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General Manager, Policy Development
Policy and Advice Division
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Consultation on draft Prudential Practice Guide (CPG) on Climate Change Financial Risks

Thank you for the opportunity to provide a response to the draft Prudential Practice Guide CPG 229 Climate Change Financial Risks.

Rest ('the Fund') is a major profit-to-member industry superannuation fund with around 1.8 million members – or around one-in-seven working Australians – that manages assets of more than $66 billion (as at 30 June 2021).

Rest welcome's APRA's draft guidance on managing the financial risks of climate change. Climate change could lead to catastrophic economic and social consequences and is an important concern of Rest's members.

Rest believes responsible investment in all forms adds value to the investment decision making process and therefore improves our members' retirement outcomes.

Rest advocates for the goals of the Paris Agreement which seek to keep global temperature rise this century well below 2 degrees Celsius. Rest recognises that meeting this goal requires government action supported by investors, industries and a range of stakeholders across the globe.

In the appendix which follows, we offer some specific comments and recommendations on the draft guidance

I invite you to contact me or [redacted], Head of Regulatory Affairs.

You can find out more about Rest's approach to climate change at Rest.com.au.

Yours sincerely,

[redacted]

[redacted]
Chief Investment Officer, Rest

Appendix – Comments on draft CPG 229 climate change financial risks

The financial risks of climate change

Rest welcomes APRA's PPG outline of the financial risks of climate change. Rest sees climate change as a material, direct and current financial risk, and that applies across risk categories, including investment, market, reputational, strategic, governance and third-party risks.

Rest believes that the draft CPG provides a good basis on which to build robust risk management of climate change risks.

To improve the relevance to superannuation funds and ensure that key risks and their implications are considered, we make the following recommendations:

- The addition of risk categories which have greater relevance to superannuation funds (as opposed to banks and insurers), for example, investment risk, and investment governance risk (clause 10).

- The addition of key broader financial institution risk categories, such as strategic risk, governance risk and outsourcing risk (clause 10).

- The recognition that the mitgation of the outlined risks has a dependency on actions taken in the present day (clause 11).

Governance

Rest has integrated the management of climate-related risks into existing governance processes and strongly supports APRA's view regarding the management of climate risks being managed within the overall business strategy and risk appetite, with Board oversight.

The Rest Board approves the annual Investment Strategy and Asset Allocation and the Climate Change Policy (available on the Rest website at https://rest.com.au/why-rest/about-rest/corporate-governance), with climate-related investment risks and opportunities governed by the Board Investment Committee. Climate-related investment risks and climate-related non-investment risks – as integrated into the Rest Risk Management Strategy (RMS) – are governed by the Board Audit, Risk and Compliance Committee (ARCC), and reported quarterly. The Rest Board oversees these governance processes.

During the past two years, the Rest board members and senior management have participated in a range of climate-related knowledge sessions, which have included the regulatory and policy environment, ESG and climate change metrics, and scenario analysis.

The Rest RMS is executed by Rest senior management. The Rest RMS outlines climate change as a material risk, with climate change subsequently included in the Risk Appetite Statement (RAS); within the investment control standards and control testing processes; and within the investment key risk indicators (KRIs).

From these experiences, we make the following recommendation on the guidance regarding governance of climate change risks:

- Extending 16.d) to specifically include, where possible, the results of climate-related scenario analysis. In the context of a superannuation fund, this would relate to the setting of an investment strategy and asset allocation.

- Consideration of metrics as related to governance. For example, the number of board or committee meetings per year in which climate-related issues have been a substantive agenda item, number of training sessions held per year on the management of climate-related issues.

Risk Management

Climate change risks and opportunities are already incorporated into Rest's risk management processes, and Rest considers that it is important to actively identify and manage climate-related risks and opportunity. Rest continues to develop the systems, policies and processes to ensure that the financial risks of climate change are:

- identified and, to the extent possible, quantified in respect of both individual assets and the fund's portfolio as a whole;
- considered in the context of the fund's investment strategy and asset allocation; and
- otherwise appropriately mitigated and managed, having regard to the goals of the Paris Agreement and other international efforts to limit climate change.

We make the following observations and recommendations to improve the relevance of the guidance to superannuation funds:

- Extending clause 25 to have greater relevance for superannuation funds, as is relevant for institutions where an ICAAP is not required. An example might be to include climate-related scenario analysis in stress testing policies and processes.
- Significant direct and indirect emissions data gaps exists across the industry, particularly as related to private market quantitative risk metrics (clause 27). Whilst Rest welcomes emerging standards, such as the Partnership for Carbon Accounting Financials (PCAF), there is still considerable development work required across investment portfolios and in bringing in consistent, standardised and comprehensive emissions reporting, particularly as related to Scope 3 emissions. Recognising this and encouraging industry uptake of emerging standards would help solve for this data gap, allowing superannuation funds to better understand and manage their risks on behalf of their beneficiaries.
- In implementing plans to mitigate the risks and manage exposures (clause 32), an emerging management tool has been to track equities portfolios against low carbon or low carbon transition benchmarks. This process provides management an indication of how portfolios track against both standard benchmarks, (where concentrations to high carbon assets are greater), and portfolios where exposures to high carbon assets are minimised. APRA may like to consider how this could be recognised within the PPG and in the context of increased focus on superannuation performance against benchmarks, including the APRA Heatmaps and the Your Future Your Super measures.

Scenario Analysis

Rest is committed to undertaking climate-related scenario analysis to inform investment decision making, including taking into account one scenario which is consistent with a lower-carbon economy and climate change of well below two degrees Celsius this century.

Working with our investment consultant, Rest has undertaken this analysis in 2020 and 2021 as part of the Investment Strategy and Asset Allocation Annual Review. To date, Rest has drawn upon two International Energy Agency scenarios, the Stated Policies Scenario (where long-term global average temperature would surpass the Paris Agreement's goals), and the Sustainable Development Scenario (which achieves net zero emissions by 2070). Rest has plans to run this analysis using the recently released IEA's Net Zero Emissions by 2050 scenario, which supports Rest's objective to achieve a net zero carbon footprint for the Fund by 2050.

Rest's 2021 analysis has found our members will be better off in the long term if the community acts to meet the goals of the Paris Agreement. Scenario testing of Rest's Core Strategy has found that returns will be nearly 2% higher per year by 2040 if the world is working to achieve the Paris Agreement goals, compared to current policy settings.

Rest has found that scenario analysis forms a key role in the development of relevant and effective risk management strategies. To improve the guidance on scenario analysis, Rest makes the following recommendations:

- The emergence of consistent and comparable scenarios is likely to encourage industry disclosure. Rest therefore encourages APRA to provide key assumptions for use in scenario analysis. We further encourage APRA to reference a net zero by 2050 scenario, and how these scenarios can build in a more just and equitable transition to the lower-carbon economy.

- While the utilisation of climate-related scenarios to 2050 and beyond is effective for managing climate-related transition risk (clause 40), a longer timeframe is required in the scenario analysis of climate-related physical risks (that is, those out to 2100), and for which would reflect Representative Concentration Pathways (RCP) 2.6, 4.5, 6.0 and 8.5.

- We recommend APRA consider these climate-related scenario analysis time horizons in the context of other time horizons. For example, the Your Future Your Super (YFYS) annual performance test time horizons. YFYS is backward looking and takes a short- to medium-term approach. This doesn't align with the longer-term, forward looking time horizon associated with the management of climate-related risks and opportunities.

Disclosure

Rest has an initiative to report climate-related progress and actions in line with the recommendations of the Task Force on Climate-Related Financial disclosures (TCFD) in its FY21 annual reporting to Members. Rest already discloses its approach to climate change on our website, which includes disclosure of the Weighted Average Carbon Intensity (WACI) for our Australian Share and International Share portfolios.

The WACI is a key recommended metric in the June 2017 TCFD Report, although Rest will be responsive to changes as the TCFD recommends other metrics in the future as this area rapidly evolves[1].

Given APRA considers the TCFD framework to be a sound basis for producing information, this therefore implies the inclusion of the Metrics and Targets TCFD recommendation. While the forming of metrics is referred to throughout the PPG, targets are not.

Rest has already set a target as related to net zero by 2050 and is in the process of setting short- and medium-term targets to support this. We recommend that APRA recognise that target setting enables management and boards to track progress against objectives, and signals intent to the management of climate-related risks and opportunities to members. These targets should incorporate APRA-defined short-, medium- and long-term time horizons.

[1] https://assets.bbhub.io/company/sites/60/2021/06/TCFD-MTT-Consultation-Webinar-Slides.pdf