State Street Trust Company Canada

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Office of the Superintendent of Financial Institutions Canada
255 Albert Street
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Via e-mail: Climate-Climat@osfi-bsif.gc.ca

Re: OSFI Consultation - "Navigating Uncertainty in Climate Change: Promoting Preparedness and Resilience to Climate-Related Risks" (January 2021)

Dear Sir / Madam,

State Street Corporation ("State Street") welcomes the opportunity to comment on the discussion paper issued by the Office of the Superintendent of Financial Institutions Canada ("OSFI") entitled Navigating Uncertainty in Climate Change: Promoting Preparedness and Resilience to Climate-Related Risks ("Discussion Paper"). This discussion paper raises important issues with respect to better understanding how to identify, categorize, prepare for and build resilience to climate-related risks that could affect Federally Regulated Financial Institutions ("FRFIs") and Federally Regulated Pension Plans ("FRPPs"). We welcome OSFI's efforts and ongoing work to examine and engage FRFIs and FRPPs on climate-related risks and offer views primarily from the perspective of one of the world's largest providers of custody services to institutional clients, but also as one of the world's largest asset managers, State Street Global Advisors. In a letter ahead of the 2021 proxy voting season[1], State Street Global Advisors renewed its call on investee companies to disclose material risks associated with climate change in alignment with the framework created by the Taskforce of Climate-Related Financial Disclosures ("TCFD") as well as their transition plans for a 'net-zero' world.

Headquartered in Boston, Massachusetts, State Street specializes in the provision of financial services to institutional investor clients. This includes the provision of investment servicing, investment management, data and analytics, and investment research and trading. With $38.8 trillion in assets under custody and administration and

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[1] https://www.ssga.com/us/en/individual/mf/insights/ceo-letter-2021-proxy-voting-agenda

$3.47 trillion in assets under management (as of December 31, 2020), State Street operates in more than 100 geographic markets globally. In Canada, State Street provides global custody and local financial services through its wholly-owned subsidiary, State Street Trust Company Canada, a Canadian federal trust company, as well as the Canadian branch of State Street Bank and Trust Company and State Street Global Markets Canada Inc. In addition, we offer investment management services through State Street Global Advisors, Ltd., a wholly-owned subsidiary, and front-to-back portfolio and risk management solutions through Charles River Development, both of which have offices in Toronto.

State Street's Approach to Managing Climate-related Risk

(referencing Q1 – Q5)

Climate risk does not necessarily manifest in the same way across companies, industries and geographies. As a custody bank, climate risk is less relevant compared to banks with alternative business models. For example, State Street does not operate a commercial, consumer, or mortgage lending business. However, given our role as a critical part of the global financial system infrastructure, our anticipation and mitigation of the potential impact to our systems and processes is a particularly high focus for us.

In 2019, State Street rolled out a new country-level risk assessment framework that allows the State Street Risk Management teams to assess climate risk, with the evaluation of climate-related risks to include factors such as natural disaster (event) risk, management of natural resources, energy transition risks, and energy security risks. These risk assessments are intended to be used where State Street has operations or is considering establishing operations. They are also intended for use when assessing the firmwide location policy, namely, the appropriate risk and exposure as new markets are explored and can be used as an additional tool in evaluation of climate risks to State Street's assets.

Any climate-related risks identified are brought to the attention of the relevant business segments to determine how to address them, including the development of mitigation plans as well as regular monitoring and reporting. Given risks evolve over time, risk identification is an ongoing process, which includes inputs across the first, second and third line control functions, and also focuses on early detection of emerging risks, which are defined as exposures that are not necessarily newly identified, but whose manifestation and full implications are not entirely known. Outputs from the internal processes, including the Material Risk Identification Process, a firm-wide Emerging Risk Survey, and Risk Identification Interviews across first- and second-line leadership to identify emerging risks, are integral in developing risk management priorities and supporting stress testing.

Currently, our assessment of climate risk falls into the following broad categories:

- Protecting the long-term resilience of our physical assets to ensure our business is built on a robust and resilient physical infrastructure that is prepared to handle events associated with climate change;
- Protecting the assets on our balance sheet by evaluating, where relevant, the impact of climate-related risks on the value of those investments;
- As an asset manager, engaging portfolio companies to identify, manage, and report on climate risk and engaging with clients on the potential impact to their portfolio holdings; and
- As a service provider to asset managers and asset owners, assessing the strategic risks of failure by State Street or our clients, to properly manage physical or transition risks or to provide 'best-in-class' climate-related products or service offerings to clients, in either case impacting our competitive position and fee revenue.

Challenges Associated with Climate Stress Testing and Scenario Analysis

(referencing Q7)

Although various climate stress scenarios have a place in bank risk management and supervision, and State Street does incorporate natural disasters and extreme weather events in our internal stress-testing exercises, mandating additional, longer-term transition scenarios to the existing financial stress tests at this stage is premature. Climate scenario analysis is still in its early stages. Stress tests are designed to assess the resiliency of banks in the face of sudden and extreme financial shocks and generally require banks to demonstrate their ability to maintain sufficient capital under stress over a period of several months. Climate change transition shocks, while potentially severe, are likely to manifest over a much longer time horizon (e.g., 20-50 years). It is conceptually and technically challenging to incorporate such scenarios and, even if feasible, would not, in our view, be the most useful supervisory tool for addressing risks stemming from climate change. Instead, we suggest supervisors and banks continue to refine the identification and measurement of such risks and create a supervisory framework best suited to ensuring that banks take these risks into account.

General Challenges Integrating Climate/ESG Data into the Global Financial System

(referencing Q6)

Banks are in the early stages of integrating climate risk into their internal governance and business strategies, and are investing in the development of new products and services to support the specific investment objectives mandated by their clients (e.g., green bonds, green lending). Nevertheless, banks face significant challenges comparable to those pertinent for asset owners and asset managers, namely:

- **Access to reliable, comparable and consistent climate data** has been a persistent barrier to widescale integration of climate risk consideration to date. Data is needed to understand the fundamentals of climate change as well as the impact it will have on activities such as pricing, credit risk, and clients. Available climate data is heavily reliant on a limited number of data sources that employ inconsistent and non-transparent methodologies. This inherent subjectivity in current climate datasets could potentially lead to different companies classifying economic activities differently.
- **Ensure appropriate sequencing of policy actions**: While we agree on the urgency to act on climate change, there needs to be sufficient time afforded to implementation to ensure FRFIs can meaningfully assess potential climate-related risks. Based on our experience of implementing sustainability-related policies in other jurisdictions, we strongly recommend that OSFI carefully considers the appropriate sequencing of policy actions needed to tackle climate change, starting by ensuring there is a baseline of adequate climate disclosures across the entire investment chain.
- **International coordination is key to ensure 'lessons learned'**: Global coordination is crucial, especially in terms of climate-related disclosure and banking supervision. Hence, we strongly support the IFRS Foundation's plan to create a global sustainability reporting standard, as well as the intentions of voluntary leadership coalitions like the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) to advance common supervisory approaches. Nevertheless, adopting a rigid approach to climate-related policy -- for example, by drastically expanding the concept of financial materiality or even too narrowly defining 'sustainable' economic activities, will not help accelerate sustainable markets.

Recommendation to Leverage TCFD, SASB, and other existing International Standards to Address Material Sustainability Risks

(referencing Q11)

The proliferation of multiple and diverse environmental, social and governance (ESG) standards and frameworks, both regulatory and industry driven, in recent years, has contributed to the challenges described above. There are, however, two frameworks to report on climate-related risks and opportunities, which have emerged as workable and widely accepted by a broad range of stakeholders:

1. the **Taskforce on Climate-related Financial Disclosures ("TCFD")** --- across the enterprise, State Street has been an avid supporter of, and dual signatory to, the TCFD framework which sets out recommendations on the integration of climate considerations across four key pillars (governance, business strategy, risk management/disclosure, targets and metrics).
2. the **Sustainability Accounting Standards Board ("SASB")** --- is a highly useful framework as it presents measurable, comparable, and consistent reporting of material ESG issues by industry. This

allows for industry-specific and standardized guidance, focused on material sustainability issues that are likely to affect the financial condition or operating performance of companies within a specific industry[2].

As noted in our introductory remarks, State Street Global Advisors also reiterated to portfolio companies earlier this year[3] the importance of utilizing the TCFD framework as a means of considering their oversight and business strategy, with a view to enhancing transparency around any identified risks.

Moreover, there is growing momentum at the international level to move towards a comprehensive corporate reporting system, as the IFRS Foundation is seeking to collaborate with existing international standards-setters like SASB and TCFD to establish a Sustainability Standards Board. As governments, regulators, investors and other stakeholders increasingly call on companies to align disclosures with these international frameworks, we expect that the quality of climate data and associated risk measurement methodologies will be refined over the course of the next few years, meaning FRFIs will be better placed to quantify actual exposures to climate risk.

Conclusion

Fundamentally, we agree that banks need to continue to assess how their business activities and operations could be impacted by climate risk, particularly where existing models may not adequately capture such risks because of limited data on historical losses. These types of risks should already be captured as part of a firm's risk assessment, although they may be identified as emerging issues because of the longer timeframe associated with such risks.

Second, with regard to transition risk, climate change is one of many emerging factors that threaten to change the way in which banks operate. Firms should devote sufficient time and expertise to understand how business models evolve as a result of climate change. In our view, the risk associated with not adapting the business to the changing environment will not necessarily manifest through direct losses. Instead, revenue impairment or a loss of clients are likelier consequences. Minimizing exposures to climate risk should therefore be dealt with as part of a firms' ongoing strategic planning process. Finally, climate change is one of the many drivers which could affect a firm's ability to maintain its core operations, meaning it should be considered as part of the overall operating model/continuity planning. In managing these types of risks, core activities after an event has occurred should be resumed swiftly to prevent negative onward impacts to clients, markets, and wider stakeholders.

[2] https://materiality.sasb.org/
[3] https://www.ssga.com/us/en/individual/mf/insights/ceo-letter-2021-proxy-voting-agenda

We encourage OSFI to continue working with FRFIs and FRPPs and other standard-setters on climate-related risks and disclosure to help develop better metrics, standard methodologies and reporting for climate-related risk issues. We appreciate the efforts of OSFI and its willingness to consider our perspective on this important matter. If you would like to discuss this topic in further detail, please feel free to contact me.

Respectfully,

Robert J. Baillie

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