ACSI

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General Manager, Policy Development
Policy and Advice Division
and
[redacted]
Head of Climate Risk
Australian Prudential Regulation Authority

Email: PolicyDevelopment@apra.gov.au

Dear [redacted]

DRAFT PRUDENTIAL PRACTICE GUIDE (PPG) ON CLIMATE CHANGE FINANCIAL RISKS

On behalf of the Australian Council of Superannuation Investors (ACSI), thank you for the opportunity to make a submission in relation to the draft Prudential Practice Guide CPG 229 Climate Change Financial Risks ('the PPG').

About ACSI

Established in 2001, ACSI exists to provide a strong voice on environmental, social and governance (ESG) issues on behalf of our members, which include 36 Australian and international asset owners and institutional investors. Collectively, our members manage over $1 trillion in assets. Our members believe that ESG risks and opportunities have a material impact on investment outcomes. Our interest is in promoting the sustainable performance and financial success of companies over the long term in the best financial interest of our members' beneficiaries.

Summary of ACSI's position on the PPG

ACSI welcomes the PPG, which clearly captures the systemic nature of climate risk and provides guidance on effective management of the risks by APRA-regulated institutions ('institutions'). The PPG provides sensible guidance that will be useful for institutions as they equip themselves with appropriate risk management and mitigation systems.

The PPG effectively frames the responsibilities of the board and senior management in managing climate risk and recognises that roles and responsibilities will appropriately vary across institutions. We support the PPG's guidance that 'climate risks can and should be managed within an institution's broader risk management framework' (p8). This reflects the importance that climate risk management is not treated in a siloed manner, but rather managed holistically as part of an institution's overall management of risk.

We recognise that understanding of effective management of climate risk continues to evolve, so it is important that APRA's guidance is flexible enough to reflect increasing maturity over time.

While we support the PPG, we also suggest how the PPG can be strengthened. Our key recommendations are in bold below.

I trust our comments are of assistance. Please contact me or [redacted], ACSI's Executive Manager – Public Policy and Advocacy, should you require any further information on ACSI's position.

Yours sincerely

[redacted]

Chief Executive Officer
Australian Council of Superannuation Investors

Suggestions for further consideration

Scenario analysis

We welcome the PPG's recognition of scenario analysis as a useful for understanding risk. The sections on scenario analysis in the PPG could be enhanced by:

- **Including the section on scenario analysis within the section on risk management.** Scenario analysis is a useful tool for institutions to better understand climate risks. It should not be considered a tick-the-box compliance issue, but rather a helpful process to assess risk and to help institutions to develop their plans and targets. APRA should consider reflecting this clearly in the PPG by discussing scenario analysis as a sub-set of risk management. This could be reinforced by having the section on scenario analysis sit within the section on risk management.
- **Emphasising that scenario analysis should be tailored and appropriate to a specific institution and its stakeholders.** The PPG should recognise that different sectors and institutions may take different approaches to scenario analysis, while still recognising that some scenario analysis principles (those that are already captured in the PPG) have application broadly.
- **Including reference to a 1.5 degree scenario.** We support the references to both physical and transitional risks, as well as a scenario that reflects the absence of mitigating actions (eg. 4˚C). The PPG should additionally include reference to a 1.5 degree scenario as one of the suggested scenarios, given that the Paris Agreement set 1.5 degrees as the limit for global warming in the long-term,[1] and this target is increasingly recognised by industry.[2]
- **Encouraging disclosure of the key assumptions used in scenario analysis.** We agree with APRA's acknowledgement that institutions will be at different stages of sophistication in their scenario analysis. Despite this, institutions should be continuing to build their capacity for robust scenario analysis. APRA should guide institutions to disclose the key assumptions that they use in scenario analysis,[3] and explain why their approach is reasonable and appropriate for the institution's circumstances.
- **Reflecting the importance of engagement and stewardship**. One of the most important ways that institutional investors can understand the climate risk in their portfolios is through engagement with their investee companies (and asset managers), to encourage robust scenario analysis and disclosure from those entities. APRA should therefore consider reflecting in the PPG the importance of this engagement, to better inform institutions' assessment of risk.
- **Considering the impacts of transitions on stakeholders.** APRA should consider noting that institutions can support a more just and equitable transition by taking employees, communities and other stakeholders into account in scenario analysis and planning, to the extent that this is relevant and feasible.

Disclosure

Robust disclosure is an important factor contributing to certainty in the market, enabling institutions to better understand their risk and make informed decisions. Institutions should be disclosing in relation to their climate risk management in a way that is clear and useful for their stakeholders.

We support the PPG's acknowledgement of the TCFD framework as a sound basis for disclosure. In the ASX 200, 86 percent of banks and 33 percent of financial services (including insurers) have adopted TCFD. This progress is promising, but there are still a number of institutions yet to adopt the TCFD framework.

Given the wide and growing support for TCFD-aligned disclosure both in Australia and internationally, we recommend that the PPG:

- **Include a more explicit statement that TCFD-aligned disclosure is better practice**. This will also align institutions with emerging international requirements and moves to mandatory TCFD disclosure regimes. Having a more standardised framework of disclosure would facilitate comparative assessment of activities across the market, which could help institutions to make better informed decisions and improve market confidence. Likewise, disclosing according to one standardised and accepted framework will be less burdensome for institutions than disclosing according to multiple different frameworks.
- **Acknowledge that TCFD disclosure should be proportionate.** APRA-regulated institutions that are most exposed to high-risk sectors should be disclosing in more detail on their climate risk. A staged approach to TCFD disclosure is also appropriate, to allow institutions to build competency.[4]

[1] Climate Analytics briefing, 'Paris Agreement 1.5 °C Temperature Limit'.
[2] For example, in the recent IEA report, 'Net Zero by 2050', May 2021.
[3] This is also recommended by the TCFD in its 'Proposed Guidance on Climate-related Metrics, Targets, and Transition Plans', June 2021.
[4] APRA may wish to consider the helpful recommendations in the report by IGCC, CDP and PRI, 'Confusion to Clarity: A Plan

Certain institutions may also consider incorporating effective management of climate risk into remuneration policies (noting that this will not be relevant to all institutions). This aligns with APRA's existing guidance, which makes clear that institutions should have remuneration policies that align remuneration with sound risk management.[5] Therefore we recommend that the PPG reflect that:

- **Where relevant, good disclosure will include any links between remuneration practices and climate risk management**: If institutions incorporate climate risk management into their remuneration practice, the PPG could encourage those institutions to disclose how they do so.

<u>Alignment with SPG 530</u>

We note that APRA is proposing to review and update SPS/G 530 in relation to consideration of ESG factors in formulating investment strategy. Currently, SPG 530 does not distinguish between ethical investing and ESG integration. Ethical investing attempts to balance the desire for returns with an investor's values by excluding investments that are inconsistent with those values (for example, excluding investments in certain industries). In contrast, ESG integration is based on research that demonstrates that ESG risks are financial, and therefore that investments will perform better over the long term when ESG risks and opportunities are appropriately managed. As APRA makes clear in this PPG 229, climate change gives rise to physical, transitional and legal risks that are all financially material, therefore we note the relevance of the review of SPS/G 530 to PPG229.

for Mandatory TCFD-Aligned Disclosure in Australia', June 2021. This includes the recommendation to set up a taskforce to consider the phase-in of mandatory TCFD-aligned disclosure, coordinated by the Council of Financial Regulators.
[5] APRA Prudential Standard CPS 510. This connection between remuneration policies and climate risk is also reflected by the TCFD in its 'Proposed Guidance on Climate-related Metrics, Targets, and Transition Plans', June 2021.