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Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Office of the Superintendent of Securities, Newfoundland and Labrador
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Dear Sirs/ Mesdames:

CONSULTATION ON CLIMATE-RELATED DISCLOSURE UPDATE AND CSA NOTICE AND REQUEST FOR COMMENT – PROPOSED NATIONAL INSTRUMENT 51-107 DISCLOSURE OF CLIMATE-RELATED MATTERS

Moody's Corporation (**"Moody's"**) is a global integrated risk assessment firm, providing data, analytical solutions and insights to help decision-makers identify opportunities and manage risks. Its business segments include Moody's Investors Service (**"MIS"**), the credit rating agency (**"CRA"**), Moody's Analytics (**"MA"**), which provides analytical solutions that support climate-related scenario analysis and stress testing, and Moody's ESG Solutions (**"MESG"**), which serves the growing global demand for data and insights on climate and other environmental, social and governance (**"ESG"**) considerations.

We wish to thank the Canadian Securities Administrators (**"CSA"**) for the opportunity to comment on the CSA Notice and Request for Comment – Proposed National Instrument 51-107 *Disclosure of Climate-related Matters* (the **"Proposed Instrument"**).

Through its different business segments Moody's is both a consumer and a provider of climate-related data. Notably, Moody's has provided data for use in the reports of the Task Force on Climate-Related Financial Disclosures (**"TCFD"**) and has co-authored a report on the development of metrics to support the TCFD recommendations[1].

We have three overarching comments on the Proposed Instrument:

1. **We welcome the CSA's intention of making disclosures aligned with the recommendations of the TCFD mandatory.**

2. **We further welcome the CSA's intention of continuing to develop regulatory requirements in line with international developments, and in particular the development of a more granular reporting framework.**

3. **In respect of the CSA's characterization of the role of CRAs, we wish to clarify that MIS assesses credit implications arising from all considerations that we can discern, whether they have a current or potential future impact**.

We address each of these points in turn below and have included specific responses to certain of the questions posed in the Proposed Instrument in the Annex attached to this letter.

1. **We welcome the CSA's intention of making disclosures aligned with the recommendations of the TCFD mandatory.**

Moody's uses climate-related disclosure to inform its analysis across its different business segments and products.

[1] "Advancing TCFD guidance on physical climate risks and opportunities", a report prepared by Four Twenty Seven and Acclimatise for the European Bank for Reconstruction and Development on behalf of the European Bank for Reconstruction and Development and the Global Centre of Excellence on Climate Adaptation. Four Twenty Seven officially became a part of MESG in 2020.

MIS uses climate-related financial disclosures to inform its credit analysis

As a leading provider of credit ratings, MIS makes use of a wide range of qualitative and quantitative information, sourced from issuers and third parties, to inform its credit analysis. This includes information with direct financial relevance, such as annual and interim reports and financial statements, as well as information that informs our wider thinking about a company's operating environment, including possible legal, regulatory and reputational considerations. We have found that considerations in respect of climate-related developments and in respect of environmental, social and governance (**"ESG"**) developments more generally can have significant credit implications, and we consider them on a systematic basis.

MIS has experienced great interest from investors seeking to understand how we consider climate and wider ESG considerations in our credit analysis and what impact such considerations have on MIS' credit analysis. We have created a range of tools to explain our analysis. Among other things, MIS has developed a cross-sector methodology on "General Principles for Assessing Environmental, Social and Governance Risks" and ESG scores that measure the credit impact of ESG considerations at the level of the issuer.[2]

In the course of developing our ESG framework and evaluation tools and in line with evolving disclosure practices, we have increased our use of climate- and ESG-relevant disclosures. The degree to which ESG factors may affect cash flows, balance sheet strength and, ultimately, credit quality, varies widely across sectors, geographies and issuers. We assess credit relevance in the context of our defined methodologies and processes, and we use issuer disclosures, among other sources, to inform our work.

MESG is both a user of climate-related financial disclosures and provides data on climate-related developments, including for the preparation of TCFD-aligned reporting

MESG is a business unit of Moody's Corporation that provides ESG, climate and sustainable finance solutions, including ESG and climate scores, analytics and sustainable finance reviewer and certifier services. Our MESG products, data, and solutions help identify and evaluate climate risks through integration into capital allocation and long-term planning. The spectrum of MESG's climate solutions and insights ranges from entity-level information to macro-level analytics; spanning identification and quantification of climate risk and readiness.

For example, MESG prepares data sets on carbon footprint, temperature alignment and climate governance which rely on information from corporate disclosures in addition to in-house modelling.

MESG also provides a range of climate-related datasets capturing physical risk, transition risk and climate governance. Banks, insurers and investors use these tools, including to inform their own TCFD-aligned reports. At the same time, we leverage issuer disclosures to prepare our transition risk and climate governance data sets.

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[2] MIS ESG scores take the form of Issuer Profile Scores (IPS) and Credit Impact Scores (CIS). IPS indicate the issuer's exposure to ESG-related risks and opportunities, incorporating related mitigants or benefits. CIS Indicate the extent to which the rating is different than it would have been in the absence of ESG considerations.

TCFD-aligned disclosures help to inform our analytical thinking and allow us in turn to provide more insightful research to the market

A principal challenge that persists while delivering high-quality analysis, insights and solutions is the need for consistent, reliable and accurate disclosure of company related climate data sets. As such, and as set out in the foregoing, Moody's has a significant interest in promoting high-quality, comparable and consistent information and data to inform our analytical thinking. We welcome and support the ongoing global efforts to enhance the quality and consistency of ESG and climate disclosure. Specifically, we have supported the work of the TCFD from the outset and have contributed to the development of the framework. For example, most recently Moody's has contributed to the contents of the "2021 Status Report: Task Force on Climate-related Financial Disclosures, October 2021" by developing the artificial intelligence component to review company reports. The Status Report also references the work of MIS in developing ESG scores that cover climate risk.

It has been our experience that the TCFD framework has already played an important role in improving issuer disclosures in respect of climate considerations since the publication of the recommendations in 2017. It has led to more consistent, comparable and meaningful disclosures by reporting issuers globally. According to findings from Moody's, based on an assessment of over 3,800 companies worldwide, the global average disclosure rate across all 11 TCFD recommendations increased to 22% in 2021 from 16% in 2020.[3] The development of the TCFD framework has arguably also spurred the debate about enhanced disclosures in respect of other ESG considerations, such as nature-related risks.[4]

In our engagement with market participants around climate risk, we have also observed that the development of greater dialogue and thinking around the most effective ways to measure and manage climate risks may translate into better climate risk management, in addition to more consistent disclosures.

We welcome the move towards making these requirements mandatory to provide further momentum to their global roll-out. The CSA's Proposed Instrument is an important step in that development.

2. **We further welcome the CSA's intention of continuing to develop regulatory requirements in line with international developments, and in particular the development of a more granular reporting framework.**

Whilst the TCFD framework has made a significant contribution, we also find that there is room for further improvement in climate-related disclosures going forward.[5]

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[3] See MESG: "Climate Solutions – Global. State of TCFD Disclosures 2021", 18 October 2021.

[4] In September 2021, Moody's joined the Taskforce on Nature-related Financial Disclosures (TNFD), a new industry-led initiative working to significantly shift global financial flows from nature-negative to nature-positive outcomes. As a member of the TNFD, Moody's will join leading organizations across key sectors and geographies to develop a reporting framework and act on evolving nature-related risks and opportunities.

[5] See for example, MIS reports: "Financial Institutions – Global: More consistent and transparent ESG disclosures will improve the visibility of related credit risk", 12 October 2021, and "Banking – Cross Region. Financial impact disclosure of banks' climate risks is progressing slowly", 2 November 2021.

In particular, we welcome the CSA's consideration of the development of metrics and its acknowledgement of the development of an eventual set of reporting standards, for example under the auspices of the International Financial Reporting Standards ("**IFRS"**) Foundation's International Sustainability Standards Board (**"ISSB"**). A widely accepted global standard that sets common definitions and assumptions would facilitate a much greater degree of consistency and comparability of disclosures across companies and jurisdictions, as well as helping to link sustainability information with financial disclosures.

In other areas of climate-related disclosure, best practice is continuously evolving.

Issuers' greenhouse gas (**"GHG"**) emissions disclosures are made on the basis of greatly differing assumptions and definitions, and with different units of measurement. The market is developing an understanding of the most meaningful approaches to GHG disclosures, and it will be helpful for regulators to keep evolving their regulatory requirements in line with this learning process.

The equivalent is true for scenario analysis. At this junction, we agree with the CSA's considerations in respect of the current shortcomings of scenario analysis. However, imperfect as current scenario analysis practices are, Moody's believes that scenario analysis can meaningfully inform our analysis. As issuers' use of scenario analysis grows more sophisticated and refined, the market will benefit from greater regulatory guidance to promote best practices and drive towards the definition of common assumptions by sector.

3. **We wish to clarify that MIS assesses credit implications arising from all considerations that we can discern, whether they have a current or potential future impact.**

We appreciate the CSA's efforts to consider in the Proposed Instrument the significance of climate-related disclosure to CRAs, such as MIS, among other users of disclosures. We have however two comments regarding the CSA's characterization of CRAs, as set forth in the following paragraph:

> *"CRAs assess the financial strength of corporate and government entities and their ability to meet principal and interest payments on their debt. They are gatekeepers of the bond market and give investors and lenders a better understanding of an entity's credit risk. As such, they are able to affect the flow of significant amounts of capital. Although many credit rating agencies have started to incorporate climate risk into their credit considerations, the standard credit risk rating horizon is 3-5 years. Assessing climate risks requires a longer-term perspective. Studies have shown that an adequate assessment of climate risks requires a ratings horizon of 15 years (Woodall, 2020)."* [6]

First, the Proposed Instrument states that the standard credit risk rating horizon is 3-5 years. This is not correct, at least in the case of MIS. As set out in the MIS publication "Rating Symbols and Definitions"[7], MIS' credit ratings are forward-looking opinions of relative credit risk with no stated time horizon. Environmental and social issues can often be diffuse, with long or uncertain time horizons (e.g., climate change and demographics), and are subject to the variability of potential

[6] Annex G, Section 4, ii, d on "Credit rating agencies (CRAs)" (p. 64) of the Proposed Instrument

[7] MIS, "Rating Symbols and Definitions", 2 November 2021

policy measures (e.g., carbon regulations and immigration policies) and the performance of the economy. This can result in a wide range of potential credit outcomes for affected issuers.

As for other considerations, MIS incorporates future ESG trends into credit ratings when it has visibility into those trends. In most cases, however, MIS' ability to forecast the impact of trends that will only unfold far into the future is necessarily limited. Nearer-term risks generally have a more direct impact on credit ratings because there is typically far greater certainty of their impact on credit profiles. As a general principle, as the time frame for a source of risk lengthens, the less certain we can be of its impact on an issuer's cash-flow-generating ability and other credit metrics, and the less clarity we have regarding the importance of that risk in relation to other risks the issuer faces. For example, longer time frames give an issuer more time to adapt by lowering costs, adopting new technologies, or realigning its business model, budgetary spending or balance sheet to changed circumstances. However, some issuers may not be able to or may fail to take effective mitigating actions.

Second, we regard the CSA's characterization of CRAs as "gatekeepers of the bond market" as misleading, as it suggests (incorrectly) that a credit rating is a prerequisite for access to the bond market. Issuers can and regularly do access the bond market and obtain credit without a credit rating. Credit ratings are just one type of information available to market participants to inform their assessment of potential investment opportunities.

We thank you for your consideration. Please find our responses to your detailed questions attached.

Yours faithfully,

"*Christine Elliott*"

Christine Elliott
Head of Global Corporate Affairs

ANNEX – Response to detailed questions

Question 4: Under the Proposed Instrument, scenario analysis would not be required. Is this approach appropriate? Should the proposed Instrument require this disclosure? Should issuers have the option to not provide this disclosure and explain they have not done so?

In our experience, scenario analysis can be a useful tool that makes a valuable contribution to our analytical work.[8] If well considered and clearly described, scenarios can provide a helpful illustration of a company's evaluation of its climate-related risk exposure. Specifically, we look for scenarios that are supported by science-based data and that set out plausible targets and plans. A company's approach to scenario analysis can yield valuable insight into how advanced it is in considering climate change risks.

Over time, the value of scenario analysis can be increased by providing standardized and well-specified assumptions for all participating issuers. Given that tools and frameworks are emerging to support such a consistent, standardized approach to scenario analysis,[9] the CSA may wish to revisit the suitability of mandatory scenario analysis when considering future amendments to the Proposed Instrument.

Question 5: The TCFD recommendations contemplate disclosure of GHG emissions, where such information is material.

- **The Proposed Instrument contemplates issuers having the option to disclose GHG emissions or explain why they have not done so. Is this approach appropriate?**

- **As an alternative, the CSA is consulting on requiring issuers to disclose Scope 1 GHG emissions. Is this approach appropriate? Should disclosure of Scope 1 GHG emissions only be required where such information is material?**

- **Should disclosure of Scope 2 GHG emissions and Scope 3 GHG emission be mandatory?**

- **For those issuers who are already required to report GHG emissions under existing federal or provincial legislation, would the requirement in the Proposed Instrument to include GHG emissions in the issuer's AIF or annual MD&A (if an issuer elects to disclose these emissions) present a timing challenge given the respective filing deadlines? If so, what is the best way to address this timing challenge?**

In our experience, disclosure relating to GHG emissions is becoming increasingly significant to many investors and in turn, to our analytical work. MESG, for instance, uses GHG emissions data in

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[8] For example, MIS also applies its own scenario analysis. See MIS: ESG – Global: Climate scenarios vital to assess credit impact of carbon transition, physical risks.

[9] Globally, many financial regulators are defining scenarios in line with the reports of the Network for Greening the Financial System (**"NGFS"**). These envisage an orderly 2ºC scenario with climate policies introduced gradually; a disorderly 2ºC scenario with climate policies introduced later; and a higher-emissions business as usual scenario with over 3ºC of warming. For transition risk, scenarios will need to be based on the uncertainty in the timing and strength of policy to support transition to a low-carbon economy and will be more important for some sectors than others. See NGFS: "Scenarios in Action. A progress report on global supervisory and central bank scenario exercises", October 2021.

creating its Carbon Footprint and Temperature Alignment datasets. We would thus welcome requirements for GHG emissions disclosures as a step in the right direction.

All of Scope 1, 2 and 3 are useful to our various assessments[10].

At the moment, we rely on estimates where issuers do not report emissions. We consider this, however, a second-best to reported emissions and welcome the gradual move towards mandatory reporting requirements for all of Scope 1, 2 and 3. Specifically, we would find it appropriate to require mandatory Scope 1 reporting as a minimum, with Scope 2 and 3 subject to a "comply or explain" requirement for the time being. Over time, we envisage that it would be appropriate to require Scope 2 and 3 disclosures on a mandatory basis. Note that for some of the most important carbon-intensive sectors such as oil & gas and auto manufacturers, the importance of Scope 3 emissions vastly outweighs that of Scopes 1 and 2.

As set out in MESG's report on the "State of TCFD Disclosures"[11], an increasing number of companies worldwide are disclosing GHG emissions. More than half of the organizations covered in MESG's report disclosed carbon footprints from their Scope 1 and 2 emissions, and 43% disclosed at least elements of all types of emissions, i.e., including Scope 1, 2 and 3.

That being said, issuer disclosure relating to GHG emissions relies on greatly differing assumptions, definitions and measurement tools, which limits the comparability, and consequently the value, of such disclosure. Establishing regulatory requirements with respect to a common GHG reporting standard would greatly increase the value of such disclosure.

Question 6: The Proposed Instrument contemplates that issuers that provide GHG disclosures would be required to use a GHG emissions reporting standard in measuring their GHG emissions, being the GHG Protocol or a reporting standard comparable with the GHG Protocol (as described in the Proposed Policy). Further, where an issuer uses a reporting standard that is not the GHG Protocol, it would be required to disclose how the reporting standard used is comparable with the GHG Protocol.

- **As issuers have the option of providing GHG disclosures, should a specific reporting standard, such as the GHG Protocol, be mandated when such disclosures are provided?**

- **Is the GHG Protocol appropriate for all reporting issuers? Should issuers be given the flexibility to use alternative reporting standards that are comparable with the GHG Protocol?**

- **Are there other reporting standards that address the disclosure needs of users or the different circumstances of issuers across multiple industries and should they be specifically identified as suitable methodologies?**

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[10] However, emissions disclosure also has limitations. We often find that emission levels alone cannot be used to accurately estimate the financial impact of carbon transition on companies. For MIS' Carbon Transition Assessment, which is an assessment of the financial risk to companies from carbon transition, we find that a focus on operational data, combined with an analysis of policy, technology and market risks provides a more accurate picture (than just using GHG emissions) of the risk of stranded assets, investment requirements and loss of cashflows which have the most direct impact on credit quality.

[11] See MESG: "Climate Solutions – Global. State of TCFD Disclosures 2021", 18 October 2021, p. 9-10.

As noted above, we are of the view that a common GHG reporting standard would greatly increase the value of disclosed GHG metrics and reduction targets. In our experience, the GHG Protocol is the prevalent standard and we use it for our own assessments.

Question 7: The Proposed Instrument does not require the GHG emissions to be audited. Should there be a requirement for some form of assurance on GHG emissions reporting?

In our view, the value of the climate-related disclosure called for under the Proposed Instrument would be greatly enhanced by an audit/assurance requirement in the event that the Proposed Instrument mandates a common GHG reporting standard.

Question 9: What climate-related information is most important for investors' investment and voting decisions? How is this information incorporated into these decisions? Is there additional information that investors require?

We wish to respond to this question not from the perspective of an investor, but rather as a user of information and a provider of climate-related data to market participants. Based on our own needs and the questions that we receive from investors, we see room for improvement in the following areas:

- The development of metrics to support the qualitative disclosures and provide greater specificity and comparability. The TCFD has developed supplementary guidance to support the development of relevant metrics for physical and transition risks[12]. We would find it helpful for regulators to develop their expectations in line with these emerging tools.

- The development of forward-looking information rather than solely historical information.

- The development of data and indicators that quantify the financial and economic risk of climate change.

- Comparable, forward-looking information on companies' efforts to manage their physical and transition risk and their climate risk resilience plans, investment plans for carbon transition, including GHG reduction targets (if applicable) with information on specified target year, base year, scope and use of offsets.

- The development of asset level data – for example, the precise location of an entity's critical factories, plants, or property – to facilitate climate physical risk assessments.

Question 10: What are the anticipated benefits associated with providing the disclosures contemplated by the Proposed Instrument? How would the Proposed Instrument enhance the current level of climate-related disclosures provided by reporting issuers in Canada?

Many issuers have already started to report in line with the TCFD requirements. This is welcome and has helped to raise the bar for climate-relevant disclosure standards. However, consistent disclosure will be necessary to achieve a fuller picture and to provide comparability across issuers. The CSA's proposed instrument will make a significant contribution towards this consistency.

[12] TCFD: Guidance on Metrics, Targets and Transition Plans, October 2021