

Carbon risk disclosure

Issues Paper

Introduction

1.1 The committee is currently conducting an inquiry into carbon risk disclosure. The committee is examining potential effects of carbon risk on financial stability; carbon risk disclosure frameworks; and regulatory oversight of carbon risk.

Background to the inquiry

1.2 A number of government bodies and other entities work together in Australia to ensure that the financial system is fair, transparent, and stable. The Reserve Bank of Australia (RBA) has the responsibility of maintaining the stability of the financial system. The RBA provides a definition of financial stability that will be used in this report:

A stable financial system is one in which financial intermediaries, markets and market infrastructure facilitate the smooth flow of funds between savers and investors and, by doing so, help promote growth in economic activity.¹

1.3 The Australian Securities and Investment Commission (ASIC) is Australia's corporate, markets and financial services regulator. ASIC has a mandate to 'maintain, facilitate and improve the performance of the financial system and entities in it'.² One of the ways in which ASIC achieves this mandate is by ensuring that market participants have access to reliable information regarding the operating environment of public companies.

1.4 Companies listed on the Australian Stock Exchange (ASX) are required to adhere to the ASX's continuous disclosure requirements which require a company to 'immediately disclose any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities'.³ This requirement is often abbreviated to 'price sensitive information', that is, information which will affect the price of a company's stock.

1.5 In addition, the ASX's Corporate Governance Council has developed the *Corporate Governance Principles and Recommendations* (ASX Principles). The ASX Principles 'are likely to achieve good governance outcomes and meet the reasonable

1 Reserve Bank of Australia, *Financial Stability*, <http://www.rba.gov.au/fin-stability/>, (accessed: 17 February 2016).

2 Australian Securities and Investments Commission, *Our role*, <http://asic.gov.au/about-asic/what-we-do/our-role/> (accessed: 16 March 2016)

3 McCullough Robertson Lawyers, *Australia's continuous disclosure system: clear or confused?*, http://www.mccullough.com.au/icms_docs/147834_Australias_continuous_disclosure_system_clear_or_confused.pdf (accessed: 16 March 2016).

expectations of most investors in most situations'.⁴ The ASX Principles are not mandatory. If a company does not adopt a recommendation from the ASX Principles, it must explain why it has not adopted the recommendation to ensure 'the market receives an appropriate level of information about the entity's governance arrangements'.⁵

1.6 Recommendation 7.4 of the ASX Principles notes that:

A listed entity should disclose whether it has any material exposure to economic, environmental and social sustainability risks and, if it does, how it manages or intends to manage those risks.⁶

1.7 The ASX Principles provide an explanation of the above recommendation:

Listed entities will be aware of the increasing calls globally for the business community to address matters of economic, environmental and social sustainability and the increasing demand from investors, especially institutional investors, for greater transparency on these matters so that they can properly assess investment risk.⁷

1.8 A number of companies in Australia voluntarily release data on their social and environmental performance, and there are also a number of voluntary disclosure schemes—such as the international Carbon Disclosure Project—that companies can be part of to improve carbon-risk transparency for their investors.

1.9 Investors seeking further information on the carbon risk of prospective investments can use a number of channels. The National Greenhouse and Energy Reporting scheme provides updates on the energy intensity of large companies in Australia.⁸ Globally, there are already nearly 400 initiatives of different status, scope, and ambition which aim to provide carbon information to the market.⁹ The data

4 Australian Stock Exchange Corporate Governance Council, *Corporate Governance Principles and Recommendations*, <http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf> (accessed: 16 March 2016), p. 3.

5 Australian Stock Exchange Corporate Governance Council, *Corporate Governance Principles and Recommendations*, <http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf> (accessed: 16 March 2016), p. 3.

6 Australian Stock Exchange Corporate Governance Council, *Corporate Governance Principles and Recommendations*, <http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf> (accessed: 16 March 2016), p. 30.

7 Australian Stock Exchange Corporate Governance Council, *Corporate Governance Principles and Recommendations*, <http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf> (accessed: 16 March 2016), p. 30.

8 Clean Energy Regulator, *About the National Greenhouse and Energy Reporting scheme*, <http://www.cleanenergyregulator.gov.au/NGER/About-the-National-Greenhouse-and-Energy-Reporting-scheme> (accessed: 22 March 2016).

9 Mark Carney, *Breaking the Tragedy of the Horizon – Climate change and financial stability*, 29 September 2015, <http://www.fsb.org/wp-content/uploads/Breaking-the-Tragedy-of-the-Horizon-%E2%80%93-climate-change-and-financial-stability.pdf> (accessed: 22 February 2016).

available through these mechanisms is often not easily comparable or verifiable. At least one investment advisory firm has noted that 'to date, corporate disclosure through annual reports and market briefings has been low'.¹⁰ Investors can also pay to access expertise from investment advisory firms who specialise in assessing the climate risks of various industries.

1.10 Currently in Australia, groups such as the Investor Group on Climate Change—representing institutional investors, with total funds under management of over \$1 trillion, and others in the investment community interested in the impact of climate change on investments—are working with companies and regulators to better understand the portfolio risks created by climate change.

International developments

1.11 Internationally, the risks of climate related events have been recognised at the highest level. In September 2015, speaking to global insurer Lloyd's of London, the Governor of the Bank of England and Chair of the G20's Financial Stability Board (FSB), Mark Carney, issued a warning of the effects of a changing climate on financial stability, stating: 'Shifts in our climate bring potentially profound implications for insurers, financial stability and the economy.'¹¹ Carney identified a number of channels through which climate change can affect financial stability. These include: physical damage to the value of financial or real assets; liability risks; and, transition risks—caused by changes in policy, technology and risk revaluations. These risks could prompt a sudden reassessment of a broad range of assets and lead to financial instability.

1.12 The Governor noted that many of these risks are 'beyond the horizon' of most actors, and that 'once climate change becomes a defining issue for financial stability, it may already be too late'.¹²

1.13 In early December 2015, 195 countries adopted what the European Commission described as: 'the first-ever universal, legally binding global contract deal'.¹³ The Paris Agreement created a long-term goal of keeping the increase in

10 RepuTex, Research Note: S&P ASX 200 Carbon Value at Risk, http://dpl/Books/2009/RepuTex_FinancialImpactsCPRS.pdf, p. 3.

11 Mark Carney, *Breaking the Tragedy of the Horizon – Climate change and financial stability*, 29 September 2015, <http://www.fsb.org/wp-content/uploads/Breaking-the-Tragedy-of-the-Horizon-%E2%80%93-climate-change-and-financial-stability.pdf> (accessed: 22 February 2016).

12 Mark Carney, *Breaking the Tragedy of the Horizon – Climate change and financial stability*, 29 September 2015, <http://www.fsb.org/wp-content/uploads/Breaking-the-Tragedy-of-the-Horizon-%E2%80%93-climate-change-and-financial-stability.pdf> (accessed: 22 February 2016).

13 European Commission, *Paris Agreement*, available from: http://ec.europa.eu/clima/policies/international/negotiations/paris/index_en.htm, accessed: 17 February 2016.

global average temperature to well below 2°C above pre-industrial levels, and aim to limit the increase to 1.5°C.¹⁴ To meet these targets countries around the world committed to reduce their greenhouse gas emissions.

1.14 Also in December 2015, the Financial Stability Board (FSB)– an international body that monitors and promotes international financial stability – announced the establishment of an industry-led Task Force (FSBT) on Climate-related Financial Disclosures. The FSB notes that the wide range of existing disclosure schemes relating to climate highlights the importance of companies and relevant stakeholders reaching a consensus on the characteristics of effective disclosures and examples of good practices.

1.15 To address this issue, the Task Force will consider the physical, liability and transition risks associated with climate change and will seek to develop a set of recommendations for consistent, comparable, reliable, clear and efficient climate-related disclosures.¹⁵

The FSBT hopes to release its recommendations by the end of 2016 and anticipates that the:

...work and recommendations of the Task Force will help firms understand what financial markets want from disclosure in order to measure and respond to climate change risks, and encourage firms to align their disclosures with investors' needs.¹⁶

Committee inquiry

1.16 In light of the recent international developments to assess and prepare for the potentially destabilising impacts of carbon risk on financial systems, the committee is investigating the adequacy of current arrangements within Australia, including regulatory and policy oversight by government and other regulators in the assessment of carbon risk and the adequacy of current carbon risk disclosure arrangements.

1.17 In light of the work of the Financial Stability Board Task Force, the committee welcomes submissions considering the scope, adequacy and functioning of the following:

- current and emerging international carbon risk disclosure frameworks;
- current carbon risk disclosure practices within corporate Australia;

14 The agreement will enter into force after 55 countries that account for at least 55 per cent of global emissions have deposited their instruments of ratifications. At the time of the agreement, China and the United States account for 44.5 per cent of global emissions.

15 Financial Stability Board, *FSB announces membership of Task Force on Climate-related Financial Disclosures*, 21 January 2016, available from: <http://www.fsb.org/2016/01/fsb-announces-membership-of-task-force-on-climate-related-financial-disclosures/>, accessed: 17 February 2016.

16 Task Force on Climate-related Financial Disclosures, *Mission*, available from: <https://www.fsb-tcfd.org/>, accessed: 17 February 2016.

- Australian involvement in the G20 Financial Stability Board discussions on carbon risk impacts for financial stability;
- current regulatory and policy oversight of carbon risk disclosure across government agencies; and
- any other related matters.