

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Chairman and Senate Committee Members

RE: Carbon Risk Disclosure

30 March 2016

1. This letter serves as the Carbon Tracker Initiative's submission to the Parliament of Australia's Senate Economics References Committee's inquiry into carbon risk disclosure.
2. Carbon Tracker is a financial think tank focused on aligning capital markets with the reality of climate change. Developing the notions of the 'carbon bubble' and 'stranded assets', our analysis contributes to a widening dialogue between fossil fuel companies, investors, and policy-makers on securing an orderly transition to a low-carbon future.
3. Since 2011, Carbon Tracker has published research identifying the oil, gas, and coal projects most at risk from becoming uneconomic, or 'stranded', in the low-carbon energy transition. Our carbon supply cost-curve approach has since been adopted by other financial organisations, including Goldman Sachs, and used by investors to demand greater transparency of risks to their investment portfolios. We supplement our global research with investment-grade sectoral analysis, for example on the [U.S. coal sector](#), [European utilities](#), and regional 'carbon bubbles', including [Australia's](#). In a letter to the [Financial Accounting Standards Board](#) and a report titled [Carbon Avoidance](#), we have also analysed the implications of our research for reserves accounting and financial reporting under existing standards. We provided that analysis at a plenary session of the Financial Stability Board (FSB), among others. We are engaging extensively with policymakers around the world on these issues.

Background

4. Ample evidence points towards increased focus on carbon risk disclosure. The Governor of the Bank of England and Chair of the FSB, Mark Carney, highlighted the risk of climate change for financial stability. Mr. Carney subsequently established an industry-led Task Force on Climate-Related Financial Disclosure (TCFD), to improve disclosure and "help financial market participants understand their climate-related risks."¹ Several European governments have commenced inquiries on the extent to which climate change poses a problem for financial stability. This demonstrates increasing scrutiny of the risks and a focus on disclosure as one part of the solution.
5. The historic Agreement signed at COP21 in Paris set a clear direction of travel for the future of energy and provided a benchmark – limiting warming to well below 2°C above pre-industrial levels – against which we can now measure progress in the energy transition. By virtue of its economic and carbon influence,² Australia's contribution to this global commitment and how it progresses is an important one. Crucial too will be its role in the TCFD process.

Australia's global influence

6. The COP21 Nationally Determined Contributions (NDC) of emissions reductions will be essential in meeting and exceeding the 2°C benchmark. Australia's NDC was clear in its objective to contribute to this global process. However, measures being taken in export markets and the increasing competitiveness of alternative energy sources mean that the market is starting to recognise that the seaborne thermal coal market is in structural decline. It is this point that we believe should be focused on with regard to carbon risk disclosure.

¹ Mark Carney, 2015, <http://www.fsb.org/2015/12/fsb-to-establish-task-force-on-climate-related-financial-disclosures/>, accessed 23/03/2016.

² Latest available data from the World Bank puts Australia as the twelfth largest economy by GDP and twelfth highest per capita emitter of carbon dioxide, <http://data.worldbank.org/>, accessed 23/03/2016.

7. For example, Australia's exports of coking and steam coal account for roughly 60 percent of global exports of these minerals.³ Therefore, the Australian Government should carefully consider how a reduction of global demand for these products might impact Australian supply. It may be that, from a carbon risk perspective, Australian companies are more exposed to the energy transitions of other countries than their own.

The challenge to future demand and supply

8. Our 2015 report, [Lost in Transition](#), showed that company assumptions on future demand for fossil fuels typically lie at the bullish end of mainstream forecasts and largely discount the pledges made by world governments. Incorporating real-time evidence from major energy consuming countries demonstrates that there is significant down-side risk in these assumptions.
9. Our research suggests that the global coal trade will be most severely impacted. In 2012 China and India accounted for roughly one-third of Australia's coking coal exports.⁴ Through energy policy changes and economic development, China and to a lesser extent India no longer operate as guarantors for future coal demand. For example, there is a growing consensus that China's demand for coal recently peaked: statistics from the Chinese Government confirm that consumption of energy derived from coal has fallen in each of the last two years.⁵ A recent report from the London School of Economics concludes that China's policy to increase the share of non-fossil fuel energy sources will result in a significant decline in coal's share of the energy mix.⁶ Such is the disruptive potential, China's financial community has begun to undertake environmental stress tests for key industries – cement and thermal coal – under multiple scenarios.⁷
10. These trends have meaningful implications for Australian supply of fossil fuel. Scrutinising supply in a 2°C-compliant scenario, our financial [analysis](#) concludes that, for Australian-based projects over the next decade, roughly US\$4 billion of investment in existing and new thermal coal and US\$66 billion of investment in existing and new gas projects is not needed. The announcement from Woodside this week that it is shelving its \$40bn Browse LNG project confirms the findings of our research. This potential for a smaller fossil fuel industry presents substantial financial risk for investors and companies moving forward and should be better discussed in companies' reporting.

The role of carbon disclosure

11. Carbon disclosure reporting should assist the Australian Government in more adequately considering the issues outlined above. Currently, there is inadequate and imbalanced discussion from oil, gas and coal companies of material trends – such as those identified in this submission around the fundamental demand for their products under a range of scenarios – that could significantly and negatively impact a company's financial condition. In large part, this stems from a failure to appreciate the implications of the changed circumstances imposed by governments and the rapid rates at which technologies are advancing. Disclosures should provide investors with information that considers a changing future, not a mirror of past trends.
12. We believe that implementing a stress-test of Australian-based fossil fuel supply in a 2°C pathway would be one sensible approach to consider. We have recently published a [paper](#) discussing the need for Chevron, one of the world's largest oil and gas companies, to undertake a stress test of their portfolio of projects against a 2°C-compliant scenario, regardless of management's belief of the likelihood of such a scenario. Implicitly, our work has suggested one way of stress-testing a company's upstream portfolio for resilience to a two-degree outcome, and we will be publishing more work in this area in the near future. The financial and energy systems need to be stress-tested against a 2°C-compliant scenario to enable regulators to consider the broader impact – both positive and negative – of the energy transition.

³ International Energy Agency, 'Coal Information', 2014. Statistics from this report indicate that Australian exports of coking coal were 58% of world exports and their exports of steam coal were 66% of world exports.

⁴ IEA, 'Coal Information', 2014.

⁵ National Bureau of Statistics in China, 'China Statistical Yearbook 2015', <http://www.stats.gov.cn/tjsj/ndsj/2015/indexeh.htm>, accessed 17/03/16.

⁶ Green, F., and N. Stern, 'China's changing economy: implications for its carbon dioxide emissions', *Climate Policy*, 16 March 2016.

⁷ ICBC, 'Impact of Environmental Factors on Credit Risk of Commercial Banks', 2016.

13. Carbon Tracker would welcome the opportunity to further assist the Australian Government in considering these issues.

Yours sincerely

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