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30 July 2021

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

via email: PolicyDevelopment@apra.gov.au

Dear Sir,

Aware Super supports the ***Prudential Practice Guide CPG 229 Climate Change Financial Risks*** in providing AFS licensees a useful benchmark and resource to manage climate-related financial risks across key areas:

1. governance,
2. risk management,
3. scenario analysis, and
4. disclosure.

We also welcome the flexibility this Guide provides in allowing each institution to adopt an approach that is appropriate for their size, member base and business strategy. The application of the PPG in line with the Task Force on Climate-Related Financial Disclosure (TCFD) framework to ensure consistency and alignment with climate risk management practices more broadly (ie. scenario analysis) is also supported.

However, certain elements need further clarification and strengthening such as scenario analysis to ensure an alignment of regulation with industry expectations and global standards, as outlined in the points below, which are consistent with the feedback and recommendations provided by IGCC, ACSI and AIST. We have also commented on potential conflicts with Your Future Your Super legislation and alignment to *SPG 530 Investment Governance*

Our background, experience and credentials on mitigating financial risks associated with climate change are shown in **Attachment A: Aware Super's experience**. Recognising the urgency with which the economy must reduce carbon emissions to minimise serious temperature rises, the Aware Super *Climate Change Portfolio Transition Plan* has been designed to undertake activities in an authentic and meaningful way. Whilst implementation of our *Climate Change Portfolio Transition Plan* will be progressive, Aware Super seeks to ensure it is fulfilling its fiduciary responsibility by acknowledging and managing some key risks—now—that could have significant impacts on members' retirement savings in the future.

1. Governance

The guidance on governance is helpful in framing the responsibilities of the board and senior management in managing climate risk.

However, we note there is no mention of the performance-based components of remuneration which is covered by *Prudential Standard CPS 510 Governance* or potentially, its impact on *CPS 511 Remuneration*, which is relevant to the management of climate risk, and the role of the Board and the collaboration between Risk and Remuneration Committees on relevant matters.

Recommendations:

- Update the *Prudential Standard CPS 510 Governance* in the context of financial climate risk management and remuneration, making it clear that climate risk is a systemic financial risk and should therefore be included as one of the risks referred to in paragraphs 56-58 of CPS 510.

- Consider *Prudential Standard CPS 511 Remuneration* to define how climate risk is designed into remuneration arrangements, board pay scorecards and executive pay scorecards, to promote effective risk management, sustainable performance and long-term financial soundness.
- The Guide should make reference to Australian legal opinions including Noel Hutley SC and Sebastian Hartford on climate change and directors' duties (23 April 2021) and Noel Hutley SC and James Mack on superannuation trustee duties and climate change (16 February 2021) in terms of company directors potentially being found liable in the future for breaching their duty of care as a result of a failure to consider climate change risks.

2. Risk Management

The PPG seeks to clarify and strengthen risk management governance practices in relation to climate change financial risks for AFS licensees in line with existing standards, and whilst not enforceable, they are an essential pathway to a mandatory TCFD-aligned disclosure framework through legislation and integration with global climate disclosure standards. However, we suggest the following improvements.

Recommendations:

- Further information on how funds can approach investment target-setting and align portfolios, to meet the Paris-Agreement targets to:
  - assist providers of global benchmarks and funds to align with those benchmarks,
  - set baseline activity of APRA-regulated entities to global market expectations, especially relating to practice risk management and governance.
- Include an explicit reference to social (just transition) considerations of climate change for example in paragraph 33.

Supervisory guidance and regulatory expectations such as via APRA's PPG provide important incentives for superannuation licensees and other financial services organisations to consider climate risks within their existing frameworks, including the board-approved risk appetite statement, risk management strategy and business plan. These provide evidence of the entity's management of climate risk.

We note that APRA provides detailed guidance on good practice in each area in the CPG229. We suggest these should be explicitly considered in light of the pressure to achieve high net investment returns. (See Section 5 below.)

3. Scenario Analysis

Scenario Analysis is useful in better understanding and identifying climate risks; to explore our resilience to financial loss under a range of outcomes; and to strengthen management of climate risk. This is a developing area for most superannuation funds and requires advanced analytical capability. It would be useful to have access to external scenario analysis and stress testing capabilities, to inform our risk identification in the short and long term for a consistent 'industry-wide' approach (see Para 40 (e)).

Please note: APRA has referred to the **Technical Supplement** provided by TCFD on ***The Use of Scenario Analysis in Disclosure of Climate-Related Risk and Opportunities (June 2017)*** as a further guide on scenario analysis and stress testing.

However, the CPG229 should specifically identify a 1.5°C scenario (Paris Agreement preferred Long-Term Temperature Goal), and highlight the importance of transition and physical risks, as outlined in Figure 1 of the TCFD's Technical Supplement.

Recommendations:

- Paragraph 36: modify to draw a link between the requirement to undertake scenario analysis, and the acceptance that climate risk is a systemic financial risk with the potential to be a material financial risk to particular institutions.
- Paragraph 38: add further details for AFS licensees to disclose why an approach was considered reasonable for that particular institution, and to state assumptions and key parameters/signposts used to inform their analysis.
- Paragraph 39: change the wording to 'should consider' rather than just 'benefit from' to make it more actionable.
- Paragraph 40(a-g): requires clearer, actionable expectations that explicitly reference the Paris-Agreement scenarios such as the long-term temperature goal of 2°C—or its preferred goal of 1.5°C—as the global warming limit in the long-term. This would be consistent with emerging best practice and industry expectations. Further reference to net zero or Paris Agreement targets would be beneficial.

4. Disclosure

Aware Super supports the TCFD-aligned recommendations for climate-related financial disclosures, as this promotes a more informed understanding of climate-related risks and opportunities, to provide 'decision-useful' information for stakeholders and members.

Recommendations:

- Paragraph 47: revise the disclosure guidance at paragraphs 47 and 48 to more clearly articulate an expectation (albeit not a 'requirement') that institutions should disclose material climate risks in line with the TCFD recommendations is best practice.
- Paragraph 48: clarify that a prudent institution would use the international reporting TCFD framework and supporting measurement practices, methodologies and guidance to disclose information to ensure a standardised industry-wide framework of disclosure to facilitate comparative market assessment and certainty.
    - 80 companies in the ASX200 currently use the TCFD framework in 2020 reporting, and a further 18 are committed to disclose against it and 17 are reviewing it, impacting superannuation funds' ability to provide a consistent disclosure of climate risk as it pertains to underlying investments, in Australia alone.
- Reference to scenarios for physical risk disclosures under TCFD and the financial impact of climate change should be made for 2030, 2050 and 2090 as per the CMSI recommendation, given the long-term nature of superannuation as an investment, as well as within the next 5 years (to align with business planning).

5. Alignment with Your Future Your Super (YFYS) legislation

A key aspect of the recent YSYF legislation is the investment performance test.

We would encourage further consideration of the interplay between YFYS benchmarking and performance requirements and the management of the financial risks of climate change to avoid adversely impacting AFS licensees' ability to manage this risk in investment portfolios.

For example, currently, the 8-year benchmarking tests encourage investors to focus on a short-term return horizon which is misaligned to the effective management of systemic climate risk and potentially highly rated investment strategies that may outperform in the longer-term.

Recommendations:

- APRA can address this concern by clarifying how institutions implementing leading practice climate risk management in accordance with the PPG would not be penalised by requirements to track a benchmark based on historic data, which is not Paris-aligned.
- In addition, a definition of short and long term should be included and should be put in the context of Your Future Your Super performance benchmark timeframes.

6. Alignment to SPG 530

APRA makes it clear in PPG 229, climate change gives rise to physical, transitional, and legal risks that are financially material, so it is incongruent for SPG 530 to refer to environmental considerations as merely 'ethical'.

Recommendations:

- Update SPG 530 to ensure that it is consistent with this PPG and reflects the financial materiality of climate risk.

In summary, we support the intentions of PPG 229. We note that even in the month of July, extreme weather events across Asia, China, USA and Europe have contributed to loss of life and livelihood, destruction of property, infrastructure and assets. The PPG sets the groundwork for a consistent approach to financial risk management of climate change which will help protect superannuation members' future savings. Our recommendations and suggestions are made on the basis of providing additional clarity.

We are happy to be involved in further working groups or to work with your teams if further information is needed.

Yours sincerely

[redacted]

[redacted]

Chief Investments Officer
Aware Super

Attachment A: Aware Super's experience

Experience and credentials

Aware Super is pleased to provide feedback to APRA *on **Prudential Practice Guide CPG 229 Climate Change Financial Risks***. Aware Super shares the focus of Australian financial regulatory bodies on climate risk and disclosure, having advocated change since 2016 and established ourselves as an industry-leader in the identification and management of climate-related risks, specifically as it relates to our investment position.

In 2018, Aware Super (then First State Super) participated in Asset Owners Disclosure Project (AODP), an independent global not-for-profit organisation that rates and ranks the world's largest institutional investors and assesses their response to climate-related risks and opportunities. Our approach was recognised by the AODP, who awarded us a BBB-rating, making us the highest-ranking Australian super fund and 13th of 100 funds surveyed. We were also the highest-ranking fund in the Asia-Pacific region.

We are actively encouraging the transition to a low-carbon future, not just because of the risks to the environment, but because it makes good financial sense to support businesses that have a long-term, sustainable outlook, as this ultimately protects the assets and benefits the long term returns of our members. Our *Climate Change Portfolio Transition Plan* clearly sets out how we are integrating climate change risk into our investment policy framework. However, we acknowledge that more work needs to be done, beyond the confines of investment management alone, across all facets of operations at an enterprise-level.

Aware Super's investment position – response to financial risks of climate change

As one of Australia's largest super funds, our primary purpose is to deliver the best possible returns to our members. To achieve this, it's important to consider potential risks to our investment portfolios and do all we can to mitigate these risks.

By taking climate change into consideration in our investment decisions, our focus is driving better outcomes for members by mitigating risks and delivering long-term returns to members, which in turn drives a positive impact on the community.

Aware Super considers climate change to be a key risk to achieving long-term sustainable returns. We were one of the first Australian super funds to develop a systematic investment plan in 2016 that strategically responds to the risks and opportunities associated with climate change.

The issue of climate change requires urgent global attention and action. At Aware Super we understand our response to a changing climate needs to be agile to meet a wide range of potential financial risks and impacts on our investment portfolio and the world at large. Building on our 2016 plan, how we address the climate-related risks and opportunities in our investment holdings is detailed in our *2020 Climate Change Portfolio Transition Plan*.

Our *Climate Change Portfolio Transition Plan* is a framework of recommendations and targets that will focus our efforts on mitigating financial risks by:

- developing a decarbonisation pathway for our investment portfolio,
- transitioning our portfolio to lower climate change risk in our investments and, where required, helping those investments adapt to a changing climate, for example, working with our agricultural investments to help them adapt their practices to a warming and changing climate,
- proactively investing to capture opportunities in energy-efficient investments, that will emerge as we move towards a decarbonised economy, and

- lowering risk through actively managing and engaging with portfolio investments on their climate change transition pathway.

As part of our *Climate Change Portfolio Transition Plan*, again recognising the global economic risks arising from climate change, we committed to a number of targets and actions including:

1. Net Zero by 2050.
2. Divesting from businesses that derive more than 10% of their revenue from thermal coal mining by October 2020 – implemented.
3. A minimum 30% reduction in emissions in Aware Super's listed equities portfolio by 2023 via the introduction of new low-carbon indices - our calculations indicate that as at 30 June 2021 we had achieved a reduction of 45%.
4. An ongoing review of the Fund's energy portfolio mix to mitigate the potential for stranded assets.
5. Fund-wide targets for investments in renewable energy and new technologies.
6. Continued engagement with companies around their individual emission reduction targets and plans.
7. Setting emissions reduction targets and supporting Aware Super's directly owned companies to reduce their emissions.
8. Advocating and supporting an economy-wide 45% reduction in greenhouse gas emissions by 2030 and, looking to replicate across our portfolio in the same timeframe.

You can read more about our approach to climate change and read the Climate Change Portfolio Transition Plan on our website.
https://aware.com.au/content/dam/ftc/digital/pdfs/member/investments/Climate_Change_Portfolio_Transition_Plan.pdf