# Chapter 4

# The case for change

4.1 This chapter sets out the evidence regarding the operation of the carbon risk disclosure frameworks set out in Chapter 3, before considering options for reform.

## The state of carbon risk reporting in Australia

4.2 The evidence to this committee was that carbon risk reporting was not sufficiently prevalent amongst Australian firms, and that when information was provided it was often of variable quality.

4.3 One submitter summarises the situation as follows:

> Research by myself and others suggests that Australian companies are currently lagging behind competitors and trading partners in their treatment and response to carbon and climate risk. For Australian large companies reporting gaps include scale, coverage, completeness, materiality, relevancy and currency…[1]

### *The prevalence of reporting*

#### *General disclosure*

4.4 WWF–Australia notes in its submission that its 2015 comparison of the top three Australian insurance companies with three global peers found that the Australian insurers made disclosures that were less specific than the overseas insurers and less linked to mainstream reporting. They were also less likely to mention a 2°C scenario; and they were less likely to include goals for reducing exposure to climate risk.[2]

4.5 Likewise, a 2015 study by Ernst and Young which found that all of the ASX 100 companies were reporting on sustainability, but only 50 were assessing the materiality of the factors they reported on. Only two companies assessed in that study, BHP Billiton and AGL, appear to have disclosed the results of scenario analysis.[3] In addition, several companies have incorporated some version of a carbon price in their calculations for the future, though this is not necessarily disclosed in company reports.[4]

4.6 Market Forces assessed 25 listed Australian fossil fuel companies and found that 10 of the 25 failed to address the science of climate change at all, and only six

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1 Mr Gareth Johnston, *Submission 18*, [p. 3].

2 WWF–Australia, *Submission 15*, pp. 6–7.

3 Market Forces, *Submission 37*, [p. 4].

4 Ms Emma Herd, Chief Executive Officer, Investor Group on Climate Change, *Committee Hansard*, 8 March 2017, p. 4; Dr John Purcell, Policy Adviser Environment, Social and Governance, CPA Australia, *Committee Hansard*, 8 March 2017, p. 10; Mr Daniel Gocher, Analyst, Market Forces, *Committee Hansard*, 8 March 2017, p. 35.

acknowledged climate change as a material business risk.[5] This is consistent with an earlier study of companies in the Australian resources sector which found that only 13 per cent had policies, plans or practices in place to assess or manage climate risk.[6]

4.7 Market Forces tracks disclosure by superannuation funds. It found that the median fund discloses only 50 per cent of its equities holdings and less than 20 per cent of their entire portfolio. Further, only six superannuation funds (representing 10 per cent of superannuation assets) have committed to the Montreal Pledge, and only two actually disclose their carbon footprint in their annual report.[7]

4.8 Analysis undertaken in 2014 by Net Balance Foundation of disclosures by ASX 200 companies found that the amount and detail of climate risk disclosures made through CDP is far greater than through mainstream company reports. Net Balance suggested that differences between CDP reporting and mainstream reporting may indicate that companies do not regard climate risk as material risk. The analysis also found that, while the findings for Australian companies were similar to the UK and the US, fewer Australian companies identify supply chain risks, although they are probably just as great as elsewhere.[8]

*The National Greenhouse and Energy Reporting Scheme*

4.9 Under NGERS, entities producing more than 25,000 tonnes of carbon dioxide equivalent from a facility, or 50,000 tonnes from a corporation, have to report their emissions. In 2015, 400 corporations reported around 322 million tonnes of carbon dioxide. At present around 60 per cent of Australia's recorded emissions are captured.

4.10 The scheme does not include emissions from the agricultural or household sectors or transport emissions from private vehicles, nor emissions via equity ownership (Scope 3 emissions).[9] Further, it has been argued that current thresholds for reporting mean that emissions which may have material financial implications are excluded.[10]

*CDP*

4.11 In 2015, 390 companies operating in Australia, including 94 ASX 200 companies, reported greenhouse emissions and other climate change information through CDP. Of the ASX 200 companies, 85 per cent reported regulatory risk, 76 per cent reported physical risk, and 73 per cent reported other risk. Of the reporting companies, 28 of the 94 were financial companies, and 23 were in materials.

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5 Market Forces, *Submission 37*, [p. 3].

6 Professor Jacqueline Peel and others, *Submission 14*, pp. 6–7.

7 Market Forces, *Submission 23,* [pp. 9–10].

8 Net Balance Foundation and CDP, *Disclosures on climate risk: A review of ASX top 200 companies*, https://static1.squarespace.com/static/52045752e4b0330b6437dade/t/542b2db6e4b0490889d531ab/1412115894293/ClimateRiskASX200.pdf (accessed 20 April 2017).

9 Investor Group on Climate Change, *Submission 28*, pp. 13–14.

10 The Climate Institute, *Submission 31*, [p. 1].

The proportion of Australian companies reporting through CDP is lower than in Europe or the US.[11] There has been no increase in the number of companies reporting since 2010, and an actual fall (from 103 in 2014 to 90 in 2015) in the number of ASX 200 companies reporting.

***The quality of reporting***

4.12 A large number of submissions suggested that carbon risk reporting in Australia was inadequate, especially in the light of the growing demand for good information among asset owners such as superannuation funds.

4.13 As the Investor Group on Climate Change says:

> For investors assessing company performance, key dimensions of carbon risk are chronically underreported, ill-defined, incomplete, immaterial, out of date, or inconsistently disclosed.[12]

4.14 Current disclosures are not considered sufficient. 350.org observed:

> The institutions that we work with repeatedly cite barriers to reducing their exposure to climate investment risks due to the wider financial community's lack of disclosure, awareness and appreciation of unburnable carbon as a measurable and serious investment risk.[13]

4.15 The submission by ANZ notes that:

> …for reporting to be useful, disclosure frameworks must generate comparable and consistent reporting. At present, there is no single framework being used by companies to report their carbon risks…Rather, carbon risk reporting varies in its scope between companies, making it difficult for stakeholders to undertake peer assessments.[14]

4.16 The best data available is that collected under the NGERS. It was pointed out that reporting of carbon emissions is not the same as reporting exposure to carbon risk.[15] There is also concern that the information there is does not map to financial reporting:

> There is no shortage of information on individual company emissions available to stakeholders. However, it is the application of this information to financial metrics that has resulted in significant confusion and, in some cases, misleading conclusions. Analysis of climate change risk is often presented in ways which allow for easy, but meaningless, comparisons between companies and sectors.[16]

4.17 Further, the data that is provided is incomplete:

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11 Professor Jacqueline Peel and others, *Submission 14*, p. 9.

12 Investor Group on Climate Change, *Submission 28*, p. 15.

13 350.org Australia, *Submission 3*, p. 2.

14 ANZ, *Submission 27*, [p. 1].

15 Financial Services Council, *Submission 17*, p. 3.

16 AGL Energy, *Submission 19*, p. 3.

> BHP, and other ASX listed companies, provide information on its Scope 1 and 2 carbon emissions. However, the real risk in terms of stranded assets relates to the extent of Scope 3 emissions, being emissions that are produced from burning fossil fuels extracted by the reporting company.[17]

4.18 The data is not comparable across companies:

> Whilst the majority of ASX 200 companies provide some detail on the scope 1 and 2 emissions profile of the business there is too often little discussion on the broader implications of this for the business, for instance, the company's ability to decarbonise and over what timeframe relative to the transition of the broader economy and with sufficient urgency given the climate science.[18]

4.19 There were concerns about the quality of some of the data. The Investor Group on Climate Change noted shortcomings with timeliness, and also with a lack of detail which would make it possible to draw conclusions about a particular facility such as a mine. It also noted that current reporting focuses on historical performance data rather than being forward looking.[19]

## The committee's view

4.20 The committee agrees with submitters that there are significant opportunities to improve carbon reporting, and that improved reporting would benefit businesses, investors and the economy. There should be better disclosure of carbon risks by more Australian firms.

4.21 The committee believes that the best way to achieve this is building on the existing regulatory framework governing corporate disclosures. Carbon risk is a business risk, and it is important for it to be treated as such. Consideration of a firm's carbon emissions is not just a question of ethics—it is a question of good business judgment.

4.22 As such, although organisations such as CDP have done good work in laying the groundwork for wider disclosure, the committee does not believe that it is appropriate for carbon disclosure to be undertaken on an exclusively voluntary basis. A voluntary disclosure regime would not be accepted for firms exposed to significant sovereign risk, or currency risk. It should not be accepted for firms exposed to climate change.

4.23 Likewise, the committee does not believe it would be appropriate to extend the operation of NGERS to capture carbon risk more broadly. NGERS was designed for a very different purpose. Accounting for the risk arising from carbon is categorically different from the accounting of carbon emissions themselves. There is no compelling reason to exempt carbon risk from the network of reporting obligations and responsibilities that the law imposes on corporations and those who run them.

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17 Environment Justice Australia, *Submission 21*, p. 6.

18 Regnan, *Submission 16*, p. 3.

19 Investor Group on Climate Change, *Submission 28*, p. 16.

4.24 The question, accordingly, is how to refine the existing financial disclosure system to improve the disclosure of carbon risk by Australian firms.

***Further guidance from regulators***

4.25 The committee notes the legal opinion by Noel Hutley SC and Sebastian Hartford-Davis that directors may be liable for failure to consider and disclose foreseeable climate risks. Based on the evidence provided to the committee, some Australian companies may not be adequately responding to this aspect of their responsibilities. The committee believes this gap is attributable in part to the need for more guidance from the financial regulators.

4.26 As one witness told the committee:

> So under the Corporations Act and under the ASX there are requirements to report material ESG risks—environment, social and governance risks—for company performance, but there is very little guidance or clarity as to how that pertains specifically to the issue of climate change and climate risk from a financial perspective.[20]

4.27 Another witness asserted that

> …we know from our own research that the vast majority of Australian companies and superannuation trustees do not recognise climate change as a material business risk.[21]

4.28 As Mr Summerhayes noted in his speech, '…while climate risks have been broadly recognised, they have often been seen as a future problem or a non-financial problem'.[22]

4.29 The requirements for disclosure under ss299(1) and 299A of the Corporations Act 2001 are broad. The committee believes clearer guidance from ASIC is needed for the requirements to have practical force for many companies. The existing guidance (such as INFO 203 regarding impairment of non-financial assets) is incomplete or out of date.

**Recommendation 1**

**4.30 That the Australian Securities and Investments Commission review its guidance to directors to ensure that it provides a proper understanding of the manifestations of carbon risk, and reflects evolving asset measurement implications of carbon risk.**

4.31 The committee notes the comments by APRA at the public hearing, and considers that its stated approach to addressing the issue of carbon risk with its regulated entities is both appropriate and in line with its prior practice.

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20 Ms Emma Herd, Chief Executive Officer, Investor Group on Climate Change, *Committee Hansard*, 8 March 2017, p. 3.

21 Mr Daniel Gocher, Analyst, Market Forces, *Committee Hansard*, 8 March 2017, p. 30.

22 Mr Geoff Summerhayes, *Australia's New Horizon: Climate Change and Prudential Risk*, speech to the Insurance Council of Australia, 17 February 2017.

4.32 The committee considers, however, that there is scope for the ASX to provide further guidance to listed entities.

**Recommendation 2**

**4.33 That the Australian Stock Exchange provide guidance regarding the circumstances in which a listed entity's exposure to carbon risk requires disclosure under Recommendation 7.4 of the Australian Stock Exchange Corporate Governance Principles and Recommendations.**

***Law reform***

*Clearer requirements to disclose carbon risk*

4.34 The committee notes the suggestion from submitters that s299(1)(f) should be amended to specifically require disclosure of climate-change and carbon risks. The committee considers that firms are already required to disclose these risks under the general provisions in ss299(1) and 299A, and that it now falls to regulators to issue appropriate guidance.

4.35 However, the committee notes that the final report from the FSB Task Force on Climate-related Financial Disclosures is due to be issued this year. The market would benefit from a coordinated approach between the different regulatory stakeholders.

4.36 The committee has observed during the course of this inquiry that there is a lack of clarity about which arm of government should have primary responsibility for ensuring there is proper disclosure of carbon risk, and responding to the Task Force's recommendations. The committee notes the overlapping spheres of responsibility of Treasury, APRA, ASIC, and the Reserve Bank of Australia.

**Recommendation 3**

**4.37 That the government nominate a single government entity to have primary responsibility for coordinating the response to the recommendations of the Financial Stability Board Task Force on Climate-related Financial Disclosures.**

**Recommendation 4**

**4.38 That the government commit to implementing the recommendations of the Financial Stability Board Task Force on Climate-related Financial Disclosures where appropriate, and undertaking the necessary law reform to give them effect.**

*Broader financial disclosure*

4.39 The committee notes the evidence to this committee that aspects of the existing corporate disclosure framework may be unduly narrow. CPA Australia gave evidence, for example, that s299A operates:

> …very much in financial terms. It looks at prospective events and future activities and how they may affect financial earnings. What we would argue is that the language needs to shift away from a concentration on impact on financial earnings to a more holistic approach as to how director assessment

> of future events impacts upon the business model—the viability of the organisation as a whole.[23]

4.40 The committee considers that there is some merit to the proposition that disclosure should encompass more than immediate financial performance. Investors would benefit from firms' considering the viability of their business model, and disclosing how their activities may impact their social licence to operate. Evidence from CPA Australia suggested that other parts of the *Corporations Act*, such as portions of s1013D regarding the contents of a product disclosure statement, could inform a redrafting of s299A.

4.41 The committee notes, however, the evidence from CPA Australia that although firms are not expressly encouraged to do so at the moment, there is also no significant impediment.[24] The committee also notes that any expansion of the obligations under s299A would have to be accompanied by a consideration of the adequacy of the protections afforded to directors and officers who make reasonable mistakes when acting in good faith. The committee notes the evidence of CPA Australia that the defences at s731 (for due diligence) and s732 (for a reasonable lack of knowledge) could play a part in ameliorating harsh results for responsible directors, but considers that these questions of detail are a proper subject for law reform.

**Recommendation 5**

**4.42 That the government review the *Corporations Act 2001* to consider whether the obligations for financial disclosure should require holistic consideration of a company's prospects, including the viability of its business model.**

## The need for carbon policy certainty

4.43 Finally, it is impossible to consider carbon risk without also considering the current uncertainty regarding climate change policy in Australia.

4.44 In December 2015, Australia made commitments at the United Nations Conference of the Parties meeting at Paris to meet certain carbon emission targets. Present government policy does not provide a clear path to meeting these targets. The result is confusion and uncertainty for businesses and investors alike as to what form climate change policy could take, and the effect it could have on their industries.

4.45 The uncertainty created by the government having vacated the field does not just make it more difficult for companies to disclose carbon risk—the uncertainty itself is a carbon risk.

4.46 Witnesses have told the committee how businesses and investors have been forced to fill in the gaps left by the government's inaction. As one witness explained:

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23 Dr John Purcell, Policy Adviser, Environmental, Social and Governance, CPA Australia, *Committee Hansard*, 8 March 2017, p. 12.

24 Dr John Purcell, Policy Adviser, Environmental, Social and Governance, CPA Australia, *Committee Hansard*, 8 March 2017, p. 12.

> [The inaction] increases the level of uncertainty associated with the financial risks attributed to the carbon. You end up with a situation where, for an investment perspective, investors and often banks are and other forms of lending are applying their own carbon price anyway, as a stress-testing parameter.[25]

4.47 A submission commented:

> Despite the Australian government discontinuing its carbon pricing mechanism, around a quarter of companies use an internally determined price per tonne of carbon to guide their investment decisions.[26]

4.48 The committee believes the government should end the uncertainty by outlining a clear policy for transitioning Australia to a low carbon future, such as the adoption of an emissions intensity scheme for the electricity sector.

4.49 The committee notes that at the time of writing, notable supporters of an emissions intensity scheme include Snowy Hydro, the Business Council of Australia, BHP, AGL, EnergyAustralia, the National Farmers Federation, Origin Energy, the Australian Energy Markets Commission, the CSIRO, Energy Networks Australia, the Chief Scientist, the Climate Change Authority, the Clean Energy Finance Corporation, as well as numerous state and territory governments.

**Recommendation 6**

**4.50 That the government end the uncertainty regarding climate change policy, and develop a stable and consistent policy (such as an emissions intensity scheme for the electricity sector).**

**Senator Chris Ketter**
**Chair**

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25 Ms Emma Herd, Chief Executive Officer, Investor Group on Climate Change, *Committee Hansard*, 8 March 2017, p. 4.

26 South Pole Group, *Submission 8*, [pp. 3–4].