PRI Principles for Responsible Investment

CONSULTATION RESPONSE

JOINT STANDING COMMITTEE ON TRADE AND INVESTMENT GROWTH INQUIRY INTO THE PRUDENTIAL REGULATION OF INVESTMENT IN AUSTRALIA'S EXPORT INDUSTRIES

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THE PRINCIPLES FOR RESPONSIBLE INVESTMENT

The United Nations-supported Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has over 3,800 signatories (pension funds, insurers, investment managers and service providers) globally with approximately US $100 trillion in assets under management. Over 181 signatories, managing AUD $1.1 trillion are based in Australia.[1]

As the world's leading initiative into responsible investment, PRI works with many investment managers, insurance, and superannuation institutions as signatories to PRI.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

The PRI welcomes the opportunity to respond to the Joint Standing Committee on Trade and Investment Growth's inquiry into the prudential regulation of investment in Australia's export industries from the perspective of a significant amount of Australian and global investors of capital, including in Australia's current and future export industries.

ABOUT THIS CONSULTATION

Following a referral from the Minister for Resources, Water and Northern Australia, the *Joint Standing Committee on Trade and Investment Growth* resolved to inquire into and report on the prudential regulation of investment in Australia's export industries. The Committee has invited submissions addressing the following terms of reference.

The domestic and foreign investment opportunities and challenges for Australia's export industries and their associated businesses, arising from changes in prudential standards and practices across banking, insurance and superannuation institutions, in addition to publicly listed companies, with particular reference to:

1. The existing and future contribution of Australia's export industries;
2. The investment guidance and advice provided by Australia's financial regulators, including the Australian Prudential Regulation Authority (APRA), the Reserve Bank of Australia (RBA) and the Australian Securities and Investments Commission (ASIC), to banking, insurance and superannuation institutions, and also to publicly listed companies, in relation to investment in Australia's export industries;
3. The approach and motivations of our financial institutions, including banks, insurers and superannuation funds, as well as publicly listed companies, to their investment in Australia's export industries;
4. The consequential impacts of (2) and (3):
   a) For legitimate. law-abiding businesses connected to Australia's export industries;
   b) On regional and rural economies that are reliant on Australia's export industries. particularly in light of the COVID-19 recession;
   c) Our national economy. particularly in light of the COVID-19 recession;
5. Any other related matter.

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[1]See https://www.unpri.org/signatories/signatory-resources/signatory-directory

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SUMMARY OF PRI POSITION

The PRI is supportive of policies which provide investors with better information to assess ESG risks and opportunities in all investments, including in export industries, given the speed of change and ambition of the climate policy positions of Australia's key trade partners.

Accordingly, we draw the Committee's attention to our perspective that:

- Australia's export industries and associated businesses are heavily concentrated in carbon intensive industries.
- The recent geopolitical shift towards a net zero commitment by 2050 by Australia's top trade partners poses significant risks to investments in the current and future export industry and the Australian economy more broadly.
- Guidance and advice from Australia's financial regulators that assists investors in assessing climate change risks promotes greater confidence in the allocation of capital appropriately with the investment objectives of asset owners.
- Reliable climate risk related regulatory guidance facilitates greater transparency into the real economic risks and opportunities affecting Australia's export industries and their associated businesses.
- A delayed move to mandatory disclosure regimes as compared to other major countries will, however, introduce uncertainty for investors and investment challenges.
- Financial institutions are largely motivated by their purpose of achieving strong long-term investment performance for their beneficiaries.
- To achieve this, they must assess the potential risks to their investment portfolios and mitigate those risks within an appropriate tolerance and appetite.
- As a result, financial institutions are supportive of government policy that reflects the real economy risks they face and facilitates the management of the physical, transitional and liability risks posed by climate change.
- An increased focus on regulatory guidance and government policy is necessary to ensure alignment with motivations of financial institutions to deliver returns on investment through the effective management of real economic and trade risks impacting the Australian export industries and their associated businesses.
- Delaying regulatory guidance will not alter investor motivations of generating risk adjusted returns, but rather see increased barriers to investment in new low carbon export opportunities which would otherwise benefit Australian export industries and the economy more broadly.

We therefore recommend that:

- The Australian Government should enable investors to assess the real economy risks and opportunities resulting from climate change.
- The Australian Government should pass climate related legislation which commits Australia to net zero by 2050 and policies ensuring a just transition that is sustainable and socially inclusive.
- Disclosure obligations of Australian companies should be aligned with the disclosure requirements contained in the TCFD framework.

CONSULTATION RESPONSE

The PRI has focused its response on the approach and motivations affecting its signatories and the investment guidance and advice provided by Australia's financial regulators, while also addressing the existing and future contribution of Australia's export industries in light of the global transition to net zero emissions and responsible investing.

The existing and future contribution of Australia's export industries

Key points & recommendations

- Australia's export industries and associated businesses are heavily concentrated in carbon intensive industries.
- The recent geopolitical shift towards a net zero commitment by 2050 by Australia's top trade partners poses significant risks to investments in the current and future export industry and the Australian economy more broadly.
- The Australian Government must act now enable investors to assess the real economy risks and opportunities resulting from climate change and pass legislation and policies facilitating a net zero commitment by 2050 to ensure a just transition that is sustainable and socially inclusive.

Export industries involved in carbon emitting resources and activities face significant risks as key markets reduce their demand in order to adhere to net-zero emissions commitments in the coming decades.

The need to act on climate is now paramount to the economic policy agenda globally. Australia's major trading partners have made commitments to transitioning to net zero emissions over the coming decades and are adopting policies such as removing subsidies on fossil fuels and promoting market access to low emission alternatives.[2] This will create "substantial shifts in global investment needs, driving down demand for assets that increase emission, and driving up demand for assets that avoid or reduce them."[3] These geopolitical trends are shifting trade fundamentals in a way which has already become evident in the relative decline in the value of carbon emitting resource exports to the Australian economy.

The Australian economy is exposed. As recognised previously by Parliament, "[t]rade has long been a driver of Australia's prosperity."[4] The Department of Foreign Affairs and Trade has confirmed that "without trade, [Australia's] standard of living would be substantially lower, the prices [Australian's] pay would be significantly higher, and [] choices of goods and services would be more limited."[5]

The Australian export industry is highly concentrated, with iron ores and concentrates, coal and natural gas accounting for a high percentage of export revenue – In 2019, the resources sector generated 58 percent of total export revenue. This concentration leaves Australia vulnerable to negative economic effects that will result from reduced demand for these commodities in line with

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[2] Agreement on Climate Change, Trade and Sustainability
[3] The Inevitable Policy Response 2021, Policy Forecast Executive Summary *Preparing financial markets for climate-related policy and regulatory risks* (March 2021) https://www.unpri.org/download?ac=12950.
[4]https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Joint_Standing_Committee_on_Trade_and_Investment_Growth/DiversifyingTrade/Report
[5]https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Joint_Standing_Committee_on_Trade_and_Investment_Growth/DiversifyingTrade/Report

climate change commitments by trade partner countries, and presents material physical, transitional and liability risks.[6]

The Australian Financial Review recently reported that "[l]ooking at Australia's top 20 trade partners, over 80 per cent of [] exports are to countries that have pledged net-zero emissions by the middle of the century (China, South Korea, the UK, the EU and several more)."[7]

Australia's Top 10 Export Markets 2018-19		
Rank	Market	Net zero commitment
1	China	2060 (intent) It is forecast that "China will end construction of coal fired power production after 2025, driven by new policies to facilitate its 2060 net zero target and ongoing market liberalisation."[8] During the recent Biden Climate Summit, China confirmed that it would "phase down" coal consumption in the five years from 2025 with Xi Jinping committing to "strictly control" coal-fired plant construction over the next 5 years.
2	Japan	2050 (pending legislation) During the recent Biden Climate Summit, Japan pledged 46-50% emissions reduction by 2030 from 2013 levels.
3	Republic of Korea	2050 (submission to the UN) During the recent Biden Climate Summit, South Korea confirmed that it would stop state institutions from financing coal power overseas.
4	United States	2050 (statement of intent and proposed legislation) It is forecast "[t]he United States will end all coal-fired power generation by 2030, through a combination of emission performance standards and carbon pricing at the Federal and State levels, combined with market forces."[9] During the recent Biden Climate Summit, President Biden also committed the United States to a 50-52% emissions reduction by 2030 from 2005 levels.
5	India	2050 target is being considered by current government. "[R]apidly evolving Indian policy and prospects for market reforms and pricing has already ended further investment in new coal."[10] India has also recently announced an India-U.S. Climate and Clean Energy Agenda Partnership for 2030, which looks to "help mobilise investments, demonstrate clean technologies, and enable green collaborations."
6	New Zealand	2050 (legislated)
7	Singapore	Emissions to peak in 2030 and then be approximately in half in 2050 with a long-term goal of net zero in the second half of the century.
8	Taiwan	Legislators from three political parties, including the ruling Democratic Progressive Party, have called for the creation of a climate action law that would include a net zero commitment by 2050.
9	United Kingdom	2050 (legislated)

[6] https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Joint_Standing_Committee_on_Trade_and_Investment_Growth/DiversifyingTrade/Report; https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Carbonriskdisclosure45/Report
[7] https://www.afr.com/policy/energy-and-climate/global-climate-action-will-reshape-australia-s-trade-20210208-p570n2
[8] The Inevitable Policy Response 2021, Policy Forecast Executive Summary *Preparing financial markets for climate-related policy and regulatory risks* (March 2021) https://www.unpri.org/download?ac=12950
[9] The Inevitable Policy Response 2021, Policy Forecast Executive Summary *Preparing financial markets for climate-related policy and regulatory risks* (March 2021) https://www.unpri.org/download?ac=12950
[10] The Inevitable Policy Response 2021, Policy Forecast Executive Summary *Preparing financial markets for climate-related policy and regulatory risks* (March 2021) https://www.unpri.org/download?ac=12950

		During the recent Biden Climate Summit, the United Kingdom promised 78% emissions reductions by 2035 from 1990 levels.
10	Malaysia	A cut in the emissions intensity of GDP by 2030, relative to 2005 levels.

Increased ambition is expected in relation to coal phase out globally:

- Policy signals and market reforms make new unabated coal uninventable by 2021-2025 in almost all countries.
- Leading countries end all unabated coal generation by 2030.
- Other major countries follow by 2040s.[11]

The Australian Government has recognised that "[t]aking greater steps to diversify markets for Australia's exports will help to mitigate [climate-related] risks, as well as opening up new opportunities for business." Time is of the essence, as the shift of geopolitical trends towards a more carbon neutral world will force trade policies to become more aligned with global climate change initiatives and commitments. A lack of timely effort by the Australian Government to set a legislated target will present challenges to export industries and barriers to both domestic and foreign investment. The scope of trade deals will be limited and export industries and associated businesses will see a rise in sanctions and tariffs. Australia's key export commodities have substitutes and even a low carbon price may significantly impact export prospects.

It is forecast that "Carbon Border Adjustments Mechanisms for carbon will become increasingly a policy option," which "could lead the United States to announce a national carbon pricing system as early as 2023 … and [] a strong carbon price path to reach a backstop of $65 by 2030."[12] Similarly, by 2030, it is expected that EU policy will "backstop an EU ETS carbon price of $75/t$CO_2$ to ensure long-term action toward decarbonization in heavy emitting sectors."[13]

The Inevitable Policy Response, a landmark project which aims to prepare financial markets for climate-related policy risks, forecasts "a response by 2025 that will be forceful, abrupt, and disorderly because of delay."[14] The importance of a just transition, where sustainable development and social inclusion is prioritised, cannot be discounted. As pointed out by the OECD, a "just transition will not happen by itself. It requires plans and policies – with a transformation that is not just about phasing out carbon intensive export industries, but also ensuring new jobs, new industries, new skills, new investment and opportunity to create a more equal and resilient economy.[15]

PRI is supportive of government policy that facilitates the reliable assessment of trade and real economy risks that inform investment decisions. They are responsible for investing significant amounts of capital, and as long-term investors are generally well suited to investing in companies and industries that effectively manage the transition away from carbon releasing resources and activities towards higher growth export opportunities in clean energy resources and technologies.

PRI is supportive of such measures which create new investment opportunities which are attractive to PRI signatory investor commitments to include environmental risk factor analysis into investment decision making processes. The Australian Prudential Regulation Authority (APRA) recently highlighted in its publication "APRA Insight" the "growing ecosystem of global alliances and initiatives [that] has emerged to guide, support, and – to some extent – standardise the finance sector's approach to addressing climate-related financial risks… is evolving rapidly, through multi-lateral and NGO actions, industry collaboration and business actions, as well as

[11] The Inevitable Policy Response 2021, Policy Forecast Executive Summary *Preparing financial markets for climate-related policy and regulatory risks* (March 2021) https://www.unpri.org/download?ac=12950.
[12] https://www.unpri.org/download?ac=12951
[13] https://www.unpri.org/download?ac=12951
[14] https://www.unpri.org/download?ac=7092
[15] https://www.oecd.org/environment/cc/g20-climate/collapsecontents/Just-Transition-Centre-report-just-transition.pdf

through regulator initiatives."[16] APRA also highlighted the following statistics which are relevant for identifying investment opportunities and challenges to Australia's export industries:

- more than one third of the global banking industry has now joined the pledge to implement the UNEP FI's Principles for Responsible Banking;
- over 140 organisations, including insurers representing more than 25 per cent of world premium volume and USD 14 trillion in assets under management, have adopted the UNEP FI's Principles for Sustainable Insurance (PSI); and
- six of the largest investor alliances, representing assets worth over USD103 trillion, have called on companies and auditors to fully reflect the effects of climate change in their declared results.[17]

PRI believes that the global transition towards net zero carbon emissions and increased focus on ESG risk analysis, specifically climate risk, as material investment risk presents important opportunities and challenges to the existing and future contribution of PRI signatory investment in Australia's current and emerging export industries.

PRI supports the integration of climate risk and ESG risk consideration into broader responsible business practices and believes that ESG materiality is likely to impact the demand for, and therefore attractiveness of investment in Australia's export industries. PRI sees a real opportunity for Australia's Government and export industries and associated businesses to align strategic planning with the inevitable transition to net zero emissions globally and take advantage of the shift in demand for increasingly carbon-neutral products. If this action is further delayed, Australia's export industries most exposed to climate related transition risks are likely to become less attractive to PRI signatory investors.

PRI recommends the Government act quickly to pass climate related legislation which commits Australia to net zero by 2050.

Investment guidance and advice provided by Australia's financial regulators

Key points & recommendations

- Guidance and advice from Australia's financial regulators that assists investors in assessing climate change risks promotes greater confidence in the allocation of capital appropriately with the investment objectives of asset owners.
- Reliable climate risk related regulatory guidance facilitates greater transparency into the real economic risks and opportunities affecting Australia's export industries and their associated businesses.
- A delayed move to mandatory disclosure regimes as compared to other major counties will, however, introduce uncertainty for investors and investment challenges.

As recognised by APRA, there is a "need to address the climate data deficit, to quantify the likely impact of the physical, transitional and liability risks of climate change and accurately assess and appropriately price these risks."[18]

> This needs to ultimately be tackled through scenario analysis, stress testing and disclosure of market-useful information. Effective action now on these fronts will promote strong understanding

[16] https://www.apra.gov.au/apra%E2%80%99s-response-to-climate-related-financial-risks
[17] https://www.apra.gov.au/apra%E2%80%99s-response-to-climate-related-financial-risks
[18] https://www.apra.gov.au/understanding-and-managing-financial-risks-of-climate-change

and management of the potential financial impacts of a changing climate on current and future business prospects, allowing well-managed entities to minimise costs and optimise benefits.[19]

Further investment guidance and advice from Australia's financial regulators on the assessment of real economy risks and opportunities presents an opportunity for domestic and foreign investment into Australia's export industries.

Rapid development in global regulatory initiatives to address ESG and climate-related financial risks – particularly with respect to mandatory disclosure, presents a risk to international investment in Australia's carbon emitting export industries in particular. Key trade partners, including the UK and New Zealand, are moving towards making climate risk related disclosures recommended by the Task Force on Climate-related Financial Disclosures (TCFD) mandatory for all companies.

While ASIC has issued guidance to Australia's listed companies recommending that they "disclose meaningful and useful climate risk related information to investors –the voluntary framework developed by the TCFD has emerged as the preferred standard in this regard," and "strongly encourage[d] listed companies with material exposure to climate change to consider reporting voluntarily under the TCFD framework," such reporting is not mandatory.[20] Earlier this year, ASIC stated that it had observed that "voluntary adoption of TCFD reporting by some larger listed companies has materially improved standards of climate-related governance and disclosure in the market."[21] [22]

APRA has encouraged the adoption of voluntary frameworks like the TCFD to assist Australian financial institutions with the assessment, management and disclosure of climate-related financial risks, but has not made such disclosure mandatory. APRA has issued guidance relevant to the prudent management of climate financial risks that is aligned with TCFD framework.

This current gap in the regulatory environment acts as a disincentive for investment in Australia where the transparency around climate-related and other ESG risks does not exist. Institutional investors often seek regulatory efficiency through consistency in regulatory frameworks across borders which in turn permits investors to streamline compliance and reduce compliance costs.

PRI believes that climate risk related regulation and rules should be introduced on a mandatory, rather than "recommendation" basis. Disclosure obligations of Australian companies should be aligned with the disclosure requirements contained in the TCFD framework. TCFD is a necessary foundation to ensure granular and comparable disclosures to hold companies to account for such commitments, though further disclosures may be required.

Domestically, Australia's financial regulators have, over the last decade and more recently with the COVID-19 pandemic, shifted the investment guidance focus to one centred on long-term sustainability and stability of the Australian financial system. Managing risks as well as opportunities presented by the effects of a changing climate has been identified as a key emerging focus area by the Reserve Bank of Australia (RBA), the Australian Securities & Investments Commission (ASIC) and APRA.

Currently, the enforceable prudential standards made by APRA and binding on financial institutions do not specifically require that ESG risk factors are identified as material risk categories as part of the financial institution's risk management framework.[23] The investment governance standards which apply to superannuation trustees similarly allow ESG factors to be included as part of the investment analysis and decision-making process, however do not require ESG factors to be considered.[24]

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[19] https://www.apra.gov.au/understanding-and-managing-financial-risks-of-climate-change

[20] https://asic.gov.au/about-asic/news-centre/find-a-media-release/2019-releases/19-208mr-asic-updates-guidance-on-climate-change-related-disclosure/

[21] https://asic.gov.au/about-asic/news-centre/articles/managing-climate-risk-for-directors/

[22] https://www.apra.gov.au/understanding-and-managing-financial-risks-of-climate-change

[23] APRA Prudential Standard CPS220 (Risk Management); APRA Prudential Standard SPS220 (Risk Management).

[24] APRA Prudential Standard SPS530 (Investment Governance).

PRI acknowledges the important role that Australia’s financial regulators play in making standards, providing guidance, and supervising banks, insurers, and superannuation funds in areas which include investment governance and risk management.

PRI has previously advocated for policy reforms that would make the identification and consideration of ESG risk factors as material risk categories (or as investment governance risks) mandatory for all financial institutions to achieve appropriate risk management outcomes and manage material risks in the best interests of investors and beneficiaries of the Australian financial system.[25]

PRI does not believe that the identification of ESG factors as material risks constrains or restricts the investment activities or objectives of financial institutions, but rather ensures that a robust process is followed for managing investment risks.

Importantly, while PRI supports any move towards a mandatory requirement to identify ESG risk factors as part of a broader risk management framework (alongside other mandatory factors), it is acknowledged that regulatory guidance does not prescribe that investors adopt any particular appetite or tolerance for ESG risk factors such as climate risks.

The focus on long-term sustainability and identification and management of ESG risks, including climate change, presents a growth opportunity for Australian export industries to align with the global shift towards a net zero economy and an increased focus on renewable energy and carbon-neutral exports.

PRI has summarised key recent guidance and advice provided by Australia's financial regulators below with additional detail appended in Appendix 1 to this submission.

APRA: Awareness to action

In 2016 the APRA formally established a thematic supervision priority on climate change financial risks and began to develop supervisory guidance. While APRA has not been prescriptive in how regulated entities should manage the financial risks of a changing climate, it has suggested that climate risk should be managed like other economic and operational risks and emphasised that "the financial risks of climate change will continue to be a focus of APRA’s efforts to increase industry resilience, and more supervisory attention is being given to understanding these risks."

In February 2020, APRA wrote to all APRA-regulated entities on the topic of understanding and managing the financial risks of climate change. APRA highlighted that the effects of a changing climate pose financial risks as well as provide new business opportunities and its 2018 climate change survey "highlighted that many large entities understand the financial risks and opportunities from a changing climate, and described the efforts taken by some entities to embed climate change considerations into risk management frameworks." While APRA encourages the adopting of voluntary frameworks for assessing, managing and disclosing climate change risks, it also intends to:

- Develop and consult on a climate change financial risk prudential practice guide.
- In collaboration with international stakeholders which are considering climate-related scenario analysis and domestic stakeholders which are considering taxonomy and scenario design questions, undertake a climate change financial risk vulnerability assessment beginning with Australia's largest authorised deposit-taking institutions.
- Update Prudential Practice Guide SPG 530 Investment Governance which "aims to assist superannuation entities in complying with requirements in relation to the formulation and implementation of an investment strategy, including in relation to environmental, social and governance (ESG) considerations" to "provide insights into

[25] PRI Submission, APRA Prudential Framework Review, 28 September 2018.

better practice, a coordinated focus from both industry and regulators is required to ensure that the financial risks of a changing climate are managed effectively."[26]

In its first issue of APRA Insight for 2021, APRA focused on its response to climate-related financial risks and the focus of regulators and international bodies on the management of such risks. APRA notes that the "impact of these impact of these international developments will present both financial risks and opportunities for Australia's financial institutions…. these implications will become more acute as the transition to the low carbon economy gathers pace around the world." APRA intends to push "regulated entities to move more swiftly from awareness to action, aim[ing] to ensure these institutions are equipped to adapt and respond to the substantial changes in the international economic and regulatory environment that are in train."

APRA published draft guidance on managing the financial risks of climate change to assist APRA-regulated entities in managing climate-related risks and opportunities as part of their existing risk management and governance frameworks.[27] The guidance identified physical, transition and liability risk as climate change financial risks, and confirms that it "is important for institutions to understand the interaction between climate risks and their business activities, as well as the compounding effect climate risks may have on an institution's other risks."[28]

ASIC: Climate risk is a systemic risk

ASIC has highlighted climate-related risk as a systemic risk in the Australian market that has the potential to significantly impact companies, investors and consumers. To date, ASIC's focus has been on listed companies to ensure they have appropriate governance structures in place to manage climate-related risks and to provide the market with reliable and useful information on exposure to climate-related risks and opportunities.

"ASIC considers that the law requires an operating and financial review to include a discussion of climate risk when it is a material risk that could affect the company's achievement of its financial performance."

In 2018 ASIC published ASIC Report 593: *Climate Risk Disclosure by Australia's Listed Companies*. The report recommended, amongst other things, that listed companies disclosure meaningful and useful climate risk related information to investors –the voluntary framework developed by the TCFD has emerged as the preferred standard in this regard and ASIC strongly encourages listed companies with material exposure to climate change to consider reporting voluntarily under the TCFD framework. ASIC supports the TCFD as the preferred market standard, both here in Australia and internationally.[29] Earlier this year, ASIC observed that voluntary adoption of TCFD reporting has, amongst larger companies, significantly increased the level of engagement, and disclosure on climate-related matters since last examining the area in 2017-18.

RBA – Climate change poses material risks to Australian financial institutions

The RBA has focused on climate change risks as being material risks to the Australian financial system and more specifically to Australian financial institutions for the last several years. Pointing to the long-term nature of climate change, however, the RBA has recognised that financial institutions can reduce their exposure to associated risks by limiting their exposure to physical risks and appropriate pricing of such risks.

[26] APRA, Understanding and managing the financial risks of climate change (24 February 2020) https://www.apra.gov.au/understanding-and-managing-financial-risks-of-climate-change
[27] https://www.apra.gov.au/news-and-publications/apra-releases-guidance-on-managing-financial-risks-of-climate-change
[28] https://www.apra.gov.au/sites/default/files/2021-04/Draft%20CPG%20229%20Climate%20Change%20Financial%20Risks_1.pdf
[29] https://download.asic.gov.au/media/4871341/rep593-published-20-september-2018.pdf

Approach and motivations of financial institutions

Key points & recommendations

- Financial institutions are largely motivated by their purpose of achieving strong long-term investment performance for their beneficiaries.
- To achieve this they must assess the potential risks to their investment portfolios and mitigate those risks within an appropriate tolerance and appetite.
- As a result, financial institutions are supportive of government policy that reflects the real economy risks they face and facilitates the management of the physical, transitional and liability risks posed by climate change.

In line with global commitments, many of PRI's Australian signatories have made a commitment to achieve net zero carbon emissions in their investment portfolios by 2050. For example, two of Australia's largest superannuation funds, have announced their commitment, motivated by the fact that they view climate change as posing key risks to their investment portfolios and in turn the retirement outcomes for Australia's population.

PRI believes that the approach and motivations of financial institutions in relation to investment decisions affecting Australia’s export industries is motivated most significantly by existing legal duties as fiduciary investors and investment objectives to deliver sustainable investment outcomes for their beneficiaries. This is achieved by the integration of analysis of ESG risks within investment analysis and decision-making processes, while also recognising that this may also better align investment outcomes with broader objectives of beneficiaries and society.

PRI signatories seek to deliver strong long-term investment performance for beneficiaries. With many of our Australian signatories connected to the Australian superannuation industry, our signatories are obliged to act in the best interest of beneficiaries and promote the financial interests of those beneficiaries. A recent legal opinion relating to Superannuation Trustee Duties and Climate Change suggests that in order to meet these obligations – "to act prudently and in the best interests of members" – a superannuation trustee "must have set in place processes that enable it to understand and manage the financial risks posed by climate change."[30]

These legal responsibilities of financial institutions are a fundamental motivating factor. The Australian Government supports the settled legal position that these duties and the resulting motivations do not constrain the ability of institutions to invest in Australia's export industries, so long as the duties are met. In 2019, the Joint Standing Committee on Trade and Investment Growth inquired into and reported on Australia's exports and attracting investment. Recommendation 9 associated with that inquiry recommended that:

> The Committee recommends that the Australian Government establish a Superannuation Task Force to explore, develop and recommend structural changes and possible incentive-based programs and regulations to increase the level of Australian superannuation fund investment in Australian industries, particularly those with an export focus.[31]

PRI notes that the Government did not support the recommendation "because it conflicts with core duties of superannuation trustees."[32] The Government pointed to the statutory codification of the obligation of superannuation trustees to act in the best interests of their members and to maintain

[30] https://equitygenerationlawyers.com/wp/wp-content/uploads/2021/04/Hutley-SC-Mack-Superannuation-Trustee-Duties-and-Climate-Change-Memo-2021.pdf

[31] https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Joint_Standing_Committee_on_Trade_and_Investment_Growth/Supporting_exports_and_attracting_investment/Report

[32] https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Joint_Standing_Committee_on_Trade_and_Investment_Growth/Supporting_exports_and_attracting_investment/Report

funds solely for a range of purposes that involve the provision of retirement benefits to members. The Government recognised, however, that trustees "are not constrained in investing in Australian industries with an export focus (or any other types of investments), so long as they comply with the best interest duty and the sole purpose test."[33]

A necessary part of delivering strong long-term investment returns (which is also mandated by financial regulators) is giving regard to the current and foreseeable risk, including ESG. When investors sign the Principles for Responsible Investment, they agree to a set of activities to incorporate ESG considerations into their investment practices. Investors' large, and growing, participation in the PRI reflects the increasing acknowledgement that ESG related risks impact investments and the ability of financial institutions to deliver strong and sustainable long-term returns.

The risk of litigation and damages for failing to meet the necessary standard of care in failing to adequately identify and manage climate related risks was recently demonstrated where a member of the *Retail Employees Superannuation Trust* (Rest) filed suit against the trustee. The case highlighted the need to manage ESG risks and their impact on the core motivations of financial institutions. In 2018, member McVeigh filed suit against Rest, first alleging breaches of the *Corporations Act 2001* for failure to provide information related to climate change business risks and later amended his suit to allege the fund's trustee failed to act with the requisite car, skill and diligence and failed to act in his best interests by not properly considering climate change risk.

The parties agreed to settle the litigation with Rest acknowledging that "climate change could lead to catastrophic economic and social consequences and is an important concern of Rest's members," and "is a material, direct and current financial risk to the superannuation fund across many risk categories, including investment, market, reputational, strategic, governance and third-party risks."[34] As part of its risk management practices, Rest agreed to "take further steps to ensure that investment managers take active steps to consider, measure and manage financial risks posed by climate change and other relevant ESG risks."[35]

As identified above, Australian regulators and participants in the global financial system more generally have identified climate change as a systemic risk which must be considered and addressed by financial institutions.

[33]https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Joint_Standing_Committee_on_Trade_and_Investment_Growth/Supporting_exports_and_attracting_investment/Report

[34] Media Release, Statement from Rest (2 November 2020) https://equitygenerationlawyers.com/wp/wp-content/uploads/2020/11/Statement-from-Rest-2-November-2020.pdf

[35] Media Release, Statement from Rest (2 November 2020) https://equitygenerationlawyers.com/wp/wp-content/uploads/2020/11/Statement-from-Rest-2-November-2020.pdf

Consequential impacts of regulatory guidance and motivations of financial institutions

Key points & recommendations

- Increased regulatory guidance and government policy is necessary to ensure alignment with motivations of financial institutions to deliver returns on investment through the effective management of real economic and trade risks impacting the Australian export industries and their associated businesses.
- Delaying regulatory guidance will not alter investor motivations of generating risk adjusted returns, but rather see increased barriers to investment in new low carbon export opportunities which would otherwise benefit Australian export industries and the economy more broadly.

PRI is supportive of and advocates for changes to regulatory standards and guidance which facilitates and promotes understanding of ESG risk factors such as climate risks informing investment strategy, analysis, and decision-making.

Such guidance and settings are well suited to promoting confidence that investments in “legitimate, law-abiding businesses connected to Australia's export industries” and “rural economies that are reliant on Australia's export industries” are in line with the legal obligations of fiduciary investors and appropriate for the investment objectives, horizons, and risk appetite or tolerance of the investor.

APPENDIX 1

Guidance and advice	Affected Institution(s)	Specific content
APRA: Awareness to action		
Information Paper, Climate change: Awareness to action (20 March 2019)	Banks General insurers Superannuation trustees	APRA surveyed 38 large banks, insurers and superannuation trustees last year to assess their views and practices related to climate-related financial risks. The survey found a substantial majority of regulated entities were taking steps to increase their understanding of the threat, including all of the banks, general insurers and superannuation trustees surveyed. APRA called on entities to move from gaining awareness of the financial risks to taking action to mitigate against them. Other key findings were: • A third of respondents believed climate change was a material financial risk to their businesses now and a further half thought it would be in future; • A majority of banks considered climate-related financial risks as part of their risk management frameworks; and • Reputational damage, flooding, regulatory changes and cyclones were nominated as the top climate-related financial risks.
February 2020 Letter to all APRA-regulated entities	Banks General insurers Superannuation trustees	APRA wrote to all APRA-regulated institutions outlining plans to develop and consult on a climate change financial risk prudential practice guide, intended to assist entities in complying with existing prudential requirements in the areas of prudent management of climate change financial risks, aligned with

		recommendations of the TCFD, including aspects of governance, strategy, risk management, metrics and disclosure. APRA will also be seeking to undertake a climate change financial risk vulnerability assessment. The assessment will begin with Australia's largest authorised deposit-taking institutions (ADIs). Beginning with the ADI industry will provide helpful insights on the impact of a changing climate on the broader economy, which will be analysed in conjunction with the Reserve Bank of Australia (RBA). The ADI vulnerability assessment will be designed in 2020 and executed in 2021, with other industries to follow. It also outlined APRA's intent to update superannuation Prudential Practice Guide SPG 530 Investment Governance, which includes paragraphs related to ESG investments.
Prudential Practice Guide Draft CPG 229 Climate Change Financial Risks April 2021	Banks General insurers Superannuation trustees	The PPG aims to assist an APRA-regulated institution in complying with Prudential Standards CPS 220 Risk Management (CPS 220), SPS 220 Risk Management (SPS 220), CPS 510 Governance (CPS 510), SPS 510 Governance (SPS 510) and, more generally, to outline prudent practices in relation to climate change financial risk management. The guide recognises that "[a] A prudent APRA-regulated institution would take a strategic and risk-based approach to the management of the various risks and opportunities arising from climate change, recognising the unique nature and far-reaching potential impacts of a changing climate."
ASIC: Climate risk is a systemic risk		
Managing climate risk for directors (February 2021)	Listed entities and their directors	ASIC intends to adopt a consultative approach as we continue to monitor the adoption of TCFD reporting and the development of climate-risk disclosure practices over the coming period. However, as is always the case, we may consider enforcement action should there be serious disclosure failures. This includes whether the failures relate to the impact of climate change, or to

		other matters such as operations or the prospects of the business. Guidance for directors: • Consider climate risk. • Corporate governance that facilitates level of oversight over climate risks and opportunities and the governance structures in places to assess, manage and disclosure these risks and opportunities. • Comply with the law that requires a discussion of climate risk when it is a material risk that could affect financial performance. • Listed companies with material exposure to climate risk should consider reporting under the TCFD framework.
REP 593 Climate risk disclosure by Australia's listed companies (September 2018)	Listed entities	ASIC report sets out our findings and high-level recommendations for listed companies and their directors and advisers on climate risk disclosure. Key recommendations included: • Directors and officers should adopt a probative and proactive approach to emerging risks, including climate risk. • The existing law requires disclosure of material business risks affecting future prospects in an operating and financial review, which may include climate change. • Specific disclosure is more useful than general disclosure. The voluntary framework developed by the TCFD may help listed companies in considering how to disclose material climate risks and what type of information to disclose.

Regulatory Guide 247 – Effective disclosure in an operating and financial review (August 2019)	Listed entities and their directors	This guide prescribes that an operating and financial review, which is a key part of annual reporting by listed entities, "should include a discussion of environmental, social and governance risks where those risks could affect the entity's achievement of its financial performance or outcomes disclosed, taking into account the nature and business of the entity and its business strategy." The guide recognises that climate change is "a systemic risk that could have a material impact on the future financial position, performance or prospects of entities," and directors may consider "whether it would be worthwhile to disclose additional information that would be be worthwhile to disclose additional information that would be relevant under integrated reporting, sustainability reporting or the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), where that information is not already required for the OFR."
RBA – Climate change poses material risks to Australian financial institutions		
Financial Stability Review (October 2019)	All Australian financial institutions	The Review identified climate change as a source of increasing risk to financial institutions and the financial system more broadly. "The physical effects of climate change can have a significant impact on Australian financial institutions. As an example, inflation-adjusted insurance claims for natural disasters in the current decade have been more than double those in the previous decade. This impact is likely to grow over time." Risks are classified as either: • Physical: disruptions to economic activity or reductions in asset values resulting from 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.
Financial Stability Review (October 2020)	All Australian financial institutions	The Review recognises that "[o]ne ongoing challenge for the financial system is the financial risks arising from climate change," resulting in exposure "risks that will rise over time and, if not addressed, could become considerable." Risks to financial stability may arise from both physical and transition risks associated with climate change.