

Inquiry into the Prudential Regulation of Investment in Australia's Export Industries

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Westpac Banking Corporation
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WE ARE

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Westpac is pleased to provide a submission to the Parliamentary Joint Committee on Trade and Investment Growth's Inquiry into the Prudential Regulation of Investment in Australia's Export Industries.

Australia's export industries make a valuable contribution to Australia's economy and employment. As one of Australia's major banks, Westpac recognises the important role we play in supporting Australian business and the economy. Across our Consumer and Business Division and Westpac Institutional Bank, Westpac supports over 100,000 businesses, including a large number that export Australian products and services, or provide services to those exporters.

Australia's export industries

In 2020, based on Australian Bureau of Statistics figures, Australia's top ten export industries, as shown in the table below, made up two-thirds of Australia's exports. Three exports – iron ore, coal and natural gas – comprised around 45 per cent of Australia's total exports.

Export	\$bn	Share of total exports
Iron ore	115.8	26.7
Coal	43.8	10.1
Natural gas	36.2	8.3
Education	31.5	7.3
Gold	25.5	5.9
Beef	9.7	2.2
Aluminium ores	8.3	1.9
Copper ores	7.0	1.6
Crude petroleum	6.2	1.4
Personal travel	5.1	1.2
Total	289.1	66.6

Westpac supports companies operating in all of Australia's export sectors, subject to our risk appetite and lending policies. We provide a broad range of banking services to exporters, including transactional banking, lending, debt capital markets arrangement, asset finance and trade finance.

Companies that operate in Australia's top resource export sectors are typically large companies with global operations and networks. In addition to seeking funding from large Australian banks such as Westpac, they are able to access funding from global banks and investors.

In particular, there is a deep global financing market for natural resource companies through bank debt and global capital markets. Whilst pricing may vary between the markets dependent upon borrower financial profile and perceptions of risk, these markets have remained open and liquid and continue to show appetite to support the sector. Recent examples include a major Australian gold producer raising US\$1.15b of unsecured notes in US debt markets with maturity of 10 and 30 years; and a prominent Australian iron ore producer raising US\$1.5b of unsecured notes in US debt markets, with a maturity of 10 years. We also note there have been a number of equity raisings achieved by small cap resource companies across different commodities, notwithstanding the adverse economic environment caused by COVID-19.

The natural resources sector is heavily backed by the four Australian domestic banks plus global banks across Asia, North America and Europe. The oil and gas sector typically

attracts a wider universe of international lenders driven partly by the larger size of financing for that sector but also in light of the greater understanding in the sector as compared to mining. In most cases, for larger resource companies, lending will be done on a syndicated or a club basis, with a number of banks involved (domestic and international) to manage banks' overall risk appetite. A recent example is the refinancing of US\$8.3b of facilities for a large oil and gas project through 29 domestic and international banks.

Expectations from governments and regulators

In supporting Australia's export industries, Westpac must comply with a range of legal and regulatory requirements and evolving expectations. As recognised by this inquiry, of particular importance are prudential regulations set by the Australian Prudential Regulation Authority (APRA) to promote the stability of the Australian financial system.

In *Prudential Standard CPS 220 Risk Management*, APRA requires APRA-regulated institutions to "have systems for identifying, measuring, evaluating, monitoring, reporting, and controlling or mitigating material risks that may affect its ability ... to meet its obligations to depositors and/or policyholders." This includes requirements to have a risk management framework that is appropriate for the size, business mix and complexity of the institution and a Board-approved risk appetite statement.

Ultimate responsibility for compliance with CPS 220 falls on the Board of the institution. Failure to comply with CPS220 could lead to a direction from APRA, and breach of a direction from APRA would be a criminal offence.

In recent years, the risks due to climate change have been an area of focus for international and domestic financial regulators. APRA's former member Geoff Summerhayes gave his first speech on climate risk in 2017.¹ Regulators' focus in this area is of particular relevance to banks' approaches to supporting Australia's key export industries such as coal and natural gas.

Regulators, including APRA, consider that climate change presents risk and opportunities to the financial system and individual financial services companies. There are a range of initiatives and regulatory requirements that have been put in place to ensure financial services companies are appropriately managing these risks.

Regulators expect financial institutions to manage and report on climate risk in line with the recommendations of the Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TFCD), being:

- Governance: Disclose the organisation's governance around climate-related risks and opportunities.
- Strategy: Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning where such information is material.

¹ <https://www.apra.gov.au/news-and-publications/australias-new-horizon-climate-change-challenges-and-prudential-risk>

- Risk management: Disclose how the organisation identifies, assesses and manages climate-related risks.
- Metrics and targets: Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

APRA recognises the TCFD as a core driver of action to address climate-related financial risks. APRA also notes the influence of the Network for Greening the Financial System, a group of over 83 central banks, standard-setting bodies and financial regulators from countries that account for around 75 per cent of global emissions. The NGFS develops recommendations, tools, models and other supporting guidance for addressing climate-related financial risks. The NGFS's Climate Scenarios are now informing APRA's Climate Vulnerability Assessments (CVAs).

The TCFD has also been supported by Australia's other main financial service regulators. The Australian Securities and Investments Commission has noted that disclosing and managing climate-related risk is a key director responsibility and has recommended the TCFD framework to listed companies.² The Reserve Bank of Australia's Deputy Governor, Guy Debelle, also endorsed Australian businesses to implement the recommendations of the TCFD, noting that "[f]inancial stability will be better served by an orderly transition rather than an abrupt disorderly one."³

On 22 April 2021, APRA released a draft of its first cross-industry prudential practice guide (PPG) on the management of climate-related financial risks.⁴ PPGs are not legally binding but provide further guidance to regulated entities on how they can fulfil their prudential obligations. APRA has said that "drawing on aspects of the TCFD, as well as other international regulatory initiatives and precedents, the PPG will support the Australian finance sector as it seeks to effectively address climate-related risks."⁵ APRA has sought feedback from industry by 31 July 2021 and the PPG is expected to be finalised by the end of 2021.

APRA's other major initiative in addressing climate risk is CVAs of Australia's major banks. The CVAs are aimed at:

- Assessing the vulnerability of institutions, the financial system and the economy to both physical and transition risks arising from climate change; and
- Understanding how financial institutions may adjust their business models in response to the unique challenges proposed by different scenarios.

During the first half of 2021, APRA commenced engagement with Westpac and other major Australian banks on CVAs. The CVA is expected to focus on stress testing material parts of Westpac's credit strategy, under two climate scenarios focussed on transition and physical risk. A qualitative assessment of operational, market and liquidity risk, and data quality is also expected.

Over the longer term CVAs are expected to be rolled out to the rest of the banking sector, as well as the insurance and superannuation sectors.

² <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2019-releases/19-208mr-asic-updates-guidance-on-climate-change-related-disclosure/>

³ <https://www.rba.gov.au/speeches/2019/sp-dg-2019-03-12.html>

⁴ <https://www.apra.gov.au/consultation-on-draft-prudential-practice-guide-on-climate-change-financial-risks>

⁵ <https://www.apra.gov.au/apra%E2%80%99s-response-to-climate-related-financial-risks>

In addition, there are other requirements placed on banks by governments and regulators that may affect our decisions to support companies operating in export markets. This includes Westpac's requirement to publish an annual Modern Slavery Statement in response to the Australian *Modern Slavery Act 2018 (Cth)* (Australian Modern Slavery Act) and the United Kingdom's *Modern Slavery Act 2015 (UK)* (UK Modern Slavery Act). The Australian Modern Slavery Act requires Australian businesses with revenue more than \$100m per annum to assess and address modern slavery risks in their global operations and supply chains – for financial institutions this also encompasses modern slavery risks in lending and investments.

Expectations from investors

Investors are also active in encouraging banks to take action to address key risks in their business, including the risk of climate change. Climate change is a consistent theme in meetings that we have with both domestic and international institutional investors, who represent Westpac's largest shareholders.

Large global institutional investors are strongly focussed on climate risk in their investment portfolios. A prominent example is BlackRock. In his 2021 public letter to CEOs, BlackRock CEO Larry Fink set out the fundamental reallocation of capital that will occur due to markets factoring in climate risk and the need for companies to disclose how they are responding and incorporating climate risk into their long-term strategy.

These investors operate globally and have choices about where to place their investment funds, as do large Australian institutional investors. Large investors are increasingly committed to net zero portfolios by 2050, and in some cases have a requirement for companies in their portfolios to be decarbonised by 2050 or earlier.

Climate Action 100+, comprising more than 545 global investors responsible for more than \$52 trillion in assets under management encompasses large global as well as local investors, engages with companies linked to high emissions, and has three asks:

- implement a strong governance framework which clearly articulates the board's accountability and oversight of climate change risk;
- take action to reduce greenhouse gas emissions across the value chain, consistent with the Paris Agreement's goal of limiting global average temperature increase to well below two degrees Celsius above pre-industrial levels, aiming for 1.5 degrees. Notably, this implies the need to move towards net-zero emissions by 2050 or sooner; and
- provide enhanced corporate disclosure in line with the TCFD.

To continue to attract investment it is important that Australian banks are demonstrating meaningful steps to manage the key risks that are of concern to investors.

Westpac's approach

To meet our legal and regulatory requirements outlined above, and ensure we are appropriately managing the risks associated with banking particular export sectors, Westpac has a comprehensive Risk Management Framework. Our Risk Management Framework and supporting frameworks and policies determine the sectors in which we will operate and how we will assess customers and transactions.

Westpac's appetite for risk is informed by our strategic objectives and business plans, regulatory rules and ratios, and the potential for adverse outcomes that result in material impacts on our customers, our staff, our regulatory relationships and/or our financial position. This includes the potential for capital and liquidity ratios to fall below target levels in stressed scenarios.

Our approach is designed to deliver effective risk management outcomes including:

- delivering suitable, fair and clear outcomes for our customers that support market integrity;
- protecting Westpac Group's depositors, policyholders and investors by maintaining a balance sheet with sound credit quality and buffers over regulatory minimums; and
- meeting our regulatory and statutory obligations.

Westpac's Sustainability Risk Management Framework⁶ is an integral component of our broader Risk Management Framework. It sets out our approach to managing sustainability risks in all aspects of our operations, including environmental, social and governance risks in lending and investment.

In addition, credit policies are designed and implemented to support credit risk management. These include over-arching Group policies and sector and product specific credit policies to govern the extension of credit where such guidance is warranted. The sector policies describe the target market, customer underwriting standards, transaction underwriting standards and the determination of Customer Risk Grade and Loss Given Default.

Climate change

We view climate change as a financial risk, and we are committed to managing our business in alignment with the Paris Agreement and the need to transition to net zero by 2050. Risks associated with climate change have environmental, social and economic dimensions and are predicted to impact all aspects of society. These factors have the potential to have financial impacts through property damage, business disruption, human health effects and market dislocation.

Our approach to financing emissions-intensive sectors is grounded in the principles, benchmarks and underwriting standards established in our Climate Change Position Statement and Action Plan⁷. It is based on a thorough assessment and understanding of the industry life-cycle of the particular sector, and the implications of climate change science.

We commit to engage with customers, particularly those operating in the most emissions intensive and climate-vulnerable sectors, to develop financing strategies that can support their response to climate change impacts.

In addition, we are transparent about our policies and sector criteria, articulating the conditions under which we will and will not provide finance to certain sectors.

⁶ <https://www.westpac.com.au/about-westpac/sustainability/governance-and-accountability/sustainability-risk-management/>

⁷ <https://www.westpac.com.au/content/dam/public/wbc/documents/pdf/aw/sustainability/WBC-climate-change-position-statement-2023.pdf>

In line with increasing climate change-related financial risks, we do expect banks that have committed to the Paris Agreement to continue to reduce their exposure to sectors that are not aligned with a pathway to a net zero economy as a way to mitigate against the potential for growing credit defaults. Westpac has been consistent in our approach to this in engaging with our customers and providing clear, long term commitments to support them through this transition.

Addressing climate change also creates opportunities. Efforts to reduce global greenhouse gas emissions and to address the physical impacts of climate change require changes in investment patterns and a shift in business models. As a major financial institution, Westpac can act as a market facilitator, supporting customers and communities to adopt measures that will support the transition to a more resilient and prosperous society.