Submission on APRA's Draft Prudential Practice Guide – *Draft CPG 229 Climate Change Financial Risks*

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Australian Prudential Regulation Authority
Consultation on Draft Prudential Practice Guide on Climate Change Financial Risks

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THE LAW SOCIETY OF NEW SOUTH WALES
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The NSW Young Lawyers Business Law and Communications, Entertainment and Technology Law Committees make the following submission in response to APRA's Draft Prudential Practice Guide (July 2021) – *Draft CPG 229 Climate Change Financial Risks.*

NSW Young Lawyers

NSW Young Lawyers is a division of The Law Society of New South Wales. NSW Young Lawyers supports practitioners in their professional and career development in numerous ways, including by encouraging active participation in its 16 separate committees, each dedicated to particular areas of practice. Membership is automatic for all NSW lawyers (solicitors and barristers) under 36 years and/or in their first five years of practice, as well as law students. NSW Young Lawyers currently has over 15,000 members.

NSW Young Lawyers Communications, Entertainment and Technology Law Committee

The Committee aims to serve the interests of lawyers, law students and other members of the community concerned with areas of law relating to information and communication technology (including technology affecting legal practice), intellectual property, advertising and consumer protection, confidential information and privacy, entertainment, and the media. As innovation inevitably challenges custom, the Committee promotes forward thinking, particularly about the shape of the law and the legal profession.

NSW Young Lawyers Business Law Committee

The Committee comprises of a group of approximately 1,600 members in all aspects of business law who have joined together to disseminate developments in business law and foster increased understanding of business law in the profession. The Committee reviews and comments on legal developments across corporate and commercial law, banking and finance, superannuation, taxation, insolvency, competition and trade practices, among others.

THE LAW SOCIETY OF NEW SOUTH WALES
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Recommendations

The NSW Young Lawyers Communications, Entertainment, and Technology Committee and Business Law Committee (collectively the **Committees**) welcome the release of the Prudential Practice Guide (**PPG**) Draft CPG 229 Climate Change Financial Risks (**Draft PPG**) by the Australian Prudential Regulatory Authority (**APRA**) on behalf of NSW Young Lawyers.

When reviewing the issues concerned, the Committees recommend APRA take into account the following considerations:

1. The Committees recommend that in risk identification, APRA-regulated entities adopt a formula that is: understanding the scientific basis of that entity's climate change financial risk, applying that science and accessing expertise.
2. APRA should facilitate access by companies which are bound by the Draft PPG to a pool of experts with expertise in assessing financial risks of climate change (i.e. a searchable tool of experts by postcode on APRA's website). Companies would not, however, be compelled to utilise experts from that pool.
3. APRA should encourage companies to keep adequate records of their risk identification process for climate change, including the assumptions and projections used as a premise, as opposed to simply including a structure for identifying risks[1] to improve transparency.
4. The Committees recommend that the Draft PPG contain international best practice examples of risk monitoring that APRA-regulated entities can use to be guided or inspired by.
5. The Committees recommend that with respect to scenario analysis, APRA and financial institutions work collaboratively to develop scenarios and identify risks in relation to climate change. Specifically, that APRA provide more in-depth guidance and, if necessary, sector-specific information.
6. Guidance on SPS 220 through this Draft PPG or through SPG 220 should clearly articulate that RSE licensees must address or turn their mind to climate risk as a risk to be addressed in any adopted risk management framework.
7. The Committees recommend that a voluntary or additional disclosure regime would enhance investor confidence. Such disclosures should be consistent and easily comparable.

[1] APRA, *Prudential Standard CPS 220 Risk Management* (at 5 July 2021) [22].

1. Risk Management

Risk identification

Recommendations

1. The Committees recommend that in risk identification, APRA-regulated entities adopt a formula that is: understanding the scientific basis of that entity's climate change financial risk, applying that science and accessing expertise.
2. APRA should facilitate access by companies which are bound by the Draft PPG to a pool of experts with expertise in assessing financial risks of climate change (i.e. a searchable tool of experts by postcode on APRA's website). Companies would not, however, be compelled to utilise experts from that pool.
3. APRA should encourage companies to keep adequate records of their risk identification process for climate change, including the assumptions and projections used as a premise, as opposed to simply including a structure for identifying risks[2] to improve transparency.

1. In principle, the Committees support the formalised approach to identifying climate risks. The formalised approach may provide structure and clarity to an institution's approach to climate risks. However, the following features of climate risks may prove problematic for the identification process that APRA proposes:
   a) *Understanding the scientific basis:* identifying climate risks involves understanding complex factors and a range of speculative assessments of the scope and extent of future impacts. While there are many reputable sources of information available, institutions are likely to require an analysis of climate risks specific to their businesses. This level of specificity may not be available via general publicly available sources of information.[3]
   b) *Applying the science:* the process of identifying climate risks may be an intensive process. For example, the International Finance Corporation outlined the following steps to be considered in an identification process:[4]
      - Considering the current activities of the business;

[2] APRA, *Prudential Standard CPS 220 Risk Management* (at 5 July 2021) [22].
[3] Swenja Surminski et al, 'Assessing climate risks across different business sectors and industries: an investigation of methodological challenges at national scale for the UK' (2018) 376(2121) *Philosophical Transactions of the Royal Society* 5.
[4] International Finance Corporation, 'Climate Risk and Business: Practical Methods for Assessing Risk' (Report, 2010), Annexure A.

- Noting the future activities of the business, the projected timeframes and likely stakeholders;
- An identification of the best practice climate science;
- Applying the relevant climate science to the practice of the business, noting that such science may be specific to timeframes and locations; and
- If accurate and specific data is not available, making projections based on existing data.

Such a process as the one outlined above can also be complicated by significant degrees of interdependencies between businesses. For example, there is potential for impacts on business where significant events occur directly or indirectly to suppliers, trading partners, market participants or countries involved in sale or transport.[5]

c) *Accessing expertise:* as a new and developing area of concern for business, some institutions may not have the specialist expertise required to effectively undertake the process of identifying climate change risks. In particular, this process requires a level of scientific literacy in order to appreciate what constitutes a reputable source and to resolve disagreement between sources of conflicting guidance.

d) *Costs to companies:* there may be additional material costs associated with increased regulatory compliance requirements, particularly where (as stated above) there are complexities and uncertainties in accurately pinning down the risk. This is reflected in the number of reasons that allow large institutions to maintain compliance, such as the ability to absorb the associated time and costs as well as the multiple country regulations that they often need to comply with.[6]

Risk monitoring

Recommendation
4. The Draft PPG contain international best practice examples of risk monitoring that APRA-regulated entities can use to be guided or inspired by.

[5] Richard J Dawson, 'Handling Interdependencies in Climate Change Risk Assessment' (2015) 3(4) *Climate* 1079, 1081.
[6] Lyndon Fagan, 'ESG Insights: Climate change is influencing capex, divestments and M&A; aluminium and thermal coal in focus' (Asia Pacific Equity Research, J.P.Morgan, June 2020) 3-4.

2. The Committees recommend that APRA reiterates the importance of risk monitoring to ensure that quantitative and qualitative results collected in relation to climate related financial risks are effectively communicated to management and stakeholders of APRA-regulated entities.[7] Such transparency can increase public confidence and ensure that the actions of the management and stakeholders of APRA-regulated entities to intercept and address climate related financial risks are on track with expected results to be achieved in the future.
3. The Committees recommend that risk monitoring frameworks should include classification schemes that can effectively act as a base component used to rank (according to each APRA-regulated entities' relative vulnerability to climate related financial risks) climate change financial risk, which helps to assess their financial impact across time (short, medium and long term).[8] Alongside prudent risk limits, APRA-regulated entities will then be able to build models which ensure their resilience to environmental risks and the deployment of adequate capital sources to mitigate these risks.
4. The Committees submit that risk monitoring frameworks should measure the estimated magnitude of the risk through specific climate-related risk tools which include:
    a) as mentioned above, the short, medium and long term expected impact (primary impact);
    b) the uncertainty of timing in relation to public policy; and
    c) continuing technological developments.[9]
5. The Committees recommend the above approach given traditional risk monitoring methodology is backwards-looking through the use of historical data. In contrast, climate change financial risks pose non-linear and unprecedented disruptions thus requiring progressive risk monitoring frameworks.[10]
6. The Committees note that the Draft PPG contains international best practice examples that APRA-regulated entities can use to be guided or inspired by. The Committees submit that because the Draft PPG does not create any new requirements or obligations of APRA-regulated entities, offering tangible suggestions for the risk monitoring of climate change financial risks would be beneficial.
7. The Committees recommend the following risk monitoring processes, metrics and methodologies:
    a) The Committees recommend the Draft PPG emphasise that risk monitoring should not occur in a vacuum. The Committees submit that in addition to the assessment of an entity's services and size among other things, risks should be monitored holistically using policy-relevant sectoral assessments (fossil fuel consumption, utility use, energy-intensity, building,

[7] DAC Working Party on Aid Evaluation, *Glossary of Key Terms in Evaluation and Results Based Management* (Report, Organisation for Economic Co-operation and Development, 1 January 2002) 22.
[8] Basel Committee on Banking Supervision, *Climate-related financial risks - measurement methodologies* (Report, Bank for International Settlements, April 2020) 13.
[9] Network for Greening the Financial System, *Guide for Supervisors: integrating climate-related and environmental risks into prudential supervision* (Report, The Network of Central Banks and Supervisors for Greening the Financial System, 27 May 2020) <https://www.ngfs.net/en/guide-supervisors-integrating-climate-related-and-environmental-risks-prudential-supervision>.
[10] Ibid.

transportation and agriculture).[11] Sectoral carbon and emission intensity as well as sensitivity to climate policies of an entity's counterparties varies and interrelates. For instance, certain sectors are more sensitive to transition risk than others (based on sectoral carbon intensity).[12] The Committees submit that APRA-regulated entities should pursue sector-specific risk information and regularly update their internal risk monitoring metrics with it.

b) The Committees submit that APRA-regulated entities should consider implementing either a top-down or bottom-up approach to their risk monitoring framework to ensure it can appropriately monitor which risks might be non-linear and correlated.[13]

c) The Committees submit that APRA-regulated entities should explore precisely what physical and transition risks are/look like for themselves and how they are assessed against prudential risk areas such as credit risk, market risk and operational risk.[14]

d) For financial institutions, where quantitative information is lacking or absent, internal processes should be launched to monitor climate change financial risks quantitatively. This can include exposure mapping such as heat maps to visually lay out the material impact to certain portfolios. Heat maps are considered to provide 'a high-level overview of the materiality to certain risk indicators of a bank's exposure across things like sectors or asset classes'.[15]

8. The Committees submit that useful supervision guidance for prudential supervisors such as APRA can be sourced from the Network for Greening the Financial System's recent report, *Guide for Supervisors: Integrating Climate-Related and Environmental Risks into Prudential Supervision (2020)*, particularly in relation to setting supervisory expectations.[16]

9. The Committees submit that setting recommendations of risk monitoring for supervisory groups themselves will in turn help APRA-regulated entities understand what is expected of them in the five following areas:

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[11] A useful framework to this effect can be found in both of the following reports published by the Central Bank of the Republic of Austria: Battiston et al, *Austrian banks' exposure to climate-related transition risk* (Financial Stability Report No. 40, 2020) 31–44 and Battiston et al, *A climate stress-test of the financial system* (Nature Climate Change No. 7, 2017) 283–288.

[12] See, eg, Allen Thomas et al, 'Climate-related scenarios for financial stability assessment: an application to France' (Working Paper Series No. 774, Bank of France, 16 July 2020) and Bank Negara Malaysia, 'Climate change and principle-based taxonomy' (Discussion Paper, 27 December 2019).

[13] Basel Committee on Banking Supervision, *Climate-related financial risks - measurement methodologies* (Report, Bank for International Settlements, April 2020) 7-8.

[14] See, eg, Bank of England, *Transition in Thinking: The Impact of Climate Change on the UK Banking Sector* (Report, 26 September 2018).

[15] Ibid 24.

[16] Network for Greening the Financial System, *Guide for Supervisors: integrating climate-related and environmental risks into prudential supervision* (Report, The Network of Central Banks and Supervisors for Greening the Financial System, 27 May 2020) <https://www.ngfs.net/en/guide-supervisors-integrating-climate-related-and-environmental-risks-prudential-supervision>.

a) *Governance*: To manage climate change financial risks by clearly defining and assigning responsibilities within existing governance structures;
b) *Strategy*: For APRA-regulated entities to be aware of potential changes to business environment and adopt a strategic approach to cater for the climate-change financial risks;
c) *Risk management*: APRA-regulated entities should have cohesive risk management procedures, contextual to climate change financial risk;
d) *Scenario analysis and stress testing*: Methodologies and tolls should be developed to capture the size of climate change financial risk; and
e) *Disclosure*: Disclosure of information and metrics on the climate change related risks, their potential impact and safety and soundness of the institution and how they manage those risks should be included in the supervisory guidance.

2. Scenario Analysis

Recommendation

5. The Committees recommend that with respect to scenario analysis, APRA and financial institutions work collaboratively to develop scenarios and identify risks in relation to climate change. Specifically, that APRA provide more in-depth guidance and, if necessary, sector-specific information.

10. The Draft PPG seems to advise institutions develop a broad, and arguably unrealistic, portfolio of scenarios in relation to climate change.
11. The Committees recommend that APRA should engage with the issue of climate change and offer assistance to institutions in respect of compliance with the PPGs.[17] The case study provides suggestions on some ways in which stakeholder-engagement could be facilitated without placing an undue burden on all parties involved.

Case study: Superannuation

12. The Committees agree with APRA's tripartite classification of financial climate risks described in the Draft PPG on a principled-basis. These include: (i) physical risk; (ii) transition risk; and (iii) liability risk. However, the Committees caution that although financial institutions should be safeguarding against

[17] Sam Hurley and Kate McKenzie, 'Climate horizons: next steps for scenario analysis in Australia', (Discussion Paper, Centre for Policy Development, 28 November 2017) <https://cpd.org.au/wp-content/uploads/2017/11/Climate-horizons-CPD-discussion-paper-November-2017.pdf>.

these risks, APRA should provide guidance on the interaction of the Draft PPG (and any contemplated Prudential Standards concerning Climate Risks) with existing prudential standards. For example, guidance may be provided on whether climate risks should be contemplated within the scope of the measures taken by APRA-regulated funds to manage and/or mitigate risks contemplated under SPS 220 *Risk Management* and if so, which prudential standard(s) should take precedence.[18]

13. In particular, the Committees call to attention licensees of registrable superannuation entities (**RSE**). These entities possess obligations under the superannuation laws to act in the best interests of their members alongside their obligations under general trust law to act in the best interests of beneficiaries. The Committees note that these obligations are often considered to be one and the same however also recognise the recent passage and subsequent assent of the *Treasury Amendment (Your Future, Your Super) Act 2021* (Cth) (**YFYS**) which inserts the word "financial" to the best interests duty of RSEs under section 52 of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**).
14. Therefore, the focus of this part of the Committees' submission is on the duty of RSE licensees to ensure that they act in their members' best financial interests, and how they will do this by managing and responding to risks posed by climate change to the bottom lines of members in the superannuation system.

Recommendation

6. Guidance on SPS 220 through this Draft PPG or through SPG 220 should clearly articulate that RSE licensees must address or turn their mind to climate risk as a risk to be addressed in any adopted risk management framework

15. Due to the significant impact that the three financial risks identified above may have on returns to the superannuation system, the Committees are of the view that climate risk should be inserted as a specific head of risk mentioned in *SPS 220 Risk Management*,[19] and in particular RSE licensees must be addressing these risks as part of their risk management framework including their:
    a) Risk appetite statement;
    b) Risk management statement;
    c) Relevant risk management policies, procedures and controls; and
    d) Assessment of the effectiveness of the above as part of the review process.

[18] APRA, *Prudential Practice Guide: Draft CPG 229 Climate Change Financial Risks* (Draft PPG) (April 2021) [7]..
[19] APRA (n 1).

Physical Risk

16. The Draft PPG considers physical risk as direct damage to assets or property which may have downflow effects of defaulting on loans due to inability for payment by affected borrowers or an increase in insurance claims.[20]
    a) In 2019, the Queensland floods led to damages amounting to approximately $1.24 billion in insurance costs with the ABC estimating the number of addresses where insurance was unaffordable or unavailable to rise from 445,000 addresses to 718,000 by 2100.[21] The modelling showed that there already existed towns with predominantly uninsurable addresses. For example, the town of Bourke already had 95% of addresses noted as being uninsurable in 2019.
    b) In northern Queensland, one holiday resort owner found a treble increase in their insurance premiums to insure their buildings.[22]
    c) It is estimated that by the end of 2021Q1 there will be approximately 11,700 insurance claims arising from the floods earlier this year in Western Sydney.[23] The estimated insurance bill by April 2021 was approximately $537 million.[24]
17. As RSE licensees are some of the largest investors of infrastructure in the Australian market, the physical financial risks of climate change will no doubt impact on the ongoing viability of investment in infrastructure by super funds. For example:
    a) It was a consortium comprised of SunSuper, the Commonwealth Superannuation Corporation and the Future Fund which had recently agreed to purchase a 49% stake in Telstra's dedicated InfraCo for approximately $2.8 billion.[25]

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[20] APRA (n 17).
[21] Inga Ting et al, 'The rise of red zones of risk', *ABC News* (online, 23 October 2019) <https://www.abc.net.au/news/2019-10-23/the-suburbs-facing-rising-insurance-costs-from-climate-risk/11624108?nw=0>.
[22] Sofie Wainwright, 'Insurance cripples northern Australians as they wait on promised Government action to stem rises', *ABC North Queensland* (online, 26 October 2020) <https://www.abc.net.au/news/2020-10-28/rising-insurance-costs-crippling-northern-australians/12816848>.
[23] Ian Wright, 'Please, don't look away. The NSW flood recovery will take years and people still need our help', *The Conversation AU* (online, 7 June 2021) <https://theconversation.com/please-dont-look-away-the-nsw-flood-recovery-will-take-years-and-people-still-need-our-help-161792>.
[24] Elias Visontay, 'NSW urged to buy thousands of flood-prone homes in western Sydney', *The Guardian AU* (online, 10 April 2021) <https://www.theguardian.com/australia-news/2021/apr/10/nsw-urged-to-buy-thousands-of-flood-prone-homes-in-western-sydney>.
[25] Zoe Samios, 'Telstra sells towers stake for $2.8b to return half the money to shareholders', *Sydney Morning Herald* (online, 30 June 2021) <https://www.smh.com.au/business/companies/telstra-sells-towers-stake-for-2-8b-to-return-half-the-money-to-shareholders-20210630-p585gn.html>.

b) Australia's second largest superfund, AwareSuper, possesses an infrastructure portfolio amounting to approximately $9.5 billion in size.[26] Infrastructure investment is common especially amongst the large industry super funds.

c) In a submission to Treasury Consultation on the draft YFYS, Infrastructure Partnerships Australia mentioned that APRA data showed approximately $111.5 billion was invested by Australia's super funds in infrastructure.[27] They also noted the importance of the superannuation system in injecting capital in infrastructure required to assist with Australia's COVID-19 recovery.

18. The Committees note that the Australian Council of Superannuation Investors in a report in 2020 found that though there was an increase in companies which have disclosed climate footprints, very few have reported the physical risks of climate change in a meaningful manner.[28]

19. Part of the physical risks include the harm suffered by people from climate change. The recent decision in *Sharma v Minister for the Environment* [2021] FCA 560 (***Sharma***) demonstrates that there is a new risk for any expansion for an investment in any 'dirty' industries such as the resources or manufacturing sectors. In the decision of *Sharma*, the Federal Court of Australia found that there was real risk of death or personal injury in bushfires caused by climate change.[29] Although the Court did not restrain the Minister for Environment from making a decision (as no decision had been made yet), it did recognise the duty of care owed to Australian children.[30] The decision of the Minister on whether to approve the expansion of the mine would need to be consistent with this duty of care. This leads to the issue of RSE licensees being exposed to holding 'dud' assets explored below.

Transition Risk

20. The Draft PPG considers transition risk as incidental consequences of an adjustment to a low-carbon economy including stranded assets and impacts on pricing and demand.

a) In a report in 2020, Deloitte concluded that unchecked climate change would cost Australia in average annual terms across 50 years a reduction in economic growth of 3% p.a. and around 310,000 jobs p.a.[31] One example mentioned by the report is the decision of Brown Brothers,

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[26] Daniel Kemp, 'Aware Super to prioritise direct investments over new fund commitments', *Infrastructure Investor* (online, 5 April 2021) <https://www.infrastructureinvestor.com/aware-super-to-prioritise-direct-investments-over-new-fund-commitments/>.
[27] Infrastructure Partnerships Australia, 'Submission in Response to Your Future, Your Super Exposure Draft Legislation', 21 December 2020 <https://treasury.gov.au/sites/default/files/2021-02/c2020-124304_infrastructure_partnerships_australia.pdf>.
[28] Australian Council of Superannuation Investors Ltd, 'Promises, Pathways and Performance: Climate change disclosure in the ASX200' (Research Report, 18 October 2020) 23.
[29] *Sharma v Minister for the Environment* [2021] FCA 560, [253] (Bromberg J).
[30] Ibid [491], [510] (Bromberg J).
[31] Deloitte Access Economics, A new choice: Australia's climate for growth (Report, November 2020) <https://www2.deloitte.com/au/en/pages/economics/articles/new-choice-climate-growth.html>.

a wine manufacturing company that had been located in Victoria for 120 years, to move to Tasmania due to climate being more favourable for their business operations. As the warmer temperatures in Victoria can cause grapes to ripen earlier and affect grape quality, the company expanded into Tasmania's east coast for the cooler climate.[32] Deloitte also cites concerns of regional economies in Queensland, Western Australia and the Northern Territory being casualties of climate change.[33] This demonstrates the impact of climate change which are challenging the long-standing viability of certain sectors operating in certain geographic regions.

b) PwC in a report last month focusing on the Top 40 mining companies in the world (where 3 of the top 4 are Australian) noted a trend of divestment from thermal coal by key players BHP (ranked 1st largest), Rio Tinto (2nd), Vale (3rd) and Anglo American (9th). PwC considered these deals to be defensive to 'safeguard shareholder value as coal goes out of favour' noting that growth deals in this space were rare.[34] Finally PwC noted that the number of acquisitions of coal assets dropped from 5 in 2018 to none in 2019 and 2020.[35]

c) The BHP 2020 Annual Report reveals that many of its largest 20 shareholders hold shares as a nominee or custodian with the Commonwealth Superannuation Corporation as 9th largest shareholder through custodian HSBC and Hub24, a platform service, the 16th largest shareholder through custodian BNP Paribas.[36] AustralianSuper, the largest super fund in Australia by membership, holds approximately $2.4 billion of BHP shares in its balanced investment option as at the end of 2020.[37]

21. The Committees note YFYS would include portfolio holdings disclosures which would enable members to understand where their superannuation assets are invested in and could exercise choice to act according to their ESG appetite. These create a residual transition risk for RSE licensees due to the difficulty of changing investments on an ad hoc basis and could result in crystallising any loses from 'dud' or 'dirty' assets. Furthermore, there exist residual risks from policy decision-making overseas or shareholder activism. For example, the Hague District Court's decision of *Milieudefensie v Royal Dutch Shell* issued the equivalent of a mandatory injunction compelling Shell to reduce its emissions

[32] Fiona Breen, 'Rising temperatures spark 'race to Tasmania' for winemakers escaping heat', ABC News (online, 5 June 2016) < https://www.abc.net.au/news/2016-06-05/rising-temperatures-spark-winemakers-move-to-tasmania/7371262>.
[33]Deloitte (above n 30).
[34] PwC, *Mine 2021: Great expectations, seizing tomorrow* (Report, June 2021) 20 <https://www.pwc.com.au/mining/global-mine-2021.html>.
[35] Ibid 5.
[36] BHP, *BHP Annual Report 2020* (Annual Report, 2020) 347 <https://www.bhp.com/-/media/documents/investors/annual-reports/2020/200915_bhpannualreport2020.pdf>.
[37] 'AustralianSuper – Balanced', *AustralianSuper* (Web Page) <https://portal.australiansuper.com/investments-and-performance/what-we-invest-in/superannuation-premixed-investment-options/balanced.aspx>.

by net 45% by 2030.[38] While this is only provisionally enforceable pending appeal by Shell, the Court found that all CO2 emissions regardless where in the world the emissions are made would contribute to climate damage in the Netherlands.[39]

22. There is also growing shareholder activism on the issue of climate change. In particular:
    a) Rio Tinto made history by being the first Australian company to support shareholder activism on the issue of climate change.[40] Similar shareholder activism has been engaged against companies overseas with Chevron targeted by the same group who led investors to call for emissions cuts at Shell and BP.[41]
    b) The fears of divestment are gradually being reassured. For example, BlackRock Investments found that divestment from ‘dirty’ assets by pension funds in the USA led to more financially sound decisions as fossil fuel driven-stocks tanked and underperformed.[42]
    c) Australia is slowly becoming a change leader in the space of climate change litigation as noted by King & Wood Mallesons.[43] With a greater willingness for courts to hear these forms of disputes, RSE licensees expose themselves to liability from members, the public and any applicable shareholders.
23. Therefore, it is the view of the Committees that to safeguard the superannuation system from unacceptable exposure to climate change, APRA should require RSE licensees to explain why they are holding on to:
    a. ‘dirty’ assets which possess high transition costs due to the inherent climate impact these assets possess e.g. thermal coal mines; and
    b. ‘dud' assets which possess extreme risk exposure to external climate impacts e.g. infrastructure assets which may no longer be insurable within their investment horizon because those types of assets are no longer viable for that geographic region.

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[38] *Mileudefensie et al v Royal Dutch Shell Plc*, Hague District Court C/09/571932/HA ZA 19-379 (English) (26 May 2021).
[39] ‘Climate Change Litigation Bombshell: Dutch Lower Court Orders Royal Dutch Shell to Reduce CO2 Emissions’ *Jones Day Commentaries* (Web Page, June 2021) <https://www.jonesday.com/en/insights/2021/06/climate-change-litigation-bombshell-dutch-lower-court-orders-royal-dutch-shell-to-reduce-co2-emissions>.
[40] Nick Toscano, ‘Rio Tinto swings behind activist shareholder demands on climate’, *Sydney Morning Herald* (online, 19 March 2021) <https://www.smh.com.au/business/companies/rio-tinto-swings-behind-activist-shareholder-demands-on-climate-20210318-p57c3y.html>.
[41] Jasper Jolly, ‘Climate activist shareholders to target US oil giant Chevron’, *The Guardian Australia* (online, 20 May 2021) <https://www.theguardian.com/business/2021/may/20/climate-activist-shareholders-to-target-us-oil-giant-chevron>.
[42] Tom Sanzillo, ‘IEEFA: Major investment advisors BlackRock and Meketa provide a fiduciary path through the energy transition’, *Institute for Energy Economics and Financial Analysis* (Blog Post, 22 March 2021) < https://ieefa.org/major-investment-advisors-blackrock-and-meketa-provide-a-fiduciary-path-through-the-energy-transition/>.
[43] Daisy Mallett and Sati Nagra, ‘Climate change litigation – what is it and what to expect?’, *King & Wood Mallesons Insights* (Blog Post, 27 February 2020) < https://www.kwm.com/en/au/knowledge/insights/climate-change-litigation-what-is-it-and-what-to-expect-20200227>.

24. The Committees acknowledge Parliamentary rejection of the proposed investment powers and regulation making powers under the best financial interests' duty of RSE licensees as part of YFYS, however, as the prudential regulator, APRA may still ensure that RSE licensees engage and manage climate risk through guidance, the issue of prudential standards, and/or imposition of licence conditions.
25. The Committees also acknowledge that inaction by RSE licensees in the past has led to litigation.[44] Indemnity from fund assets by a RSE licensee due to climate change financial risks is not in the best interests of members and compromises member and retirement outcomes.

3. Disclosure

Recommendation

7. The Committees recommend that a voluntary or additional disclosure regime would enhance investor confidence. Such disclosures should be consistent and easily comparable.

26. The Committees consider that a voluntary or additional disclosure will be beneficial to an institution by enhancing trust, building confidence and facilitating greater transparency in respect of the institution within the broader market.[45] The Committees note there is a growing number of companies that have responded to the call for climate-related disclosures.[46] This is in line with the focus on reputational risk and ESG reporting under increasing scrutiny by investors, government bodies, employees and the wider community.[47]
27. The Committees consider that a standard disclosure should be adopted across a range of sectors, industries and/or portfolios. The Committees note that reporting driven by disclosure frameworks such as the Financial Stability Board's Task Force for Climate-related Financial Disclosures (**TCFD**) is likely to be located in the annual reports. For example, JPMorgan reported that most mining companies that were analysed have released sustainability reports along with their annual reports.[48]
28. The Committees support the avenues for assessing the rigour of an institution's climate-related disclosures.[49] The Financial Stability Board expressed the characteristics of effective disclosures to be consistent, comparable, reliable, clear and efficient.[50] While not an exhaustive list, effective

[45] Sharmini Chetwode et al, 'Carbon offsets: Tools for the low carbon transition' (Equity Research, Goldman Sachs, June 2020) 3.
[46] Ibid 24.
[47] Ibid.
[48] Fagan (n 5).
[49] Sharmini Chetwode et al (n 51) 25.
[50] Financial Stability Board, *Proposal for a Disclosure Task Force on Climate-related Risks* (9 November 2015).

disclosures are likely to arise from companies and stakeholders aligning themselves with such practices.[51] The Task Force also advised the principles for effective disclosures include representing information that is relevant and verifiable and provided on a timely basis.[52]

29. The Committees acknowledge there may be a degree of correlation between the size of the institution and level of environmental disclosure.[53] The reasons underpinning greater disclosure from large institutions may include:
    a) the ability to absorb the cost, time and investment in producing the reports;
    b) the political and shareholder pressure is often greater on large institutions; and
    c) multiple country regulations that larger institutions have to comply with.[54]
30. The Committees consider that APRA should collate and publish disclosure metrics as guidance for reporting for industries it regulates on a periodical basis. The recent *TCFD Forward-looking Financial Metric Consultation* revealed that half of the 209 respondents agreed that disclosure would be worth the effort with further standardisation of metrics.[55] While institutions focused on improving their disclosure practices may be better positioned long-term, the Committees note this should be supplemented by appropriate guidance to assist institutions with complying with existing prudential requirements as well as domestic and international engagement with other regulators.

[51] Ibid.
[52] Task Force on Climate-related Financial Disclosures, Financial Stability Board, *Recommendations of the Task Force on Climate-related Financial Disclosures* (Final Report, 15 June 2017) 18.
[53] Fagan (n 5).
[54] Ibid.
[55] Task Force on Climate-related Financial Disclosures, Financial Stability Board, *Forward-looking Financial Metrics Consultation* (Summary of Responses, March 2021) 9.

Concluding Comments

NSW Young Lawyers and the Committees thank you for the opportunity to make this submission. If you have any queries or require further submissions please contact the undersigned at your convenience.

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