New Zealand Banking Association
Te Rangapū Pēke

Submission

to the

Reserve Bank of New Zealand

on the

Consultation paper: Managing Climate-related Risks

7 June 2023

NEW ZEALAND BANKING ASSOCIATION – TE RANGAPŪ PĒKE
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About NZBA

1. The New Zealand Banking Association – Te Rangapū Pēke (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.

2. The following eighteen registered banks in New Zealand are members of NZBA:
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   - Bank of China (NZ) Limited
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   - China Construction Bank
   - Citibank N.A.
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   - Heartland Bank Limited
   - The Hongkong and Shanghai Banking Corporation Limited
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   - KB Kookmin Bank Auckland Branch
   - Kiwibank Limited
   - MUFG Bank Ltd
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited

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Introduction

4. NZBA welcomes the opportunity to provide feedback to the Reserve Bank of New Zealand (**RBNZ**) on the Consultation: Managing Climate-related Risks (**Consultation Paper**). NZBA commends the work that has gone into developing the Consultation Paper and the draft Guidance: Managing Climate-related Risks (**Guidance**).

5. NZBA is generally supportive of the Guidance. NZBA recognises why RBNZ considers guidance necessary and welcomes the assistance that guidance will provide about the expected risk management requirements in this area. We recognise and support RBNZ efforts to align the Guidance with Basel Principles[1] and APRA CPG 229[2].

6. As a general comment, it is important to recognise that climate risk management is a new and complex topic that is quickly evolving. The way the Guidance talks about the disclosure regime means it risks becoming out of date soon after it is finalised.[3]

7. In that context, NZBA welcomes guidance around RBNZ's expectations, and highlight the importance of that guidance being able to evolve (through regular reviews) alongside enhanced views on climate risk data, modelling and risk management.

8. We have provided specific feedback below, by reference to the questions provided in the Consultation Paper, where we feel that the guidance either lacks clarity or creates potential inconsistencies with the climate-related disclosures (**CRD**) regime.

Responses to specific questions

Question One: Do you think that the Guidance sufficiently promotes common understanding of good practice in managing climate-related risks?

9. NZBA is generally supportive of the Guidance and agrees that it promotes a common understanding of good practice in managing climate-related risks.

Question Two: Is there anything in the Guidance that you would remove, add, or amend? Please provide specific reasons and details as far as possible.

10. It would be more user-friendly to have the key guidance and expectations summarised clearly (e.g. in bullet point form) at the beginning or end of each section, separate from the more expansive explanatory sections.

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[1] Basel Committee on Banking Supervision's *Principles for the effective management and supervision of climate-related financial risks,* dated June 2022.
[2] Australian Prudential Regulation Authority's *Prudential Practice Guide: CPG 229 Climate Change Financial Risks,* dated November 2021.
[3] For example, with statements such as "We encourage entities that are CREs to prepare for the new regime in good time", "We are aware of external organisations developing sectoral scenarios for both banks and insurers, which could assist entities in their first disclosures", and references to first-time adoption provisions.

11. It would also be more user-friendly from an industry perspective if the Guidance was set out in sections more aligned to a risk management framework. NZBA suggests that the RBNZ looks to the Australian guidance[4] as well as guidance from the EU[5] and other jurisdictions for examples.

12. Additionally, it would be useful for the guidelines to include references to global trends in the field of climate-related risk management, potentially through the provision of links to frameworks in other jurisdictions that RBNZ considers best practice.

13. NZBA considers that the Guidance could be clearer about how it will be used as part of RBNZ's supervisory approach. This includes further clarity on the frequency that RBNZ would expect a regulated entity such as a bank to give updates; whether the annual Climate Statement will satisfy RBNZ requirements; and if RBNZ would expect more detailed reports as part of a bank's prudential updates.

14. Further guidance could also be provided on the limitations and application of quantitative modelling. The ability to quantitatively model climate risk is evolving, as is the maturity of organisations. Ensuring that the limitations and application of quantitative modelling is understood will ensure organisations engage thoroughly with the uncertainty of climate change, as opposed to risking an over-reliance on modelling for an uncertain future. In addition, the usefulness of qualitative data in enhancing the climate-related resilience of an organisation could be more clearly explained.

    14.1. Paragraph 41 labels quantitative metrics as helping entities, but it does not also mention the benefits of qualitative metrics, particularly as a complement.

    14.2. Paragraph 44 explains that limitations of quantitative information may require the incorporation of additional qualitative information.

    14.3. Both paragraphs 41 and 44 may implicitly downplay the value of qualitative data as complementary and in many cases necessary to use for organisations to understand and manage climate risks. Particularly for less mature organisations, or for complicated components such as insurance retreat, qualitative measures can be incredibly useful, and we consider that the guidance downplays this value.

15. The delineation between physical and transition risk in the Guidance could also be clearer. For example, paragraph 17 of the Guidance refers to insurance retreat as an example of transition risk. Physical risk is often understood as risks arising as a result of climate change, while transition risks are seen as those arising from collective efforts to prevent future climate change. In our view, insurance retreat is a cascading impact from the increase in frequency and severity of adverse climate events (e.g. coastal flooding from sea-level rise) and therefore more appropriately categorised as physical risk (as opposed to, for example, risks arising from the necessary transition to net zero, such as emissions pricing).

16. Our comments on specific paragraphs of the Guidance are set out in the table contained in the appendix to this submission.

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[4] In particular, we refer to APRA CPG 229.

[5] For example, the Basel Principles, and the European Central Bank's *Final Guide on climate-related and environmental risks: Supervisory expectations relating to risk management and disclosure*, dated November 2020.

Question 3: Do you agree that issuing guidance is better than either of the alternative Options 1 and 2?

17. NZBA welcomes that RBNZ has decided to produce guidance rather than regulation. The guidance approach recognises that the underlying data is still being accumulated, the climate risk models are at an early stage of maturity and the scenario assessments, transition and adaptation plans are still being developed. In that environment, we support an approach that allows climate risk skills and knowledge to be fostered and allows entities to develop their own risk mitigation plans as they engage with stakeholders and their internal governance processes. We note that it may be appropriate to move to requirements over time.

Question Four: Do you foresee any conflicts between complying with the CRD regime and using our proposed Guidance on managing climate-related risks? Please provide specific details as far as possible.

18. We do not see any conflict, strictly speaking, between the Guidance and the CRD regime.

19. NZBA considers that the references to scenario analysis and stress testing could be clarified in terms of RBNZ's expectations regarding stress testing and how that differs from scenario analysis, in particular for CREs subject to the XRB standards for the CRD regime.

Question Five: What new compliance costs (if any) do you expect your organisation to face as a result of the Reserve Bank issuing the Guidance? Please provide estimated dollar amounts as far as possible.

20. We do not expect any additional costs for CREs as a result of RBNZ issuing the Guidance, assuming scenario analysis is as defined by the XRB. Additional costs have been (and continue to be) incurred to uplift management of climate-related risks for the industry's own risk management purposes, and to comply with the CRD regime.

Questions Six: What areas of the Guidance (if any) do you view as imposing regulatory burdens on your entity that are not justified by expected benefits?

21. With industry uplift of climate-related risk management already underway, NZBA does not anticipate a significant regulatory burden as a result of the Guidance. For example, while there is significant effort required for IRB banks to continue to build more robust and sophisticated climate-related elements into their credit models, this work is being driven by best practice rather than being considered a regulatory burden.

Guidance Reference	Proposal	NZBA Response
	Part 1 – Introduction	
"Best Practice", "Good Practice" and "Better Practice" Paragraphs 1, 6, 22, 27, 32, 33, 35, 3, 45, 63 (among others)	These three terms appear to be used interchangeably throughout the Guidance.	It would be helpful if the Guidance could be consistent with the terminology it uses or, alternatively, clarify why such terminology differs so that entities can understand what standard RBNZ expects entities to reach.
	Part 2 – Climate-related risks	
Credit risk Paragraph 21(a)	Notes the interaction between climate-related risks and business activities as including: "*(a) credit risk – through a potential increase in defaults on loans by businesses and household that may be affected by adverse climate events, as well as the potential for assets used as collateral to decline in value"*	The Guidance focuses solely on physical risk with no mention of transition risks or liability risks (though paragraph 35 does cover lending sectors with higher risk to physical and transition risks).
Reputational risk Paragraph 21(g)	Notes the interaction between climate-related risks and business activities as including: "*(g) reputational risk – including an entity's ability to attract and retain customers and employees due to changing employee and community expectations"*	The Guidance excludes potential impacts on investor or rating agency sentiment which could have material impacts on funding.
Operational risk Paragraph 21 (c)	Describes operational risk as the risk of supply chain disruption and forced facility closures	The Guidance excludes potential impacts of repair and adaptation costs for existing sites (in place of total closure where appropriate), as well as the increased costs of doing business (i.e. ensuring customer access to basic banking

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		facilities like cash, ATM, and eftpos) after a major weather event.
	Part 4 – Governance	
Risk criteria for lending sectors Paragraph 35	Lists a range of risk criteria factors for identifying lending sectors with higher or lower exposures to physical and transition risks.	The Guidance should refer to changing customer preferences and reputational risk as risk criteria factors.
Providing products and services	Outlines ways of working with customers, counterparties and organisations that face higher climate-related risks and the steps that could be taken if engagement is unsuccessful.	The Guidance could clarify how competing considerations, i.e., affordable access to housing, should be weighed against climate-risk considerations when assessing the provision of products and services.
	Part 5 – Scenario Analysis	
Quantitative Climate-related risk analysis Paragraph 62	The Guidance lists a number of "leading practice" points that entities should have regard to when developing capability to conduct advanced quantitative climate-related risk analysis.	The Guidance does not refer to impacts on borrowers and their ability to repay. This could potentially be included under *"(e) measuring the impact of climate-related risks on a range of business obligations and considerations, including solvency, liquidity, and the ability (as appropriate) to meet obligations to depositors and policyholders*".