Box A

# Australian Financial Regulators' Actions on Climate Change-related Risks

Banks, asset managers and other institutions in the financial system potentially face significant risks arising from climate change. As such, understanding and responding to these risks falls within the mandates of Australian financial sector regulators. Over recent years, Australian regulators have taken steps to ensure that financial institutions and other corporations manage the financial risks associated with climate change.[1] Coordinating their activities through the Council of Financial Regulators (CFR), Australian agencies are also actively engaged in international forums to learn about and contribute to the development of best practice in addressing climate-related risks.

The CFR's Working Group on Financial Implications of Climate Change facilitates agencies' coordination and collaboration on climate change-related financial risks. The Working Group, which was created in 2017, is currently chaired by the Reserve Bank of Australia (RBA) and includes the other three CFR agencies – the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC) and the Australian Treasury. This Box outlines the work underway and planned by CFR agencies in relation to climate-related risks, grouped under four broad themes:

- **Measuring and understanding climate-related risks** – a focus in 2021 has been a Climate Vulnerability Assessment (CVA) for Australia's five largest banks, run by APRA on behalf of the CFR agencies.
- **Setting supervisory expectations** – APRA and ASIC are setting expectations for the management and disclosures of climate-related risks by supervised entities.
- **Further improving disclosures** – CFR agencies are working to identify interim steps that will improve the ability of Australian firms to disclose climate-related risks, such as collecting higher-quality climate data and using consistent scenarios.
- **Impact of taxonomies and standards** – CFR agencies will consider how emerging international approaches to defining 'sustainable' activities or financial products, such as taxonomies, may affect Australian firms, and how these could be adapted to meet Australian needs.

## Measuring and understanding the exposures of financial institutions and the financial system to climate-related risks

Many financial regulators globally have started work to identify and measure the risks to financial institutions posed by climate change, including by designing climate stress tests or conducting scenario analysis. APRA, on behalf of the CFR agencies, is currently conducting a CVA. Planning for the CVA began in early 2020, making Australia one of the first countries to undertake this type of analysis.

The CVA has three key objectives:

1. to measure the potential financial risks to banks posed by both physical risks (i.e. the impact on asset values and incomes from more intense and frequent extreme weather events and higher average temperatures) and transition risks (i.e. how profits and asset values are affected by changes in policy, technology and behaviours related to the move to a lower emissions economy)
2. to understand how banks could adjust their business models and implement management actions in response to the different scenarios
3. to improve banks' capabilities for managing climate risk.

Aggregated results for Australia's five largest banks are expected to be published in 2022. APRA intends that the experience gained from this CVA will be applied to similar future activities in the insurance and superannuation sectors to understand their climate risks, as well as inform future banking sector activities.[2]

The RBA has also undertaken analysis to help understand the effects of climate change on banks from a more top-down perspective.[3] This involved estimating the potential scale of banks' housing and business lending exposures to climate-sensitive regions or industries.

The CFR agencies closely coordinate with the Australian private sector on the measurement of climate-related risks. One notable industry-led collaboration is the Climate Measurement Standards Initiative (CMSI), involving banks, insurers, academics and climate service providers. The CMSI has developed physical risk scenarios for the analysis of climate-related damage to buildings and infrastructure.

CFR agencies are also contributing to work on understanding and measuring the climate-related exposures of financial institutions and the financial system via participation in a number of international groups. In particular, APRA and the RBA are members of the Network of Central Banks and Supervisors for Greening the Financial System, contributing to its work on the development of common climate change scenarios used for stress tests or scenario analysis.

### Setting supervisory expectations for the management of climate-related risks

Like many of their international counterparts, APRA and ASIC have been setting expectations for how banks and insurers manage climate-related risks.

APRA is advising regulated institutions to consider climate risks within their governance and risk management frameworks. As part of this, in April 2021, APRA released for consultation a draft Prudential Practice Guide (PPG) on Climate Change Financial Risks. This PPG is designed to assist entities in developing frameworks for the assessment and monitoring of climate-related financial risks. APRA intends to publish a final version of the guidance by the end of this year.

ASIC's focus is on encouraging listed companies to manage and communicate their climate-related risks. This includes highlighting that, where climate-related risks are material, companies should consider providing further and more detailed voluntary disclosure under the recommendations developed by the global industry-based Taskforce on Climate-related Financial Disclosures.[4]

CFR agencies are actively engaged in international forums and with peers to learn about and contribute to the development of best practice in addressing climate-related risks, including discussions about the supervision of climate risk to facilitate information sharing and the alignment of domestic and international actions.

## Regulators are focused on further improving the quality, consistency and breadth of climate risk disclosures

ASIC is conducting surveillance of climate risk governance and disclosure practices of listed financial and other companies in Australia. It is also examining the extent of potential harms from greenwashing (i.e. representing financial products as more 'green' than they really are), and determining what interventions (if any) are necessary in light of those harms. ASIC's work in these areas draws on insights gained from engagement with international peers, including participation in working groups of the International Organization of Securities Commissions Sustainable Finance Taskforce.

An important development in this area is the International Financial Reporting Standards Foundation proposal to create a new International Sustainability Standards Board to drive greater consistency in sustainability reporting. In addition, some jurisdictions have, or are moving towards, mandating the disclosure of climate risks, including the European Union, New Zealand and the United Kingdom. The CFR Working Group on Financial Implications of Climate Change is considering possible impacts of these developments for Australian firms and whether and how Australia should respond to these international developments (noting that any policy decisions would be determined by the Australian Government). A priority for 2021/22 is to identify and strengthen the building blocks that will be needed to improve the ability of Australian firms to disclose climate-related risks, through steps like improving data quality and developing consistent scenarios.

## Monitoring the development of taxonomies

International efforts to use finance to support the transition to a lower emissions economy and other sustainability goals have resulted in the need for taxonomies and other approaches to define 'sustainable' activities or financial products. CFR agencies have engaged with relevant industry initiatives, including the Australian Sustainable Finance Initiative (ASFI) – an industry group that is investigating the potential for a sustainable finance taxonomy in Australia. ASIC and APRA have been observers at ASFI's steering committee, and expect to join a newly formed advisory committee.

The development of consistent and widely recognised taxonomies internationally may have implications for the pricing of climate risk and investment in Australia. Taxonomies can be used to redirect money towards sustainable projects, and therefore may incentivise investment in particular sectors and industries. CFR agencies are using their involvement in international groups, such as the G20 Sustainable Finance Working Group, as a way to learn about and – where needed – seek to influence the development of taxonomies. The Working Group may also consider how broader international approaches to defining sustainability investments, including taxonomies, could be adapted to meet Australian needs.

## Endnotes

[1] For further details, see CFR (2021), 'Council of Financial Regulators Climate Change Activity Stocktake 2021', September. Available at <https://www.cfr.gov.au/publications/policy-statements-and-other-reports/2021/council-of-financial-regulators-climate-change-activity-stocktake-2021/>.

[2] For further details on the objectives and key design features of the CVA, see APRA (2021), 'APRA Publishes New Details on Climate Vulnerability Assessment', Media Release, 3 September. Available at <https://www.apra.gov.au/news-and-publications/apra-publishes-new-details-on-climate-vulnerability-assessment>.

[3] See Bellrose K, D Norman and M Royters (2021), 'Climate Change Risks to Australian Banks', RBA *Bulletin*, September.

[4] For example, see ASIC (2021), 'Corporate Finance Update', Issue 4, March. Available at <https://asic.gov.au/about-asic/corporate-publications/newsletters/asic-corporate-finance-update/corporate-finance-update-issue-4/>.