WESTPAC NEW ZEALAND CLIMATE RISK REPORT FY21

November 2021.

Our position.

Westpac New Zealand Limited (Westpac NZ[1]) is committed to transparency and action across its business to address climate change. Climate-related risk is a financial risk. Westpac NZ's annual Climate Risk Report sets out the bank's response to climate-related risks and opportunities.

Westpac NZ recognises climate change is a major threat to our collective wellbeing and the need for urgent action. Businesses and the financial sector have a major role in reducing emissions and preparing communities for the impacts of climate change. The bank is committed to addressing climate change, understanding the risks and helping customers and communities respond.

Westpac NZ acknowledges the need for the New Zealand economy to reach net zero greenhouse gas emissions by 2050 and is committed to managing its business in alignment with these goals. Westpac NZ works with customers and communities to facilitate this and respond to the challenges of climate change in a holistic and integrated way, with short, medium and long-term targets. This includes:

- increasing lending and facilitating access to capital in the form of sustainable bonds to support customers to reduce their emissions
- considering environmental, social and governance (ESG) risk factors in the bank's lending
- reducing operational emissions, maintaining carbon neutrality and understand the emissions-intensity of the bank's lending
- helping to advance the finance sector's response to climate change.

Westpac NZ incorporates Westpac Group's **Climate Change Position Statement and 2023 Action Plan** into 'Manaaki Te Ao' (Care for the Planet), the climate change pillar of its 2025 Sustainability Strategy. Westpac NZ's assessment of climate-related risks focuses on the policy, regulatory, technology and market changes related to climate change (transition risks) and the impacts of changes in climate patterns and extreme weather events (physical risks).

Westpac NZ believes that relevant, accurate, comparable, and timely climate-related disclosure, in line with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations, is important to stakeholders and will help promote efficient capital markets and broader financial system stability. Westpac NZ supports the policy underpinning the Climate Disclosure Bill[2] as set out in the **New Zealand Bankers' Association (NZBA) submission**.

This report is based on the TCFD recommendations and builds on the bank's inaugural Climate Risk Report in 2020. Westpac NZ intends to continue expanding the scope of climate risk reporting over time.

[1] In this report, 'Westpac NZ' and 'the bank', 'we' and 'our' refer to Westpac New Zealand Limited. 'Westpac Group' refers to Westpac NZ's parent, Westpac Banking Corporation (ABN 33 007 457 141) and its consolidated subsidiaries.

[2] Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill

Governance.

Westpac NZ's governance of climate-related risks involves the Westpac NZ Board, senior management and broader organisation.

Board oversight.

The Westpac NZ Board charter sets out that a key responsibility of the Board is considering the social, ethical and environmental impact of Westpac NZ's activities, setting standards and monitoring compliance with the bank's sustainability policies and practices. The Board also approves the bank's Sustainability Strategy.

The Board Risk and Compliance Committee (BRCC) charter was recently updated to include oversight of the identification, assessment, management and disclosure of climate-related risks to Westpac NZ.

The Board delegates to the BRCC to review and approve the Sustainability Risk Management Framework[3], which includes climate-related risks, every two years.

BRCC receives a quarterly Sustainability Risk Report that includes updates on climate-related risks.

Management's role.

The Executive Risk Committee (RISKCO) is a management committee that has delegated authority from the Westpac NZ Chief Executive to oversee material risks across the bank, including climate-related risks. RISKCO is chaired by the Westpac NZ Chief Risk Officer and attended by members of the Executive Team and senior Risk representatives.

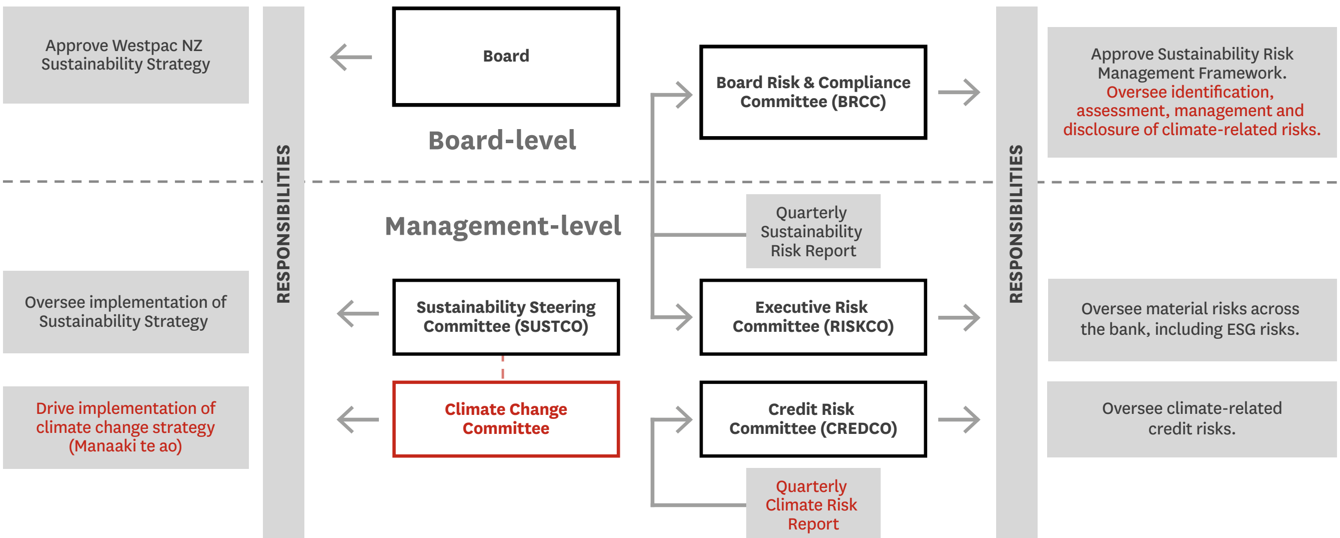
RISKCO receives a quarterly Sustainability Risk Report that includes updates on climate-related risks.

A subcommittee of RISKCO, the Credit Risk Committee (CREDCO), oversees climate-related risks that present a credit risk to Westpac NZ. CREDCO recommends enhancements to the Westpac NZ Credit Risk Management Framework, risk appetite statements and credit policies. CREDCO receives quarterly climate risk updates.

The Westpac NZ Sustainability Steering Committee (SustCo) is a subcommittee of - and comprises all members of - the bank's Executive Team. SustCo oversees the delivery of Westpac NZ's 2025 Sustainability Strategy, including the Care for the Planet / Manaaki Te Ao strategy pillar (refer Strategy section).

To enhance Westpac NZ's climate governance, the Climate Change Committee (CCC) was established in 2021 as a subcommittee of SustCo. The CCC is chaired by the General Manager Linc, Strategy & Sustainability and includes a number of senior decision makers from different parts of the bank. It meets at least quarterly and oversees progress on implementation of Manaaki Te Ao. This includes:

- monitoring external developments,
- identifying synergies between different workstreams,
- coordinating resources; and
- acting as an initial escalation point for any issues and barriers.



Westpac NZ is also represented on the Westpac Group Climate Change Financial Risk Committee, which focuses on work to identify and manage climate-related financial risks, including the potential impact on credit exposures from climate change-related transition and physical risks across the wider Westpac Group.

[3] This Framework was previously referred to as the ESG Risk Management Framework, with the name change approved as part of the most recent review.

Strategy.

Westpac NZ integrates climate-related risks and opportunities into its wider business strategy. It focuses on the most relevant aspects of climate change, their implications on customers, communities and the bank. This helps to maximise the impact of Westpac NZ's response.

Sea level rise and residential property.

Lending potentially exposed to coastal hazards resulting from sea level rise, including flooding or erosion is a source of risk to Westpac NZ.

During 2020, the bank undertook a detailed scenario analysis of its exposure to coastal hazards (flooding and erosion) resulting from sea level rise. The analysis identified that around 2.3% of Westpac NZ's residential mortgage lending portfolio is potentially subject to heightened risk from these hazards[4]. The availability of affordable insurance and ability of the regulatory system to adapt were identified as key risk factors, which determine the financial impacts on borrowers and the bank. For more detail refer **2020 Climate Risk Report**.

In 2021 Westpac NZ updated its assessment of the above key risk factors, concluding:

- while a sudden wholesale insurance withdrawal from high-risk areas appears highly unlikely Westpac NZ still expects insurance costs to increase over the next five years. Insurance withdrawal from some locations most at risk is likely
- signalled changes to resource management legislation have the potential to significantly improve the regulatory framework
- the introduction of a dedicated Climate Change and Adaptation Act could provide clarity around the process and cost of managed retreat.

Despite the additional analysis, the wide range of possible scenarios in relation to key risk factors limit Westpac NZ's ability to accurately estimate future financial impacts at this time. The proportion of the bank's residential mortgage lending potentially exposed to sea level rise remained stable.

[4] That analysis looked at current and future risks out to 2050 under 1.5˚C and 4˚C climate change scenarios (Representative Concentration Pathways RCP2.6 and RCP8.5). Heightened risk is defined as annual exceedance probability of 10% or more, as well as general exposure to coastal erosion under NIWA's Coastal Sensitivity Index.

Industries exposed to climate-related risk.

Westpac NZ continues to improve its understanding of the risks and opportunities for the sectors most affected by transition and physical risks, particularly in relation to the agricultural sector.

In 2018 Westpac NZ commissioned a **Climate Change Impact Report**, which assessed the impact of climate change on New Zealand's economy through to 2050, and identified key sectors exposed to transition and physical risks.

The recent final advice to Government provided by the Climate Change Commission sets out transition pathways for key industry sectors. The advice concludes that the transition to net zero is both achievable and affordable. While overall economic impact is expected to be moderate some industry sectors will bear a disproportionately higher impact than others. Westpac NZ participated in the **consultation process**.

In general, emissions-intensive sectors face comparably higher transition risks. In 2021 Westpac NZ commenced work to understand the emissions-profile of its lending portfolio.

Westpac NZ's lending exposure to key industries subject to climate-related risks.

INDUSTRY SECTOR	CLIMATE-RELATED RISKS	POSSIBLE IMPLICATIONS FROM CLIMATE CHANGE COMMISSION'S ADVICE	TOTAL COMMITTED EXPOSURE
Agriculture • Dairy • Sheep Beef • Horticulture • Forestry	Mix of physical risks, e.g. drought, flooding, erosion, storms, and transition risks, e.g. consumer preferences, regulation, as well as opportunities, e.g. forestry and horticulture (Refer Agriculture section below).	Emissions reductions of methane, nitrous oxide and, to a lesser degree, carbon dioxide, require widespread adoption of best practice farm management systems. For some farms stocking numbers may have to reduce moderately. Significant expansion of both exotic and native forests is required to meet emissions budgets.	$10,119m • $6,448m • $2,121m • $1,203m • $347m
Oil & Gas (incl. mining & production, supply & retail)	Primarily transition risk as demand for fossil fuels (oil, gas, coal) declines over the long-term.	While gas plays a role in replacing coal, input in industrial processes and back-up power generation, demand will more than halve over the coming decades. The electrification of transport will phase out demand for petrol and diesel.	$460m
Transport (incl. air, rail, road freight and port operations)	Mix of physical risks, e.g. exposed infrastructure, disruption from extreme events, and transition risks, e.g. transition to electric vehicles, hydrogen etc.	Current assets can operate until the end of their economic life. Low emissions assets generally have higher upfront cost but lower running costs, making the transition a finance challenge. The electrification of the private vehicle fleet may be hampered by supply constraints.	$1,973m
Electricity Generation (inc. generation, transmission and distribution)	Mix of physical risks, e.g. dry years, disruption from extreme events, and transition risks, e.g. phasing out of non-renewables.	New baseload generation capacity will be renewable. Current uncertainties over the future of large users (e.g. Tiwai) are a barrier to large scale investment in new generation.	$2,073m

Australian & NZ Sector Industry Code (ANZSIC) has been used as the basis for disclosing industry sectors. Westpac NZ ceased lending to the coal mining sector in 2019.

Financial risks to the bank may primarily arise through credit risk where sectors or individual customers are unable to align their strategy with a transition to net zero by 2050. In particular:

- Some companies and sectors face higher decarbonisation costs in the medium-term
- High emissions exporters could face additional tariffs or limited access to key markets
- Companies unwilling to align with a net zero transition may be exposed to emerging litigation risks
- Companies may struggle to access capital and/or face higher costs as banks and investors are increasingly required to report and manage the emissions-intensity of their portfolios.

Finance opportunities for banks.

The significant investment required for a transition to net zero presents considerable opportunities to New Zealand, its business, communities and Westpac NZ. According to the Climate Change Commission's advice, New Zealand's transition can be achieved largely through known technologies and with much of the investments occurring in mature industry sectors, presenting potential finance opportunities for banks.

Sustainable Finance.

Climate change is a focus for the Sustainable Finance team and its engagement with customers. Science-based targets to reduce greenhouse gas emissions were common sustainability performance targets in sustainable finance structures executed by Westpac NZ with customers in FY21 and continue to be a key requirement of structures in development.

Westpac NZ encourages all institutional customers to participate in sustainable finance, particularly sustainability-linked lending and green bonds, to play their part in addressing climate change. A recent example includes partnering with Summerset on its Sustainability-Linked Loan, which incorporates a clearly defined pathway to reduce greenhouse gas emissions into its sustainability performance targets. Summerset's $700m Sustainability-Linked Loan was the largest in the New Zealand market at time of issue and the first retirement village in NZ to link sustainability to its lending arrangements.

During the year, Westpac NZ also participated in the world's first Climate Bonds Initiative-certified shipping Green Loan for KiwiRail to finance its purchase of two new ferries. This $350m Green Loan set a new benchmark for global best practice for green finance, paving the way for investment in mitigating emissions from global shipping and more broadly, the rapid decarbonisation of transport.

Agriculture.

The agricultural sector faces a particularly complex mix of physical and transitional risks, while also offering significant opportunities. Westpac NZ has engaged a group of independent external experts to undertake a comprehensive sector climate risk assessment.

As part of this work the following key risks and opportunities were identified:

RISK	DESCRIPTION
Physical risks can impact farm incomes, affect livestock wellbeing and in some instances have the potential to inundate productive land. Some risks, such as successive severe droughts or the outbreak of major diseases can threaten the viability of individual farms and/or reduce farm values.	
Drought	Largely the result of changes in weather extremes, droughts are expected to become more frequent and severe, differing depending on location and farming system (e.g. irrigation).
Heat stress	Projected to increase with an extra 5 moderate heat stress days per year after 2050.
Flooding (river/ surface)	Heavy rainfall and storms are projected to cause increased damage to farms.
Flooding (coastal)	Risk of coastal flooding in low-lying areas increases as a result of sea level rise.
Pests & diseases – physical	Distribution of existing and new pests and diseases are projected to increase in a warmer climate.
Transition risks can increase costs, result in more volatile or lower prices for products, as much of the sector's financial performance may increasingly depend on its emissions profile and broader sustainability credentials.	
Emissions reductions	NZ legislation requires a rapid reduction of farm greenhouse gas emissions, including methane and nitrous oxide.
Change in consumer preference / social license to operate	Consumers' environmental concerns shift dietary preferences away from animal protein and undermine agriculture's social license.
International trade	Climate impacts on global food production are expected to increase commodity volatility.
Opportunities	
Warmer temperature	Warmer temperatures can increase productivity, particularly in horticulture. This includes longer growing seasons. New (tropical) crops could become viable.
Resource efficiency	Successful emissions reduction can lead to improved efficiency across the farm system in relation to energy, water and waste management.
Diversification	Conversion of production type as part of diversification can increase farm profitability while reducing greenhouse gas emissions.
Sustainability premium	Increasing demand for sustainably produced food offers opportunity to attract premiums.

This work is ongoing and, in conjunction with its external partners, Westpac NZ aims to:

- analyse key risks and opportunities
- identify and assess vulnerability factors
- identify and evaluate feasible adaptation options to support customers' adaptation; and
- assess Westpac NZ's lending exposure to climate-related risks and opportunities in the agricultural sector.

Westpac NZ's response.

Westpac NZ is committed to helping New Zealand transition to net zero and adapt to the impacts of climate change.

Since its 2020 Climate Risk Report Westpac NZ:

- launched **Westpac NZ's 2025 Sustainability Strategy He rau ringa manaaki / Many hands working together,** including three inter-related climate targets:
  - reduce operational CO_2e emissions by 30% from 2019
  - enable $10b in sustainable finance
  - manage climate-related financial risks
- endorsed the introduction of mandatory annual disclosures of financially material climate-related risks and opportunities for most financial market participants[5]
- participated in the consultation process on the Climate Change Commission's advice to Government
- commenced work to understand the emissions-intensity of the bank's lending
- contributed towards the Sustainable Agriculture Finance Initiative (SAFI)
- supported the launch of Toitū Tahua, the Centre for Sustainable Finance as a founding partner
- increased total lending towards climate change solutions by $184m year on year.

Westpac NZ regularly reports on its progress against the targets of its Sustainability Strategy. (refer **2021 Sustainability Report**).

During the financial year Westpac NZ aims to:

- continue analysis of climate-related risks, focussing on high-risk sectors and a wider range of physical risks
- incorporate climate-related risk considerations into industry sector strategies, underwriting standards, and assessment processes
- address information imbalances about climate-related risks by improving the quality and accessibility of relevant information for customers and stakeholders
- support efforts to enhance New Zealand's regulatory environment in relation to resource management, provision of natural hazard information and adaptation
- enhance the bank's systems to understand its financed emissions.

[5] via the NZBA submission on the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill dated 28 May 2021.

Risk management.

Managing risk is central to Westpac NZ's business. The bank manages climate-related risks similar to other financial risks. The bank's approach is evolving as it deepens its understanding of these risks.

The bank's Sustainability Risk Management Framework sets out the overall approach to climate risk, defining roles and responsibilities in accordance with Westpac's Three Lines of Defence standard. This framework is reviewed annually and has evolved to meet Westpac NZ's changing needs and expectations.

Westpac NZ's exposure to climate-related financial risks is primarily through credit risk relating to lending to individuals and businesses. Westpac NZ is aware of a broader range of climate-related risks, such as litigation, regulation and reputation risks, which may impact the bank.

Management of physical risks.

Based on a high-level risk screen of its lending portfolio, Westpac NZ identified risks to the built environment and productive land as most relevant. This broadly aligns with the focus areas articulated by the Reserve Bank of New Zealand and reflects Westpac NZ's lending portfolio in terms of total amounts outstanding and tenure of these loans.

Incorporating the findings from Westpac NZ's physical climate risk scenario analysis into existing risk management frameworks is ongoing and includes:

- exploring ways to integrate climate-related risks into residential mortgage lending
- enhancing climate-risk related sections in ESG Credit Risk Policy
- deepening the understanding of climate risks in the agricultural sector, including available options for farmers to adapt to climate change.

Many key risk factors are outside Westpac NZ's immediate control. These include the risks of insurance cost and availability, and regulatory settings relating to climate change adaptation, discussed above. Westpac NZ acknowledges that other physical climate risks such as sea level rise and erosion, river/surface flooding, drought or cyclones pose potentially significant risks.

Management of transition risks.

Climate-related risks are considered as part of relevant industry sector reviews. These reviews assess specific risks in these industries and determine Westpac NZ's underwriting standards.

In line with Westpac NZ's ESG Credit Policy, business lending applications over $1 million are subject to an assessment of ESG risks. This explicitly includes climate-related risks. Identified ESG risks are evaluated and mitigants considered. Transactions with high residual ESG risks are escalated to senior management for consideration. In addition to customer credit assessment, Westpac NZ also manages climate-related risks at a portfolio level in line with its Credit Risk Management Framework.

Westpac NZ's ESG approach recognises that due to increasing regulatory and consumer pressure, emissions-intensive sectors will need to align their long-term strategy and capital investment to a net zero-emissions economy. Customers will need capital to make this transition. There are financial risks arising from lending to customers unable to undertake this transition.

During 2021 ESG assessment processes have been enhanced with additional system-controls to ensure assessments are consistently undertaken.

Metrics and targets.

The bank's key metrics demonstrate progress supporting the transition to a net zero emissions economy.

Support for climate solutions.

Lending to Climate Change Solutions (Total Committed Exposure) - $1.6bn

To drive capital flows towards sustainable business models, assets, and outcomes, Westpac NZ sets a $10bn target in sustainable finance[6] by 2025. This covers a range of sustainable finance instruments including lending towards climate change solutions[7], Sustainability-Linked Loan[8], and facilitation of sustainable bonds.

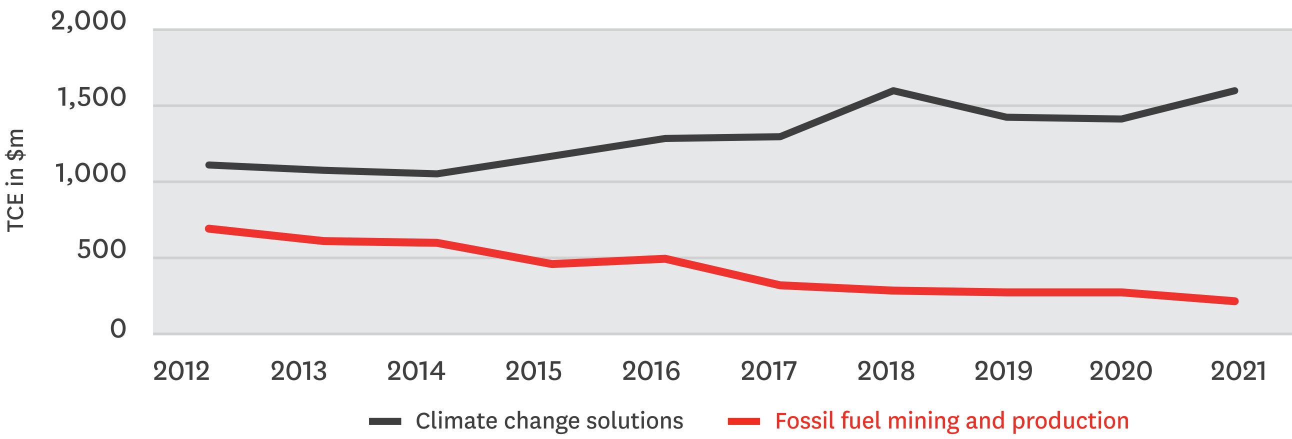
All sustainable finance will meet the eligibility criteria established in the international sustainable finance principles. The bank's targets are a total commitment, measuring the cumulative flow of capital that will support New Zealand in becoming a thriving, inclusive, net zero economy.

Fossil fuel extraction.

Lending to fossil fuel mining and production (Total Committed Exposure) - $223m

Westpac NZ is committed to support the transition towards a net zero emissions economy and is working with its customers in the fossil fuel sector to develop finance structures that align with this objective.

Climate change solutions vs. Fossil fuel mining and production.



Shows TCE at the end of full and half year reporting periods (excludes any lending repaid prior to the end of the respective reporting period).

The Westpac NZ Risk Appetite Dashboard, which is reported to RISKCO and BRCC, now contains a climate risk metric (climate change solutions lending vs. fossil fuel ratio), tracking the shift in Westpac NZ's lending portfolio towards climate change solutions lending. Work will continue to enhance climate-related risk appetite metrics as data around the bank's financed emissions improves.

[6] This target comprises (a) $5bn for lending to climate change solutions, $700m lending for healthy, affordable and social housing and other environmental, social and sustainability-linked lending (building on Westpac NZ's FY20 exposure) and (b) facilitation of sustainable bonds from 1 October 2020 to 30 September 2025. All lending will meet the eligibility criteria set out in the international sustainable finance principles.

[7] Climate change solutions includes lending to projects, assets or activities that are considered consistent with the investment required to achieve the goals of the Paris Agreement and address the impacts of climate change. This includes (but is not limited to) lending to the categories of energy efficiency, green buildings, renewable energy, low carbon transport, waste, forestry, that align to the **Green Loan Principles**. For the purpose of this report contingent liabilities, such as Pre-settlement Risk (PSR) facilities are excluded. As at 30 September 2021 these account for $108m.

[8] Sustainability-Linked Loan incentivise the borrower's achievement of ambitious, predetermined sustainability objectives. The borrowing costs under the facility are adjusted up or down depending on the borrower's performance against predetermined sustainability targets. Sustainability-Linked Loan must align with the **Sustainability-Linked Loan Principles**.

Direct operational footprint.

	2021	2020
Scope 1	1,315.32 tCO_2e	1,419.92 tCO_2e
Scope 2	1,730.23 tCO_2e	1,763.88 tCO_2e
Scope 3	Mandatory: 995.56 tCO_2e Additional: 919.02 tCO_2e	Mandatory: 1,827.75 tCO_2e Additional: 1,002.50 tCO_2e
Total	4,960.13 tCO_2e	6,014.05 tCO_2e

As a Toitū carbonzero certified organisation, Westpac NZ is committed to reducing its operational carbon emissions by a further 30% by 2025 (vs. 2019), to align with the Paris Agreement. As part of this target, Westpac NZ has a goal to convert 100% of its vehicle fleet to electric or plug in hybrids by 2025. Westpac NZ has reduced its operational carbon emissions by 19% in the year to 30 June 2021 and 35% against its base year 2019 respectively.

The reductions are largely due to COVID-19 border restrictions and domestic lockdowns reducing business travel. As one of the bank's largest emission sources, there is ongoing focus on reducing electricity consumption. More energy efficient appliances and heat, ventilation and air conditioning (HVAC) services have been installed to reduce electricity from the grid. Lockdowns, and more employees working from home together with reduced branch opening hours have reduced electricity consumption. Work from home and increased flexibility may result in Westpac NZ's emissions being transferred from corporate sites to employees' homes. The bank is therefore looking to expand Scope 3 emissions to include employee commute and working from home emissions.

Financed emissions.

Westpac NZ recognises the emissions of the businesses it lends to, or 'financed emissions', as a key tool to manage transition risk in its lending portfolio. As part of expanding the capture, management and reporting of Scope 3 emissions Westpac NZ engaged an external consultant to help understand its financed emissions based on the reporting standard of the Partnership for Carbon Accounting Financials (PCAF). At a high-level, the PCAF methodology calculates the share of a borrower's total Scope 1 and 2 emissions that are attributable to the bank.

This work is ongoing and seeks to enable Westpac NZ to improve its systems and processes to report financed emissions in the foreseeable future, in response to emerging regulatory expectations (e.g. mandatory climate risk disclosure).

Climate change portfolio resilience.

The table below shows the proportion of lending secured by properties exposed to a heightened natural coastal hazard risk from sea level rise under a 4 degrees Celsius warming scenario[9].

	APPROXIMATE SHARE OF SECTOR PORTFOLIO		
SEGMENT	**FY21**	**FY20**	**COMMENT**
Residential mortgages	2.3%	2.3%	Refer Strategy section.
Commercial property lending	2.1%	2.2%	Potential credit risk impact lessened by terms of lending in this sector, e.g. loan-to-value ratios and amortisation.
Agricultural lending	2.9%	3.4%	Further sector-specific work planned for FY21. Increase from FY20. Additional lending subject to checks of flood risk controls as part of ESG risk assessment.

[9] Intergovernmental Panel for Climate Change (IPCC), Representative Concentration Pathway (RCP) 8.5.

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