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Climate-Related Risk Management for Financial Services – Regulation is Heating up

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Key takeaways:

- The Australian Prudential Regulation Authority (**APRA**) is ramping up regulations on climate–related risks and taking submissions for its new guidelines.
- The guidelines are not enforceable requirements, but it shows that regulators are pushing the financial services sector to adopt a more formal approach to climate-related risks.
- Non-bank financiers, investment managers, and operators of Managed Investment Schemes and other financial services providers that are not regulated by APRA are likely to be subject to similar obligations to formally disclose climate-related risks.
- The Australian Securities Investment Commission (**ASIC**) has already begun writing to companies they consider are 'lagging' in their disclosure of these risks.

What is happening?

On 22 April 2021, APRA released its draft Prudential Practice Guide on Climate Change Financial Risks (CPG 229). The guide outlines a number of recommended policies and procedures to manage risks faced by APRA-regulated institutions, as a result of climate change.

APRA has requested submissions and stakeholder feedback on CPG 229 by 31 July 2021, with an intention to finalise it by the end of 2021.

On top of APRA's call for submissions, ASIC has embarked on its own approach to reigning in climate-related risks, deeming it a "key director responsibility" (according to ASIC Commissioner Cathie Armour) [1].

What is climate-related risk?

Climate-related risks fall into 3 categories:

1. Physical risks: think direct damage as a result of an extreme weather event;
2. Transition risks: think policy changes, disruptive technology; and
3. Liability risks: think stakeholder litigation and new regulation being enforced.

Those risks translate to very real outcomes such as more 'act of god' or 'force majeure' weather events, impacted investment returns, higher credit risks, heavier regulatory oversight and disrupted industries and businesses.

Who does it affect?

APRA-regulated institutions

CPG 229 is an expression of APRA's preferred standards and does not create any enforceable requirements. It is designed to be flexible to allow an institution to take an approach that is appropriate for its size, customer base and business strategy. According to the guide, CPG 229 will only apply to 'APRA-regulated institutions' including ADIs, superannuation funds and general and private health insurers.

Institutions which fall into any of the above categories should review the draft and consider making a submission to APRA about the application of CPG 229. The draft can be found here and further information on stakeholder submissions can be found here.

Non-ADI financiers and other financial services entities.

Climate change poses a real risk to finance and investment businesses. Non-ADI financiers and other financial service providers should consider incorporating climate-related risk management policies into their existing risk framework.

Entities issuing interests in managed investment schemes to retail investors should consider any climate-related risks and make appropriate disclosures via their Product Disclosure Statement (**PDS**). Companies issuing securities to the general public are already expected to disclose climate-related risks in their prospectuses (outlined in RG 228), so it is only a matter of time until those risks will be expected to be disclosed in a PDS.

Beyond disclosures to investors, climate-related risks should be on the agenda for Boardrooms across the country. Australian directors should seriously consider these risks as a key factor in discharging their duty to act in the best interests of a company. ASIC has already begun writing to companies it considers "laggards" in their disclosure of material climate-related risks to remind them of their statutory obligations.

If you would like to discuss how these changes may affect you, please contact Miles Anderson on 02 8235 1244.

[1] Cathie Armour, Commissioner, Australian Securities & Investment Commission, *Managing climate risk for directors*, 2021, Company Director Magazine.