30 July 2021

General Manager, Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority

PolicyDevelopment@apra.gov.au

Prudential Practice Guide: Draft CPG 229 Climate Change Financial Risks

Australian Ethical Investment welcomes the opportunity to make a submission on the draft Prudential Practice Guide PG 229 on Climate Change Financial Risks.

Who we are

Australian Ethical Investment Limited was established in 1986 to manage the savings of Australians in an environmentally and socially responsible way. Today we manage over $6 billion in superannuation and managed funds for over 60,000 Australians. Our ethical investment approach aims to deliver strong financial performance alongside value for all beings for all time by shaping a future that better serves people and the planet.

Importance of climate risk management and disclosure across the financial system and economy

Climate change is a systemic threat to the financial system, and more broadly to the short and long term interests of people, animals and the environment. An effective response to this threat requires climate-aware decision making by citizens, consumers, companies, financial institutions and governments. Good quality climate disclosure is needed to inform these climate-aware decisions, and to promote the urgent increase in capacity and action needed to address the climate threat.

More specifically in the financial sector, there is a two-sided need (1) for access by financial institutions to improved climate-related information to allow better analysis of the multi-faceted risks and opportunities associated with climate change, and (2) for financial institutions to better manage and report on their climate-related risk and opportunity.

APRA's proposed CPG 229 will play an important role to help meet these needs. **We strongly support the guidance, as well as the recommendations made in the submissions of the Investor Group on Climate Change (IGCC) and Financial Services Council (FSC) to clarify and supplement APRA's draft guidance.**

In particular we support the swift phasing in of mandatory climate disclosure in accordance with the TCFD framework, and the plan to achieve that outlined in the IGCC paper '*Confusion to clarity: A plan for mandatory TCFD-aligned disclosure in Australia*'.

In addition, we recognise the need for careful attention to be paid to the alignment between the content and objectives of CPG 229 and (1) benchmarking under the *Your Future Your Super* legislation and (2) the treatment of ESG considerations under SPG 530 on Investment Governance. We provide some additional comments and suggestions on achieving this alignment in the balance of our submission.

Your Future Your Super (YFYS) benchmarking and SPG 530

Commentary on the YFYS benchmarking has identified the risk that it may encourage superannuation trustees to invest in the nominated benchmark passive indices, which may not be consistent with achievement of the best risk-adjusted returns for members. Specifically in relation to climate risk, there is the concern that the nominated benchmarks and the 8-year time horizon may inhibit Paris-aligned investment management approaches which are targeting superior longer term financial outcomes for members. There are related concerns that SPG 530 fails to adequately recognise the financial risks and opportunities associated with ethical and ESG (including climate) considerations.

We appreciate the merits of benchmarks constructed from the historical performance of credible and broad mainstream market indices. However, there are obvious limitations to the guidance that such indices may provide for future performance, in particular in an environment which includes new or emerging systemic risks and risks which require collective action to address most effectively.

To take a simplistic climate example, suppose that a global crisis of some sort triggers a slowing or reversal of climate action by governments, associated with an extended period of relative strong financial performance by high emissions parts of the economy and by corporate climate-laggards. YFYS may then make it more likely that super funds with investment strategies aligned with net zero by 2050 are labelled as underperformers, encouraging outflows from those funds and discouraging climate action more broadly, and so increasing the likelihood of higher levels of global warming and its adverse consequences for risk adjusted returns.

This example illustrates the basic problem of dealing with challenges like climate change whose solutions require collective action by a sufficient percentage of action-takers, and which allow "free-riders" to reap the benefits of the solutions without contributing to them. We believe this problem can be met by finding ways to encourage a virtuous cycle of positive-climate action by super funds (and citizens, consumers, companies, other financial institutions and governments), and to discourage a vicious cycle of obstruction of climate action.

In the case of YFYS benchmarking, for example, APRA should consider the circumstances in which it may be appropriate for Paris-aligned investment benchmarks to be used when assessing the performance of funds meeting Paris-aligned investment criteria.

In relation to SPG 530, it would be valuable for the guidance to recognise that a narrower, shorter term risk focus can promote poor investment outcomes by discouraging consideration of factors like climate change and excessive inequality which threaten major social and economic dislocation. The guidance could also usefully address expectations for the type and level of analysis expected from funds to support strategies which incorporate ethical- and ESG-based exclusions and stewardship strategies, aligned with the best financial interests of beneficiaries.

If you have any questions about our submission please contact our Head of Ethics Research, [redacted] We are very happy to discuss our views further.

Yours sincerely

[redacted]

Chief Executive Officer
Australian Ethical Investment

Australian Ethical Investment Ltd | ABN 47 003 188 930 | AFSL 229949 | GPO Box Centre Sydney, GPO Box 8, Sydney NSW 2001
T 1800 021 227 (8:30am to 5:30pm AEST Mon-Fri) | **E** enquiries@australianethical.com.au | australianethical.com.au