13 August 2021

[redacted]
General Manager, Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority

By email: PolicyDevelopment@apra.gov.au

Dear [redacted]

Draft Prudential Practice Guide on Climate Change Financial Risks

COBA welcomes the opportunity to comment on APRA's draft Prudential Practice Guide on Climate Change Financial Risks (CPG 229).

COBA is the industry association for Australia's customer owned banking institutions (mutual banks, credit unions and building societies). Our sector provides retail banking services to a wide range of communities, geographies and demographics. Collectively, our sector has $147 billion in assets, around 10 per cent of the household deposits market and more than 4.5 million customers. Our members range in size of less than $200 million in assets to around $15 billion in assets.

Key points

- **We agree on the clear need for all APRA regulated entities to manage climate-related financial risk given the wide-reaching impacts of a changing climate.**
- **We support APRA's guidance approach on climate-related financial risk.**
- **We strongly support the proportionate application of these expectations that consider an entity's size, business mix and complexity. As smaller retail banks, mutual ADIs will be subject to more proportionate expectations compared to their larger and more complex peers.**
- **We request more information sharing with industry from APRA on best practice and benchmarking in climate risk management practices.**
- **We note that scenario analysis is likely to be the most difficult of these expectations for mutual ADIs, particularly regarding access to data and resourcing.**

Managing climate-related financial risk

A bank's core business is financial intermediation, i.e. lending and taking deposits within an accepted risk profile. These risks have traditionally come in the form of credit risk, market risk, operational risk, liquidity risk and reputational risk. Climate risk is a risk that cuts across all these areas given the unique nature and far-reaching potential impacts of a changing climate. We agree that ADIs should take a strategic and risk-based approach to managing these risks and opportunities as outlined in the practice guide.

To undertake financial intermediation, banks source funding from both investors and customers that ultimately are someone's savings in one form of another. The attitudes towards climate change and the management of climate risks in both these groups have changed. International[1] and domestic investors[2] are becoming more concerned around how entities manage climate risks. In 2021, the majority of Australians (61 per cent) continue to view climate change as a critical threat to Australia's vital interests in the coming decade.[3]

Irrespective of an individual entity's ESG position and policymakers' views or actions on climate change, climate risk is a risk that ADIs must manage and understand. The critical nature of this risk and the concerns of key stakeholder means that a prudent and sound entity would incorporate these considerations into risk management and governance practices. COBA welcomes APRA's expectation that climate risk be considered within the existing risk management and governance frameworks (i.e. CPS 220 and CPS 510) subject to the unique elements of climate risk – its irreversible and unprecedented nature, its far-reaching impact and its uncertain time horizon.

While banks view climate risks through the three lenses of physical, transition and liability risks, the physical risks of climate change are particularly dramatic as they reveal themselves through natural disasters that can damage the collateral that underpins most bank lending. On a more human level, this is someone's home and is highly likely to be their most valuable asset. Recent bushfires and floods in Australia have shown the human and economic costs of natural disasters. The RBA has outlined concerns about the potential for more frequent and severe nature disasters[4]:

> "An increase in the frequency and severity of natural disasters will increase the incidence of damage to, or destruction of, physical assets that are insured or used as collateral. Assets that are exposed to increasing physical risk (such as property located in bushfire-prone or coastal areas) could decline in value, particularly if these risks become uninsurable."

As custodians of our members' life savings and funders of their most significant asset, it is prudent that we understand and manage the risks and wide-reaching impacts of a changing climate.

Prudential practice guides as illustration of a sound practice that continues to evolve

COBA welcomes APRA's prudential practice guide approach. This approach gives regulated entities more clarity on APRA's regulatory expectations. It also encourages greater consistency across the regulated population and provides examples of better industry practice.

Treasury[5] outlines the role of practice guides as providing "guidance on APRA's view of sound practice in particular areas. Prudential practice guides frequently discuss legal requirements from

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[1] See Blackrock CEO Larry Fink's letter on A Fundamental Reshaping of Finance

[2] See AustralianSuper website on Climate Change

[3] Lowy Institute Poll 2021: Climate change and energy

[4] Financial Stability Review – October 2019 Box C: Financial Stability Risks From Climate Change

[5] Treasury Submission to the Inquiry into the Prudential Regulation of investment in Australia's export industries

legislation, regulations or APRA's prudential standards, but do not themselves create enforceable requirements".

It is important that something as critical as climate risk is not seen as a compliance task or one-off project but rather a continuously evolving risk practice area. We believe that this practice guide approach assists with this framing. COBA and COBA members are examining how we can work together with APRA and other stakeholders to improve practices and drive efficiencies in the management of climate-related financial risks in the customer-owned banking sector. We would appreciate if APRA continued to share practices, insights and benchmarking on the management to reduce the 'learning' costs for industry, particularly smaller ADIs, regarding climate risk management.

It is critical that in communicating these expectations APRA does not create bounded compliance dates given that guidance and risk practices in this area are constantly evolving. A bounded date can create a 'compliance' approach to climate risk. This approach would be contrary to an objective of uplift in the consideration and management of climate risks (for example, considering how climate risk interacts with incoming consumer obligations, the Financial Accountability Regime[6] etc). Any milestone setting must also consider the significant regulatory change program over the next few years given the limited risk and compliance resources within regulated entities and the absence of climate risk data that is readily accessible for ADIs to use to model the impacts of climate risk on their operations. Additionally, any milestones must also consider avoiding a rush on specialist resources, for example, such as that seen regarding Open Banking, cybersecurity and around the BEAR where ADIs are competing in a limited pools of specialised skills.

COBA notes that a number of regulators have placed time-bound expectations with respect to their climate risk guidance:

- The UK's Prudential Regulation Authority (PRA) created an expectation upon release of its practice guide in April 2019 that banks put an implementation plan in place by October 2019 and subsequently set an end-2021 timeline for firms to have 'fully embedded' their approaches to managing climate-related financial risk.[7]
- The European Central Bank (ECB) asked banks to perform self-assessments in early 2021 against its supervisory expectations and develop action plans. In 2022, the ECB will conduct a full supervisory review of banks' practices and take concrete follow-up measures where needed.[8]

International experiences on guidance

The APRA approach to publish a practice guide aligns with other financial regulators' approaches and their increasing expectations on climate risk management. The UK PRA was the first supervisor to set expectations in April 2019 calling for a 'strategic approach' to climate change risk.[9] The European Central Bank (ECB) published its final guide on climate-related and environmental risks in November

[6] Noting that the FCA has created an expectation of having someone responsible for the management of climate risks under the SMR, however, this is not a prescribed responsibility.

[7] Bank of England/PRA – manage climate-related financial risk

[8] ECB publishes final guide on climate-related and environmental risks for banks

[9] Enhancing banks' and insurers' approaches to managing the financial risks from climate change

2020.[10] Earlier this year, Canada's Office of the Superintendent of Financial Institutions launched a consultation on climate-related risks in the financial sector.[11] The Reserve Bank of New Zealand has also noted that it is stepping up its understanding and supervision of climate change-related risks[12].

Increasing domestic expectations

ASIC has been voicing its views on climate risk from at least 2018 with ASIC Commissioner John Price stating: "More generally, we encourage companies and directors to carefully consider the TCFD's report, not just in the disclosure context, but as a key resource to assist in understanding, identifying and managing climate risk and opportunity."[13] The potential for liability risks is increasing, as illustrated by the implications for directors' duties canvassed in legal opinions by Noel Hutley SC.[14]

Strong support for proportionality in applications of these expectations

COBA strongly supports APRA's commitment to proportionality so that the guide is "flexible in allowing each institution to adopt an approach that is appropriate for its size, customer base and business strategy". As smaller retail banks, the climate risk practices used by customer owned banks will differ from those of much larger and more diverse financial institutions.

We strongly support APRA's statement in its Letter to ADIs highlighting its commitment to proportionality:

> "Entities will retain the flexibility to configure their approaches to climate risk management in a manner best suited to their particular risk profile and business model and not all of the guidance will be relevant to all entities. APRA expects the implementation of the guidance to reflect an entity's size, business mix and complexity, noting that concentrations in a particular market, sector or geographic location may expose an entity to more material climate risks."

We believe that it should be clear that all aspects of the guidance are able to be applied proportionately. While there are some references to proportionality regarding risk management (para 19), risk monitoring (para 26), scenario analysis (para 37), there are some areas where it is not clear. For example, while the guide outlines that it considers the TCFD is an appropriate framework regarding disclosures, we would expect any disclosure framework to be proportional given that TCFD report acknowledges stakeholder concerns regarding proportionality for small institutions.[15]

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[10] ECB publishes final guide on climate-related and environmental risks for banks

[11] OSFI launches consultation on climate-related risks in the financial sector

[12] RBNZ Disclosure and supervision of climate-related risks

[13] ASIC Commissioner John Price speech on Climate change

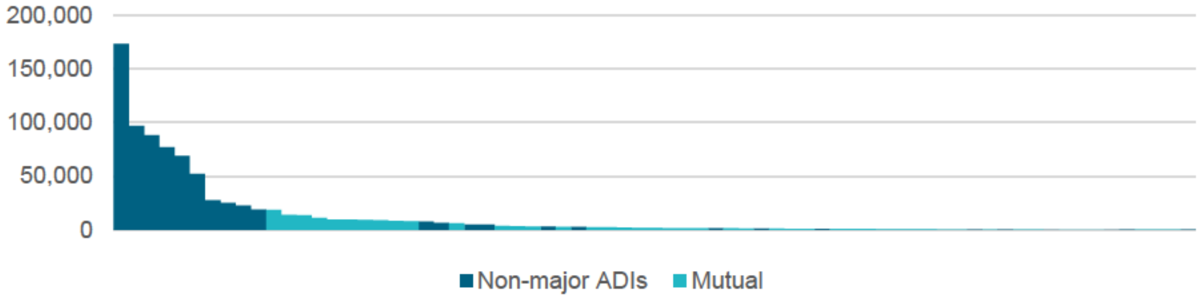
[14] For example, CPD releases new materials on directors' duties, climate risk and net zero

[15] TCFD recommendations report Page 35

Customer owned banks as smaller ADIs

COBA members are significantly smaller than most listed ADIs and are dwarfed by the major banks and by the larger regional banks (which in some cases are part of larger financial services groups). Chart 1 below show our relative size compared to the non-major banks with the major banks dwarfing those in the graph. APRA must ensure that any supervisory expectations arising from this guide and any subsequent extension of APRA's Climate Vulnerability Assessment program is fit for purpose for smaller ADIs.

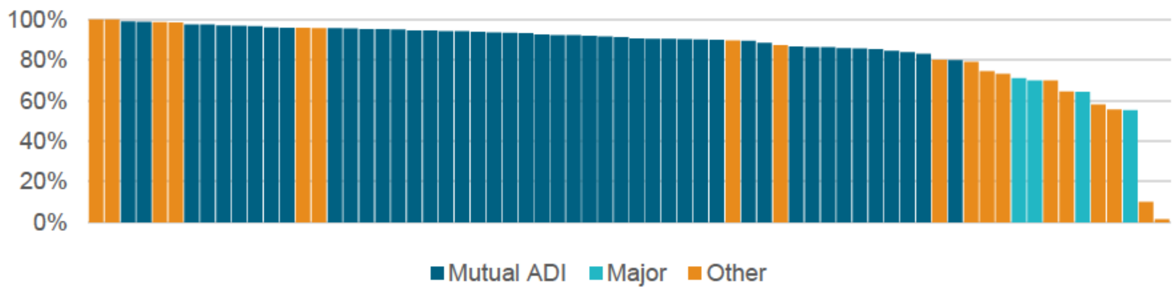
Chart 1: ADIs by assets (excluding major ADIs)[16]



Customer owned banks as retail focussed business models

Credit unions and building societies were established by their customers to serve their communities. This focus on our communities is just as relevant today. As a result, COBA members remain retail banks with a focus on mortgage lending with very limited direct lending exposures to climate risk-exposed industries. Our sector is less likely to be exposed to transition risks from direct lending, noting that some COBA members' key demographics may include those employed by these industries. The application of any expectations must consider these factors.

Chart 2: Percentage of assets in mortgage lending[17]



In additional to size considerations, disclosure expectations must also consider that customer-owned banking institutions are not ASX-listed like other ADIs, as a result the disclosure mechanisms to our owners and to the market are different to that of an ASX-listed entity.

[16] COBA estimates from APRA monthly ADI statistics

[17] COBA estimates from APRA monthly ADI statistics

Thank you for the opportunity to respond to the draft guide. Some further comments are in **Attachment A.**

COBA and our members look forward to engagement with APRA on information sharing on best practice and benchmarking in climate risk management practices across the ADI sector. Collectively, by working together we will be able to improve practices and drive efficiencies in the management of this critical risk.

If you wish to discuss any aspect of this submission, please contact [redacted].

Yours sincerely,

[redacted]

[redacted]
Chief Executive Officer

Attachment A: Practice Guide Comments

Governance

- COBA agrees it is prudent practice for the Board to seek to understand and regularly assess the financial risks arising from climate change given the Board's ultimately responsible for the sound and prudent management of risk as well as increasing liability risks.

- Some COBA members have already started uplifting executive consideration of climate risk in anticipation of this APRA guidance, while others have started sharing information on these risks at Board / Board Risk Committee meetings.

- Some COBA members have included climate risk placeholders within Board risk reporting. We would appreciate knowing when there is further information about better practice on climate risk reporting that can be shared across the regulated population, particularly with respect to retail banking. COBA notes it would be beneficial if APRA shared examples of such measures.

Risk Management

- COBA strongly supports the reference to 'size, business mix and complexity' in para 19

- Some COBA members have already marked climate risk within their Risk Management Strategy as a material risk and added it as an enterprise level risk. Others have already considered tolerances in Risk Appetite Statements.

- COBA acknowledges APRA's consideration of ICAAP as an appropriate framework (para 25). Some COBA members are already incorporating this into their ICAAP framework. COBA notes there may be benefits in sharing information about how smaller ADIs utilise the ICAAP framework with these risks.

- COBA suggests that APRA provide some additional examples of the metrics used, both quantitative and qualitative, to measure and monitor climate risks.

- COBA notes that access to "proprietary sources" can be limited for smaller ADIs. APRA and other stakeholders should consider the merits of increasing publicly available data sources.

- COBA members have noted that they have generally considered the impacts of climate change in their business continuity planning, particularly with respect to the operation of branches (para 31). More broadly, we would be interested in what is the better practice regarding outsourcing and service providers given these third parties may not be subject to climate risk disclosure or risk management requirements.

Scenario Analysis

- COBA strongly supports the references to scenario analysis being proportionate to an institution's size, business mix and complexity. As noted in APRA's letter, scenario analysis is likely to be the area with the widest range of capabilities and practices. COBA supports APRA's intention to share the lessons from the CVA exercise with the wider industry, however, any extension of the exercise must be done in a fit for purpose and proportionate manner.

- COBA expects that the majority of our sector, given individual member size and that they are likely to be early stages of climate risk analysis, is likely to fit into the narrative-driven scenario group outlined the PPG. As such, we would welcome more guidance on the use of narrative-driven scenario analysis given our sector is likely to lack the data, resource, expertise relative to larger peers. COBA is open to facilitating APRA engagement with our sector on this.

- COBA members have noted that a key barrier to smaller ADIs being able to understand scenario analysis is the complexity, quality and cost of data.
  - A COBA member has noted that open-source high quality public data will assist entities in assessing these risks. They also noted that scientific data is unlikely to be fit for purpose to view this through a commercial decision lens.
  - This COBA member has also noted that a national granular database of physical risks (down to street address level) would greatly assist in risk assessments. They noted that reliance on private providers is unlikely to get systematic results.
- COBA members also seek consistency on what is considered to be short and medium for the scenario analysis. In business planning, short, medium and long-term are likely to have different meanings relative to the much longer-term nature of climate risks.

Disclosure

- As noted in the above letter, disclosure in the mutual ADI context is different compared to our ASX-listed peers, with disclosures mostly coming through the annual report and APS 330 disclosure process. Note that APRA is expected to reduce the burden of APS 330 disclosures on smaller ADIs in future.
- COBA notes that if APRA, ASIC or policymakers were to consider mandatory climate risk disclosures, the introduction of these disclosures should be sequenced in a way to allow smaller ADIs to learn from the experiences of larger and more complex ADIs who are better resourced to undertake this exploratory work.
- COBA also notes that we would expect any disclosure framework to be proportional to size, business mix and complexity.