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

30th March 2016

Submission to the Senate Economics Reference Committee on Carbon Risk Disclosure

Dear Committee Secretary,

South Pole Group welcomes this opportunity to comment on this issue.

About South Pole Group

South Pole Group is one of the world's leading climate action solution providers, measuring and reducing climate impact for its clients. Headquartered in Zurich, Switzerland, with 17 offices around the globe and over 150 climate change professionals, the company has achieved savings of over 50 million tonnes of CO2 since being incorporated in 2006. In Australia, South Pole Group operates through its subsidiary Climate Friendly, and has a partnership with CAER, a leading Australian provider of independent research into the environmental, social, governance (ESG) and ethical performance of companies.

With the largest and deepest coverage of high quality company greenhouse gas (GHG) information in its proprietary database, South Pole Group has screened close to USD 2 trillion assets under management for their climate impact. South Pole Group pioneered high volume portfolio carbon screening that is now available on CleanCapitalist.com, YourSri.com and Bloomberg terminals (APPS CARBON) and has been a strong contributor to industry initiatives such as the Montreal Carbon Pledge and the Portfolio Decarbonization Coalition (PDC).

Furthermore, South Pole Group partners with a wide range of other specialists on a non-exclusive basis to complement its research and service provision with the other best market offerings available. Partners include CDP (previously known as the Carbon Disclosure Project), Fossil Free Indexes, oekom research, Global Footprinting Network, Ethifinance and the 2 Degree Investment Initiative.

South Pole Group helps governments, such as those in Switzerland and Germany, determine climate change associated risks for their respective financial markets.

Recent developments

The year 2015 closed with a landmark step as nearly 200 countries adopted the Paris Agreement at the COP21 climate negotiations. The agreement sets a goal to limit global warming to well below 2 degree Celsius, ties countries to continuous ambition and reporting, and sets the foundations for a new market mechanism under the United Nations to increase overall action on climate change.

In the wake of the Paris Agreement, more and more investors, researchers, governments and international non-governmental organisations (NGOs) are realising that investments in companies that produce a high amount of CO_2 or promote fossil energy are high in risk. The harder we strive to meet the 2 degree climate target, the more profound the economic transition and subsequent potential losses for investors.[1]

The first step in managing investment climate risk and exposure is to measure it. After taking a closer look at the financial sector, asset managers and asset owners have been increasingly encouraged to disclose their carbon footprint over the past two years. The French government has published a legislation that requires investors to disclose their climate impact.[2] The legislation by the French parliament was followed by a number of preliminary actions from other European governments, including Switzerland[3], Germany[4] and Sweden[5], who are all in the process of assessing the link between carbon risks and financial stability. This shows that carbon risk disclosure is at the top of the agenda of many other national governments, making the Australian Senate inquiry timely.

In Sweden, all the major national pension funds (known as the 'AP' funds) have been strongly encouraged to report their emissions by their former financial markets minister Peter Norman and his successor Per Bolund. In 2015, all of the six AP funds disclosed their emissions and subsequently agreed on a common reporting standard. Other Swedish investors adopted the standard as a best practice framework. Furthermore, the fund 'AP4' is now a high profile participant of the PDC.[6] This was made possible through firstly understanding the fund's carbon exposure by disclosing portfolio emissions, which in turn enabled the fund to develop and follow a clear strategy focused on low-carbon investments.

In addition to measures implemented or under consideration by national governments, there is also movement at the sub-national and supranational level. In the US, Dave Jones, the Commissioner of the California Department of Insurance, made carbon risk disclosure compulsory in January 2016 for insurance companies in California[7]:

> *"I require (…) insurance companies to provide detailed and specific disclosures of their investments in the carbon economy including coal, oil and gas. We will make this new information public."*

[1] Also discussed under the term 'carbon bubble', more information can be found at http://www.carbontracker.org/our-work/
[2] http://www.trucost.com/blog/142/France/investors/carbon/reporting
[3] http://www.bafu.admin.ch/dokumentation/medieninformation/00962/index.html?lang=de&msg-id=59285
[4] http://www.spiegel.de/wirtschaft/soziales/regierung-erwaegt-gutachten-zur-gefahr-einer-carbon-bubble-a-1036196.html
[5] http://www.government.se/opinion-pieces/2015/12/the-sustainability-revolution-in-finance/
[6] http://www.unepfi.org/fileadmin/documents/PortfolioDecarbonizationCoalition.pdf
[7] http://www.insurance.ca.gov/0400-news/0100-press-releases/2016/statement010-16.cfm

An initiative at the supranational level is the EU funded project CLIMPAX[8] that will rank all European mutual funds[9] by their climate impact. This is the first ranking of its kind and enables retail as well as professional investors to:

a) understand every investments' climate impact automatically, and
b) take climate friendlier investment decisions, which
c) are aimed at encouraging and supporting company management to reduce their greenhouse gas emissions.

Understanding portfolio emissions - from corporate to portfolio disclosures

About 45% of the companies listed in the ASX 200 index currently disclose their carbon footprint. These companies receive a qualifying score on their level of transparency from CDP, an international climate NGO. Australian companies receive an average "CDP disclosure score" of 86 out of 100. Over the last four years, the average disclosure score has risen by approximately 30%, whereas the number of companies disclosing has dropped by 5% (see Table 1).

Index	Reporting year	Disclosure rate	Average Trust Metric of Reporting Companies	Average CDP Disclosure score	Rate of companies disclosing and scoring 85 or higher
DAX	2015	90.0%	89.0%	93.6	96.3%
FTSE 100	2015	99.0%	87.0%	94.0	82.0%
ASX 200	2015	45.0%	79.2%	86.3	61.1%
	2014	51.5%	78.2%	75.6	28.2%
	2013	50.5%	77.9%	67.9	19.8%
	2011	50.0%	75.1%	65.8	19.0%

Table 1: Number of companies reporting within ASX 200 and average CDP disclosure scores[10]

Compared with other indexes around the world, such as the German DAX (index of 30 companies) and FTSE 100 (UK index of 100 companies), where 90% and 99% of the companies disclose their emissions with a trust factor of 89% and 87% respectively, the ASX 200 has a much lower disclosure rate of 45% and a trust factor of 79.2% for the companies disclosing. Furthermore, the average CDP disclosure score is 7-8 points lower for the ASX 200. This shows that while ASX companies on average score highly on the CDP disclosure score, there is still room for improvement for the top listed companies in Australia.

It can be observed that companies in Australia demonstrate an increasing appetite for acting on climate change. This is evident through companies steadily developing their approach to climate change management as reflected in the improving CDP scores.

This is perhaps indicative of a corporate understanding of the issues that is greater than the political pressure to act. Despite the Australian government discontinuing its carbon pricing

[8] http://www.climate-kic.org/projects/the-first-climate-impact-rating-for-investment-funds/
[9] A mutual fund is an investment programme funded by shareholders that trades in diversified holdings and is professionally managed.
[10] Bloomberg and South Pole database; comparison for the year 2015 (marked green in table 1)

mechanism, around a quarter of companies use an internally determined price per tonne of carbon to guide their investment decisions.[11] This demonstrates the value and/or the potential risk that those companies see from carbon pricing, and their belief that pricing will happen in the future.

The importance of addressing long-term carbon investment risks in the Australian finance sector

Climate change has been accepted as a key long-term risk by investors. That this is no longer a 'niche' issue was highlighted when Mark Carney, Governor of the Bank of England and chairman of the financial stability board (FSB), stated in December 2015 that[12]:

> *"Climate change will threaten financial resilience and longer term prosperity"*

As Australia has one of the highest nominal GDP per capita rates and approximately 10% of its GDP comes from natural resources, such as oil, natural gas and coal, it should carefully assess the carbon risks its financial centre faces.[13] As a member of the G20, the Australian government should engage with the Task Force on Climate-related Financial Disclosures (TCFD) chaired by Michael Bloomberg, which is developing voluntary, consistent climate-related financial risk disclosure for use by companies to provide information to investors, lenders, insurers, and other stakeholders. The Task Force will consider the physical, liability and transition risks associated with climate change and what constitutes effective financial disclosure across industries. 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.[14]

Australia's share market is heavily exposed to the risks of climate change and the stranded asset risk of fossil fuel investments. Yet, while many global investment managers and pension funds are making moves to understand their carbon risk and its impacts on their portfolios, Australian investors are often still grappling with how to best address the carbon challenge. Pension funds are essential to the pension schemes of members of an economy. As they have a significant responsibility, they are given special attention in the analysis of potentially systemic long-term risks such as climate change. Like their global peers, Australian pension funds are under increasing pressure to consider climate change impacts within their portfolios in order to safeguard their members' savings. Despite growing concerns of fossil fuel assets becoming stranded, the average Australian pension fund maintains investments in the causes of climate change, leaving it exposed to carbon risk. Ultimately, super funds in Australia can use this risk as an opportunity to become innovative leaders in this regard, and can serve as a role model for other pension funds assessing their climate impact in order to become climate neutral.

[11] CDP Australian Climate Leadership Report 2015, https://www.cdp.net/CDPResults/CDP-Australia-climate-change-report-2015.pdf
[12] http://www.bankofengland.co.uk/publications/Pages/speeches/2015/844.aspx
[13] World Development Indicators: Contribution of natural resources to gross domestic product, http://wdi.worldbank.org/table/3.15
[14] Task Force on Climate-related Financial Disclosures (TCFD), https://www.fsb-tcfd.org/

Recommendations

<u>The Australian regulator should consider encouraging investors to:</u>

- systematically measure the climate risks for their investments and perform stress tests on them;
- develop specific internal capacities in the area of climate change and investments;
- report the climate impacts of their investments to stakeholders;
- become involved in private international transparency initiatives such as the Montreal Carbon Pledge;
- incorporate climate improvement strategies in their investment decisions and set climate protection goals. This can occur in the trade-off between divestment of – or specific interactions with – climate-intensive companies;
- seek out climate-friendlier investment alternatives for their own portfolio from the steadily growing range available or develop their own alternatives. Passive investment strategies in connection with low carbon indices such as Solactive, Stoxx, Edhec or others can be used for this purpose;
- influence the real economy to help their investments achieve climate resilience by using their right to vote as active shareholders, interacting with the companies in which they invest and even divest.

It is up to policymakers to help, advance and, where possible, steer the process of incorporating climate concerns in the investment decisions of the Australian financial centre. **<u>Australian policymakers should:</u>**

- provide the required databases to promote awareness among decision-makers and stakeholders and communicate with them, for example through actor-specific workshops;
- support and provide critical assistance to more extensive research on specific topics, such as research on any connection between financial performance and CO_2-intensive investments;
- promote the sharing of expertise with other countries through climate transparency initiatives and their specific financial market actors (e.g. Sweden, France, California);
- develop policies that request or support investors to set climate targets and regularly control them in order to include the financial industry in the achievement of national climate targets;
- consider how to further encourage the financial sector to appropriately price the external costs of climate change to assist the diversion of capital flows towards climate-friendlier alternative industries and activities, and through this support innovation;
- consider how reporting requirements at the company level could be improved to better address investor needs and ensure alignment with investor disclosure requirements, if such disclosures were to be implemented or encouraged.

Kind regards,

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