CANADA'S ROAD TO RESILIENCE: A Look at Evolving Climate Risk Policies & Practices

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From fires to floods and hurricanes to heat waves, new policies are forcing property owners, buyers, lenders, and insurers to consider climate risks.

Increasingly, climate risk considerations play a crucial role in commercial real estate transactions. As new policies emerge, owners, developers, lenders, and other stakeholders are being asked to evaluate and disclose physical climate risks for specific properties.

Recently, Canada became the latest major government to release climate risk management guidelines for financial institutions and insurance companies. Jurisdictions like the European Union, the United Kingdom, and Switzerland have advanced similar initiatives. Canada's B-15 guideline outlines specific expectations for how financial institutions manage and disclose climate-related financial risks. The new policy will undoubtedly impact CRE transactions, market prices, and property management.

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Assessing and Understanding Climate Hazards

The state of practice in Canada is evolving quickly, said Joelle Doubrough, senior environmental planner for SLR Consulting, during a recent webinar. Environmental assessment processes are changing, with companies evaluating both how the project will affect the environment (like greenhouse gas emissions) and how climate hazards will affect the project today and in the long term.

Additionally, Canadian municipalities are considering climate hazards when reviewing development applications, which can also influence zoning decisions, she said. For example, municipalities have updated their flood zones to reflect evolving flood risk data. Climate risk is becoming a part of municipal action plans and impacting local decision-making.

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Any climate risk assessment must be done in conjunction with existing due diligence processes. "Critical to this evaluation is reliable climate data, especially data that focuses on physical climate risks, such as heat, fire, precipitation, flood, and drought," Jeff Doerner, senior vice president of North American sales for ERIS, said during the webinar.

Canada is a large, geographically diverse country, with specific climate risks in different regions. For example, fires and floods are a concern in the western part of the country, while on the East Coast, hurricanes are an issue. And the central part of the country often deals with extreme cold and ice storms. Climate risk data helps us understand these natural hazards, said Cal Inman, CEO and Founder of ClimateCheck. That kind of information will be crucial for financial institutions tasked with managing climate-related risks.

Canada's New Policy for Financial Institutions

Canada's Office of the Superintendent of Financial Institutions (OSFI) issued Guideline B-15 in March, which addresses how federally regulated financial institutions (FRFI) should assess, manage, and disclose climate-related risks. The guideline applies to more than 350 banks and insurance companies, and the goal is to help these institutions build resiliency in the face of climate hazards.

Specifically, the guidelines incorporate five fundamental principles:

- **PRINCIPLE 1:** Create an appropriate governance and accountability structure for managing climate-related risks.
- **PRINCIPLE 2:** Incorporate both physical and transition risks in the FRFI's business model and strategy.
- **PRINCIPLE 3:** "Manage and mitigate climate-related risks in accordance with the FRFI's Risk Appetite Framework."
- **PRINCIPLE 4:** "Use climate scenario analysis to assess the impact of climate-related risks on [the FRFI's] risk profile, business strategy, and business model."
- **PRINCIPLE 5:** "Maintain sufficient capital and liquidity buffers for ... climate-related risks."

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Under Guideline B-15, the FRFI will develop and implement a climate transition plan to help manage increased climate-related risks and the transition toward an economy with lower greenhouse gas emissions. Each institution will assess its plan's achievability based on different climate scenarios and describe how it would measure progress. There are also financial disclosure requirements to protect policyholders, creditors, and depositors. Canada's six largest banks and internationally active insurance groups registered in Canada must start reporting by the end of fiscal year 2024.

Comparison to U.S. Policy

In the United States, while there are no specific guidelines or requirements for financial institutions and insurers related to climate risk evaluations, some lenders already factor ESG-related metrics (including climate risk) into their lending and underwriting policies. In addition, more formal climate risk disclosure requirements for all public companies are forthcoming. In March 2022, the Securities and Exchange Commission (SEC) proposed a rule that would require climate-related disclosures for publicly traded companies. For example, registrants would have to disclose information about:

- governance of climate-related risks and relevant risk management processes,
- the material impact of climate-related risks,
- how identified risks would affect business strategy and outlook,
- the financial impact of climate events, and
- both direct and indirect greenhouse gas emissions.

The proposed rule has garnered much attention and thousands of public comments. While the rule release was expected before the end of April, it is unclear when it will be finalized. The SEC may be working to align its disclosure requirements with EU rules. Former SEC Commissioner Robert Jackson said it's likely the agency will release the rule this fall. Although only applicable to publicly held companies, the SEC's final climate risk disclosure requirements will undoubtedly inform best practices and industry standards for private entities in the U.S.

Climate Risk Data and Analytics

As climate risk policies evolve and become more prescriptive, investors, lenders, and other real estate stakeholders need to understand and quantify chronic and acute hazards like high temperatures, wildfires, and flooding that affect their bottom lines. It is critical to measure and manage these potential risks.

Climate risk data provider ClimateCheck analyzes the frequency and severity of each hazard and uses that data to make future extreme weather projections based on multiple greenhouse gas emission scenarios. That data is specific to distinct regions in Canada facing different climate hazards.

"So we can understand the local context around the property," Inman said during a recent webinar, and use that information to communicate building vulnerability and to find solutions that will build resiliency.

For example, their flood models examine how a specific property has been affected by flooding in the past and looks to relevant data like sea level rise, storm surge, and how porous the area is to rate the property for future risk based on potential emissions outlooks. ClimateCheck also includes data on community-level risks surrounding the property. All data is compiled into a report to help Canadian real estate professionals understand how vulnerable a property is to climate risk.

"With all of our data, we provide a one through 100 rating that represents a relative risk to that individual property," while providing a baseline of how one property compares to the rest of the province or territory, Inman said.

Climate Event Projections

ClimateCheck's hazard screening "looks at the likelihood of an event happening," Doubrough said. The screening examines each hazard "and the likelihood of it occurring under existing conditions, as well as how that likelihood is changing over time. That's really important for climate risk, so you can understand how your risk profile changes over time."

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Climate data can be used as part of a vulnerability assessment to gauge a property's risk to various climate conditions more accurately. For example, if the property has been affected by flooding, a consultant will examine the state of the sub-structure and other factors that may make the building and property more vulnerable to additional damage, Inman said.

"When we talk about risk, it's important to understand that risk is subjective," Doubrough said. What one property owner or business considers high-risk might be considered low risk to another, because that second individual has the financial ability to absorb that risk.

However, "understanding how your risk profile is changing will allow you to take adaptive and resilient measures," she said.

Conclusion

New requirements like those in Canada's B-15 guideline illustrate the growing importance of factoring climate risk into existing due diligence processes and into overarching strategies. Policies are shifting, and companies should begin making climate risk a business and financial consideration now.

> "Policies are shifting, and companies should BEGIN MAKING CLIMATE RISK A BUSINESS AND FINANCIAL CONSIDERATION now."

As the likelihood of significant climate events continues to grow, it is more important than ever for environmental professionals and other CRE stakeholders to consider potential climate impacts. Risk tolerance levels aside, adding climate change assessments to environmental due diligence procedures makes good business sense; it provides a framework to address short-term financial and legal considerations while managing and mitigating long-term risks.