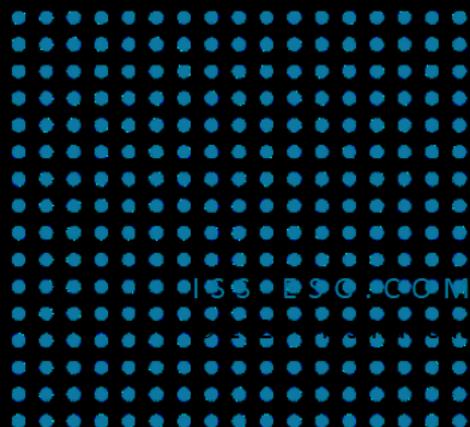


ISS ESG Submission+ to APRA



ABOUT ISS ESG

ISS ESG is a division of Institutional Shareholder Services (ISS). Founded in 1985, ISS empowers investors and companies to build for long-term and sustainable growth by providing high-quality data, analytics and insight. ISS, which is majority owned by Deutsche Bourse AG, along with Genstar Capital and ISS management, is a leading provider of corporate governance and responsible investment solutions, market intelligence, fund services, and events and editorial content for institutional investors and corporations globally.

ISS' approximately 2,200 employees operate worldwide across 29 global locations in 15 countries. Its more than 4,600 clients include many of the world's leading institutional investors who rely on ISS' objective and impartial offerings, as well as public companies focused on ESG and governance risk mitigation as a shareholder value enhancing measure. Clients rely on ISS' expertise to help them make informed investment decisions.

ISS ESG solutions enable investors to develop and integrate responsible investing policies and practices, engage on responsible investment issues, and monitor portfolio company practices through screening solutions.

ISS ESG also provides climate data, analytics, and advisory services to help financial market participants understand, measure, and act on climate-related risks across all asset classes. In addition, ESG solutions cover corporate and country ESG research and ratings enabling its clients to identify material social and environmental risks and opportunities.

INVESTOR GROUP ON CLIMATE CHANGE

ISS is a member of the Investor Group on Climate Change (IGCC). We note the IGCC's recent submission on this topic and strongly support the IGCC's broad policy messages. We further emphasize our support of the IGCC's comments in relation to the alignment of CPG 229 with the Your Future Your Super legislation and SPG 530.

KEY POLICY MESSAGES

- ISS welcomes the PPG, which will serve as a critical benchmark and resource for financial institutions in the prudent management of material climate change risks.
- ESG research providers like ISS ESG are able to provide [high quality proxies for published data](#) to assist our clients in conducting climate scenario analysis on a company and portfolio level; however, financial institutions have necessarily more detailed insights into their own operations, with the unique capacity to assess the climate risks of the entirety of their lending, investment and underwriting portfolios.
- The quantity and quality of current disclosures by financial institutions - particularly in relation to Scope 3, financed emissions - is inadequate for investors to respond effectively to material climate-related risks and opportunities, and for governments and financial regulators to suitably address [systemic risks](#) to the stability of the financial system.
- In order to achieve an efficient allocation of assets and an orderly transition to net zero emissions by 2050 ([cited](#) by the UNFCC and the IPCC as necessary to achieve the 1.5 °C temperature goal laid out in the Paris Agreement with no or limited overshoot), there is an urgent need for transparency, consistency and comparability of disclosures. A voluntary approach to climate-related financial disclosure has proven insufficient.
- It is therefore critical for APRA, in collaboration with Australia's other financial regulators, to take part in establishing clear and mandatory reporting requirements in order to protect the stability of the financial system and remain in step with global developments and investor expectations.
- The alignment of the PPG with the TCFD recommendations is an appropriate and necessary step in the [phased implementation of mandatory climate risk disclosures](#).

COMMENTS ON THE DRAFT PPG

Governance

Comment

- This section suitably highlights the integral role of board-level oversight of climate risks, supported by clear structures and responsibilities among both the board and senior management.
- Notably absent, however, is any mention of remuneration. In line with [Prudential Standard CPS 510 Governance](#), Paragraphs 56-58, a prudent financial institution will adjust performance-based remuneration components in order to support the institution's long-term financial soundness, with specific reference to management of risk. In light of the increasing materiality of financial risks arising from climate change, it may be necessary and appropriate to explicitly draw a line between CPS 510 and governance of climate risks.
- Furthermore, [analysis](#) conducted by ISS ESG suggests that sound management of ESG issues, including climate change, has the capacity to enhance a company's financial performance. It is thus all the more appropriate to consider highlighting the connection between remuneration and management of climate risk - with the potential for both positive and negative remunerative consequences.
- The links between remuneration practices and sustainability objectives are discussed in the ISS ESG Thought Leadership paper entitled: [Is Your Board ESG-Competent? Questions Investors Should Be Asking About Director Sustainability Competencies in 2021](#)

Recommendations

- ISS recommends that this section should address the topic of remuneration, with reference to CPS 510.

Risk Management

Comment

- The guidance provided in this section is useful and appropriate, particularly given the range and complexity of business models the PPG seeks to address.

Background for Recommendations

- For financial institutions, financed emissions (Scope 3) constitute the vast majority of emissions profiles, and are thus of the utmost salience. Measuring these emissions is a critical foundation for the effective management of climate change risks, e.g. through scenario analysis and target-setting.
- Measuring and reporting on financed emissions continues to be impeded by the availability and accuracy of data as well as an absence of harmonised methodologies.
- In light of these challenges, the PPG would be enhanced by providing more detailed guidance on the measurement of Scope 3 financed emissions and the possible implementation of portfolio-

level targets that establish a pathway aligned with emissions reductions resulting in net zero emissions by 2050.

- The Partnership for Carbon Accounting Financials ([PCAF](#)) recently released a harmonised global accounting standard for financed emissions. The [PCAF Standard](#) has been reviewed by the GHG Protocol and conforms with the requirements set forth in the Corporate Value Chain (Scope 3) Accounting and Reporting Standard for Category 15 investment activities.
- Moreover, the PCAF methodology has been adopted by the [Science-Based Targets Initiative](#) (SBTi), which this year released a [methodology](#) to allow financial institutions to develop science-based targets at the asset class level. Though data quality and availability remains an issue, PCAF notes: “Data limitations should not deter financial institutions from starting their GHG accounting journeys. Beginning with estimated or proxy data can help identify carbon-intensive hotspots in lending and investment portfolios.”
- For a more detailed discussion of science-based targets and measuring financed emissions, see ISS ESG’s [discussion piece](#) on the topic.

Recommendations

- In relation to Paragraphs 27-28: more detailed guidance should be provided in relation to measuring Scope 3 financed emissions.
 - To support the consistency and comparability of data, a paragraph should be inserted noting PCAF as a suitable methodology for measuring financed emissions (in the same vein as Paragraph 42).
- In relation to Paragraphs 32-33: more explicit emphasis on the role of net zero-aligned targets is appropriate.
 - To support the consistency and comparability of data, a paragraph should be inserted citing various third-party methodologies as suitable options for net zero-aligned target setting. These may include the IIGCC’s [Net Zero Investment Framework](#), the Net Zero Asset Owner Alliance’s Inaugural [Target Setting Framework](#) and the SBTi’s [Financial Sector Science-Based Targets Guidance](#).

Scenario Analysis

Comment

- This section includes detailed and appropriate guidance; however, it would be enhanced by the use of stronger language and the inclusion of an explicit reference to a net zero by 2050 scenario, which is [cited](#) by the UNFCCC and the IPCC as necessary to achieve the 1.5 °C temperature goal laid out in the Paris Agreement with no or limited overshoot.

Recommendations

- In relation to Paragraph 36: stronger wording should be used to reflect the financial materiality of climate risk and ensure that CPS 229 is aligned with [CPS 220](#), Paragraph 24, which notes: “The risk management framework must include forward-looking scenario analysis and stress testing programs, commensurate with the institution’s size, business mix and complexity, and which are based on severe but plausible assumptions.”

- In relation to Paragraph 38: further detail should be added to promote transparency surrounding how institutions determine the financial materiality of climate risks in the context of their operations. For example (proposed wording in red):
 - 38. An institution in the early stages of climate risk analysis is likely to begin by developing an understanding of the material risks to which it is exposed, including identifying industries and regions with particular risks within the institution's portfolio. A range of analytical approaches, from simple to complex, are available to support an institution's understanding of their material climate risks; institutions should choose approaches appropriate to their circumstances **and maintain records and disclose why that approach was considered reasonable in the institution's circumstances. Institutions should also disclose the core assumptions and parameters/signposts that were relied upon.**
- Consideration should also be given to potential regulatory requirements for portfolio disclosure by Australian investors, as discussed in Chapter 2 of ISS ESG's research paper: [Volatile Transitions - Navigating ESG In 2021 \(ANZ Edition\)](#)
- In relation to Paragraph 39: it is pleasing to see the draft acknowledge alternative risk management approaches which may be implemented in the presence of limitations, and to note that approaches are expected to evolve over time. A minor wording adjustment, shown in red, is recommended to enhance the strength of this paragraph:
 - 39. Where an institution lacks the data, resources or expertise to conduct climate risk stress testing with appropriate quantitative assessments, it may still benefit from **and should consider** narrative-driven scenario analysis . Qualitative scenarios can still provide insights into the operations and channels of risk transmission, and findings from such an assessment can be reflected in business plans, strategies and risk management practices.'
- In relation to Paragraph 40. b.i): in light of the materiality of climate risk laid out in the section 'The financial risks of climate change,' it is necessary to explicitly refer to a net zero by 2050 scenario.
- Moreover, citing a target of net zero by 2050, which generally aligns with a 1.5°C pathway, is in line with emerging best practice and industry expectations, as well as international standards.
 - For example, the European Union's [guidelines on reporting climate-related information](#) note: 'Companies are encouraged to consider a 1.5°C scenario, in light of the conclusions of the IPCC 2018 Special Report.' (p.17)
- In relation to Paragraph 40. b.i) and b.ii): this paragraph would be enhanced by establishing clearer expectations, primarily by replacing 'could' with 'should.' Suggested wording is shown in red:
 - 40. b. i) Future temperature rise – scenarios **should** include:
 - 40. b. ii) Economic transition pathway – scenarios **should** include:

Disclosure

Comment

- As is addressed by the draft PPG, disclosure is an essential component of prudent risk management and should not be avoided even in the absence of certainty. Figure 1 of the PPG highlights the need for institutions to ‘implement proportionate... disclosure practices.’ Moreover, in order for disclosures to be useful to investors, they must be comparable and consistent. It is therefore appropriate to more strongly establish the expectation that institutions [report in line with the TCFD framework](#), reflecting current best practice and in line with international developments. While we acknowledge that APRA is limited in its capacity to impose disclosure requirements, it is nevertheless appropriate for APRA to establish clear, albeit non-binding expectations of prudent approaches to risk management.

Recommendations

- In relation to Paragraph 47: the wording should be revised to more clearly establish the expectation that institutions report against voluntary disclosure frameworks, in order to prudently and effectively manage risk. Possible revised wording is shown in red:
 - 47. Beyond any statutory and regulatory requirements, a prudent institution **would disclose its approach to measuring and managing climate risks in a manner that is clear and meaningful to its stakeholders. APRA encourages institutions to disclose the potential impact of material climate risks on the institution, including quantitative metrics such as exposure to sectors with higher climate risk.**
 - The proposed revision aligns with international expectations, for example as laid out in the [non-binding guidance](#) recently issued by the Monetary Authority of Singapore.
- In relation to Paragraph 48: APRA’s endorsement of the TCFD is well aligned with industry best practice and international developments. However, the wording could more strongly establish the expectation that institutions report in line with the TCFD framework. Possible revised wording is shown in red:
 - 48. **Better practice disclosures would be in accordance with well-regarded international reporting frameworks such as the TCFD recommendations and take account of generally accepted measurement practices, methodologies, and guidance.** APRA considers the framework established by the TCFD to be a sound basis for producing information that is useful for an institution’s stakeholders.

**We empower investors and companies to build
for long-term and sustainable growth by providing
high-quality data, analytics, and insight.**

SUCCEED WITH ISS ESG SOLUTIONS

Email sales@iss-esg.com or visit iss-esg.com for more information.

ISS ESG is the responsible investment arm of Institutional Shareholder Services Inc., the world's leading provider of environmental, social, and governance solutions for asset owners, asset managers, hedge funds, and asset servicing providers. With more than 30 years of corporate governance expertise and 25 years of providing in-depth responsible investment research and analytics, ISS ESG has the unique understanding of the requirements of institutional investors. With its comprehensive offering of solutions, ISS ESG enables investors to develop and integrate responsible investing policies and practices, engage on responsible investment issues, and monitor portfolio company practices through screening solutions. It also provides climate data, analytics, and advisory services to help financial market participants understand, measure, and act on climate-related risks across all asset classes. In addition, ISS ESG delivers corporate and country ESG research and ratings enabling its clients to identify material social and environmental risks and opportunities.

This document and all of the information contained in it is the property of Institutional Shareholder Services Inc. ("ISS") or its subsidiaries. The Information may not be reproduced or disseminated in whole or in part without prior written permission of ISS. ISS MAKES NO EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE INFORMATION.

© 2019 | Institutional Shareholder Services and/or its affiliates