financial institutions.

RISK MEASUREMENT

In order to measure NCCR, BCFSA, financial services providers, and consumers require high quality and accessible quantitative and qualitative information.

BCFSA has identified five key data challenges to information related to NCCR.

1. **Availability:** Obtaining data on climate risks is challenging.
   a. Data on physical hazards such as floods is often outdated and unavailable at sufficient granularity. For example, there is currently no consistent flood mapping available for all of B.C. as flood risk management is mostly done at the community level and hence flood maps are local;
   b. Estimates of damages to buildings based on natural catastrophes is not publicly available;
   c. Multi-hazard approaches need to be developed as buildings are often exposed to multiple hazards, such as floods, wildfires, and earthquakes; and
   d. Emissions data needed to assess transition risk is difficult to obtain, particularly for small and medium-sized enterprises.
2. **Certainty:** There is a high degree of uncertainty regarding the timing and severity of natural catastrophes and the impact of changes at the global level and on the local level. Additionally, both climate and earthquake risk models often rely on historical data to infer future risks. Historic events might not be a good predictor for future events.
3. **Standardization:** Lack of standardization creates challenges for comparing reporting of risk exposures of different financial services providers. Moreover, standard climate scenarios need to be developed and established to obtain consistent and comparable assessments of future hazard and transition risk.
4. **Accessibility:** Financial services providers and government agencies could take additional steps to share data and information.
5. **Complexity:** Financial services providers need to translate NCCR data into information that the average person can understand. Insufficient understanding of NCCR data can lead consumers to be inadequately prepared for natural catastrophes, potentially resulting in financial and social impacts.

SUMMARY

BCFSA's analysis indicates that NCCR are material, and potentially systemic to the safety and soundness of B.C.'s financial services sector. Given this assessment, our position is that BCFSA must act to ensure that the entities we regulate exercise prudent risk management, and they help ensure consumers are protected and continue to be treated fairly.

Financial services providers will need to determine the impact of NCCR to their business operations and consumers. While some financial institutions and pension plan administrators have begun to incorporate NCCR into their risk management frameworks and/or corporate strategies, it is our view that additional NCCR guidance is needed to appropriately capture these risks and ensure a consistent and comprehensive approach across the financial services sector.

In this changing environment, the financial services sector will need to adapt products and services to address changing risks or to meet shifting consumer demand. The decisions financial services providers make to address NCCR, including changes to product and service offerings, will affect consumers. By making information available and understandable, financial services providers can empower consumers to make informed decisions regarding their exposure to NCCR.

Data and information challenges can have significant implications for financial services providers, regulators, and consumers. Incomplete, inconsistent, or unavailable data and information can make it difficult for financial institutions and regulators to make informed decisions about how to manage and allocate resources and determine and monitor risk exposure. BCFSA recognizes the importance of high quality and accessible information and supports efforts to improve the availability of NCCR related information to help inform decision making. We will explore ways to help ensure financial services providers and consumers have access to data and information needed to determine NCCR exposures.

Part

04

BCFSA's Proposed Regulatory Approach

The objective of BCFSA's approach is to increase the resilience of both financial services providers and consumers in the face of NCCR.

Resilience

Resilience refers to the capacity to withstand or to recover quickly from difficulties. For BCFSA's proposed regulatory approach, this means:

- Ensuring the operational resilience (i.e., the ability to deliver critical operations through a temporary disruption) of financial institutions and the ability of both BCFSA and financial institutions to respond swiftly and efficiently to a natural catastrophe;
- Ensuring that financial services providers understand the impact of NCCR on their strategy and business model, and can respond to plausible but severe climate scenarios; and
- Consumers' resilience is enhanced by ensuring consumers have access to information, advice, and financial products and services that can help them make good financial decisions and provide financial protection. This approach goes beyond compliance and encourages financial services providers to prioritize the fair treatment of the consumers they serve and to put the best interest of consumers first.

PILLARS

BCFSA's proposed approach has two pillars supporting its strategic imperatives of safety and soundness and consumer protection. The first pillar focuses primarily on financial institutions and pension plan administrators identifying, measuring, and managing NCCR for themselves and consumers. While mortgage brokers, real estate service providers, and real estate developers should also identify and manage NCCR, the actions they take should be commensurate with the risk posed to their customers and clients. The second pillar highlights the responsibility all financial services providers have in ensuring consumers have sufficient understanding of the products and services they are receiving. This includes understanding how NCCR can impact the appropriateness of the offered products and services in meeting consumers' interests and needs.

SCOPE

BCFSA will take an integrated and proportionate approach to NCCR. This means we will prioritize sector-wide solutions that consider the size, scale, and complexity of affected financial services providers. The guidance we provide to financial services providers will encourage them to consider NCCR holistically. A holistic approach to NCCR would require financial services providers to consider the impacts of NCCR on both their business and the consumers they serve rather than considering each of these in isolation.

While other provincial regulators may have prudential and market conduct mandates, BCFSA is the only regulator in Canada that oversees financial services for real estate throughout the product life cycle from development marketing, property sales, property insurance, property management, mortgage brokering, lending, and insurance renewals. This provides us with a unique opportunity to take a holistic approach across regulated segments, especially when it comes to the life cycle of a consumer's highest value asset, their home.

BCFSA has a focused role in addressing NCCR. With respect to the broader issue of climate change, a "whole of society" approach is needed to address the causes of climate change, mitigate risk drivers, and build resilience. Such an approach necessitates the active involvement and collaboration of governments, regulators, private sector participants, and consumers towards shared or complementary goals. Our role as a regulator is to conduct ongoing surveillance of the financial services sector to identify material risks and intervene as necessary with regulatory expectations to ensure safety and soundness and to protect consumers. While BCFSA will continue to provide expert advice to government on NCCR in financial services, governments are better positioned to develop climate policies to mitigate climate change (i.e., to reduce carbon emissions) and to adapt to its impacts.

BCFSA's proposed approach may be complemented by several potential government actions and initiatives. Governments can provide reliable, authoritative data including hazard mapping and emissions data to help end users. Governments can use fiscal, monetary, and tax policy to help address the causes of climate change, incent adaptation efforts, and support the most vulnerable populations. Governments can intervene in markets (e.g., insurance) where affordable products or services may be limited or not available.

SUMMARY

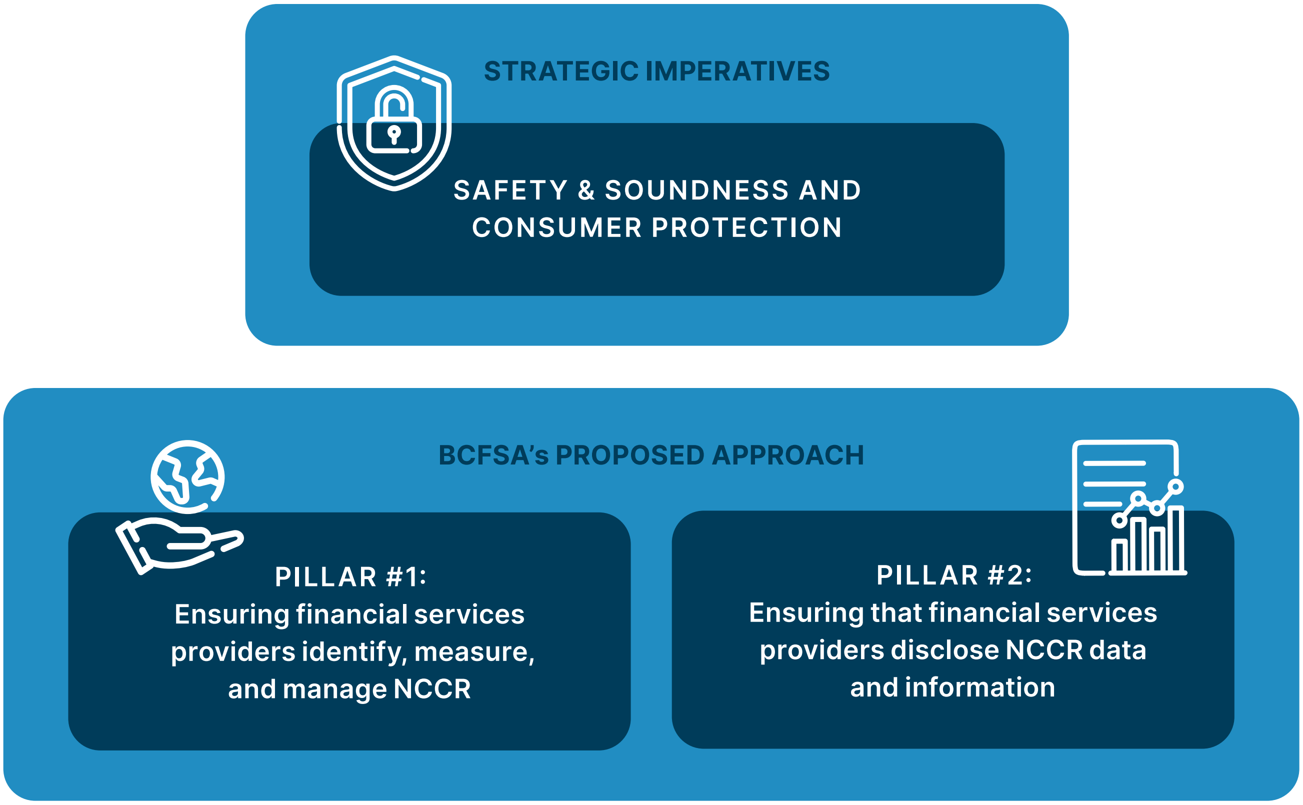
BCFSA will take a risk-based, proportionate, and integrated approach to ensuring financial services providers in each of the segments we regulate have a holistic strategy for addressing NCCR. This approach leverages our unique position as an integrated regulator of the financial services sector responsible for ensuring both safety and soundness and consumer protection.

Our approach will focus on:

Pillar #1: Ensuring financial services providers identify, measure, and manage NCCR, commensurate with the level of risk to both their business and to consumers; and

Pillar #2: Ensuring financial services providers disclose sufficient information to consumers so that they can understand the products and services they are being offered and/or have received.

Both pillars need to be supported by improved access to user-friendly climate data.


STRATEGIC IMPERATIVES
SAFETY & SOUNDNESS AND CONSUMER PROTECTION
BCFSA's PROPOSED APPROACH
PILLAR #1:
Ensuring financial services providers identify, measure, and manage NCCR
PILLAR #2:
Ensuring that financial services providers disclose NCCR data and information

PILLAR #1: IDENTIFYING, MEASURING, AND MANAGING NCCR

The first pillar recognizes that each of the segments we regulate, as well as the consumers they serve, will be affected by NCCR. Therefore, all financial services providers should consider NCCR holistically, ensuring they understand its impacts on both their business and on consumers.

BCFSA is considering the following actions to ensure financial services providers identify, measure, and manage NCCR to their business and consumers:

- Issuing NCCR-specific guidance for financial institutions and pension plan administrators based on the recent guidance developed by the Office of the Superintendent of Financial Institution ("OSFI") for financial institutions and the Canadian Association of Pension Supervisory Authorities ("CAPSA") for pensions plan administrators;
- Applying an NCCR lens to several planned guidance documents in BCFSA's Regulatory Roadmap[7] to ensure NCCR are considered;
- Strengthening brokerage governance requirements to ensure real estate and mortgage brokerages are resilient to NCCR and that they can continue to provide products and services to their customers and clients through potential disruptions;
- Monitoring NCCR on a proactive basis and building observations and lessons learned into our prudential supervisory approach; and
- Overseeing the conduct of financial services providers to ensure they comply with regulatory requirements and fiduciary responsibilities, treat consumers fairly, and provide consumers with the information and advice they need to make an informed decision.

NCCR Management Guideline (Short Term)

BCFSA intends to develop an NCCR Management Guideline that would establish expectations for financial institutions to identify, measure, and manage NCCR for both their business and consumers. This includes integrating NCCR into governance, strategy, and risk management processes and frameworks. The proposed guideline would broadly follow OFSI's B-15 Guideline on Climate Risk Management with modifications based on the unique characteristics of B.C.'s regulated financial institutions. BCFSA will expect pension plan administrators to follow CAPSA's forthcoming Risk Management Guideline and incorporate material NCCR into governance, strategy, and risk management processes.

BCFSA recognizes the importance of high-quality data for identifying and managing NCCR. Many of BCFSA's regulated entities are small or mid-sized, and many of their customers are also small or medium-sized organizations and few are publicly traded. BCFSA acknowledges that there may be challenges acquiring climate-risk data that is high-quality, reliable, and comparable, at least initially.

BCFSA is exploring how best to integrate market conduct expectations into future guidance on NCCR to ensure financial institutions approach these risks holistically. This would highlight the importance for financial institutions to consider the risks for both their business and consumers, and changes in consumer needs and preferences, ensuring the fair and inclusive treatment of consumers.

7 The Regulatory Roadmap lays out BCFSA's anticipated regulatory priorities for the next three fiscal years. It is intended to increase transparency of regulatory priorities and enable regulated entities to prepare for consultations and implementation of upcoming regulatory initiatives. The Regulatory Roadmap may be found on the BCFSA website.

OSFI's B-15

OSFI's B-15 guidance includes expectations on:

- Governance: integrating NCCR into business model and strategy.
- Risk management: having appropriate risk management processes to manage NCCR, and processes to identify, estimate, and manage NCCR exposures on assets and liabilities in accordance with risk appetite framework.
- Climate scenario analysis and stress testing: using climate scenarios developed by OSFI to assess the impact of climate-related risk drivers on its risk profile, business strategy, and business model.
- Capital and liquidity adequacy: maintaining sufficient capital and liquidity buffers for climate-related risks; OSFI is also considering whether the current capital framework sufficiently captures such risks.
- Disclosures: providing transparency to market participants respecting the financial institution's risk exposure and how they are managing that exposure.

BCFSA Will Apply an NCCR Lens to Several Planned Guidance Documents (Short Term)

BCFSA also intends to apply an NCCR lens to several planned guidance documents in BCFSA's Regulatory Roadmap to ensure NCCR are considered holistically, including:

- As part of BCFSA's capital modernization initiative, BCFSA plans to update the Capital Adequacy Return ("CAR") for credit unions and develop a Capital Management Guideline. Beyond regulatory capital requirements, financial institutions should take NCCR into consideration when understanding their risks and assessing how much capital they need to support business activities. BCFSA's expectations are outlined in the Internal Capital Adequacy Assessment Process ("ICAAP") Guideline for credit unions and Own Risk and Solvency Assessment ("ORSA") Guideline for insurers; and
- As part of updating BCFSA's Residential Mortgage Underwriting Guideline ("RMUG") and in developing a Commercial Lending Guideline for credit unions, BCFSA would expect credit unions to consider incorporating NCCR into their underwriting practices.

Brokerage Governance (Short to Medium Term)

While NCCR may be more impactful to the overall operations and business model of financial institutions and pension plans, real estate and mortgage brokerages are also affected by these risks. In the short to medium term, BCFSA will explore as part of work to strengthen brokerage governance requirements, guidance to ensure that brokerages maintain robust policies and procedures so that they are prepared for potential disruptions to their operations because of NCCR and other material risks. BCFSA intends to engage with real estate brokerages on these matters in the upcoming fiscal year and moving forward, will look for ways to leverage this work in the context of the mortgage broker segment. As is the case with B.C.'s credit unions, BCFSA recognizes that mortgage lenders have significant exposure to NCCR with respect to their commercial and residential mortgage portfolios.

Prudential Supervision and Continuous Monitoring (Ongoing Activity)

While BCFSA seeks input on the development of forward-looking guidance, we will also continue to proactively monitor NCCR to build observations and lessons learned into our supervisory approach, including supervisory risk assessments. As a risk-based regulator, BCFSA has developed a financial model to estimate the impact of physical risks to lending portfolios of B.C. credit unions, which are used by our Supervision Team when engaging with regulated entities. Scenario analysis is important for financial institutions and pension plans to identify and measure risks and fulfill their fiduciary duties when managing assets. It also forms a basis for BCFSA to aggregate sector-wide information that informs future regulatory action.

Regulators across all markets are increasingly requiring companies, including financial institutions, to provide timely, comprehensive, and comparable climate-related risk (and sustainability) reporting. BCFSA will continue to identify where additional reporting is required to better understand and measure NCCR, and to ensure financial institutions and pension plans are conducting prudent risk management to identify material NCCR. For example, BCFSA is updating loan data reporting requirements from credit unions to include NCCR data. Going forward, BCFSA intends to work with fellow regulators and standard setting bodies to identify the NCCR data that it requires to better measure and monitor pension plans, credit unions, and insurance companies' exposure to NCCR as well as connections to the work of financial service professionals, including real estate licensees and mortgage brokers. BCFSA will ensure that data and information are aligned with national and international standards, so as not to put B.C. organizations at a competitive disadvantage. Finally, to ensure transparency, BCFSA will monitor how financial institutions and pension plans adopt and adhere to emerging reporting and disclosure standards and best practices.

Given the nature of the B.C. financial services sector and the entities we regulate , BCFSA will consider how best to adopt and/or adapt the climate scenarios developed by OSFI. As part of our supervisory approach, BCFSA will also consider requiring financial institutions and pension plans to assess the impact of NCCR on their business and to report the results to BCFSA. Scenario analysis can estimate both NCCR on companies' balance sheets and increase awareness of potential deficiencies in their risk management frameworks.

Market Conduct Oversight (Ongoing Activity)

British Columbians look to financial services providers for products, services, and expert advice that can help them meet their financial needs. To help ensure consumers are protected, BCFSA establishes rules, codes, or standards of conduct. As part of its continuous monitoring and ongoing market conduct oversight, BCFSA will ensure that financial services providers treat consumers in accordance with established standards. BCFSA is also exploring whether supplemental guidance is needed to build on consumer protection principles embedded in rules, codes, and standards that are affected by NCCR.

BCFSA can reinforce its expectation that all financial services providers should consider the interests of the target consumer group or their clients when designing and delivering products and services, and related disclosure materials. Any shortcomings in the product or service design or related disclosure documents can increase the likelihood of inappropriate choices from consumers.

BCFSA acknowledges that NCCR may disproportionately affect people in vulnerable situations. In many cases, those in vulnerable situations can least afford financial products and services. As climate change increases the frequency and intensity of climate-related natural catastrophes, the number of people in vulnerable situations is also expected to increase. BCFSA encourages financial services providers to continue to create new, innovative, and inclusive products and services that meet the diverse and changing needs of consumers.

PILLAR #2: DISCLOSING NCCR DATA AND INFORMATION TO CONSUMERS

The second pillar emphasizes that financial services providers should disclose sufficient information to consumers to enable them to make informed decisions with a focus on NCCR disclosures.

BCFSA is considering two types of disclosures:

1. Market Transparency NCCR Disclosures: for the purposes of improving transparency by reducing uncertainty and allowing consumers and investors to understand the exposure of financial services providers to NCCR and strategies they employ to address these risks.
2. Property-Specific NCCR Disclosures: disclosures in relation to real estate to improve consumers' awareness of the risks to them and their assets (e.g., homes and businesses), ensuring they have the information they need to make informed decisions.

Market Transparency NCCR Disclosures (Medium Term)

Market discipline can promote safety and soundness in financial systems by ensuring consumers understand the risks to which financial institutions and pension plans are exposed and how those risks are managed. BCFSA intends to explore NCCR disclosures, in alignment with national standards, for the purposes of increasing transparency. Broadly, this would mean aligning disclosure requirements for financial institutions with the framework developed by the Task Force on Climate-related Financial Disclosures ("TCFD"), which requires financial institutions to publicly disclose their climate risk governance, strategy, risk management, and metrics and targets.

International Disclosure Standards

In its 2015 proposal[8] to establish an industry-led disclosure task force (i.e., TCFD), the Financial Stability Board noted that disclosures "could promote more informed investment, credit [or lending], and insurance underwriting decisions… enabl[ing] stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system's exposures to climate-related risks."

Since then, financial regulators and standard setting bodies have begun work to establish common definitions, measurements, accounting standards, and approaches to disclosures for both emissions and climate risks. These metrics build on the TCFD disclosure framework.

The Sustainable Finance Action Council, of which BCFSA participates as an observer, has recommended that Canadian disclosure requirements be substantially aligned with the International Sustainability Standards Board requirements.

BCFSA's position is that increased transparency around governance, corporate strategy, and risk management is essential so that consumers know the exposure of financial institutions and pension plans to NCCR and strategies they employ to address risks. Further, feedback from consumers may encourage financial services providers to consider the resilience of their strategies and capital spending, which should help promote a smooth rather than an abrupt transition to a lower-carbon economy. These are business decisions that are consistent with modern risk management practices.

BCFSA supports external assurances (i.e., audits) in helping ensure disclosure and claims made by financial institutions and pension plans related to sustainability are accurate, not misleading, and aligned with emerging best practices and standards.

Property-Specific NCCR Disclosures (Medium Term)

Financial services providers are also being called on to disclose to real estate consumers the potential impact to their financial wellbeing and their property from NCCR. Consumers may not be aware of the risk, or ways they can work to mitigate impacts from these risks on their property.

The Canadian Climate Institute has found that Canadians are unknowingly buying and building homes and other infrastructure in areas at high risk of flooding, wildfires, and other climate change impacts.[9] Moreover, the products and services available to real estate consumers that can mitigate their financial risks are often complex, which may make it difficult for consumers to understand what they are being offered as well as what they have already purchased. This may result in consumers being inadequately protected from financial losses resulting from a climate-related natural catastrophe or an earthquake.

8 Available at: https://www.fsb.org/wp-content/uploads/Disclosure-task-force-on-climate-related-risks.pdf
9 Infrastructure-English-FINAL-jan17-2022.pdf (climatechoices.ca)

CCIR's Work on NCCR

BCFSA currently chairs the Canadian Council of Insurance Regulators' ("CCIR") working group on Climate Change, Natural Catastrophes, and Consumer Awareness. BCFSA led the development of CCIR's Position Paper[10] on ways that insurers and insurance products can better protect Canadians' personal property against the risks posed by natural catastrophes and a changing climate.

Real estate consumers should have the information and advice they need to better understand the likelihood and extent to which a natural catastrophe like a flood, wildfire, or earthquake could impact the property they are buying and/or own. Financial services providers can provide expert knowledge on the products they provide and the services they offer as well as access to information about a consumer's risk profile, both of which may not be readily available and/or understandable to consumers.

Therefore, BCFSA is exploring requiring property-specific NCCR disclosures in relation to real estate. From initial developer disclosures for pre-sales of multi-unit dwellings to point of sale disclosures for all properties, BCFSA will explore how regulated entities that provide financial services, including real estate licensees, mortgage brokers, and insurance companies could effectively disclose available NCCR information to real estate consumers.

As part of this work, BCFSA will explore potential ways to promote a common view of risk at the property level. Access to NCCR data and information, which can be facilitated through disclosures, can assist real estate consumers, builders, the financial services sector, and governments prioritize property-level and community-level climate resilience and adaptation investments.[11] This information can also help ensure consumers make informed decisions when purchasing or leasing property, making investments in ongoing property improvements, obtaining financing, or purchasing or renewing property insurance that provides adequate protection against NCCR. In addition, property-specific disclosures could include information about its carbon emissions and energy-efficiency and level of retrofit against flooding and earthquake. In many European countries, these disclosures are mandatory.

Climate Risk Scores

One concept gaining momentum is the use of property-level climate risk scores to raise awareness and encourage climate risk mitigation investments. For example, in a recent report[12] titled, "Designing the Path to Climate Compatibility: Climate Risk Disclosure and Action in the Canadian Housing Context," the Insurance Bureau of Canada and the Canada Mortgage and Housing Corporation explore the use of Real Estate Climate Risk Index and accompanying disclosures to assist homeowners, homebuilders, the financial sector, and governments to "mobilize capital toward effect and efficient property-level climate resilience and prioritize community-level adaptation investments."

10 Available at: https://www.ccir-ccrra.org/Documents/View/3759
11 Retrieved from IBC website: "Designing the Path to Climate Compatibility: Climate Risk Disclosure and Action in the Canadian Housing Context"
12 Retrieved from IBC website: "Designing the Path to Climate Compatibility: Climate Risk Disclosure and Action in the Canadian Housing Context"

Part

05

Next Steps & Discussion Questions

BCFSA is inviting interested stakeholders and members of the public to provide their feedback on the proposed approach outlined in this discussion paper. Below there are discussion questions to guide the conversation. We encourage stakeholders to share their perspectives, opinions, and suggestions. We aim to increase engagement with industry, our diverse stakeholders, and different levels of government during the consultation period.

Have Your Say

Send us your thoughts on the concepts and proposals outlined in this discussion paper by completing our consultation feedback form.

The consultation is open until November 30, 2023. BCFSA values all the input it receives and your comments will be considered as we move forward with this important initiative.

General

- 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?
- Is the proposed approach appropriate for the financial services sector in B.C. given our mandate and strategic imperatives?
- Are there any unique characteristics that BCFSA needs to consider that would necessitate BCFSA modifying its approach from other regulators?
- How should BCFSA apply proportionality when developing its approach?
- From a consumer's perspective, are there additional areas that BCFSA should focus that fit with our mandate?

Credit Unions

BCFSA is proposing to develop an NCCR Guideline that would follow OSFI's B-15 Climate Risk Guideline, which would require financial institutions to identify, measure, and manage NCCR to themselves and consumers. BCFSA has included earthquakes in its definition of NCCR, meaning financial institutions would also need to consider their earthquake exposure. BCFSA proposes that for transition risk, the standardized scenarios developed by OSFI/BoC should be used, with necessary modifications that reflect unique characteristics of the B.C. environment. BCFSA acknowledges that not all credit unions have the internal capacity to conduct a full analysis.

- What are the key considerations and challenges for credit unions to identify and measure NCCR?
- What should BCFSA consider when developing its guidance that better reflect the unique characteristics of B.C. incorporated credit unions?

BCFSA is proposing that credit unions should disclose their approach to NCCR in alignment with each of the TCFD pillars of governance, strategy, risk management, and metrics and targets. These disclosures should be reliable, verifiable, and objective, which will eventually require third-party assurance.

- Should disclosures be voluntary or mandatory? Why?
- Should disclosures be standardized, or should credit unions have discretion to decide for themselves how to report?
- Should BCFSA require assurances for disclosures?
- What other factors should BCFSA consider?

Insurance Companies

BCFSA is proposing to develop an NCCR Guideline that would follow OSFI's B-15 Climate Risk Guideline, which would require B.C. incorporated insurance companies to identify, measure and manage NCCR to themselves and consumers. BCFSA has included earthquakes in its definition of NCCR, meaning insurance companies would also need to consider their earthquake exposure. Given that BCFSA already expects B.C. incorporated insurers to comply with OSFI's B-9 Earthquake Exposure Sound Practices Guideline, BCFSA's approach is not anticipated to have a significant impact on how insurers manage seismic risk.

- What are the key considerations and challenges for insurance companies to identify, measure, and manage NCCR?
- What should BCFSA consider when developing its guidance that better reflects the unique characteristics of B.C. incorporated insurance companies?

While BCFSA's proposed NCCR guideline would broadly follow OSFI's B-15 Climate Risk Guideline, BCFSA is considering how best to integrate market conduct expectations into its guidance to ensure financial institutions approach these risks holistically. This would highlight the importance for financial institutions to consider NCCR for both their business and consumers. BCFSA's market conduct expectations would apply to both B.C. insurance companies and extraprovincial insurance corporations.

- Should BCFSA's market conduct expectations with respect to NCCR be included in the NCCR guideline or should they be covered in other market conduct guidance?
- What factors should BCFSA consider when integrating market conduct expectations into future NCCR guidance?

BCFSA is proposing that B.C. incorporated insurance companies should disclose their approach to NCCR in alignment with each of the TCFD pillars of governance, strategy, risk management and metrics and targets. These disclosures should be reliable, verifiable, and objective, and may eventually require third-party assurance.

- Should disclosures be voluntary or mandatory? Why?
- Should disclosures be standardized, or should insurance companies have discretion to decide for themselves how to report?

BCFSA is proposing property-specific NCCR disclosures to consumers when they initially purchase a homeowners insurance policy and at the time of renewal.

- What challenges do you foresee with property-specific NCCR disclosures?

Trust Companies

BCFSA is proposing to develop an NCCR Guideline that would follow OSFI's B-15 Climate Risk Guideline, which would require B.C. trust companies to identify, measure, and manage NCCR to themselves and consumers. BCFSA has included earthquakes in its definition of NCCR, meaning B.C. trust companies would also need to consider their earthquake exposure.

- What are the key considerations and challenges for trust companies to identify, measure, and manage NCCR?
- What should BCFSA consider when developing its guidance that better reflect the unique characteristics of B.C. trust companies?

Pensions

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.

- What are the key considerations and challenges for pension plans to identify, measure, and manage physical and transitions risks?
- 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?
- What should BCFSA consider as part of our approach to scenario analysis and stress testing for pension plan administrators?

BCFSA is proposing that pension plan administrators increase disclosures in alignment with each of the 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.

- Should disclosures be voluntary or mandatory? Why?
- Should disclosures be standardized, or should pension plans have discretion to decide for themselves how to report?
- What are the challenges associated with meeting disclosure requirements in alignment with TCFD?

Mortgage Brokers

BCFSA believes that it is prudent that all mortgage brokers should consider how physical risk could impact themselves and consumers over time. While the principles of identifying and measuring physical risks still apply to mortgage brokers, the actions that mortgage brokers are expected to take to manage risk should be commensurate with the risk. Mortgage brokers should take appropriate measures to ensure they can manage disruptions in their operations due to climate and/or seismic events. It is proposed that mortgage brokers could be called upon to disclose to consumers a property's exposure to NCCR.

- What challenges do you foresee with mortgage brokers (including lenders) having to provide advice or disclosures based on property-specific climate risk?

Real Estate Service Providers

BCFSA believes that it is prudent that all real estate service providers should consider how physical risk could impact themselves and consumers over time. While the principles of identifying and measuring physical risks still apply to real estate providers, the actions that real estate providers are expected to take to manage risk should be commensurate with the risk, as their operations could be affected abruptly or over time due to climate and/or seismic events.

It is proposed that real estate service providers would be called upon to disclose to consumers a property's exposure to NCCR. They will also be expected to be knowledgeable about NCCR and financial services products that can help consumers better protect themselves.

- What challenges do you foresee with requiring real estate service providers to disclose property-specific NCCR, or the disclosures themselves?

Real Estate Development Marketing

BCFSA believes that NCCR disclosures throughout the life cycle of real estate, including in real estate development marketing, could play an important role in protecting consumers.

- What benefits and challenges do you foresee with property-specific NCCR disclosures?

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