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By Electronic Submission

MOODY'S ESG SOLUTIONS GROUP RESPONSE TO THE AUSTRALIAN PRUDENTIAL REULATION AUHORITY'S REQUEST FOR FEEDBACK ON THE PRUDENTIAL PRACTICE GUIDE: DRAFT CPG 229 CLIMATE CHANGE FINANCIAL RISKS

Moody's ESG Solutions Group appreciates the opportunity to provide comments to the Australian Prudential Regulation Authority (APRA) with respect to its draft prudential practice guide on climate change financial risks.

Moody's ESG Solutions Group is a business unit of Moody's Corporation. Moody's ESG Solutions Group provides ESG, climate and sustainable finance solutions, including ESG and climate scores and analytics, sustainable finance reviewer and certifier services and sustainability ratings.

There is growing recognition that financial institutions, including insurers, banks and other financial actors, face significant risks from climate change and that there is a need to size and manage these risks appropriately.

Moody's ESG Solutions welcomes the Australian Prudential Regulatory Authority's guidance to help its regulated entities integrate climate risk into their processes. We also support efforts towards alignment with established disclosure frameworks and, in particular, reference to the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations.

We would like to highlight below a few elements of the guidance that we believe warrant further consideration:

We thank you for your consideration and would appreciate the opportunity for a follow up discussion.

Yours sincerely,

Managing Director – Global Head of Environmental, Social and Governance

Fig 2. Physical risk – In addition to direct asset-level impacts, we would also highlight that physical climate hazards can cause supply chain disruptions and hinder labor productivity, through events such as storms inundating key transportation infrastructure or heat waves and wildfire smoke threatening human health.

17. We agree with these recommendations and would further highlight the need for capacity building across both an organization's senior management and working level staff in terms of understanding the transmissions channels through which climate risk can translate into credit and financial risk.

24. When considering exposure to physical risks, an assessment of sector vulnerability can provide meaningful insights at sector level, as the guidance suggests. One part of vulnerability is how a sector or company is likely to be affected if an extreme event does occur. The other part is how exposed the sector or company is to those extreme events. And while that first component of vulnerability (also understood as sensitivity) can be generalized at a sector level, physical risk exposure can vary within a sector, at the entity level based on the precise locations of company operations and their exposure to physical climate hazards such as storms, floods, wildfires, heat waves and others. We therefore think it's important for institutions to assess physical risk exposure at the facility level when possible (as well as adaptation which is mentioned in section 27).

Systematic identification and monitoring of highly exposed entities will allow institutions to better manage their climate risk exposure; for example, through customer engagement as described in section 33. While data at the company level is more widely available for large listed companies, we recognize the challenges that institutions may face in gathering relevant information for smaller companies. While we expect corporate disclosure and data to improve over time, financial institutions can also use model driven approaches to capture probable exposure based on companies' size, location and industry.[1] Such an approach would help organizations identify where potential risks exist across large investment or lending portfolios, and complement practices for the eventual capture and collection of climate-related data from clients as part of on-boarding and renewal processes.

27. While the guidance notes that more advanced quantitative risk metrics include direct and indirect emissions and exposure to physical climate risks, we would highlight that more comprehensive and granular quantitative datasets are available today that are based on the latest scientific evidence and can support disclosure of these indicators. As quantitative metrics provide the most decision-useful information, we would encourage APRA to consider including established metrics in section 26 on expected practice. Specifically, scope 1, 2 and 3 carbon footprint data is available for a broad universe of companies. Similarly, guidance on data on the exposure to physical risk – ranging from indicators on a portfolio's sector-level climate exposure to the proportion of investee companies' facilities that are exposed to specific climate hazards – would support enhanced disclosures.

32 & 33. We welcome the guidance that institutions should establish and implement plans to mitigate climate risks within their current portfolio. In addition, we suggest that the guidance could also outline the need for specific approaches to manage risk as part of an institution's initial on-boarding/

[1] ESG Score Predictor: Applying a Quantitative Approach for Expanding Company Coverage Moody's Corporation, **July 2021.**

underwriting process. We also suggest that such risk assessment and risk management processes include an assessment of an institution's potential financial impact from physical and transition risk exposure, leveraging relevant metrics, such as climate-adjusted probability of defaults.[2]

36. As discussed in the guidance document, we highlight the importance of leveraging forward-looking data for climate risk assessments, including scenario analysis and stress testing. While performing forward-looking scenario analysis that connects climate risk exposure with financial and credit risk implications is a nascent discipline, we note that tools are being developed to support this need and there is an opportunity to begin leverage existing datasets as they continue to improve.[3]

42. We welcome recognition of the work of the Network for Greening the Financial System (NGFS) as a useful reference for scenario analysis and note that the NGFS has released updated scenario guidance since the publication of the prudential practice guide. Globally, financial regulators are setting scenario analysis requirements based on the NGFS scenarios, which we believe will help reduce fragmentation and promote global consistency.

48. We support the guidance to disclose in line with the TCFD recommendations and would also encourage institutions to consider additional quantitative metrics, particularly with regards to physical risk. Further guidance on quantitative metrics for physical climate risks and opportunities can be found in a report co-authored by Moody's affiliate Four Twenty Seven and published by the European Bank for Reconstruction and Development and Global Centre on Adaptation in 2018, titled Advancing TCFD Guidance on Physical Climate Risk and Opportunities.

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[2] Assessing the Credit Impact of Climate Risk for Corporates, **Moody's Analytics, March 2021.**

[3] Climate Risk Macroeconomic Forecasting **Moody's Analytics, March 2021.**