regnan

28 April 2016

Submission: Task Force Climate- Related Finance Disclosures Consultation

We are pleased to provide comments from an investor perspective to the Task Force Climate-Related Finance Disclosures.

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 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.

Additional comments regarding the work of the Taskforce

We are supportive of the aims and scope of Taskforce and 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 objectives stated in Paris will need to be addressed to minimise the severity of climate change impacts. This will

Regnan - Governance Research
& Engagement Pty Ltd
ABN 93 125 320 041
AFSL 316351

Level 9, 387 George Street
Sydney NSW 2000
Australia

Phone +61 2 9299 6999
Fax +61 2 9299 6799
www.regnan.com

require cooperation and action between the public and private sector, supported by the investment community. Enhanced climate disclosures will also play a facilitating role in this transition.

In addition to our response to the formal questionnaire are some additional observations and commentary.

a) Carbon risk vs climate risk

We are supportive of the Taskforce's remit including disclosures of broader risks related to climate change beyond carbon risk. Of particular concern in current practice 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. Even where emissions are a key risk driver, other information may be needed for meaningful risk assessment e.g. for oil and gas stocks, emissions in reserves needs to be triangulated with cost curve positions and expected lifespan.

b) Voluntary nature of reporting

Whilst it is appropriate to prepare the Taskforce's recommendations as voluntary it would be prudent to assume that, at least in some jurisdictions, that they will become mandatory. The Taskforce is strongly encouraged to design for this probability.

This may be either formally through national regulation, or informally, as the key reference point against which company reporting will be judged.

c) Role of central banks and regulators

In addition to the needs of the financial sector we note that central banks and regulators have not been called out as user groups within the questionnaire. These groups will most certainly play a role in the assessment of systemic risk and the appropriateness of responses. Although listed as stakeholders through the development process this group should be specifically considered as a primary user of climate risk disclosures.

d) Coverage of the framework

Given the systemic nature of many climate change risks and the prevalence of inherent interdependencies, disclosure frameworks should be developed in such a way as to be applicable for a range of different organisations, not simply listed companies.

The majority of organisations, regardless of ownership structure, impact and are impacted by the financial system (for instances as borrowers) and therefore should be encouraged to disclose in line with the framework developed by the Taskforce. Likewise such an approach would assist in the assessment and reporting of Scope 3 emissions as well as the other risks within the value chain, including the potential for increased supply chain risks as a result of the physical impacts of climate change.

e) Principles based framework

We are supportive of a principles based approach to disclosure that is suitably flexible in order to support meaningful disclosures over time and that accommodates a more sophisticated understanding of the associated risks as the issues mature. Further, consistent with principle 1 regarding the disclosure of relevant information, these disclosures should include both risks and opportunities.

We note, however, the Taskforce’s acknowledgement of the potential for conflict between the principles and would encourage the development of further guidance for reporters in the management of these tensions. For instance our research and engagement activities has demonstrated that the materiality of issues can be quite different for companies within the same industry sector. In this instance a focus on comparability (principle 5) may sacrifice the relevance of the information presented (principle 1). In this scenario our preference would be for fulsome reporting relevant to the risks that are the most material to a company’s operations.

In addition there remains a need for detailed, technical guidelines in order to improve comparability. Examples of specific areas where this would be welcomed include for fugitive emissions, emissions from agriculture and emissions from the aviation sector.

f) Scenario analysis

We consider that it would be useful for the Taskforce to promulgate the value of scenario analysis and advance an expectation that a range of plausible scenarios be examined and reported on, wherever this is undertaken. While climate scenario thinking is gaining traction, all too many companies choose to focus narrowly on a central case that is supportive of the current strategy. This is potentially misleading to less expert report users, but even more concerning, is that this limited thinking may also be fed into risk analysis internally.

Further, these scenarios should be comprehensive and internally consistent. For instance, the emissions trajectories assessed should be coupled with an analysis of the physical impacts these scenarios imply to ensure that the full range of risks and opportunities are considered.

Disclosures, should be grounded in the latest climate science (recognising scientific understanding is still evolving) as well as regulatory trajectories, not merely current state, as both will influence the magnitude and nature of risks and opportunities.

There is a potential role for the Taskforce in providing guidance on scenarios and to reinforce the need for these to be based on up to date information from credible, accepted sources; that are internally consistent and transparent in their assumptions; and grounded in climate science.

g) Other information gaps

Finally, we would like to draw the Taskforce's attention to a number of more specific gaps we have observed in current disclosures. In particular,

- A lack of guidance or clear calculation methodology remains for a number of specific categories of emissions. Of most interest in relation to the listed companies in Regnan's research universe 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 National Carbon Offset Scheme 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.

- Poor disclosures in **relation to 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.

- Entity level Scope 1 and 2 emissions data is insufficiently granular to allow investors to make decisions on the relative risks of individual assets. We note that under some national schemes much of this information is already reported, including under Australia's National Greenhouse and Energy Reporting Scheme (2007) but is not disclosed.

- Timeliness of disclosure remains 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.

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. We are supportive of the TCFD's principles based approach and see its potential to facilitate these kinds of disclosure.

Should you have any questions in relation to this submission, please contact Alison Ewings on (+61 2) 9299 6995, or alison.ewings@regnan.com or Alison George on (+61 3) 9982 6404 or alison.george@regnan.com.

Yours sincerely,

Amanda Wilson
Managing Director
Regnan – Governance Research & Engagement

About Regnan

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

Its research is used by institutional investors making investment decisions, and also used in directing the company engagement and advocacy it undertakes on behalf of long term investors with $82 billion, or ~5.5%, invested in S&P/ASX200 companies (at 31 Dec 2015).

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).