Maritime Union of Australia

Submission to APRA

Response to Draft Prudential Practice Guide: CPG 229 Climate Change Financial Risks - of April 2021

30 July 2021

Introduction

The Maritime Union of Australia (MUA), an affiliate of the International Transport Workers Federation (ITF), is an active participant in Australian and global public policy discussion on the quality and performance of investment of workers' superannuation and pension fund savings.

We therefore take an active interest in the regulatory frameworks aimed at guiding superannuation and pension fund trustee directors in performing their fiduciary duty. We particularly focus on environmental, social and governance (ESG) risk.

In that context we welcome the opportunity to comment on APRAs Draft Prudential Practice Guide: CPG 229 Climate Change Financial Risks of April 2021.

Strengthening the Draft Guide – the human or social factor risk from climate change

We welcome the acknowledgement that transition risk induced by the adaptation response to climate change can lead to disruption to businesses and economic sectors such as assets becoming stranded or supply chains becoming disrupted. We similarly welcome the acknowledgement that this can lead to both operational risk such as forced facility closures, and reputational risk, including an institution's ability to attract and retain customers and employees due to changing employee and community expectations, or in response to policy drivers.

In that context we urge APRA to include in its guidance a reference to the human element or social factor risk from climate induced events and from industrial transitions, be they in energy, resources, transport, agriculture or tourism.

A UN Discussion Paper on the Social Dimensions of Climate Change noted that "*People are not only the victims of negative impacts of climate change; they are the drivers of climate change and the essential agents for redirecting development trajectories. This understanding – of the central role of people, social dimensions and institutions – should profoundly reshape the way in which policy-makers craft and implement climate change policy.*

It is especially compelling at this important juncture when many nations are committing to more robust mitigation and adaptation strategies, and the international community is deliberating core elements of the next climate change paradigm amid pressing expectations for concrete results.

At its most basic, climate change impacts people and response measures depend on people to be successful. Thus the social dimensions of climate change, the interplay between climate as a phenomenon, its related policy, and society – including the role of people as victims to and agents of climate change – are critical to successful climate policy. To date, however, the human variable of the climate equation has been too frequently missing or weak."[1]

The Paris Agreement itself acknowledged the importance of the social dimension. The preamble states that governments should take into account "*the imperatives of a just transition of the workforce and the creation of decent work and quality jobs in accordance with nationally defined development priorities*."[2]

A specific reference to a just transition in APRA Guidance

A report produced by the London School of Economics and Political Science reported that "*the just transition is a necessary agenda for investors to work on, one that is fully consistent with the fiduciary commitment to responsible investment and the integration of environmental, social and governance (ESG) dimensions in all decision making. The just transition is equally relevant for investors whether they are focused on the E or the S of ESG and reveals the need to bring these dimensions together. As fiduciaries, there are important contributions that can be made as stewards of assets, allocators of capital and influential voices in public policy. These now need to be deployed in a strategic fashion*."[3]

We therefore urge APRA to include in those sections of its guidance addressing risk management and in particular when referring to risk mitigation, a proposal that it would be prudent that a just transition be an important factor for an institution to consider as part of their risk mitigation planning.

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[1] United Nations Task Team on Social Dimensions of Climate Change: Discussion Paper, *The Social Dimensions of Climate Change*, https://www.who.int/globalchange/mediacentre/events/2011/social-dimensions-of-climate-change.pdf

[2] UNFCCC (2015) *The Paris Agreement*. http://unfccc.int/files/home/plication/pdf/paris_agreement.pdf

[3] The Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science in conjunction with the Initiative on Responsible Investment at the Hauser Institute for Civil Society at the Harvard Kennedy School, in partnership with the PRI, *Climate change and the just transition: A guide for investor action*, December 2018, https://www.unpri.org/download?ac=9452

The ACTUs Guidance on Securing a Just Transition says that "*Successful just transition planning will help achieve a fully employed, engaged and productive work force across the economy, which from an investment perspective means more productivity and better investment outcomes for the funds.*"[4]

The Guide sets out a three step process for investors to consider in their risk mitigation strategies:

- Step 1: Engage:
  - Ensuring social dialogue with workers and their unions, and potentially government; and,
  - Consulting broadly with key stakeholders such as communities.
- Step 2: Plan:
  - Collaborate to produce concrete, time-bound, asset level, business, and sectoral plans for a just transition, including emissions reductions, workforce, and community planning. Through this process of just transition planning the interests of long-term investors and their investments are better aligned, noting that company-level decisions to cut emissions can have effects - positive and negative - on workers and communities and might require hiring of additional workers, improving the skills of workers, redeploying workers, or early retirement of workers in high-emissions business areas.
- Step 3: Enact:
  - Deliver plans and advocate for broader action to promote just transition. Delivery of company plans should be accompanied by regular monitoring, reporting and social dialogue focused on accountability, results, and learning. Transparency towards workers, communities, other stakeholders, and shareholders is key. Company plans for just transition are most effective when they are tied to the broader context of action by other employers, local and regional governments, national governments, and investors. Companies should advocate and collaborate, individually and through organisations, for stronger collective just transition planning

The PRI which represents investors with over US$2.75 trillion assets under management, says that neglecting ESG issues can lead to asset owners mispricing risk and making poor investment decisions.[5] Furthermore, Principle 2 (of its 6 Principles) encourages PRI signatories to be active owners and incorporate ESG issues into their ownership policies and practices. PRI says that "*Active ownership is generally regarded as one of the most effective mechanisms to reduce risks, maximise returns and have a positive impact on society and the environment – for passive and active investors*."[6]

The London School of Economics report concluded that "*The evidence shows that the shift to a resilient, low carbon economy will boost prosperity and be a net driver of job creation. There will be transitional challenges, however, for workers, communities and countries as this shift takes place. To address this, investor strategies to tackle the growing threat of climate change need to incorporate the full range of environmental, social and governance (ESG) dimensions of responsible investment. As fiduciaries,*

[4] ACTU, *Securing a Just Transition: Guidance to assist investors and asset managers support a just transition,* February 2021, https://www.actu.org.au/media/1449436/securing-a-just-transition_feb2021.pdf

[5] Principles for Responsible Investment (PRI), *Investment Consultants and ESG: An Asset Owner Guide, https://www.unpri.org/asset-owner-resources/investment-consultants-and-esg-an-asset-owner-guide/4577.article*

[6] PRI, *A Practical Guide to Active Ownership in Listed Equity*, https://www.unpri.org/listed-equity/a-practical-guide-to-active-ownership-in-listed-equity/2717.article

investors can make an important contribution to achieving a just transition, as stewards of assets, allocators of capital, and as influential voices in public policy."[7]

The report set out five motivations for investor action which are aligned with core duties and interests of investors and also show that contributing to the just transition is a way for investors to deliver positive social and environmental impacts. The five motivations are:

1. Broadening the understanding of systemic risks from climate change, by factoring in issues such as social exclusion and increasing inequality.
2. Reinvigorating fiduciary duty by better capturing the interrelated environmental and social drivers of long-term performance and by taking better account of beneficiary interests in sectors and regions affected by the transition.
3. Recognising material value drivers in terms of corporate practices in the workplace and the broader social licence to operate business performance will be increasingly conditioned by the just transition.
4. Uncovering investment opportunities that combine climate and social goals such as inclusive growth, identified through the lens of the just transition.
5. Contributing to societal goals including existing responsibilities to respect international human rights and labour standards as well as new ways of realising the Sustainable Development Goals.

Based on these motivations, the report identifies five areas for action through which investors can make the just transition part of their core operating practices:

1. Investment strategy: Assessing exposure to the social dimension (including employment impacts) of the transition, pursuing dialogue with workers and other key stakeholders, and integrating just transition factors into investment beliefs and policies.
2. Corporate engagement: Including just transition factors in investor expectations, requesting disclosure, benchmarking performance, and pressing for improvement. The guide provides an initial set of questions for corporate engagement.
3. Capital allocation: Incorporating the social dimension into strategies for climate investment across all asset classes, including listed equities, bonds, private equity and real assets.
4. Policy advocacy and partnerships: Making the just transition a part of policy dialogue at sub-national, national and international levels as well as taking part in place-based partnerships.
5. Learning and review: Understanding emerging lessons and disclosing results so that the efficiency and effectiveness of investor action on the just transition continue to improve.

We believe that APRA should be incorporating these types of investor actions in its updated guidance.

The European Commission also regards mitigation of climate change as a means to create more jobs than it will cost, but notes that the changes will be sectoral. It says that realising employment opportunities will require substantial investment in employee skills and innovation and that it is important for the benefits and costs of low-carbon restructuring to be evenly shared across various sectors, occupations, population groups and regions.

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[7] The Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science in conjunction with the Initiative on Responsible Investment at the Hauser Institute for Civil Society at the Harvard Kennedy School, in partnership with the PRI, *Climate change and the just transition: A guide for investor action*, December 2018, https://www.unpri.org/download?ac=9452

The EU says successfully transitioning to a carbon-neutral society will not only require emission reduction measures and business and energy policies, but also employment, social welfare, education and regional policies and notes that the principle of a just transition will seek to meet these challenges. This means implementing emission reductions in a way that is fair to workers. It is about creating new, decent and sustainable jobs, in-service training for new employment, and security of earnings. The goal of a just transition is to increase the participation and commitment of workers in deciding policies for mitigating climate change nationally, regionally and within businesses, thereby promoting a smooth transition to a carbon-neutral society.

In December 2020, the European Parliament agreed to establish the Just Transition Fund, one of the three pillars of the Just Transition Mechanism (JTM) which is part of the European Green Deal to create a climate-neutral economy in Europe by 2050. Among other things it is designed to address the social aspects of the transition, in particular the creation and safeguarding of jobs.[8]

We urge APRA to consider social and human risk in finalising its guidance on managing the financial risks of climate change, and in so doing recommend that institutions place a just transition lens on their investment risk strategies so that the human and community impacts are factored into those risk assessments. This should be incorporated in the risk management, scenario analysis and disclosure sections on the guidance.

APRA inclusion of social risk will ensure consistency with other regulators

We note that ASIC says disclosing and managing climate-related risk is a key director responsibility because climate-related risk is a systemic risk in financial markets that has the potential to significantly impact companies, investors and consumers.

ASIC says its focus is on ensuring listed companies have appropriate governance structures in place to manage this issue, and providing the market with reliable and useful information on their exposure to material climate-related risks and opportunities.

ASIC also considers that the law requires listed companies to undertake an operating and financial review which includes a discussion of climate risk when it is a material risk that could affect the company's achievement of its financial performance.[9]

The Reserve Bank has concluded that "*climate change is exposing financial institutions and the financial system more broadly to risks that will rise over time, if not addressed. According to the Intergovernmental Panel on Climate Change (IPCC), it will take significant effort to limit global warming to 1.5°C above pre-industrial levels, as targeted in the Paris Agreement. Even if targets are met, this level of warming is likely to be accompanied by rising sea levels and an increase in the frequency and intensity*

[8] European Commission, Commission welcomes the political agreement on the Just Transition Fund, 11 December 2020, https://ec.europa.eu/regional_policy/en/newsroom/news/2020/12/12-11-2020-commission-welcomes-the-political-agreement-on-the-just-transition-fund

[9] Australian Securities and Investment Commission (ASIC), *Managing climate risk for directors*, https://asic.gov.au/about-asic/news-centre/articles/managing-climate-risk-for-directors/

of extreme weather (including storms, heatwaves and droughts). Some of these outcomes are already apparent. These changes will create both financial and macroeconomic risks."[10]

The Reserve Bank says that the financial risks arising from climate change can be classified as either:

- Physical: disruptions to economic activity or reductions in asset values resulting from the physical impacts of climate change;
- Transitional: the impact of changes in regulation or pricing introduced to facilitate a transition to a low-carbon economy; or
- Liability: an inadequate response to these risks also raises the potential for reputational and legal risk.

Importantly, the Reserve Bank notes that "*Banks (and other lenders) are also exposed to physical risks because climate change can result in a decline in the income or value of collateral that they are lending against. Such effects can go beyond the industries directly affected by climate change (such as agriculture and tourism), to the households and businesses that rely on income from those industries. Australian financial institutions that have exposure to carbon-intensive industries – such as power generation and mining, or to energy-intensive firms – will also be exposed to transition risk. Transition to a lower carbon economy can also affect institutions with exposures to individuals and communities reliant on these industries. Sudden or unexpected regulatory change could quickly lower the value of such assets or businesses, some of which may become economically unviable or 'stranded'. Such regulatory changes could either be domestic or come from abroad, given the carbon intensity of Australia's exports. Transition risk could also arise if large investment in technologies allowed new entrants to displace established but emissions-intensive practices, or if consumer preferences shifted rapidly towards 'green' products. If such changes occur abruptly, and certain sectors or firms face large losses, there could be broader dislocation in financial markets, despite the opportunities created for some firms from these changes.*

Transition risk will be greatest for banks that lend to firms in carbon-intensive industries and to individuals or businesses that are reliant on these firms. Other financial institutions investing in carbon-intensive industries, such as superannuation and investment funds, are also exposed to the risk that climate change will diminish the value of their investments. This could occur both through direct investments in carbon-intensive industries, or indirect investments in banks that lend to these industries.

Financial institutions may also face reputational damage if they are seen to be contributing to climate change or failing to manage climate risks. This could affect an institution's ability to retain customers and raise funding. Firms also face legal risks if directors fail to address the potential exposure of their firms to climate-related risks, according to the Hutley opinion (a landmark legal opinion on directors' duties in relation to climate change under Australian law)."[11]

The Australian Securities Exchange (ASX) reports that it is playing an important role in supporting a smooth and orderly transition to a low carbon economy by fulfilling its purpose as a marketplace for capital to be allocated and risk to be assessed and priced. Company reporting and disclosure is central to how capital is allocated and risk priced. ASX supports and promotes disclosure of material risks, including climate change risks, so that investors can make informed decisions when allocating capital.

[10] Reserve Bank of Australia (RBA), *Financial Stability Risks From Climate Change*, https://www.rba.gov.au/publications/fsr/2019/oct/box-c-financial-stability-risks-from-climate-change.html

[11] Ibid

In 2019, the ASX endorsed the Task Force on Climate-related Financial Disclosures (TCFD) framework as best practice disclosure for those companies that have a material exposure to climate change risks. The ASX says this endorsement has two important outcomes:

- For companies, it encourages self-assessment of their climate change exposure, which can have significant implications for their ability to create long-term value; and
- For investors, it allows meaningful comparison across companies, sectors and segments of the listed market. [12]

The opportunity for APRA

We note that APRA has made a tentative start to incorporation of social factor risk in other Prudential Guidance. For example, Prudential Practice Guide SPG 530 – Investment Governance of November 2013 includes at Clauses 34 to 36 environmental, social and governance (ESG) risks that it suggests investors should consider, though limited essentially to ethical investments; while Prudential Practice Guide SPG 220 – Risk Management of July 2013 refers to employment practices and work health and safety as material risks.

Given the extensive shift in understanding of social factor material risk and the considerably stronger commitment across the investment community to a raft of international frameworks such as the Guiding Principles on Business and Human Rights along with legislated requirements regarding modern slavery in supply chains that APRA should take the opportunity in settling a new Prudential Practice Guide on Climate Change Financial Risks to position itself at the leading edge by adopting robust guidance around a social factor risk and a just transition.

Benefits to workers

Members of the MUA work in sectors such as the offshore oil and gas industry and in the shipping aspects of manufacturing supply chains in energy intensive sectors where climate related transitions are like to have a disruptive effect on the companies in those sectors with subsequent employment, labour relations and community impacts. Many of the companies in those sectors are listed on the ASX and on other major global exchanges where Australian superannuation funds (and banks) and pension funds throughout the world will be invested.

MUA members would be among many worker beneficiaries if APRA were to provide clear guidance to RSEs to ensure they take into consideration the social factor risk of climate induced transitions, and to ensure those transitions are just and positive for affected workers.

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[12] ASX, *Corporate Governance Principles and Recommendations*, 4th Edition, February 2019, https://www.asx.com.au/documents/regulation/cgc-principles-and-recommendations-fourth-edn.pdf