31 March 2016

Senate Standing Committees on Economics
Attn: Dr Kathleen Dermody, Committee Secretary
PO Box 6100
Parliament House
Canberra ACT 2600
economics.sen@aph.gov.au

Dear Dr Dermody,

Submission: Carbon Risk Disclosure Inquiry

We are pleased to provide comments from an investor perspective on the Inquiry into Carbon Risk Disclosure.

About Regnan

Regnan – Governance Research & Engagement Pty Ltd was established to investigate and address environmental, social and corporate governance (ESG) related sources of risk and value for long term shareholders in Australian companies.

Our research is used by institutional investors making investment decisions and in directing the company engagement and advocacy Regnan undertakes on behalf of long-term investors with more than $82 billion invested in S&P/ASX200 companies (at 31 December 2015). This approximates 5.5% of this index. These institutions include Advance Asset Management; Commonwealth Superannuation Corporation; BT Investment Management; Catholic Super; First State Super; HESTA Super Fund; Vanguard Investments Australia; VicSuper; and the Victorian Funds Management Corporation.

Our clients' interests are long term and widely diversified. They account for a large and growing share of funds provided to businesses, and bear a growing share of the responsibility for providing for Australians in their retirement years.

The distinct perspective afforded by this long term horizon and broad diversification enables such investors to focus on the maximisation of aggregate economic benefits (or minimisation of aggregate costs) over the long term. This perspective contrasts with many individual businesses and

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industries (including many owned by such investors) whose goals are governed by the narrower economic focus and/or shorter term financial interests they are obliged to prioritise.

Carbon risk vs climate risk

Consistent with these contrasting perspectives, we would encourage the Committee to expand its terms of reference to include disclosures of broader risks related to climate change, beyond carbon risk. Of particular concern is the lack of disclosures in relation to the more systemic risks that climate change presents to the entire economy and the flow on impacts to individual companies.

In addition there remain a number of areas that are underreported at an individual company level. These may include but are not limited to increased physical risks from a changing climate, market risk (including within a company's supply chain and customer base) and the reputational risk from consumer and shareholder backlashes for perceived inadequate action.

Our research into individual companies reveals a strong focus on disclosing company level carbon exposures, primarily provided in the form of reported emissions data covering scope 1 (direct) and 2 (electricity) and, less frequently, scope 3 (indirect) emissions. Emissions data is critical but insufficient information. Considered within the context of the company's operations, other climate risks may be far more material. For instance those with key assets within a geographically concentrated area, including single mine site operations, and the providers of supporting infrastructure are of particular risk of increased inundation events that have the potential to cause major disruptions to the operation of the mine.

We acknowledge the role for the finance sector in supporting the decarbonisation of the economy. The current shortfall between the aggregated Intended Nationally Determined Contributions (INDC) and the shared objective stated in Paris will need to be addressed to minimise the severity of climate change impacts. This will require cooperation and action between the public and private sector, supported by the investment community. Enhanced climate disclosures will also play a facilitating role.

Further comments relevant to the terms of reference are outlined below.

a) Current and emerging international carbon risk disclosure frameworks

We are aware that other submissions – including by the Investor Group on Climate Change, of which Regnan is a member – will provide an overview of current and emerging frameworks thus our submission does not address this.

We do, however, draw the Committee's attention to a number of gaps we see in disclosure frameworks currently available, in particular:

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- A lack of guidance or clear calculation methodology remains for a number of specific categories of emissions. Of most interest in relation to listed companies would be a more standardised approach to:
    - agricultural and forestry emissions
    - emissions from air travel – in particular a consistent approach to whether additional factors should be applied for emissions released at altitude, and
    - fugitive emissions – our preference is for emissions to be measured on site given the significant variations that can arise between estimated and calculated emissions

- A current lack of clarity as to what should be reported under scope 3 (indirect) emissions. This results in a diversity of current practice that impairs comparisons and can be misleading by omission as the most material components are often excluded. For instance, a bank may report on business related travel or paper consumption, including under the NCOS guidelines, but not report on the emissions indirectly attributed to their lending and investment portfolios. By failing to report on 'financed emissions' a key potential climate risk is not being disclosed to investors and what is reported may tend to create the impression that scope 3 risks are trivial. The emissions of key emissions intensive suppliers are another common omission despite the potential for future carbon cost pass through.

b) Current carbon risk disclosure practices within corporate Australia

Disclosures vary across companies. Whilst the majority of ASX200 companies provide some detail on the scope 1 and 2 emissions profile of the business there is too often little discussion on the broader implications of this for the business, for instance, the company's ability to decarbonise and over what timeframe relative to the transition of the broader economy and with sufficient urgency given the climate science.

There is even **less reported in relation to the non-carbon climate risks** with potential to impact long term value. A number of companies provide case studies where actions have been undertaken in relation to building resilience to physical risks, typically in relation to infrastructure assets; even rarer are scenario based analyses on the systemic impacts of climate change. A small number of companies have acknowledged the need to manage within a two degree constrained economy and develop business plans consistent with a net neutral operating environment for emissions, however, disclosures on what this means in practice are largely yet to follow.

We would draw the Committee's attention to some current examples of these types of disclosures, including climate resilience reporting from Stockland and portfolio analysis undertaken by BHP.

We consider the focus should be on **fulsome reporting relevant to those risks that are the most material to a company's operations**. In addition to emissions data, further information, which will vary by sector, will be required. For instance metrics for the oil and gas sector may include remaining project life, production cost curve position, and other mitigating factors such as contract terms and GHG emissions abatement (carbon sequestration). However also of critical importance is the need for disclosures to include a discussion of the implications of climate risk for business strategy, together with details of mitigation activities undertaken.

Where numerical information is provided, it **should be sufficiently granular** as to allow investors to make decisions on the relative risks of individual assets. We note that much of this information is already reported under the NGER scheme but is rarely made publicly available. NGERS data also only relates to Australian sites, thus does not provide a complete picture for many companies.

Timeliness of disclosure is also a concern. Whilst a small number of, typically large, companies release sustainability reports at the same time as annual reports we would encourage this practice to be more widespread. There is still significant time delays in some of the key disclosures, including the CDP which can (depending on the year end reported) in some cases be almost two years old when released. Our preference is that **all material information should be provided in core, investor focused disclosures** in a timely manner.

c) Australian involvement in the G20 Financial Stability Board discussions on carbon risk impacts for financial stability

Given Australia's high per capita emissions, Regnan is supportive of Australian involvement in the stability board discussions. The exposure of Australia, due to its emissions intensive economy and exposure to extreme weather events, makes it highly vulnerable to these risks.

d) Current regulatory and policy oversight of carbon risk disclosure across government agencies

The economy-wide implications of climate change, including in relation to financial stability, means that it would be appropriate for oversight to sit in the centre of government, most likely in Finance or Treasury, where economic stress testing typically takes place.

a) Any other related matters

As outlined in our introductory comments, there is a need to expand disclosures from simply carbon risk (i.e. those related to an organisation's emissions) to climate risk, to allow investors to better understand and assess the full range of risks brought about by a changing climate.

Whilst the technical aspects of how to calculate the numerical component of emissions would benefit from greater harmonisation, this will not fully meet the needs of investors. What is of more importance is greater context to enable investors to understand the materiality of the impacts, the opportunities that exist to mitigate material risks and the extent to which these are being pursued.

Should you have any questions in relation to this submission, please contact Alison Ewings on (02) 9299 6995, or alison.ewings@regnan.com or Alison George on (03) 9982 6404 or alison.george@regnan.com.

Yours sincerely,

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Managing Director
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Regnan was launched in 2007 having operated previously as the BT Governance Advisory Service. It is owned by institutional investors: BT Investment Management and Commonwealth Superannuation Corporation (CSC) (formerly ARIA).