Actuaries Institute.

1 December 2023

Sustainable Finance Unit
Climate and Energy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: sustainablefinanceconsultation@treasury.gov.au

Dear Sir/Madam,

Consultation paper: Sustainable Finance Strategy

The Actuaries Institute ('the Institute') welcomes the opportunity to provide feedback on this consultation paper issued November 2023. The Institute is the peak professional body for actuaries in Australia. Our members work in a wide range of fields including insurance, superannuation and retirement incomes, enterprise risk management, data analytics, climate change impacts and government services. We have a longstanding commitment to contribute to public policy discussions where our members have relevant expertise.

We support the key objectives of the Sustainable Finance Strategy ('the Strategy'). The Strategy will be a critical foundation to supporting the Government's objective in meeting its emissions reduction target, which will require a significant amount of private and public investment for an orderly and positive economic transition.

Set out below are our responses to specific questions in the consultation paper.

Question 1: What are the opportunities for Government, regulators and industry to support companies to develop the required skills, resources and capabilities to make climate disclosures under the proposed new obligations? *(Page 11)*

The Government is implementing mandatory climate-related financial disclosure requirements for large companies and financial institutions, proposing to commence 1 July 2024 for largest listed and unlisted companies. Like any regulatory disclosure change, the Government and regulators need to support companies by releasing timely and clear guidance. Examples of best practice disclosures are also helpful for companies disclosing for the first time.

There should be a dedicated stream for dealing with industry Q&A, including validity of disclosures and audit function. Furthermore, the Government could provide or endorse simplified, free scenario modelling tools, guidance and templates for climate disclosures.

For scenario analysis, we note in New Zealand that the Insurance Council of New Zealand produces scenarios for the general insurance industry and the international Network for Greening the Financial System (NGFS) has released the NGFS IIASA Scenario Explorer.

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APRA also needs to update the CPG 229, originally released in 2021, to reflect these new changes. The Institute would also expect that this Guidance will be phased out and replaced by a Standard or Requirement. There is also potential to incorporate climate-related disclosures into each of the Life Insurance Prudential Standards or General Insurance Prudential Standards.

Question 2: How should the Government, regulators and industry prepare for global developments in sustainability-related financial disclosure frameworks and standards, including the TNFD? *(Page 11)*

There should be careful consideration of phasing and sequencing across different parts of the financial system to not overwhelm the capacity and smooth functioning of the system. For example, for financed emissions to be reported by asset owners, banks and insurers, the financed assets themselves must be producing reliable disclosure data so sequencing is important.

There should also be careful consideration of the disclosure and reporting requirements applicable to Australian branches and subsidiaries of global entities that are already reporting under comparable frameworks and standards, such that the Australian requirements are not unreasonably onerous or inconsistent in application relative to the global reporting.

Question 5: What are appropriate long-term governance arrangements to ensure that the taxonomy is effectively embedded in Australia's financial and regulatory architecture? (*Page 16*)

There should be a regular review of taxonomy every year at the beginning of implementation, then every 2-years after the first 3-year period. This can be assigned to the Taxonomy Technical Expert Group (TTEG) as they will be developing the taxonomy with the Council of Financial Regulators Climate Working Group.

Science-based criteria will change over time and is subject to feedback. A regular review means Australia would stay up-to-date with the latest developments from international bodies.

To ensure the taxonomy is embedded, awareness and education at the start is important. There needs to be education for investors and consumers on how to use and read the taxonomy.

Question 6: What are key gaps in Australian capability and practice, including relative to 'gold standard' approaches to transition planning developed through the TPT and other frameworks? *(Page 19)*

Corporate transition planning requires forward-looking statements covering an entity's targets, actions, and/or resources for its transition towards a lower-carbon economy, including actions to reduce its greenhouse gas emissions. A key gap is that stakeholders need a better understanding of the existing rules that apply to forward-looking statements and how these should be applied to transition planning (for example, guidance on reasonable grounds for making forward looking statements in relation to climate risk), thereby improving compliance and reducing risk of litigation or regulatory action.

As transition planning is not being voluntarily included in financial statements at present, users of these statements will need help understanding how to interpret and use this information. For example, there are instances where it is possible for "real world" emissions to increase while disclosed emissions appear to reduce. This could happen if an intensity-based measure only is used; or if the financed portion of a company reduces from one period to the next this can mean financed emissions go down even if real world emissions go up. It is important to close the capability gap that exists among many users of financial statements to enable them to interpret and interrogate transition plans and emissions disclosures.

Question 7: To what extent will ISSB-aligned corporate disclosure requirements improve the transparency and credibility of corporate transition planning? What additional transition disclosure requirements or guidance would be most useful in the medium-term? *(Page 19)*

IFRS S2 incorporates many specific disclosure requirements regarding transition plans, with the overall goal of enabling primary users to understand the impact of climate-related risks and opportunities on a company's strategy and decision-making. This could prove useful, for example, when a company needs to explain whether a climate-related risk it has identified is physical or transitional in nature. In addition, companies will also have to disclose the amount and percentage of their assets or business activities that are vulnerable to transition risks specifically. For companies that have already developed a transition plan, IFRS S2 requires them to disclose key information about:

- Critical assumptions and/or dependencies that they identified when developing their transition plan; and
- How they are resourcing, or plan to resource, the activities outlined in their transition plans.

  Mandatory disclosure of this information is likely to improve the transparency and credibility of corporate transition planning, but additional guidance on the following could be useful:

- Expectations and guidance around how to explain deviation of actual emissions from target emissions from one reporting period to the next;
- Sector average transition pathways (emission-intensity based) so that users of these disclosures can compare companies to an independently verified "average"; and
- What classifies as capital expenditure on activities outlined in a transition plan as these activities may serve multiple purposes, for example, emissions reduction and asset upgrade.

Sector average emissions intensities could be linked to the Sector Plans that are currently under development and due to be released by Government in 2024.

Question 13: Are there specific areas where the Government or regulators could further contribute to market-wide understanding of systemic sustainability related risks, including climate-related financial risks? *(Page 25)*

Very few historic government or regulator assessments of climate risk have been market-wide or covered the whole system. An example is APRA's Climate Vulnerability Assessment (CVA) for banks was done separately to the CVA for insurers. Little is known about how the insurance of homes and Australia's residential mortgage debt could together interact with climate risk, and furthermore the impact on systemic risk when the interaction of climate risks with other risks such as interest rates and inflation are considered.

Similarly, in the 2023 Intergenerational Report (IGR), the four climate risk impacts that were included were modelled independently of one another, and of global/systemic risks of climate change. While this is an excellent start in reflecting climate risk in this key Report, by not allowing for dependence between climate risks or the known risk of "compound events" the costs are likely to be materially understated.

The IGR separately modelled:

- The impact of heat stress on labour productivity (the estimated cost range of $135-423 billion is solely reflective of the effect of heat on labour productivity, and this is roughly equivalent over next 40 years to an average yearly effect of around 0.3% of today's GDP);
- The impact of heat stress on agricultural crop yields;
- The impact on tourism flows and expenditure; and
- The impact of natural disasters of bushfires, tropical cyclones, floods and storms, but excluding drought and heatwaves.

In reality these events are all likely to occur together as a "compound event" with a total cost much greater than the sum of its parts. For example, drought and hot spells affect agriculture, increase bushfire risk and reduce labour productivity all at once. In addition, as climate change progresses more multiple climate shocks happen simultaneously around the world.

We acknowledge the significant additional complexity and uncertainty in understanding and modelling compound events, that this is a rapidly evolving area of research and that to at least some extent their existence and consequences are incorporated in the IPCC's Shared Socio-economic Pathways (SSPs), which have underpinned parts of the IGR.

We therefore encourage the collaboration across parts of government and regulators to include both modelling the dependence between parts of the financial system and compound events to further support Australia's capacity to make an orderly transition to net zero, in line with the objectives of the Sustainable Finance Strategy.

Question 16: Do you agree that the existing regulatory and governance frameworks and practices have adapted well to support the better integration of sustainability-related issues in financial decision making? Are there barriers or challenges that require further consideration? This may include: … regulation of the superannuation system … (Page 30)

Page 29 of the consultation paper states that the Government's decision to extend the superannuation performance test lookback period from eight to ten years will encourage long-term investment approaches, including the investment in the transition to net zero. We continue to have very significant concerns with the revised test, including that it is, in fact, still a major inhibitor to superannuation funds adopting sustainability-related issues in financial decision making. The constraining impact of the Your Future Your Super (YFYS) performance test on investment activities relating to ESG, sustainability and carbon transition has been regularly raised as a concern by industry. The test encourages superannuation funds to "hug" the test benchmarks otherwise risk the severe consequences of failing the test. For example, the prescribed test benchmark for Australian equities (S&P/ASX 300 Total Return Index) does not include an ESG filter, and superannuation funds that choose to apply an ESG filter when investing in Australian equity assets risk under (or over) performance when measured against the test's benchmark. Consequently, the test can act to the detriment of a sustainable finance strategy.[1] We support recent comments from the Assistant Treasurer that the performance test will need to evolve into a more enduring test[2], and believe that the evolution of the performance test should incorporate improvements so that it does not constrain investment activities relating to ESG, sustainability and carbon transition.

If you would like further information or to arrange a meeting to discuss this submission, please contact me on (02) 9239 6100 or executive@actuaries.asn.au.

Yours sincerely
(Signed) Elaine Grace
CEO

[1] Actuaries Institute submission of 2 May 2023 Consultation: Superannuation Performance Test Regulations 2023, and submission of 16 August 2022 Consultation: Faith-based products.

[2] Stephen Jones, Address to the AFR Super and Wealth Summit 2023 | Treasury Ministers, 31 October 2023.