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General Manager, Policy Development
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Dear General Manager

Draft APRA CPG 229 Climate Change Financial Risks

The Australian Financial Markets Association (AFMA) [1] and Asia Securities Industry & Financial Markets Association (ASIFMA) [2] (collectively, "the Associations" or "We") welcome the opportunity to comment on APRA's Draft Prudential Practice Guide 229 on Climate Change Financial Risks (draft CPG 229) (the Guide). The Associations have established dedicated workstreams to address the growing focus on the financial services industry to respond to environmental, social and governance (ESG) challenges.

Our objective in sustainable finance is to promote harmonisation of sound market practices. We aim for financial market participants and stakeholders to consider existing and emerging best market practices and guidance in ESG. We support the development of a coherent market structure to

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[1] The Australian Financial Markets Association (AFMA) was formed in 1986. Today we are the leading industry association promoting efficiency, integrity and professionalism in Australia's financial markets – including the capital, credit, derivatives, foreign exchange and other specialist markets. Our membership includes more than 130 market participants, from Australian and international banks, leading brokers, securities companies and state government treasury corporations to fund managers, energy traders and industry service providers. Our role is to provide a forum for industry leadership and to advance the interests of all these market participants.

[2] ASIFMA is an independent, regional trade association with over 140 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative, competitive and efficient Asian capital markets that are necessary to support the region's economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the United States and AFME in Europe, ASIFMA also provides insights on global best practices and standards to benefit the region.

sustainable finance. To that end, we support APRA's view that each institution should adopt approaches in governance, risk management, scenario analysis and disclosure that are appropriate for its size, customer base and business strategy.

Identifying, assessing and managing climate-related financial risks are fast-evolving areas with many initiatives being developed across multilateral and jurisdictional levels. The financial services industry is evolving business structures to achieve various sustainability goals while maintaining commercial viability. Efficient practices for ESG data, taxonomy, asset assessments, accounting and reporting around sustainability financing are constantly being developed.

We appreciate APRA engaging with institutions to better understand how they address climate change financial risks. We support a rational development of regulatory expectations that are well attuned to industry capability, outcomes-focused and consistent with emerging global best practices where possible.

We look forward to working with APRA on developments in the ESG space as standards and systems evolve and to share further international perspectives on the development of sustainable finance.

We would welcome the opportunity to meet with APRA to share further international perspectives on development of sustainable finance globally including, if helpful, a roundtable with firms operation in Australia and internationally to further share their perspectives and insights.

We trust our comments below on the draft CPG 229 will be of assistance.

Please feel free to contact us for more information.

Yours sincerely

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1. Climate change financial risks

We note that APRA has identified 'liability risks' as a separate classification of climate change financial risks in addition to transition and physical risks. We suggest APRA aligns these risk types to those outlined by the Task Force on Climate-related Financial Disclosures (TCFD) where liability risks are captured under transition risks. We support this streamlined classification to avoid fragmented considerations of climate-related financial risks.

The TCFD framework, which is supported by APRA, will also be applied across a number of jurisdictions such as the Monetary Authority of Singapore's (MAS) Guidelines on Environmental Risk Management for Asset Managers[3] which follow similar risk classifications. New Zealand's mandatory climate-related disclosure requirements[4] set to apply from 2022 also adopt the two-pronged risk classification recommended by TCFD. As several other jurisdictions appear to adopt similar risk classifications, we suggest APRA's guidance include liability risks under transition risks in the interest of encouraging high-level consistency at the international level.

We note that such TCFD and international alignment will assist Australian regulated entities with exposures to foreign assets and foreign financial entities operating in Australia to adopt largely consistent reporting practices which are efficient, comparable and reduce fragmentation in an area where harmonisation is important. While jurisdictional reporting requirements may vary in the specifics that they ask for, overarching consistency on risk definitions, reporting expectations and benchmarking to common best practices should be aimed for. This will also support the implementation of globally consistent frameworks within the same institutions and the necessary cross-border flow of capital to support transition and sustainable financing.

2. Governance

We agree that climate risks should be considered and managed within an institution's overall business strategy and risk appetite, and the board of directors should be able to evidence its ongoing oversight of these risks when they are deemed to be material to effectively discharge their director duties. We also agree that the board may delegate certain functions of climate risk management but needs to maintain mechanisms for monitoring the exercise of this delegated authority.

We appreciate the reference to CPS 510, but we caution against any further prescription of the board's role beyond the roles outlined by the draft CPG and CPS 510. While we understand APRA has not indicated any intentions to do this, we take this opportunity to comment based on regulation in other areas.

In recent times, the industry experience has been that regulation requires boards to be across a number of the more specific risk areas in detail, such as with information security, which may create

[3] Monetary Authority of Singapore, *Guidelines On Environmental Risk Management (Asset Managers)*, 2020.
[4] New Zealand, Mandatory Climate-related Disclosures.

imbalances between appropriate delegation principles and effective governance objectives. It is important that appropriate distinctions between the roles of boards and managers are maintained clearly, and oversight functions of the board are clearly scoped.

3. Applicability to foreign entities and support for global consistency

We support that APRA's guidance needs to take account of the cross-border compliance environment that foreign entities operate in and assist them in understanding how regulatory obligations apply to local branches of foreign entities.

We note that there are benefits from aligning local regimes in a way that recognises that international banks (including Australian entities operating elsewhere) can implement group frameworks which better position the group to deliver the desired outcomes.

Questions arise on how an APRA-regulated institution, which is part of a global group and most likely follows globally adopted risk management frameworks, may be required to adopt the guidelines or identify its linkages to the global frameworks. In our view, CPS 220 largely addresses these questions and appreciate the Guide referencing CPS 220 to clarify application to the branches of foreign entities.

In this regard, we suggest Paragraph 19 of the Guide could be amended to reflect the following:

> A prudent institution would seek to ensure that its arrangements to identify, measure, monitor, manage, and report on its exposure to climate risks are conducted in a manner appropriate to the institution's size, business mix and complexity of its business operations, *whether it is a domestic headquartered APRA-regulated entity or a branch of an offshore-headquartered entity.*

An example of addressing this need can be found in the New Zealand climate-related disclosures where foreign entities would need to meet certain thresholds to be required to report disclosures. Particularly, overseas incorporated organisations would be required to make disclosures if their New Zealand business is over the thresholds outlined to ensure their New Zealand stakeholders' needs are met[5]. Such an approach may also be supported by introducing capacities to rely on disclosures at group level where appropriate. This will allow administrative efficiencies and lower the risks of inconsistent reporting that may be misinterpreted.

4. Addressing climate change financial risks

We support the view that climate risks should be considered within an institution's existing frameworks, including the board-approved risk appetite statement, risk management strategy and business plan. We also support that the policies and procedures developed under the risk

[5] *Ibid.*

management framework would include a clear articulation of the respective roles and responsibilities of business lines and risk functions with respect to climate risk. However, we draw APRA's attention to a few important considerations with regard to addressing climate change financial risks.

Risk Identification – Data challenges

We note that a number of financial institutions have adopted frameworks that outline their financing practices with stipulated policies and procedures around asset classification, risk identification, measurement and monitoring of risk exposures, external assurances and so on. An important component of these frameworks are climate vulnerability assessments (CVAs), which we understand APRA is undertaking as part of its industry engagement.

While firms work towards establishing robust financing procedures and appropriately assess their climate vulnerabilities, it is important to note there are several issues around the availability of good quality and appropriate data. These include -

- the variety and inconsistency of the data and measures
- the different ways in which companies report on the available data
- lack of transparency among ESG data providers
- differing ways of materiality determination of ESG data

To resolve these issues, collaborative industry effort and cross-border engagement is needed to understand what data is needed across economic sectors, and the benchmarks and frameworks to standardise it. As mentioned above, the industry is navigating these challenges to reach optimal solutions. To assist in these endeavours, we hold that a supportive regulatory environment that engages closely with the industry to understand these practical challenges, is important.

Climate scenarios

Further to our comments above on the need to fill the gaps in ESG data, we support the use of internationally consistent scenario and stress testing practices. There is growing need for reliable information for scenario analyses. In addition to determining consistent data and information needs for climate scenario analysis, we support developing technical, business and scientific standards which allow a consistent and comparable reporting within and across jurisdictions.

We note from industry experience that there is some degree of confusion around what constitutes a "A short-term assessment" and "A long-term assessment". We appreciate that while the Guide provides more clarity on the factors to consider for these assessments, particularly on business planning cycles, members expressed that APRA could perhaps provide indicative timelines to define "short-term" and "long-term".

Risk Monitoring

We note that quantitative metrics to measure scope 1, scope 2 and material scope 3 emissions (e.g., IIGCC net zero framework) are gaining global focus. We understand from member experience that measurement methodologies for scope 3 emissions face significant gaps due to the lack of information and data. While firms develop reliable tools to quantify the potential impact of climate-related risks and opportunities at the asset and project level, provided the data is available, to assess this at a portfolio level requires further capability uplift and methodology development.

Further, while emission reporting practices across various sectors are understandably different, in many cases they are not carried out altogether, though this is rapidly changing. Consequently, financial institutions must conduct their own modelling around emissions to assess their risk exposures. However, this leads to divergent methodologies used to measure or estimate emissions which may potentially be less accurate if the asset or project related data is not readily available. This again highlights the need for better data availability and more consistent emission reporting methodologies.

We are engaging with industry to understand their practices and welcome engagement with APRA to develop standardised practices in risk management for the financial services industry. We support APRA and other authorities' engagement to further develop the availability of necessary data.

Risk Management

We agree that institutions should work with customers, counterparties and organisations that face higher climate risks, to improve the risk profile of those entities. This work should be supported by appropriate policy and regulatory settings that consider the health of the business environment. We also agree that financing to assist customers to adapt to climate change is an important function of the financial system where this can be done within risk appetites with suitable risk mitigating measures.

In an economy like Australia, transition finance plays an important role to drive the shift to a low-emissions economy. We note the approach taken by the Canadian government[6], as well as the recent consultation by the EU[7] which recognises that policy support could help encourage transition financing. In support of such a shift, we also note the Climate Transition Finance Handbook, a guidance for Issuers published by International Capital Market Association (ICMA).

We appreciate that APRA's approach reflects an understanding of transition financing and support the development of rational policy approaches based on recognition of transition effort instead of binary separation between 'green' and 'not green' activities.

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[6] Government of Canada, Final Report of the Expert Panel on Sustainable Finance - Mobilizing Finance for Sustainable Growth

[7] EU Platform on Sustainable Finance, Public Consultation Report on Taxonomy extension options linked to environmental objectives

Risk Reporting and Disclosures

The Associations support timely, comprehensive and risk-based reporting and disclosures by institutions on material climate risk exposures, including monitoring and mitigation actions. Reporting based on reliable data, assessment methodologies and risk management by institutions is essential to facilitate investment decision-making. For this, financial firms require companies in the real economy to report on their exposures as this data is needed to assess risk at a counterparty, sectoral and portfolio level.

In line with our comments above, we note that reporting and disclosure requirements on material climate risk exposures should be based on formats that are largely consistent with international best practice and allow comparability across jurisdictions. We also support reporting practices that are practical, administratively cost-effective and aligned to a reasonable extent with existing reporting obligations applicable to firms.

Supplementary to our comments above on allowing reliance on group-level disclosures where appropriate, we note the limited benefit of requiring local-level disclosures at this stage. Comparing Australian banking groups' disclosures with other firms' group-level disclosure will allow for better comparison and encourage better practices, rather than local level disclosures which may be open to misinterpretation.