Ethical Partners
FUNDS MANAGEMENT
Level 6, Johnsons Building, 36 Grosvenor St, Sydney, NSW 2000
Ph: 02 8999 1228 www.ethicalpartners.com.au

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

By email: PolicyDevelopment@apra.gov.au

14 July 2021

Dear Sir or Madam,

Draft Prudential Practice Guide (PPG) on Climate Change Financial Risk

Thank you for the opportunity to provide feedback on APRA's draft Prudential Practice Guide (PPG) on Climate Change Financial Risk. We acknowledge the significant work undertaken by APRA to develop a guide to assist APRA-regulated entities in managing climate-related risks and opportunities as part of their existing risk management and governance frameworks. We are encouraged to see the increased industry awareness, understanding and management of climate risk that have resulted from the steps that Australia's financial regulators have taken to this point, and we applaud APRA's further efforts in this PPG to move further to address these risks.

This submission is on behalf of Ethical Partners Funds Management Pty Ltd (EPFM). EPFM is an Australian equities boutique specialist Ethical fund manager that currently manages over $2.5 billion in funds under management. The business founders Nathan Parkin and Matt Nacard have a combined 35 years' experience in financial markets.

Ethical Partners investment Process formally integrates environmental and social (ESG) factors directly into our screening to inform our investment universe, as well as our investment decisions, valuations, and portfolio construction. Optimum climate change disclosures and risk mitigation by Australian companies is therefore of utmost importance to our investment process. As such, we read the climate disclosures of every company in the ASX 200 and engage on climate change risk management with hundreds of companies a year. We believe that this gives us a valuable platform to be able to assess climate change financial disclosure and climate risk management across the ASX.

Ethical Partners also firmly believes that the economic impacts of climate change present real and material risks to the long term returns for our clients, as well as a systemic threat to the financial system. As a long-term institutional investor, managing money for several large institutional asset managers, Ethical Partners understands that climate change is one of the most significant investment issues and opportunities facing us today.

It is from this context that EPFM is grateful to have the opportunity to consider how APRA's draft Prudential Practice guidance may be beneficial within the context of our operations and business, as well as for the companies whom we invest in. We have also provided feedback on our observations on the draft PPG's overall applicability and flexibility, given the diverse institutions it is designed to assist.

EPFM welcomes the PPG which is a useful benchmark and resource for financial institutions.

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- Ethical Partners further applauds that APRA's Draft PPG highlights that the financial risks associated with climate change have a number of elements that distinguish them from other financial risks and require special attention including:
  - the potential for irreversible changes in climate, with impacts that may not easily be mitigated or reversed
  - the far-reaching impact to all parts of the financial system
  - the potential for risks to manifest across multiple lines of the business at the same time
  - the uncertain and extended time horizon over which climate risks may materialise, which extended beyond typical business planning cycles
  - the unprecedented nature of climate change which renders backward looking risk assessment methods inadequate.

- Ethical Partners also applauds the useful and relevant information in the Draft PPG such as:
  - articulating the nature of financial risks of climate change
  - providing guidance on governance, risk management, scenario analysis and disclosure.

- Ethical Partners also agrees with the IGCC that the "introductory material on financial risk of climate change outlines the nature of climate risk well, and provides useful guidance and expectations for institutions, including emphasising the need for a strategic approach to managing climate risk.

<u>Ethical Partners would also submit that as investors, we find the quantity and quality of climate-related disclosures currently inadequate for us as investors to effectively respond to and manage material climate risks and opportunities.</u>

- Given the urgency of the climate threat, we firmly believe that the existing voluntary approach to climate-related financial disclosure has proven to be insufficient. Thus, EPFM see that setting clear, mandatory requirements will help to align regulation with industry expectations and global standards and reduce existing burdens by reducing and streamlining decision-making.

- Recent analysis that Ethical Partners undertook on 216 ASX companies found that only 6/10 companies fully disclose their emissions footprint to their shareholders, and that approximately 3/10 companies are reporting fully against the TCFD. Less than 5/10 companies have set any emissions targets that are disclosed to shareholders.

- This is clearly inadequate for investors to be able to make informed decisions about company's climate risk management and mitigation, impact, decarbonisation plans, physical and transition risks and their potential financial impacts from climate change.

- As investors, we firmly believe that transparency, consistency and comparability of disclosures is crucial in order to make informed and efficient asset allocation disclosures, and it is clear that a voluntary approach to climate related disclosure has proven to be insufficient.

<u>Ethical Partners would further submit that the absence of adequate information on climate risk and opportunities is already contributing to systemic financial stability risks and barriers to investment in low-emissions and climate resilient economic activity.</u>

- We also believes that clearer reporting of climate risk management by Australian companies is crucial to maintaining international capital flows into Australian companies, as it brings our

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reporting standards in line with international markets that have already mandated the TCFD, and provides potential international investors with comfort about Australian companies ability to mitigate their risks and maximise their opportunities in the evolving low-carbon economy, particularly within the context of difficult policy negotiations on climate in the Australian context. We believe that this will be important to avoid potential market fragmentation caused by the rapid developments occurring in overseas markets.

<u>We believe that the draft PPG's structure and general guidance has overall applicability to the range of institutions that it is designed to assist.</u>

<u>We also see that structuring the PPG in line with the TCFD framework as practical to maintain consistency and alignment in reporting.</u>

<u>Ethical Partners would however suggest there is a need to clarify and strengthen some elements of the PPG, including on scenario analysis and disclosure and to phase in a mandatory TCFD-aligned regime overtime.</u>

- EPFM supports IGCC's recent paper, 'Confusion to clarity: A plan for mandatory TCFD-aligned disclosure in Australia' and the requirement for implementation of an economy wide mandatory TCFD-aligned disclosure regime. This report also notes the IGCC's support for APRA implementing the Draft PPG and for taking a proactive approach in this process. Ethical Partners, along with the IGCC firmly believes that supervisory guidance and expectations such as via APRA's PPG, while not enforceable, are an important part of the pathway to a mandatory TCFD-aligned disclosure.

- Ethical Partners believes that taking all steps possible to advancing the path to a mandatory TCFD is crucial. Ethical Partners would submit that APRA can play an important role, in coordination with the Australian Council of Financial Regulators, industry, government and standard setting bodies to achieve this goal. The experience with Modern Slavery Reporting has shown that mandating this reporting for companies has led to a marked increase in companies assessing, reporting on, and mitigating their risks of exposure to Modern Slavery. In comparison to the 3/10 companies currently reporting against the TCFD, our recent analysis found that 8/10 companies reported against the Modern Slavery Statements. This proportion of companies addressing Modern Slavery risk jumped markedly from the same research process conducted 2 years ago, before the introduction of mandatory reporting, where only 3/10 companies even mentioned Modern Slavery in their reporting or policies, let alone reported in a systematic fashion about their risks. We believe this clearly demonstrates the effectiveness and need for mandatory reporting on climate risk as well.

- We also believe that it would be valuable for PPG to include further commentary on <u>target setting</u> including Paris-aligned targets in the context of leading practice risk management and governance.

- In particular, the scenario analysis section could be clarified and strengthened to include reference to the need to apply a <u>Paris aligned scenario.</u> We also believe that it is important to further clarify the link between the need to undertake scenario analysis and systemic financial risk posing material financial risk to institutions, to clarify the need for transparency of an institutions decisions about what is 'appropriate to their circumstances', to make the guidance on use of qualitative scenarios clearer and more actionable and to include clear and actionable expectations around existing references to 'leading practice.'

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- Ethical Partners also observes that Remuneration is not specifically mentioned in the draft PPG. We believe that the section on governance could contain guidance making clear that climate risk is a systemic financial risk and could therefore be linked to climate risk management responsibilities and performance-based remuneration metrics.

- We would also welcome further commentary on management of a financial institutions' Scope 3 emissions and the social considerations of climate change related to a just transition.

- Ethical Partners would lastly submit that the Paragraphs 47 and 48 could be revised to more clearly articulate an expectation (albeit not a "requirement") that institutions disclose material climate risks in line with the TCFD expectations, and to clarify that an institutions applying better practice would use the TCFD framework and supporting guidance to disclose information. We believe that strengthening the PPG in these areas is important to reflect industry expectations and leading practice in relation to disclosure expectations.

Once again, we applaud APRA on the development of the Draft PPG, and we thank you for the opportunity to respond to the Draft PPG and for considering EPFM's feedback.

Kind regards,

[redacted]

[redacted]
CEO, Ethical Partners Funds Management

[redacted]

[redacted]
Investment Director, Ethical Partners Funds Management