SUBMISSION

Submission to the Senate Inquiry into Carbon Risk Disclosure

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Introduction

WWF-Australia welcomes the opportunity to make this submission to the Senate Economics Reference Committee.

WWF-Australia is part of the WWF International Network, the world's largest and most experienced independent conservation organisation. We have over 300,000 active supporters in Australia and a global network active in more than 100 countries. WWF's mission is to stop the degradation of the planet's natural resources and to build a future in which humans live in harmony with nature.

WWF has been an advocate for national and international action to avoid dangerous climate change for more than two decades.

The Paris COP21 agreed to limit climate change to well below a 2°C increase on pre-industrial levels, and pursue efforts to limit warming to below 1.5°C. This is the first global agreement of its kind where both developed and developing countries have agreed to act. It recognises the world has fundamentally changed and marks the end of the fossil fuel age and acceleration of the renewable energy revolution. This sentiment was reinforced by developing countries, who want to achieve economic growth and poverty alleviation through clean renewable energy.

The science is unequivocal and the signal to investors is clear. For Australia it means aiming for net zero emissions by middle of the century. With an ambitious mechanism within the Paris Agreement that includes five yearly reviews, climate finance and adaptation, and opportunities for governments to enhance and build on their actions, the pace of change is likely to accelerate.

Business made its presence felt at the Paris COP, urging stronger responses from governments while also committing themselves to action. Over 100 major companies agreed to set science-based emissions reduction targets, as part of the Science-Based Targets initiative run by CDP, the UN Global Compact, WRI and WWF; many other commitments were made under the 'We Mean Business' banner, which aims for companies to commit to long term targets around zero net emissions.

The accelerated movement towards net zero carbon emissions has had, and will continue to have, a profound effect on market valuations of economic assets. We only have to look at the collapse in valuations of major coal assets to see the shift that is taking place, with some of Australia's big miners seeking to remove coal assets from their books. This trend reflects growing recognition that there is a material risk to companies and investors who are heavily exposed to fossil fuel assets and carbon-intensive industries. This carbon risk will only grow over time and unless the risk is managed could have significant costs to Australian economy.

It is imperative that government plays a leading role in helping to build resilience in our financial, accounting and auditing systems, to ensure minimal disruption and avoid potential financial shocks resulting from market valuation of carbon risk. This economic transition needs to be at the heart of the Government's agenda to smooth the transition towards decarbonisation on the path to a zero net carbon economy.

When referring to carbon risk disclosure, we refer specifically to the physical, regulatory, market and reputational risks associated with carbon intensive economic activities, which may be relevant to business, asset managers, lenders and insurers.

Recommendations:

1. Provide enhanced powers to APRA and other corporate regulators to ensure stronger and more consistent public disclosure of all carbon risk and related matters.

2. The Auditing and Assurance Standards Board, APRA, ASIC and other appropriate government institutions to work with key companies, industry associations and regulators to define a process for harmonising carbon disclosure methodologies, codifying these requirements and ensuring there is consistent reporting for verification purposes.

3. Develop a process to mandate disclosure of climate risk, including a requirement for companies to stress test their businesses against different climate thresholds including net zero emissions using a credible methodology; and to disclose this within financial statements.

Current and emerging international carbon risk disclosure frameworks

While the divestment movement has been highly successful in bringing attention to the finance sector about the need to shift away from investments in fossil fuels, there is still a long way to go for financial institutions to deeply understand and therefore act upon their carbon risks across all sectors of the economy where they have a financial footprint as investors, lenders or insurers.

A recent MSCI (Morgan Stanley Capital International) report estimates that one third of the companies in the MSCI ACWI index (comprising approximately 20 per cent of global emissions in 2014) have set carbon reduction targets that would result in a 27 per cent reduction in emissions by 2030 compared to 2015. However these gains are largely offset by the two thirds of companies without targets, leaving overall corporate emissions relatively flat. Companies tend to have a compliance approach rather than a risk management approach. [1]

To help business and investors manage future carbon risk, there is substantial work being conducted overseas to develop standards for disclosure. Here below is a snapshot of the international efforts taking place.

(a) The lack of codified standards for disclosure is starting to be addressed through the work of the G20 Financial Stability Board as well as the Fiduciary Duties Board. The establishment of these bodies is an important recognition that climate change is likely to be a great disrupter to continuing global economic prosperity and that substantial and urgent action needs to be taken to help shift the trillions of capital towards a zero net carbon economy before 2050. The Fiduciary Duties Board will seek to develop and codify standard procedures for understanding and disclosing obligations of financial institutions about carbon risk. With assistance from Generation Foundation UNPRI has launched this three year project to:

- Encourage governments and regulatory agencies in the eight jurisdictions covered in the 2015 report (Australia, Brazil, Canada, Germany, Japan, South Africa, the UK and US) to clarify the scope of fiduciary duty such that investors must take explicit account of environmental, social

[1] https://www.msci.com/www/blog-posts/the-paris-climate-deal/0273355114

and governance issues in their investment practices and proactively engage with companies on these issues

- Extend the original report's analysis to key Asian markets: China (including Hong Kong), India, Malaysia, Singapore and South Korea
- Develop an international statement on fiduciary duty and sustainable development which would create a cohort of signatories committed to integrating sustainability into their fiduciary duties.[2]

(b) The report, Insurer Climate Risk Disclosure Survey Report and Scorecard: 2014 Findings and Recommendations developed by US based CERES has been helpful in understanding how poorly positioned US insurance companies are on managing their climate change related risks.[3] As a result of this report the US National Association of Insurance Commissioners mandated disclosure for insurance companies' general reporting requirements in key US states and has taken further action recommending that regulators take further action as follows:

- Require climate risk disclosure in all U.S. states;
- Release an improved Climate Risk Disclosure Survey;
- Advocate for quantitative evaluation of insurers' climate risk management; and
- Provide insurers with comprehensive climate science resources.

(c) The Bank of England Prudential Regulatory Advisory issued a letter and questionnaire to leading UK insurers in June 2014[4] designed to assist in developing a response to the UK Government's climate change adaptation report and inform the next UK climate change report and associated impacts of climate change on the insurance industry's business planning horizon, as well as the role of the insurance industry and insurance regulation.

(d) There has been considerable activity on developing a methodological framework for assessing the exposure of the financial system to climate policy risks. This recent work on the EU financial system seeks to extend the notion of climate policy risk scenarios in order to go beyond the mere fossil fuel production sector and encompass the indirect effects through key economic sectors such as energy-intensive sectors, housing and finance. A key finding is that the direct exposure to fossil fuel production sector and energy-intensive sectors, while limited overall, is important for investment funds and that banks and pension funds have important exposures to investment funds, and thus bear important indirect exposure to fossil fuel.[5]

(e) France is considered to be one of the leading countries in climate change disclosure. Article 173 of the *Law for the Energy Transition and Green Growth* requires that institutional investors report their "contribution to the international goal of limiting global warming and to the achievement of the objectives of the energy and ecological transition."[6] There are also implementation guidelines submitted by the French Treasury on this provision.[7]

(f) The coalition of NGOs including WWF, WRI and CDP working through the Science Based Targets initiative is also calling on companies to adopt 'science-based targets' to reduce GHG emissions and set targets that are "in line with the level of decarbonisation required to keep global temperature increase below 2°C compared to pre-industrial temperatures, as described in the Assessment

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[2] http://www.unpri.org/press/fiduciary-duty-in-the-21st-century-announced-a-three-year-programme-to-integrate-sustainability-into-investors-fiduciary-duties/
[3] https://www.ceres.org/resources/reports/insurer-climate-risk-disclosure-survey-report-scorecard-2014-findings-recommendations/view
[4] http://www.bankofengland.co.uk/pra/Documents/about/praletter020614.pdf
[5] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2726076
[6] http://2degrees-investing.org/IMG/pdf/energy_transition_law_in_france_-_briefing_note_final.pdf) page 7
[7] http://2degrees-investing.org/IMG/pdf/2ii_art173_decree_en.pdf

Report of the Intergovernmental Panel on Climate Change (IPCC)[8]. This will also help to drive disclosure by companies both domestically and internationally.

(g) The Portfolio Decarbonisation Initiative published by WRI, UNEP FI and 2oC Investing Initiative has various resources to help with footprint measurement and disclosure (including lending, investment and operational) in *Climate strategies and metrics exploring options for institutional investors.*[9] *There is also the 2 Degree initiative which has outlined some principles for assessing the Alignment of Portfolios with Climate Goals* 2oC Investing Initiative.[10]

(h) Boston Common Asset Management has developed criteria for global investor engagement with banks contained in their report *Are banks prepared for climate change*"which includes conducting regular stress tests that model the effects of adverse climate events, rebalancing portfolios in view of potential risks from climate change, consider the legal and reputational risks of investments from climate change, reassess loan pricing with an eye to changes in borrower behavior, including potential shifts in demand for high-carbon fuels, general ESG screening and risk assessment, price externalities (including carbon and water).[11]

(i) UK based Preventable Surprises is encouraging financial institutions to actively engage with companies through a concept called 'forceful stewardship' which requires a higher level of shareholder voting and corporate engagement.[12]

(j) There has also been extensive effort internationally to shine the spotlight on corporate climate policy and advocacy that goes against any government mitigation efforts including membership of industry associations that advocate against climate action. Eg UNPRI investor expectations on corporate climate lobbying:[13]

All of the above initiatives and activities will have a significant impact on companies and financial institutions and the implications for Australia are immense. International investors are scouting the globe looking for companies with higher standards of carbon disclosure and Australia's companies are competing in this market place.

Current carbon risk disclosure practices within corporate Australia

There are several guiding frameworks for disclosing carbon risk in Australia, including:

- ASX Recommendation 7.4 of its Corporate Governance Council Principles and Recommendations: "*which asks companies to disclose whether they have any material exposure to economic, environmental and social sustainability risks and, if they do, how they manage or intend to manage those risks.*" [14]

[8] (http://sciencebasedtargets.org/)
[9] http://unepfi.org/pdc/resources-2/
[10] (http://2degrees-investing.org/IMG/pdf/2dportfolio_v0_small.pdf)
[11] http://www.bostoncommonasset.com/documents/ImpactReport-2015-10-Banks_ClimateChange.pdf
[12] https://preventablesurprises.com/wp-content/uploads/2011/03/Preventable-Surprises-October-report_FINAL.pdf)
[13] http://www.unpri.org/wp-content/uploads/Investor-Expectations-on-Corporate-Climate-Lobbying_en-GB.pdf
[14] http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf

- ASIC Regulatory Guide 247 with 247.63 *"recommending the directors' operating and financial review (OFR) includes a discussion of environmental and other sustainability risks where those risks could affect the entity's achievement of its financial performance or outcomes disclosed."*[15]

However independent analysis shows that current framework is inadequate.

For exmaple, Ernst & Young (2015)[16] undertook a review of disclosure by ASX 100 companies and concluded the following:

> *"While our research found that all the ASX top 100 are disclosing sustainability aspects, they are doing so at very different levels of sophistication. Fifty percent are undertaking materiality assessments and the majority of those are including the all-important external stakeholder perspective. That leaves 50 companies only reporting on general sustainability aspects — that may or may not be of importance or relevance to their business and their stakeholders. It is clear however, that the ASX top 100 is still exploring the concept of assessing material sustainability aspects as well as the implications of material sustainability disclosures. Since understanding and reporting on material sustainable aspects requires a tailored approach, organisations will need to consider the best way for them to undertake the process and then determine the most appropriate ways to communicate in order to maximise the benefits to stakeholders and the organisation itself. A continued focus on material aspects is essential as business and stakeholder needs change, and as new aspects emerge."*

On June 22 2015, APRA wrote to the CEOs of general insurers regarding the public disclosure for prudential purposes stating that APRA "strongly encourages each insurer to review its approach to public disclosure of prudential matters in light of this letter, with the aim of enhancing market discipline"[17] APRA has also provided a practice guide to superannuation trustees on investment governance, including on environmental, social and governance issues.[18]

With the aim of putting the spotlight on the Australian insurance sector, WWF released a report in October 2015 in "Insurance and climate change disclosure in Australia"[19]. The aim of the report was to peer review the largest three Australian insurers (IAG, Suncorp and QBE) against their international peers (Alliance, AXA and Prudential US) and the four Australian banking peers. The results were quite discouraging.

Based on all publicly disclosed information reviewed we found:

- While the peer group generally discloses publicly their climate change policies/strategies through stand alone statements, annual reviews and/or sustainability reports, local insurers do not appear to disclose through these channels.
- It appears that no Australian insurer mentions the importance of a 2°C climate change target as an international consensus position or as an important climate threshold in any public documents. [This still remains the case three months after the Paris COP]
- Disclosure by Australian insurers of climate change matters in annual reviews and/or sustainability reports seems generally less specific and detailed than that made by the peer group.
- Disclosure by Australian insurers of specific climate change matters are generally less specific and detailed than that made available by them in more specialised disclosure submissions or reports.

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[15] http://download.asic.gov.au/media/1247147/rg247.pdf
[16] http://www.ey.com/Publication/vwLUAssetsPI/materiality-and-sustainability-disclosure-key-insights-from-the-ASX-top-100/$FILE/EY-materiality-and-sustainability-disclosure.pdf p5.
[17]http://www.apra.gov.au/CrossIndustry/Documents/150622-LTI-Public-disclosure-for-prudential-purposes-for-insurers-June-2015.pdf}
[18] http://www.apra.gov.au/Super/Documents/Prudential-Practice-Guide-SPG-530-Investment-Governance.pdf
[19]http://awsassets.wwf.org.au/downloads/cl047_insurance_and_climate_change_disclosure_in_australia_02nov15.pdf}

- There is no disclosure by Australian insurers of low carbon investment targets or statements around divestment in carbon intensive companies or products.
- There is signifcant scope for Australian insurers to augment their public position on the need for more ambitious climate change mitigation and communicating to consumers the risks and benefits of adaptation and mitigation.
- Recent actions by international and Australian insurance industry regulators demonstrate that they are taking a closer interest in key environmental, climate change risks and related disclosure and this may lead to greater expectations on insurers to be more active in their public disclosure of risk.

Recommendation 1: Provide enhanced powers to APRA and other corporate regulators to ensure stronger and more consistent public disclosure of all carbon risk and related matters.

Australian involvement in the G20 Financial Stability Board discussions on carbon risk impacts for financial stability

The Financial Stability Board, established in 2009 post the GFC, submitted a proposal to the G20 last year for the creation of an industry led disclosure task force on climate-related risks. Out of the Paris COP came the establishment of a Task Force on Climate-related Financial Disclosure (TCFD) established by Bank of England Governor Mark Carney and chaired by Michael Bloomberg. Australia's Reserve Bank has been invited to sit on the task force along with all the other major economies, central bankers and key international financial institutions.

The proposal is to look at developing voluntary, consistent climate related disclosure that would be useful to lenders, insurers, investors and other stakeholders in understanding material financial risks.

At the Paris COP last year Carney warned that investors face "potentially huge" losses from climate change action that could make vast reserves of oil, coal and gas "literally unburnable". He added that he wants a market structure that will bring about "an ordered transition" to a zero-carbon economy. He pointed out that the 185 national climate targets tabled for Paris contain real information about where governments and the world are headed. And that investors need to be asking companies "what's your strategy for net zero (emissions)?"

A key concern here is the so-called voluntary nature of such a proposal. Unless disclosure is codified and made mandatory it is likely that companies will obfuscate and limit their disclosure. The government should be alert to this and flag the possibility that regulatory action might be required to ensure fulsome, timely and consistent reporting by institutions and companies including 'stress testing' companies against different climate change scenarios to ensure that they are future proofed against a zero emissions world.

Because there is no level playing field, it would be in everybody's interest for companies to be legally bound to report their carbon intensity and future carbon liability under a zero carbon scenario. If only one insurer, bank or super fund does so, companies have an option to go elsewhere to compete for money so it would be better if a government mandated this requirement and legislation was brought in for example over a two year period so methodologies and consistent reporting could be developed and verified.

WWF understands there is an Australian Portfolio Carbon Working Group with the four major banks as an informal, collaborative working group recognised under the auspices of the UNEP FI. The purpose of the working group is to share insights and alternative approaches that will enable financial institutions to measure and disclose their climate performance, with the aim of demonstrating how we can support the transition to a lower-carbon economy. WWF welcomes such collaborations and hopes that the result would be more transparent and consistent disclosure on carbon risk.

Recommendation 2: The Auditing and Assurance Standards Board, APRA, ASIC and other appropriate government institutions to work with key companies, industry associations and regulators to define a process for harmonising carbon disclosure methodologies, codifying these requirements and ensuring there is consistent reporting for verification purposes.

Current regulatory and policy oversight of carbon risk disclosure across government agencies

As mentioned above the ASX and ASIC listing rules require companies to disclose their "risks" that are material and the EY report clearly indicated that the level of disclosure is inconsistent. These rules have not be tried and tested and require better guidance on expectations. APRA also requires risk disclosure and have prudential practice guidance for financial institutions. However these tend to be general rather than prescriptive requirements and WWF would encourage appropriate government institutions to work with key companies, industry associations and regulators to harmonise disclosure methodologies, codifying these requirements and ensure there is stronger and more consistent public disclosure of all carbon risk and related matters.

Corporate reporting rules around contingent liability, reporting on how companies are managing their carbon risks is fundamentally important to managing carbon risk however there appears to be minimal effort on the part of government to regulate companies' disclosure requirements or take companies to task for their inadequate levels of disclosure.

At the moment companies are not obliged to undertake stress testing for climate resilience and there is no mandatory requirement for companies to do so, except by encouragement through active ownership of investors. How financial institutions set milestones and metrics to allow monitoring of progress will be fundamental to their decarbonisation transition plans. Furthermore, companies are not well positioned to deal with these carbon risks as many companies' carbon management strategies do not align with the climate science, and do not necessarily account for future carbon risks adequately.

Recommendation 3: Develop a process to mandate disclosure of climate risk, including a requirement for companies to stress test their businesses against different climate thresholds including net zero emissions using a credible methodology; and to disclose this within financial statements.

Any other related matters

WWF's Insurance Disclosure report provides just one example where Australian companies are being left behind by their international peers on climate risk disclosure. Superannuation Trustees are also lagging behind with a paucity of disclosure for their members. There is a need for all companies and financial institutions to do better and superannuation members are starting to demand better disclosure.

This submission's recommendations should be seen as a way for government to support a movement towards a low carbon, globally competitive economy where Australia will be competing internationally for capital.