Climate & Recovery Initiative Public Forum
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Remarks by Geoff Summerhayes on 'Mainstreaming climate risk'

[Transcript prepared by Centre for Policy Development]

I finish my five-year tenure as an APRA Board Member at the end of this year. 2020 has been an extraordinary year of unprecedented global developments, including on climate change.

I am grateful to CPD for providing this opportunity to share some reflections on progress that has been made on addressing climate change risk as a financial risk.

I also want to outline some vital next steps from APRA and other regulators.

Australia's financial system depends on international capital, so one of the main points I want to emphasize, is how Australia's response on climate financial risk has been, and will continue to be, informed by regulatory and market developments internationally.

We are now better placed for this challenge, and we need to be. Because we are confronting fundamental questions about our institutions' competitiveness and risk preparedness in global capital markets that will be reshaped at an accelerating pace by impacts and responses to climate change.

To begin with, let's look back four years – it was new ground for an Australian financial regulator to speak publicly on climate risk when I gave APRA's first major statement on its approach to climate financial risk in early 2017.

At that time, financial firms were largely unsure about the need, and how to integrate, systemic climate risks into core business planning, risk and investment decisions.

And it's fair to say there was some uncertainty among regulators about the right approach – including the right combination of carrots and sticks to support better industry responses.

The key message I delivered then was that rather than being a long-term or non-financial problem, some climate risks are distinctly financial in nature, and many were foreseeable, material and actionable then.

But, as I explained at the time, we weren't the only ones who said this domestically. it was consistent with the approach that global regulators were taking, led by then Bank of England Governor Mark Carney.

APRA's considerations in 2016 to make statements on climate change were informed by two global developments and one local: The Paris Agreement, the FSB's Taskforce on Climate-related Financial Disclosures, and here domestically, the Hutley - Hartford Davis opinion on director's duties.

The implications of these signals, in capital markets, financial regulation and legal cases has continued apace since.

As far as climate financial risk is concerned, today, Australia's financial regulators are on a unity ticket: APRA, ASIC and the Reserve Bank have comprehensively outlined our respective approaches, responses and expectations to climate risk.

A key point I want to make is that, over this period, a key priority for us, given international capital flows, has been ensuring that Australian institutions understand these global trends and are converging to what is emerging global practice on climate risk.

Frankly – with climate risks upon us, and the system-wide impacts of climate change increasingly apparent, we were seeking to ensure that Australian institutions were not unprepared or adversely impacted by what was happening globally.

APRA took the view in late 2016, ahead of our public intervention, that delaying would have made the transition risks for Australia regulated firms even sharper and more difficult to manage.

In practice, this has meant:

- Mainstreaming awareness of climate change as a financial risk and key issue for corporate governance and prudential supervision.
- Establishing a very clear focus on the hallmarks of global leading practice, including the use of robust, Paris consistent scenarios as a starting point for assessing risk.
- Setting clear expectations about the adoption of new global standards on climate risk governance and disclosure, through the TCFD framework; and
- Encouraging and supporting industry leadership and ownership on this issue – something that is absolutely vital given Australia's globally-connected markets and institutions.

For regulators, this has also meant building our own global linkages and participation on climate risks – including through initiatives such as the global UNEP Sustainable Insurance Forum (which I chair) and the Central Banks and Supervisors Network for Greening the Financial System (NGFS) which involves the Reserve Bank of Australia and the bulk of its global counterparts — the US Federal Reserve has announced it will join soon.

So – where are we now?

There has been a rapid transition in the larger firm's mindset to incorporating climate in strategy, governance and risk management.

We are seeing a significant shift towards industry ownership and leadership on climate risk.

One example is the work of the industry-led Australian Sustainable Finance Initiative (ASFI), which after more than a year of deliberations will release its recommendations tomorrow.

Another example is the ongoing work of groups like the Investor Group on Climate Change and other organizations like ABA, ICA and Australian Institute of Company Directors, collectively and individually, working to build understanding to benefit all.

This event is another example where CPD and ClimateWorks have convened leaders from across the economy to identify the alignment opportunities between our COVID recovery and these climate priorities.

In June, the NGFS described the COVID-19 pandemic as “a real-life stress test of what we could potentially experience in an increasingly unstable climate or disorderly transition shock”.

Which is why the Council of Financial Regulators is conducting a climate vulnerability assessment (CVA) as part of our climate risk initiatives. We will be working with the larger banks in Australia in 2021 to implement the CVA, building both knowledge and understanding of climate risks and opportunities in the banking sector, as well as supporting industry leadership and capability development, and providing valuable insight into priority areas for further development.

We expect the insights from the CVA to be valuable across industries, and in combination with the draft Prudential Practice Guide on climate risk that APRA intends to publish in 2021, which will provide tangible guidance and support for the finance sector as it continues to embed consideration of climate risk into its governance, strategy and risk management functions.

Our lived experience of the bushfires last summer is also a further reminder of what climate change is going to mean for Australia. The bushfires left a financial impact of over $10 billion, (of which less than half was covered by insurance), 33 people dead, over 3,000 homes destroyed, and billions of animals dead or displaced.

And while 2019 was the hottest year on record for Australia – as well as the driest year on record in NSW – the science points to 2019 in the not too distant future being seen as an average year.

The Bushfire Royal Commission recognized the risks that more frequent extreme weather events pose in terms of disaster resilience, and has put forward a range of recommendations.

In the same vein, financial regulators recognise the material risk presented by climate change for the finance sector, and are acting to support the industry as it addresses these risks and also the opportunities where they occur.

Let’s look at the road towards COP26.

Steps towards better management on climate financial risk are critical – because the pace of change, and the risks and opportunities that go with it, will continue to accelerate.

Even in the past few weeks, we've seen a series of announcements from companies, investors and trading partners.

To facilitate the flow of capital globally, financial regulation tends to progressively align and, in some cases, quickly.

So some recent international policy and regulatory announcements are seen as reliable market signals for the direction of travel.

These include the UK announcement that climate disclosures will be made mandatory for large companies and financial institutions over the next five years as part of its net zero commitments.

Closer to home, New Zealand will do so by 2023. The US Federal Reserve has recently published its first statement on the financial and economic implications of climate change.

With all roads leading to COP 26 in Glasgow next year, we can expect this dynamic environment to continue – with major near and long-term implications for Australian institutions.

The COVID pandemic and the global recovery and rebuilding phase before us will have major implications for how this plays out.

In many countries, Australia included, this is seen as an immense opportunity to accelerate investment, innovation and the transition that can support a strong recovery now and a more resilient, climate-aligned economy in the future. The Australian Finance Minister has been making this point strongly in recent weeks.

With both risks *and* opportunities rising, it will be critical for Australian firms to ensure that they have sufficient responses to both physical and transition risks, but also are maintaining our highly regarded financial sectors' competitiveness in the emerging green economy.

Thanks to steady progress on climate risk in recent years, we're approaching this juncture in a stronger position.

I’m encouraged that we’re up for the challenge – not just of responding to risk, but of seizing new financial sector opportunities that will flow from this next industrial revolution, to a low carbon future, which like previous transitions will not only require massive investment, it will also create a wealth of opportunities and leave a raft of stranded assets weighing on those that didn’t see it coming.

I am fond of the quote. “History doesn’t repeat itself but it often rhymes.”

Australia has lead by example during the pandemic. We can be justifiably proud of our country’s leadership at all levels and across all sectors of the community.

We will need all of that and more for the climate change challenge.

It is encouraging to see the leaders convened at this event collaborating and initiating.

APRA and CFR agencies will continue to play their part to support capability building and climate risk management to ensure a stable and resilient financial system for this and future generations of Australians.