

[REDACTED]  
Australian Prudential Regulation Authority  
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July 28, 2021

## **Prudential Practice Guide Draft CPG 229 Climate Change Financial Risks**

### **Submission by the Responsible Investment Association Australasia**

The Responsible Investment Association Australasia (RIAA) welcomes the opportunity to make a submission to APRA on the consultation for the draft Prudential Practice Guide (CPG 229) Climate Change Financial Risks.

### **About RIAA and its members**

RIAA champions responsible investing and a sustainable financial system in Australia and New Zealand and is dedicated to ensuring capital is aligned with achieving a healthy society, environment, and economy. With over 400 members managing more than \$9 trillion in assets globally, RIAA is the largest and most active network of people and organisations engaged in responsible, ethical and impact investing across Australia and New Zealand. RIAA's membership includes superannuation funds, fund managers, banks, consultants, researchers, brokers, property managers, community trusts, foundations, faith-based groups, financial advisers, financial advisory groups, and others involved in the finance industry, across the full value chain of institutional to retail investors.

### **Scope of this submission**

This submission covers only aspects of the draft CPG 229 that RIAA regards as needing revision. This submission is not intended as an appraisal of all aspects of the draft PPG.

### **Summary**

RIAA strongly supports APRA's efforts to strengthen climate change financial risk management in Australia. The Prudential Practice Guide 229 on Climate Change Financial Risks will clarify the expectations of liable reporting entities for disclosing climate risks and opportunities.

RIAA supports the PPG's alignment with the international Task Force on Climate-related Financial Disclosures (TCFD) framework, which will align Australia with international norms and in particular assist Australian entities operating internationally.

RIAA believes APRA should use CPG 229 to send a signal to APRA-regulated institutions that, in accordance with international trends, climate risk related disclosures are likely to eventually become mandatory. This would assist with the scope and speed of this PPG's uptake and provide the Australian sector with better certainty now and into the future.

Clarifying and strengthening the quality of disclosures remains important, as investment managers, asset owners and investors, require relevant, reliable, and ideally consistent frameworks and information sets on which to base their decisions – investment or otherwise.

The following amendments to the draft CPG 229 shall help deliver this.

1. Link the draft PPG with paragraphs 56-58 of the Prudential Standard CPS 510 Governance, ensuring that climate risk management responsibilities and *performance-based remuneration metrics* for relevant executives (where applicable) also apply.
2. Clarify the expectations around climate risk management where this relates to boards delegating functions to index fund managers of assets in their respective portfolios.
3. Strengthen language around the expectations of climate risk management such as where climate risks are material – “this will (not just ‘may’) require updating existing risk management policies and procedures”
4. With respect to scenario planning, correct the error which refers the goal of the Paris Agreement to be limiting a rise by 2°C, rather than the Agreement’s stated goal “to limit global warming to well below 2, preferably to 1.5 degrees Celsius, compared to pre-industrial levels.”
5. Remove any ambiguity around the expectations of a prudent institution by strengthening the wording around the requirement to use the TCFD framework and supporting guidance to disclose information.

### **Introduction**

General - RIAA strongly supports the efforts of APRA in seeking to assist institutions enact prudent practices in relation to climate change financial risk management and believes this draft PPG, once revised, shall have a positive impact in the Australian marketplace to better clarify the expectations of liable reporting entities for disclosing climate risks and opportunities.

International requirements – The pace and ambition of legislative and other initiatives to address climate change is accelerating globally. Many of these impact Australian-domiciled businesses that operate in other jurisdictions (for example, Australian banks and investment managers operating in both Australia and New Zealand). RIAA supports the current structure of the PPG being in line with the TCFD framework, which is a practical way to maintain consistency and alignment of climate risk management practices and the emerging regulatory environments in other jurisdictions, particularly New Zealand where so many Australian financial services organisations also operate.

It would also be prudent for APRA to align not just in principle and structure with international norms as articulated in the TCFD, but also in step with New Zealand’s External Reporting Board (XRB) and Financial Markets Authority’s scope of mandatory climate-related disclosures for regulated entities operating in New Zealand. Acknowledging the remit and regulatory agency bestowed upon APRA, it is also worth noting that New Zealand’s own climate-related disclosures requirements (with first disclosures due in 2023) shall be mandatory and the thresholds that guide liable reporting entities shall be increased from time to time.

Mandatory disclosure - Providing a stronger signal to APRA-regulated institutions about the inevitability of climate risk related disclosures also becoming mandatory in Australia may assist with the scope and speed of this PPG’s uptake.

### **Specific comments**

In addition to aligning with other international frameworks, following is an outline of RIAA’s view on specific areas where the draft PPG could be clarified and/or strengthened.

Governance - Given that climate risk is also a systemic financial risk, the draft PPG section on governance should be revised to link with paragraphs 56-58 of the Prudential Standard CPS 510 Governance, ensuring that

climate risk management responsibilities and *performance-based remuneration metrics* for relevant executives (where applicable) also apply.

With regard to paragraph 15 of the draft PPG regarding the permissibility of boards to delegate certain functions of the management of climate risks ‘as long as the board maintains mechanisms to monitor the exercise this delegated authority’, RIAA recommends that the term ‘delegate’ and expectations surrounding ‘mechanisms to monitor the exercise of this delegated authority’, be further clarified. Registerable Superannuation Entities (RSEs) regularly delegate investment powers to third parties such underlying investment managers including index providers. By doing so, RSEs implicitly and/or explicitly delegate the management of climate risks as part of this outsourced investment management function.

While the Future Fund is not an APRA-regulated entity, the following [media commentary](#) on the Future Fund’s oversight of its Adani Port holding is instructive, as it explains how RSEs commonly regard the ‘outsourcing’ of elements of their portfolio management:

The Future Fund’s ESG policy notes that when considering engagement of external investment managers, the Fund is careful to ‘consider the extent to which the manager is effectively managing the financial risks and opportunities that may arise from ESG issues’.

This last point is significant because in his evidence before Senate Estimates, Dr Arndt was at pains to point out that the Adani Ports holding was part of a passive equity strategy managed by State Street Global Advisors and that

‘we [Future Fund] do not analyse individual companies in that strategy’.

In other words, Dr Arndt is stressing that this is an “arm’s-length” investment (“passively” index tracked rather than “actively” managed) over which State Street has direct control and Future Fund only indirect control. The Fund has approached State Street, Dr Arndt informed the Committee, asking it to engage with Adani Ports regarding long-term ESG risks.

The PPG would do well to clarify (perhaps by way of case study) the expectations around climate risk management as it relates to outsourced investment management functions including the use of index funds in portfolios.

Risk management – The section on risk management should:

- be broadened to include the coverage of target setting, including Paris Agreement-aligned targets and portfolios; and
- be strengthened by amending paragraph 20 “where climate risks are material, this may require updating existing risk management policies and procedures”, by replacing ‘may’ with ‘will’.

Scenario analysis - Paragraph 40(a)-(g) should be revised to:

- set clearer and more actionable expectations by replacing ‘could’ with ‘should’; and
- correctly refer to Paris Agreement goal as “to limit global warming to well below 2, preferably to 1.5 degrees Celsius, compared to pre-industrial levels”. The current draft PPG phrasing of “rising by 2°C or less consistent with the Paris Agreement” is misleading.

Disclosure - Given that transparency and disclosures are cornerstones of prudent governance practices, parts of the draft PPG could be strengthened to account for this. For example:

- paragraph 47 should more clearly articulate the expectation that institutions should disclose material climate risks in line with the TCFD recommendations, as part of their prudent risk management and governance practices; and

- paragraph 48 should clarify that a prudent institution *is required* to use the TCFD framework and supporting guidance to disclose information.

RIAA also recommends clarifying and strengthening other elements of the draft PPG, including foreshadowing the phasing in of a mandatory TCFD-aligned regime in the future.

RIAA's 400+ members including Australian superannuation funds, fund managers, banks, brokers, property managers, financial advisers, financial advisory groups and others, value relevant, reliable, and comparable disclosures. Disclosures around climate change risks lead to better pricing of risks and therefore more accurate and useful asset valuations. The result is stronger risk-adjusted returns for beneficiaries.

RIAA commends APRA for its work on this draft PPG and looks forward to working with APRA and RIAA members on its adoption by the sector.

Yours sincerely,



Executive, Policy and Standards

**Responsible Investment Association Australasia**