Submission 38 – The Climate Institute

The Climate Institute made submission 31 to the inquiry into carbon risk disclosure in the 44th Parliament.

This document is intended as a supplementary submission to the original submission 31.

All submissions received in the 44th Parliament can be accessed via the following link:
http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Carbon_Risk_Disclosure/Submissions

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Senate Standing Committee on Economics: Carbon Risk Disclosure

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Below is an addendum to our submission made in March 2016. It highlights several significant developments since the original deadline for submissions to the 44th Parliament committee's inquiry.

This should be read in conjunction with our original submission.

Contents:

1. Draft recommendations of the Financial Stability Board's Task force on Climate-related Financial Disclosure (TCFD).
2. The Hutley memorandum of opinion on climate liability risk for Australian directors
3. The recent exacerbation of policy uncertainty in Australia

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1. Draft recommendations of the Financial Stability Board's Task force on Climate-related Financial Disclosures (TCFD)

The Financial Stability Board's Task force on Climate-related Financial Disclosures (TCFD), an industry-led committee, on December 14 released its draft recommendations[i].

As noted in our original submission, the TCFD has been charged with developing a *voluntary* set of climate-related financial disclosure parameters. However the objective is to address the risk of systemic failures and losses that could be avoided if climate risk is understood within all companies, asset owners and asset managers, and is disclosed in order to be priced in as accurately as possible.

The report notes that the FSB, in creating the taskforce, asked that it: "provide a source of data that can be analyzed at a systemic level, to facilitate authorities' assessments of the materiality of any risks posed by climate change to the financial sector, and the channels through which this is most likely to be transmitted." (p.3)

We would commend the entire report and its annexes to the committee, however we would like to draw the committee's particular attention to several aspects of the recommendations.

The task force recommended that:

Climate-related disclosures be made in a timely way (at least annually; p. 66)

Disclosures should be incorporated into mainstream financial filings (p. 14)

Disclosures should follow governance processes which "would likely involve review by the chief financial officer and audit committee as appropriate" (or equivalent governance processes for eg. asset owners / managers) (p.14)

All companies model and disclose their performance in a 2C scenario. It adds that "Over time, the Task Force would expect to see more quantitative analyses in disclosures, including the underlying assumptions associated with the climate-related scenarios used." It also mentions forthcoming 1.5C scenarios that may be suitable (p. 31). (See also the separate technical paper[ii])

The task force's report also:

- **Contains specific guidance for more detailed disclosure from the financial sector** (banking, insurance, asset managers, asset owners) (This is contained within the annex on Implementation). For example, it recommends that insurers disclose how they model climate risks, and that banks disclose their risk by industry and geography.

- **Contains specific guidance for industries affected by transition,** including fossil fuel and transport (Annex). For example, automobiles companies to disclose by revenue: "Vehicle sales (historical, current and projected) by category (e.g., gas vehicles, diesel vehicles, battery electric Vehicles, plug-in hybrid electric vehicles, alternative-powered vehicles (LPG, CNG, fuel cells, compressed air)."

- **Re-iterated the importance of better information in supporting financial and corporate authorities**

Other points of note for the committee:

The TCFD as a resource for Australian corporate and financial authorities:
"The Task Force believes that advocacy for these standards will be necessary for widespread adoption, including educating organizations that will disclose climate-related financial information and those that will use those disclosures to make financial decisions. To this end, the Task Force notes that strong support by the FSB and G20 authorities would have a positive impact on implementation. Members of the Task Force stand ready to support the FSB and G20 authorities in promoting adoption of the recommendations."

The TCFD as a resource on specifics of climate disclosure, including scenario development:
The Climate Institute appreciates that disclosure of carbon- and other climate-related risks is still a rapidly-evolving field. In particular, with the forward-looking nature of many (although not all) elements of climate risk, scenarios of possible future outcomes and how they may affect an organisation become more important. Scenario modelling is not without challenges

and, as the TCFD notes, conducting such exercises in relation to climate change is still relatively new.

Much of the TCFD draft recommendations focus on the role of scenarios in assessing and disclosing climate risks (and opportunities), and a great deal of information is provided within.

The Task force alone does not address all problems:
The task force's recommendations, when they are reviewed and adopted, have great potential to facilitate better climate risk disclosure.

However they are only as powerful as the implementation; and previous experience (the FSB's EDTF, a similarly-structured initiative designed to improve bank capital risk disclosure) points to the support of financial authorities as a key factor in take-up[iii].

Moreover, the FSB task force's recommendations will not address country-specific risks. As our 2015 paper "Climate risk in the Australian financial system" highlights, country-specific risks:

- The nature of our corporate and financial environment and economic structure (such as composition of our stock exchange benchmark, and the size of our superannuation asset pool).
- The nature of particular carbon and climate risks to Australia: (such as our exposure to climate-related impacts, and our economic exposure to the shift towards a zero net-carbon future, as described in the Paris Agreement).

2. Memorandum of opinion by Noel Hutley, SC, and Sebastian Hartford-Davis

The memorandum by Noel Hutley, SC and Sebastian Hartford-Davis[iv], published on October 7, articulates many aspects of climate-related liability risk for company directors in Australia.

The memo attracted significant media attention, and was heavily referenced in subsequent material published by the Australian Institute of Company Directors' Governance Leadership Centre[v].

Again, we commend this document in its entirety to the committee, but we would particularly highlight a few aspects:

Importantly, the memorandum notes the "significant variation in the approach of Australian companies to the disclosure of climate change and other sustainability risks within annual reports".

It also highlights how previous examples litigation in Australia may in fact be climate-related, such as that relating to Lake Somerset and Lake Wivenhoe dams after the 2011 floods in Queensland; and that these illustrate failing to foresee, and failing to adapt to, climate change.

Finally, the memorandum notes that there is "certainly no legal obstacle to Australian directors taking into account climate changes and other sustainability risks, where those risks are, or may be, material to the interests of the company. The ASX Listing Rules arguably mandate this."

We would add that while the rules may effectively mandate this, if such a requirement is not explicitly described, it may continue to be ignored, which could perpetuate avoidable risks for directors, companies, and other participants in the Australian economy.

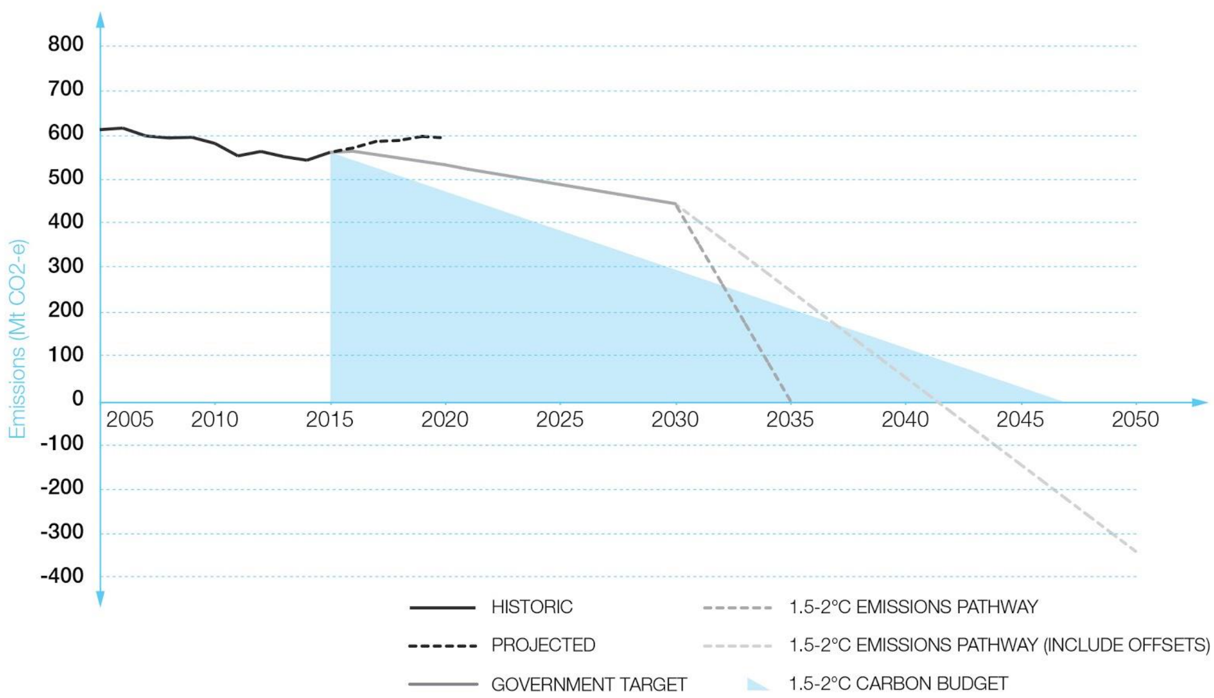
3. Recent climate policy instability in Australia and implications for companies, investors and other financial actors

Finally, we would like to draw attention to the increasing risks from climate policy uncertainty since the previous iteration of this inquiry.

On November 10, the Australian prime minister, foreign minister, and energy and environment minister announced Australia would ratify the Paris Agreement, which had entered into force several days earlier after meeting the prescribed international ratification hurdle. This ratification had bipartisan support.

The Climate Institute has analysed[vi] the policy implications of Australia's commitment to the Paris Agreement, which the government announced on November 11, 2016 would be ratified:

FIGURE 3
Post-2030 emissions pathways to meet a 1.5-2°C carbon budget.



Source: The Climate Institute

The chart above draws upon analysis by the Commonwealth Government's Climate Change Authority (CCA). It illustrates the wide gap between the current climate policy regime and both our existing 2030 commitments, as well as the longer-term targets contained in the Paris Agreement, which sees global greenhouse gas emissions moving to zero around 2050.

In the paper, Beyond the Limits, we described the implications of this gap:

With no access to negative emissions, post-2030 emissions need to fall to net zero emissions in around five years to stay within the carbon budget. Even with access to substantial emissions offsets, national emissions would still need to fall very sharply and reach zero in the early 2040s. After this point, national emissions would need to be negative, with around 1,600 million tonnes either sequestered in carbon stores or purchased from other countries. This is around three years of current annual emissions.

The effects of such a shortfall would clearly be dramatic and profound.

The Hutley opinion, which drew on the same CCA modelling of the emissions gap, noted "The Authority concluded that, to meet Australia's emissions reductions goals, emissions will need to decline more steeply in coming years than they have in the past."

The Hutley memo added that:

"A change in the regulatory environment is foreseeable, and probably inevitable."

Despite numerous authorities pointing to the likely benefits of certainly policy tools, particularly an emissions intensity scheme, in addressing this shortfall, the committee will be aware that certain policy tools were ruled out by the prime minister shortly after the terms of reference for the 2017 climate policy review were released.

Yet this ruling out of some policy options does not negate the policy risk for companies; rather, it increases it. Corporate Australia and other parts of our society are well aware of the misalignment between what we have committed to, and the policies we currently have at our disposal to effect that.

This was underlined by a joint statement[vii] signed by 18 organisations, including the Business Council of Australia, Energy Users Association of Australia, the Australian Aluminium Council and the Australian Steel Institute, and Energy Networks Australia.

" The status quo of policy uncertainty, lack of coordination and unreformed markets is increasing costs, undermining investment and worsening reliability risks."
[…]

"The 2017 climate change review should assess all policy options and provide advice to Government. Taking policy options off the table at this point risks a less efficient transformation, continued investment uncertainty, higher electricity prices and lower international competitiveness."

Footnotes:

[i] Recommendations of the Task Force on Climate-Related Financial Disclosures, December 14, 2016. https://www.fsb-tcfd.org/wp-content/uploads/2016/12/18_1216_TCFD_Report_A4.pdf

[ii] Technical Supplement: The Use of Scenario Analysis in Disclosure of Climate-Related Risks and Opportunities, December 14 2016. https://www.fsb-tcfd.org/wp-content/uploads/2016/11/TCFD-Technical-Supplement-A4-14-Dec-2016.pdf

[iii] 2015 Progress Report, Enhanced Disclosure Task Force, p. 16. Available at: http://www.fsb.org/wp-content/uploads/2015-Progress-Report-on-Implementation-of-the-EDTF-Principles-and-Recommendations.pdf

[iv] Hutley, N, and Hartford-Davis, S, 2016, "Climate Change and Directors' Duties: Memorandum of Opinion", Published by the Centre for Policy Development and the Future Business Council; available at: http://cpd.org.au/wp-content/uploads/2016/10/Legal-Opinion-on-Climate-Change-and-Directors-Duties.pdf

[v] The AICD's Governance Leadership Centre published a suite of views and articles on climate change for directors in mid-December, 2016. They can be found at: http://aicd.companydirectors.com.au/advocacy/governance-leadership-centre/practice-of-governance/is-climate-change-a-governance-issue

[vi] Beyond the Limits: Australia in a 1.5 - 2C World, 2016, The Climate Institute, available at: http://www.climateinstitute.org.au/articles/publications/beyond-the-limits.html/section/478

[vii] "Energy reform is urgent to avert systemic crises", December 13, 2016, statement text and full list of signatory organisations available at: http://www.climateinstitute.org.au/verve/_resources/joint_statement_coag_december_2016.pdf