THE UNIVERSITY OF MELBOURNE

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Inquiry into Carbon Risk Disclosure

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This submission is in 7 parts, with Parts 2-6 corresponding to the Inquiry's Terms of Reference:

Part 1: Introduction
Part 2: Regulatory and Policy Arrangements for Carbon Risk Disclosure in Australia
Part 3: Current and Emerging International Carbon Risk Disclosure Frameworks
Part 4: Current Carbon Risk Disclosure Practices within Corporate Australia
Part 5: Relevance for Australia of the G20 Discussions on Carbon Risk Impacts for Financial Stability
Part 6: Other Related Matters
Part 7: Conclusions and Recommendations

Part 1: Introduction

1.1 A new market environment post-Paris

The Paris Agreement, concluded under the United Nations Framework Convention on Climate Change (UNFCCC) in December 2015 signals a **new operating market environment for business**, including Australian corporations. In the Paris Agreement, 195 countries committed to hold global temperature increases, brought about by industrial carbon emissions, to 'well below' 2 °C and 'to pursue efforts' to limit temperature increases to 1.5 °C, 'recognizing that this would significantly reduce the risks and impacts of climate change' (Article 2.1(1)(a)). Article 4.1 of the Agreement further commits countries to a collective

goal of reaching 'global peaking' of carbon emissions as soon as possible and undertaking rapid reductions thereafter so as to achieve **zero net carbon** (a balance between anthropogenic emissions by sources and removals by sinks) in the second half of the century.

This new 'long-term temperature goal' in international climate law, coupled with the commitment to achieve zero net carbon in the second half of the century, sends a strong signal about the need for **rapid transition to a low carbon economy** in order to prevent unsafe levels of global warming. This **transition will not be achievable without private sector action** to reduce carbon emissions and increase uptake of clean energy sources. Moreover, business now has **clear guidance** at the international level concerning the pathway for future energy transition and climate policy.

1.2 Role of carbon risk disclosure in private sector energy transition

Achieving the long-term temperature goal set by the Paris Agreement will require business attention to issues of carbon risk, including the potential for **unburnable carbon** (fossil fuel energy sources which cannot be burnt if the world is to achieve zero net carbon in the second half of the century) and the possibility of **stranded assets**. In particular, with the global transition to clean energy sources endorsed by the Paris Agreement, the viability of several asset classes, including coal, oil and gas, may be affected, potentially leaving them 'stranded.'[2]

The practice of **carbon risk disclosure** involves the provision of information by companies on these risks – to their shareholders, investors and the broader public, and/or regulators. For companies, carbon risk disclosure focuses attention internally on developing strategies to **manage carbon risks to the business and to harness associated market opportunities**, including accelerating investments in technological innovation and clean energy.[3] As Michael Bloomberg, Chairman of the Financial Stability Board's newly established Taskforce on Climate-Related Financial Disclosures has stressed, another role of carbon disclosure is to **increase transparency**, which 'will help make markets more efficient, and economies more stable and resilient.'[4]

Carbon risk disclosure is therefore an important element of a broader strategy to achieve economy-wide reductions in carbon emissions and transition to clean energy sources so as to avoid catastrophic climate change impacts. When considering the role that carbon risk disclosure can play in moving towards this goal, it is important to think through:

- whether carbon risk disclosure should be voluntary or mandatory;
- who is reporting (or being required to report), considering company size, sector, carbon intensity, country of origin and operations;
- the quality and relevance of information provided; and

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[1] 'Carbon risk' here is understood as 'financial exposure to the risk of carbon emissions or carbon-intensive assets being priced, regulated, stranded by technology or incurring legal risk.' This is distinct from the concept of *climate impact risk*, where a company's assets may be damaged or devalued as a result of the physical impacts of climate change. The Climate Institute, *Australia's Financial System and Climate Risk*, (2015), 1.

[2] Climate Disclosure Standards Board, *Investments at risk: could a strong UN climate deal jeopardise current company valuations?* http://www.cdsb.net/news/events/518/investments-risk-could-strong-un-climate-deal-jeopardise-current-company-valuations. See also, *Carbon Asset Risk*, http://www.ceres.org/issues/carbon-asset-risk.

[3] N. Topping, 'How does Sustainability Disclosure Drive Behaviour Change?' *Journal of Applied Corporate Finance* 24(2) Spring 2012; J. Andrew & C. Cortese, 'Carbon Disclosures: comparability, the Carbon Disclosure Project and the Greenhouse Gas Protocol' *Australasian Accounting Finance and Business Journal* 5(4) (2011).

[4] https://www.fsb-tcfd.org.

- whether this information is useful to external stakeholders such as investors (e.g. does it allow comparisons between companies in a particular sector)?

The Australian Government last inquired into the corporate disclosure requirements and practices of Australian companies almost a decade ago in the context of Corporate Social Responsibility, recommending a continuation of business-as-usual and little change to the governing provisions of the Corporations Law.[5] Given developments in climate science, greater understanding in the business community of carbon risk and regulatory developments such as the Paris Agreement, this inquiry into carbon risk disclosure presents a timely opportunity to initiate law and policy reforms which will support corporate Australia in transitioning to a low carbon, clean energy economy.

Part 2: Regulatory and Policy Arrangements for Carbon Disclosure in Australia

With the exception of limited climate-specific laws,[6] current Australian legislation and regulations do not specifically require Australian companies or their directors to disclose information on carbon risk to investors and shareholders. While the general reporting requirements under the Corporations Law and the ASX Listing Rules are arguably broad enough to encompass carbon risk,[7] there is very little prescription or guidance on the nature and degree of response required. The relevant sources of reporting and disclosure obligations under Australian law,[8] and their limitations are outlined in Table 1 below.

Existing disclosure requirements are arguably broad enough to encompass reporting of carbon risk, particularly given the increasing recognition that this is a key strategic and financial consideration for many Australian enterprises, which will have a material impact on corporate value into the future. However, there is a strong argument that carbon risk should be disclosed as a stand-alone matter as part of broader mainstream financial reporting. This is supported by recent developments in leading economies internationally, such as France and the United States, which now have specific carbon risk disclosure measures (see further part 3 below).

To facilitate effective reporting of relevant and useful information, serious consideration should be given to introducing specific regulations requiring carbon risk disclosure and accompanying policy guidance on how carbon risk may have a material impact on a company's business and how it should be reported. One option is to use the existing mechanism of the ASC Listing Rules to this effect. Alternatively, clear guidance on a broad interpretation of the existing rules should be developed to make it clear that carbon risk should be specifically disclosed as part of broader mainstream reporting; this disclosure could be made, for example, using an ASX Guidance Note or ASIC Regulatory Guide.

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[5] Australia Parliament, Joint Committee Corporations & Financial Services, *Corporate Responsibility: Managing Risk and Creating Value* (2006); Corporations and Markets Advisory Committee (CAMAC), *The Social Responsibility of Corporations* (2006).

[6] *National Greenhouse and Energy Reporting Act 2007* (Cth).

[7] Troiano, R., 'Climate Change: Corporate Liability, Disclosure Requirements and Shareholders' Remedies' (2008) 26 *Company and Securities L.J.* 418; Purcell, J. & Loftus, J., 'Corporate Social Responsibility: Expanding Directors' Duties or Enhancing Corporate Disclosure' (2007) 21 *Aus. J. Corp. L.* 135; Bubna-Litic, K., 'Climate Change and CSR: the Intersection of Corporate and Environmental Law' (2007) 24 *E.P.L.J.* 253; and Shearing, S., 'Raising the boardroom temperature? Climate change and shareholder activism in Australia' (2012) 29 *E.P.L.J.* 479.

[8] This submission focuses on disclosure requirements under the Corporations Law and specific climate change legislation and the related compliance role of the Australian Securities and Investments Commission. Additional reporting requirements for the financial sector (e.g. superannuation entities), under the *Superannuation Industry (Supervision) Act 1993* (Cth) and the *Financial Sector (Collection of Data) Act 2001* (Cth)), and the particular compliance role of the Australian Prudential Regulation Authority are not discussed here given the narrower scope of the Inquiry but are also of considerable importance to the debate around carbon risk disclosure.

Table 1: Potential application of current disclosure and reporting obligations to carbon risk

Disclosure obligations	**Relevance to carbon risk disclosure**
Periodic Reporting Requirements *Corporations Act 2001* (Cth), ss 292 – 301 - Annual financial statements - Director's Report *Mandatory - civil penalties apply for failure to comply; offences for misleading or dishonest reporting*	• No statutory requirements relating to climate risk or indeed broader ESG (environmental, social, governance issues) for annual financial statements and director's reports. • Section 299(1)(f) does require specific disclosure if the entity's operations are subject to any particular and significant federal or State environmental regulation and if so, their performance in relation to this regulation. However this remains irrelevant so long as there are no mandatory controls on carbon emissions in Australia. • Given increasing recognition that carbon risk is a key strategic, financial consideration for many Australian enterprises, the more general reporting requirements could be interpreted to also require carbon risk disclosure. In particular, s 299A(1) requires that a director's report contain information that members of the listed entity would reasonably require to make an informed assessment of: the operations of the entity; the financial position of the entity; and the business strategies and prospects for future financial years.
Continuous Disclosure Requirements *Corporations Act 2001* (Cth), s 674-77 ASX Listing Rules - Chapter 3, Continuous Disclosure - Chapter 5 - Additional Reporting on Mining and Oil and Gas Production and Exploration Activities *Mandatory - offences for failure to report.*	• Once an entity becomes aware of any information (not already generally available) which a reasonable person would expect to have a material effect on the price or value of the entity's securities, this must be reported to the ASX. • This could potentially cover information that becomes available on carbon risk. However, there may be interpretative issues relating to whether such information is already generally available; whether the entity is 'aware' of this information (given long time frames and uncertainties relating to certain aspects of carbon risks); and whether the information concerns a material effect. • Mining, oil and gas companies have additional specific reporting requirements, including requirements to report on proven and probable mineral resources and ore/oil/gas reserve holdings; and the material economic assumptions underpinning resource development feasibility studies, unless these assumptions are commercially sensitive. These factors are relevant to carbon asset risk stranding; however, this reporting is not specifically directed to understanding and managing these risks.
Australian Stock Exchange - principles and recommended practices for good governance ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations, Third Ed.* (2014), Principles 5 and 7 *Not mandatory, but any non-compliance must be justified and reported in the annual report. Recommended disclosures should be made in the annual report or on the company website.*	• Principle 5 relates to the continuous disclosure provisions noted above. Carbon risk is likely to have a material effect on the price or value of the securities of many different Australian corporations. • Under principle 7, it is recommended that a listed entity disclose any *material exposure* to economic, environmental and social sustainability risks and how it manages, or intends to manage, those risks (rec. 7.4). The key terms (material exposure, economic/environmental/social sustainability) are broadly defined and reference is made to '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.' This suggests that reporting carbon risk would be captured by these provisions though there is no specific guidance to this effect.
Prohibitions on false or misleading disclosures *Corporations Act 2001 (Cth)*, various provisions, e.g. s 1041E *Australian Securities and Investments Commission Act 2001 (Cth),* Part 2	• There are a range of prohibitions addressing false or misleading conduct by corporations and their officers in relation to particular disclosure obligations. These attract both criminal and civil liability, with the Australian Securities and Investments Commission (ASIC) responsible for enforcement. • Where carbon risk is deemed to be relevant to particular disclosure obligations (e.g. s 299A(1) requirements for the Operating and Financial Review within director's reports, discussed above); a failure to disclose or any false or misleading statements would potentially put the entity, or its officers, in breach of the governing legislation.
Reporting greenhouse gas emissions, energy production/consumption. *National Greenhouse and Energy Reporting Act 2007* (Cth) *Mandatory for facilities and corporate groups which meet certain emissions and energy thresholds. Penalties for entities that fail to register or for non-compliance.*	• Companies and facilities (such as power stations) captured account for approx. 60% of Australia's greenhouse gas emissions. • Reported information on scope 1 and 2 emissions is important to understand carbon risk; but this reporting is not targeted to understanding and managing the associated financial risks. • Associated accounting and reporting practices provide a good basis for further development of carbon risk disclosure practices.

If mandatory provisions are adopted, it may be advisable to limit disclosure requirements to entities in a particular sector, with a particular carbon risk profile, or of a particular size or market share. This would minimise associated costs for the private sector and target regulations at companies with high carbon risk so as to maximise their impact. Given the *National Greenhouse and Energy Reporting Act 2007* (Cth) already requires companies with a significant emissions profile to report on scope 1 and 2 emissions and these companies have developed processes to comply with this legislation, broader carbon risk disclosure requirements could be initially targeted at these companies.

Recommendation 1: The Australian Government should introduce specific regulations and accompanying policy guidance to facilitate effective reporting of carbon risk as a stand-alone matter within the mainstream reporting under the Corporations Act. This could be carefully targeted to companies with high carbon risk profiles to maximise the regulatory impact and minimise costs for the private sector. As an interim measure, a Guidance Note providing a broader interpretation of the existing financial reporting rules should be developed to make it clear that carbon risk should be specifically disclosed as part of mainstream reporting.

Part 3: Current and emerging international carbon risk disclosure frameworks

This part discusses voluntary self-reporting frameworks for carbon risk disclosure at the international level; how disclosed information is used by investors to decarbonise their portfolios; and how it drives improved risk identification and management within corporations. It also notes the limitations of relying on a voluntary reporting approach. Mandatory carbon disclosure frameworks in leading economies, including France and the United States, are also discussed as a basis for potential reforms in Australia.

3.1 Voluntary carbon risk disclosure

There are a number of disclosure initiatives at the international level, involving **voluntary self-reporting** of various aspects of climate risk.[9] These initiatives target **large, listed companies** and particularly carbon-intensive sectors. Of these, the CDP (previously Climate Disclosure Project) has considerable coverage and impact (see Box 1 below).

Box 1: Voluntary Self-Reporting on climate risk through the CDP

The CDP requests information on climate risks and opportunities from the world's largest companies on behalf of a major proportion of global institutional investors. Based on self-reporting against a standardised questionnaire, CDP reports on climate *performance* (the level of action on climate change mitigation and adaptation e.g. through setting and meeting emissions reduction targets in direct operations and supply chain); and the completeness and quality of *disclosure* by participating companies. CDP now holds information from 5500 companies, representing nearly 60% of global market capitalization and 25% of the world's carbon emissions.[10]

In terms of *carbon risk*, the latest CDP questionnaire (2016) requests specific data on: any climate risks that have been identified by the company (including changes in regulation);[11] 3 year's consecutive data on greenhouse gas emissions, including detailed reporting requests for both scope 1 and 2 emissions (including external verification / assurance);[12] and sector specific information, including factors specific to *carbon asset stranding risk* for fossil fuel companies, such as disclosures regarding proven and probable fossil fuel reserves; an assessment of how climate regulation will impact the demand for, and price of, hydrocarbons; and metrics for measuring carbon emissions embedded in the reserve and resource base.[13]

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[9] Another major global sustainability disclosure initiative which includes climate change reporting is the Global Reporting Initiative. The CDP works closely with GRI to ensure that indicators are closely aligned and complementary. https://www.globalreporting.org/Information/about-gri/Pages/default.aspx

[10] Topping above n 3.

[11] CDP's 2016 Climate Change Information Request, p 9, section CC5.

[12] Ibid, section CC7, p 10.

[13] Carbon Tracker Initiative and CDSB, *Considerations for Reporting and Disclosure in a climate-constrained world* (2016), 4.

Voluntary disclosure initiatives, such as CDP, have had a significant impact in improving market transparency and encouraging companies to minimise carbon risks:

- **Investor action on carbon risk:** There has been an explosion in recent years in the use of CDP, or similar, data (including disclosed data and the fact of non-disclosure) by investors.[14] For example, *The Carbon Asset Risk Initiative*, a coalition of 75 investors managing more than $4 trillion in assets have called on 45 of the world's largest fossil fuel companies to assess and disclose these risks. This coalition seeks to prevent companies from wasting investor capital by developing high-cost, high-carbon reserves that may never be burned and to demonstrate how carbon risk poses an existential threat to their business models, accrues increasing levels of stranded assets, and puts trillions of capital expenditures at risk.[15]
- **Proactive initiatives by investors and companies that go beyond disclosure:** For example, the *Carbon Action Initiative* is a coalition of over 300 large-scale investors which is asking the world's highest emitting companies to make emissions reductions (year on year) and publicly disclose targets.[16] The *We Mean Business Coalition* provides a platform for companies and investors to commit to one or more of their initiatives, including adopting a science based emission reduction target; procuring 100% electricity from renewable sources; and reporting climate change information in mainstream reports as a fiduciary duty.[17]

However, voluntary, self-reporting schemes capture only a subset of corporations; and reporting may be of variable quality and extent:

- **Variable Quality and Extent of Disclosure:** For example, early assessments of CDP disclosure found that comparability, accessibility, and reliability of data reported were lacking, making it of little use to external decision-makers such as investors.[18] The information is also poorly represented in mainstream corporate reporting, which lacks comprehensive and comparable climate change information.[19] Together with other organisations, CDP has improved processes over time, including striving for the development of a globally used standard for emissions and energy reporting;[20] particular guidelines for sector-specific reporting; and broader more comprehensive reporting of emissions, including through the supply chain.[21]
- **Incomplete Coverage:** While the trajectory and speed of international developments in this area is remarkable; these developments **reflect the practices of a subset of corporations that are leaders in this area**. The vast majority of companies are non-leaders – while they may acknowledge climate change risks, they have no specific measures in place to address these risks.[22] For example, Loechal et al's (2013) study of companies in the Australian resources sector found that only 13% had policies,

[14] The Climate Institute (2015), above n 1.
[15] http://www.ceres.org/issues/carbon-asset-risk.
[16] https://www.cdp.net/en-US/Programmes/Pages/Initiatives-CDP-Carbon-Action.aspx.
[17] http://www.wemeanbusinesscoalition.org/take-action.
[18] See Andrew and Cortese (2011) above n 3. See also: Ans Kolk , David Levy & Jonatan Pinkse (2008) 'Corporate Responses in an Emerging Climate Regime: The Institutionalization and Commensuration of Carbon Disclosure', *European Accounting Review*, 17:4, 719-745, DOI: 10.1080/09638180802489121.
[19] http://www.wemeanbusinesscoalition.org/take-action.
[20] The Climate Disclosure Standards Board offers a global climate change reporting framework that is intended for use by companies making disclosures in, or linked to, their mainstream financial reports. It is 'standard-ready' for adoption by regulators contemplating the introduction or development of climate change disclosure practices. http://www.cdsb.net/
[21] Topping, above n 3.
[22] Carbon Disclosure Project (CDP), *Global 500 Climate Change Report 2013* (2013).

plans or practices in place to assess or manage climate risk.[23] Identifying the carbon exposure of an individual company remains challenging despite the voluntary efforts of many companies through the CDP.[24]

In order to achieve economy-wide benefits of carbon risk disclosure, serious consideration should be given to introducing standardised, mandatory disclosure requirements (although, this may be targeted – at least initially – to companies with a significant emissions profile in order to capture companies with the greatest levels of carbon risk exposure while minimising the overall regulatory burden on the private sector). International frameworks, particularly recent efforts to develop standardised metrics and sector specific guidelines, provide Australian policy-makers and regulators with ready-made standards and processes that could support increased regulation and provision of guidance to Australian companies in this area.

Recommendation 2: The Australian Government should refer to developments in voluntary disclosure at the international scale, particularly recent efforts to develop standardised metrics and sector specific guidelines, when considering regulatory options to introduce mandatory and standardised reporting requirements for carbon risk.

3.2 Leading national carbon risk disclosure schemes

Carbon and broader climate risk disclosure requirements have been introduced or are being seriously considered in a number of leading economies around the world.[25] The two schemes profiled below offer lessons for reform in Australia.

United States: In 2010, the U.S. Securities and Exchange Commission [SEC] issued guidance on how the existing disclosure requirements under federal securities laws and regulations applied to climate change matters.[26] The SEC's guidance addresses not only physical risks from climate change, but also the risks associated with the changing domestic and international regulatory environment. These risks include the need to comply with changing climate regulatory requirements, the indirect effects of those requirements, and business trends that include declining demand for carbon intensive products.

The U.S. experience reinforces the importance of enforcement in this context. A CERES report indicates that although companies increased climate-related disclosures immediately following the SEC ruling, this reform has had a more limited longer-term impact due to inadequate follow-up.[27] The report notes that 'comment letters over the last four years show minimal attention by the SEC to climate risk as a disclosure issue and

[23] Loechel, B. et al, 'Climate Change Adaptation in Australian Mining Communities: Comparing Mining Company and Local Government Views and Activities' (2013) 119 *Climatic Change* 465.
[24] The Climate Institute (2015) above n 1, at 7.
[25] For example, a report released in Feb 2016 by the European Systemic Risk Board (established by the European Commission in the wake of the 2008 financial crisis, with a mandate to oversee risk in the European financial system) calls for fuller disclosure of companies' carbon intensity in order to ensure they are prepared if rapid decarbonisation becomes necessary. ESRB, *Too late, too sudden: transition to a low carbon economy and systemic risk* (Feb 2016). The Swedish government has told the country's commercial pensions and investment sector it must find a common way to report carbon footprints or it will introduce legislation with mandatory reporting requirements: http://www.ipe.com/countries/nordic-region/sweden-threatens-carbon-reporting-law-if-pension-funds-fail-to-act/10010897.article. In the UK, the *Companies Act 2006* includes mandatory emissions disclosure requirements for listed companies.
[26] SEC, *Commission Guidance Regarding Disclosure Related to Climate Change Release Nos. 33-910627, 34-61469, FR-82* (Feb. 2, 2010).
[27] This has generated criticism of the SEC for its inadequate enforcement efforts: see http://www.ceres.org/files/confidential/investor-sec-letter-inadequate-carbon-asset-risk-disclosure-by-oil-and-gas-companies and http://www.ceres.org/files/confidential/investor-sec-letter-inadequate-carbon-asset-risk-disclosure-by-oil-and-gas-companies.

do not reveal an ongoing SEC commitment to implement the guidance.'[28] Although more companies are mentioning climate change in their reports, their actual disclosures have become briefer and less substantive.[29]

There has been particular concern about the quality of disclosure by fossil fuel companies. For example, an analysis of disclosures made under these new rules by 10 of the world's largest publicly-traded oil & gas companies found them to be 'generally inadequate to allow investors to conduct complete and accurate assessments of risks and future performance.' Despite the fact that the investigated companies were making extensive capital investments related to climate change that carried material financial risks, they were generally failing to adequately disclose them consistent with SEC rules and growing investor expectations.[30]

The financial disclosure practices of fossil fuel companies under the relevant SEC guidance have been the subject of recent investigations at a state level in the United States. For example, the New York Attorney General investigated the SEC filings from 2011-14 from Peabody Energy Corporation, and found that these disclosures misled shareholders by understating the severe potential impacts of carbon risk to its business and claiming an inability to predict the financial impacts of future climate policy laws or regulations.[31] A similar investigation has recently been launched against Exxon Mobil, claiming the company has repeatedly and deliberately concealed from investors the financial risks associated with climate change.[32] In a related matter, the SEC recently ruled that ExxonMobil must include a climate change resolution (requiring disclosure of specific risks that climate change, or legislation designed to curb it, could pose to its ability to operate profitably) in its annual shareholder proxy, so that it can be voted on by all shareholders at the next annual general meeting.[33]

These investigations and associated rulings are examples of the growing interest in enforcing (and broadening) corporate disclosure obligations as they relate to carbon risk, and support the argument that **Australian regulators should be proactive** in reviewing regulations, issuing guidance on how to report on carbon risk, and enforcing regulations against companies issuing misleading disclosures.

France: In 2015, France introduced a comprehensive piece of legislation – the Energy and Ecology Transition Law (2015-992) – which sets emissions reduction targets as well as targets for reducing primary energy consumption of fossil fuels and for the uptake of renewables. This law also strengthened mandatory climate disclosure requirements for listed companies and introduced the world's first mandatory requirements for institutional investors to report climate-related information and disclose the carbon

[28] Jim Coburn & Jackie Cook, Ceres, *Cool Response: The SEC & Corporate Climate Change Reporting* (Feb. 2014); David Gelles, 'SEC is criticised for Lax Enforcement of Climate Risk Disclosure' (23 Jan 2016), http://www.nytimes.com/2016/01/24/business/energy-environment/sec-is-criticized-for-lax-enforcement-of-climate-risk-disclosure.html?_r=0

[29] Ibid.

[30] Ibid, see also: Coburn, Salmon and Grossman, *Sustainable Extraction?: an analysis of SEC disclosure by major oil and gas companies on Climate Risk and Deepwater Drilling Risk* (CERES, 2012).

[31] This investigation, under State laws prohibiting false or misleading conduct in connection with securities transactions, was settled in November 2015. Peabody did not admit to fraudulent disclosure practices however, undertook to improve climate risk disclosure.

[32] http://www.nytimes.com/2015/11/06/science/exxon-mobil-under-investigation-in-new-york-over-climate-statements.html. A further investigation is underway in California: http://www.latimes.com/business/la-fi-exxon-global-warming-20160120-story.html.

[33] Ernest Scheyder, 'Exxon Mobil must allow climate change vote: SEC' (24 March 2016), http://www.reuters.com/article/us-exxon-mobil-shareholders-exclusive-idUSKCN0WP2TG?type=companyNews

exposure of their assets (Article 173).[34] A wide range of investors are now required to disclose how they address both 'physical'[35] and 'transition'[36] climate change risks, and to assess and report on their contribution to international efforts to cap global warming and to supporting France's energy transition targets. They must describe how they take into account issues, such as changes in the availability and price of natural resources, policy risk related to the implementation of international climate targets, and the soundness of capital expenditure for developing fossil fuels.[37] They must also set their own targets to assess their contribution to meeting international and French energy transition targets, and report on actions taken to achieve these targets, including divestment, changes made to investment strategy, engagement with issuers, and increases in investments made to thematic funds, securities or assets which contribute to the energy transition.[38]

Recommendation 3: In developing targeted regulations and/or guidance notes to inform carbon risk disclosure by Australian companies, attention should be given to the required governance arrangements for effective implementation and enforcement. This may include resourcing the relevant bodies to properly monitor reporting and where necessary enforce compliance.

Recommendation 4: Emerging frameworks in leading economies for carbon risk disclosure should be closely reviewed as a potential template for targeted, specific disclosure requirements designed to support a range of broader corporate energy transition measures in Australia.

Part 4: Current carbon risk disclosure practices within corporate Australia

Previous investigations of corporate sustainability reporting have suggested that Australian companies have been laggards in the area of voluntary reporting,[39] with limited scope and questionable quality of information reported.[40] In terms of climate risk reporting, Shearing found a comparatively poor response rate among Australian companies to CDP requests in 2010/11 for climate change information. She argues that the quality and extent of disclosure by Australian companies to CDP has been variable.[41]

The most recent report of the CDP (2015) notes that from 2010 to 2015 there has been no increase in the number of Australian companies reporting to CDP and significantly more non-responders than responders among the companies targeted by CDP.[42] However the quality of reporting has improved (e.g. independent verification of emissions reporting) and companies are also reporting significant improvements in performance (e.g. adoption of emissions reduction targets; reductions in scope 2 emissions).[43] Only two

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[34] For further information and an analysis of the implementation challenges, including the extent of qualitative and quantitative reporting required, see: 2 Degree Investing Initiative, *Decree implementing Article 173 VI of the French Law for the Energy Transition: Challenges and First Recommendations* (August 2015).
[35] Defined as exposure to the physical impacts directly induced by climate change.
[36] Defined as the exposure to changes caused by the transition to a low-carbon economy.
[37] http://www.ipe.com/countries/france/france-aims-high-with-first-ever-investor-climate-reporting-law/10011722.fullarticle.
[38] 2 Degree Investing Initiative, Final Decree on the Implementation of Art. 173 of the French Law on the Energy Transition for Green Growth – Climate and ESG disclosure from Institutional Investors, (translation from the French Interpretive Guidance, available at http://2degrees-investing.org/IMG/pdf/2ii_art173_decree_final_en.pdf)
[39] See Bubna-Litic (2007), above n 7.
[40] See also Australian Council of Superannuation Investors (ACSI), *Sustainability Reporting Practices of the S&P/ASX200 as at March 2011* (2011).
[41] See Shearing (2012) above n 7, at 483.
[42] CDP, *CDP Australian Climate Leadership Report 2015*. In 2015, 135 of companies approached by CDP did not respond to the request for climate disclosure; 99 did respond. See p 19-23.
[43] Ibid.

Australian companies were listed in CDP's global Climate A List 2015, which recognises the highest ranking scores for performance and disclosure.[44]

A detailed analysis of how carbon risk is currently incorporated by Australian companies into mainstream financial reports, if at all, was beyond the scope of this submission. However, as far as the authors are aware, this has not been an issue that has been pursued proactively by Australian regulators (ASIC and APRA) and we found no evidence of any investigations that have been conducted into potentially misleading or false disclosure in this area.

Part 5: Relevance for Australia of the G20 Financial Stability Board discussions on carbon risk impacts for financial stability

A key development for investors arising from the Paris climate conference was the establishment of the Financial Stability Board's Task Force on Climate-related Financial Disclosures to develop voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders.[45] On Friday 1 April 2016, the Task Force is scheduled to release its report on voluntary disclosures. This report is expected to contain 'high-level objectives' for the development of guidelines, as well as a set of 'fundamental principles of disclosure,' that will set the stage for a report at the end of the year containing recommendations for specific reporting practices.[46]

The G20's recognition of the risks to global financial stability posed by climate change is significant and confirms that carbon risk is increasingly viewed as a mainstream business issue. This process is expected to build on the international efforts discussed above in achieving more comprehensive and standardised carbon risk disclosure. However, as the Climate Institute argues, it will be important for Australia to focus also on the particular situation of the Australian economy and financial system. With its carbon intensive nature and high vulnerability to the physical impacts of climate change, the Australian economy is particularly exposed to these financial risks.[47]

These international developments and the particular Australian situation underscore the recommendations made in this submission, that targeted domestic regulation in this area is needed to ensure that investors and other financial market participants can obtain quality, relevant information that allows them to act on and minimise carbon risk exposure.

Part 6: Other Related Matters

The terms of reference for this Inquiry focus on disclosure of *carbon risk*. We have used a reasonably broad interpretation of this term - *'financial exposure to the risk of carbon emissions or carbon-intensive assets being priced, regulated, stranded by technology or incurring legal risk'* (see n 1) - that includes risks

[44] CDP, *CDP Global Climate Change Report 2015*, pp 10-11, 13. To be ranked in the A list, climate change reporting must be available to the public, and maximum points must be scored for greenhouse gas reduction and independent verification of reporting. See also the annual Glocal Climate 50 rankings of the Asset Owner's Disclosure Board, http://aodproject.net/climate-ratings/aodp-global-climate-500-index.

[45] https://www.fsb-tcfd.org/. The Financial Stability Board was established by the G20 in 2009 to monitor and make recommendations about regulation of the global financial system.

[46] D. Kahn, ''Tipping point' seen for climate risk disclosures', *Climate Wire*, Mar. 30, 2016.

[47] For example, the carbon-intensive resource sector is particular sensitive to international demand for export commodities; and the banking sector has a heavy concentration of residential property assets, which have high exposure to climate change hazards, such as rising sea level, and extreme weather events. See discussion in The Climate Institute (2015), above n 1.

associated with the future regulation and pricing of carbon emissions and also the particular financial, legal, transition risks posed by stranded carbon assets. This framing does not, however, include the broader profile of physical risks posed by climate change to Australian businesses whose assets or supply chains may be vulnerable to impacts, including sea level rise, storm water inundation, heat stress, drought and water scarcity. However, these impacts are clearly relevant to any assessment of material risks facing Australian enterprises and are likely to impact on corporate value into the future.

There is considerable work being undertaken at an international level to develop consistent understandings of terms such as *carbon risk* and whether and how it should be distinguished from other aspects of climate risk;[48] and the work of the FSB will be important in this respect. For the purposes of this Inquiry, it is notable that disclosure regimes in both France and United States are broadly targeted to include both physical and transition risks associated with climate change. Given the extent of exposure in the Australian economy to broader climate risks, it would be advisable for the committee to specifically consider these definitional and framing issues when considering regulatory and policy reforms.

Part 7: Conclusions and Recommendations

There is evidence from existing voluntary international schemes that carbon risk disclosure is effective in achieving market transparency and supporting investor action on carbon risk, as well as encouraging companies to identify and manage these risks. Yet voluntary reporting only captures information from a sub-set of corporations that are leaders in this area and it is difficult to achieve standardised, comparable data that is relevant for external stakeholders, such as investors. Further, there is limited and variable uptake among Australian companies.

Given that the Australian economy and financial system are particularly vulnerable to risks associated with climate change, particularly risks associated with stranded carbon assets, and leading economies around the world are now adopting mandatory climate risk disclosure frameworks, there are strong arguments for reform of the Corporations Act and associated regulations to require Australian companies to measure and disclose their carbon risks.

Improving carbon risk disclosure is in the medium to longer-term interests of corporations in all sectors of the Australian economy. Greater transparency leads to increased incentives for technological innovation and investment and more efficient decision-making. While voluntary efforts at the international scale have, to date, achieved considerable momentum in bringing the private sector on board, regulatory monitoring and oversight at the national scale would facilitate broader adoption, and more comprehensive and targeted carbon risk disclosure, that can provide the information required to support the transition to clean energy practices.

[48] See for example, World Resources Institute and UNEP Financial Initiative, *Carbon Asset Risk Discussion Framework* (2016); CERES et al, *Carbon Asset Risk: From Rhetoric to Action* (2016).

Recommendation 1: The Australian Government should introduce specific regulations and accompanying policy guidance to facilitate effective reporting of carbon risk as a stand-alone matter within the mainstream reporting under the Corporations Act. This could be carefully targeted to companies with high carbon risk profiles to maximise the regulatory impact and minimise costs for the private sector. As an interim measure, a Guidance Note providing a broad interpretation of the existing financial reporting rules should be developed to make it clear that carbon risk should be specifically disclosed as part of broader mainstream reporting.

Recommendation 2: The Australian Government should refer to developments in voluntary disclosure at the international scale, particularly recent efforts to develop standardised metrics and sector specific guidelines, when considering regulatory options to introduce mandatory and standardized reporting requirements for carbon risk.

Recommendation 3: In developing targeted regulations and/or guidance notes to inform carbon risk disclosure by Australian companies, attention should be given to the required governance arrangements for effective implementation and enforcement. This may include resourcing the relevant bodies to properly monitor reporting and where necessary enforce compliance.

Recommendation 4: Emerging frameworks in leading economies for carbon risk disclosure should be closely reviewed as a potential template for targeted, specific disclosure requirements designed to support a range of broader corporate energy transition measures in Australia.

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