December 01, 2023

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

Submitted via: SustainableFinanceConsultation@treasury.gov.au

Dear Sir/Madam,

The Treasury's Consultation on Australia Sustainable Finance Strategy (the "Consultation")

MSCI[1] welcomes the opportunity to comment on the Consultation on Australia's Sustainable Finance Strategy. We are a leading provider of ESG and climate data to the world's largest financial institutions and have collected climate and ESG related disclosures from thousands of companies globally for over two decades.

MSCI supports the Australian Government's policy objective of a comprehensive Sustainable Finance Strategy that will enable Australian firms to access the capital needed to finance their own transitions.

We have 4 general comments set out below and offer more detailed responses to the Annex I to this cover letter.

1. **Disclosure standards for climate change and ESG should be aligned with ISSB standards and other international reporting frameworks.** We support the proposed alignment of Australia's corporate disclosure framework with the International Sustainability Standards Board ("ISSB")[2] standards. The Treasury should consider acknowledging the growing prominence of wider sustainability matters which are becoming increasingly important to investors and other users of sustainability data, namely nature and biodiversity. Aligning with ISSB standards would enhance global comparability and investor-friendly disclosures by Australian entities. The ISSB standards, which also includes the disclosure of transition plans, offer a solid foundation for transparency and credibility, with a proposal for early adoption from July 2024 by the Australian Accounting Standards Board in its exposure draft standards.[3]
2. **Principles-based voluntary code of conduct for ESG ratings provider, instead of regulations.** MSCI shall welcome the development of voluntary principles-based Code of Conduct for ESG ratings based on the recommendations included in the IOSCO Final

1 MSCI ESG Ratings, research and data are produced by MSCI ESG Research LLC.

2 Exposure Draft IFRS S2 Climate-related Disclosures (IFRS | March 2022)

3 Exposure Draft ED SR1 Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information (aasb.gov.au)

Report on ESG Ratings and Data Products Providers. We support efforts that enable global and domestic rating providers to offer an independent, high-quality service to investors while adhering to important principles such as conflicts of interest management, transparency of methodologies and consistent application of rating methodologies. The Treasury may also note that the Code should not extend to data products or data providers, as it presents a number of challenges:

a. The universe of what constitutes “ESG data” is broad and rapidly evolving.
b. Not feasible to regulate the entire supply chain of raw data.
c. Principles of conduct that may be appropriate for ESG ratings present significant challenges if applied to “data services”.

The above challenges are further elaborated in the Annex (refer response to Q12).

3. **Considerations for the design of a sustainable investment product labelling regime**. Developing standards for a labeling regime for sustainable investment products could provide much required clarity about the objectives of the fund to a retail investor. The Treasury should draw insights from the EU's experiences in defining investment thresholds aligned with sustainability criteria. The Treasury should exercise caution against implementing rigid quantitative thresholds while developing standards to prevent unintended exclusions of certain categories of sustainable funds though not labelled as sustainable. It is crucial for the framework to include a transition category, recognizing funds contributing to transitional efforts without explicit ESG labels, ensuring alignment with decarbonization targets and transparent progress metrics.
4. **Effective transparency and disclosures could address greenwashing.** Uncertainties in sustainability claims arise from diverse market expectations, therefore we suggest a focus on transparency and enhanced disclosures. The Treasury should focus on the effectiveness of corporate disclosure, the development of action plans to clarify terminology in policy and regulatory frameworks and to set out clear expectations regarding transparency related to sustainability claims made by product owners and service providers.

We have set out in Annex 1 our detailed responses to the questions posed in the Consultation. While the Consultation covers a range of issues, we comment only on those matters where MSCI’s experience are most relevant.

Please do not hesitate to contact us to discuss our submission.

Yours faithfully,

/s
Ryan Mensing
Executive Director, Global Head of Policy
Government and Regulatory Affairs

Annex 1 – Responses to questions from the Consultation

Priority 1 - Establish a framework for sustainability-related financial disclosures

Q1. 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?

No comment.

Q2. How should the Government, regulators and industry prepare for global developments in sustainability-related financial disclosure frameworks and standards, including the TNFD?

The Treasury's policy objective of establishing a climate reporting framework aimed at providing investors with high quality, consistent and useful company disclosures is critically important in helping direct capital towards those activities that will shape the transition to a more sustainable economy. We are pleased that the Treasury and the Australian Accounting Standards Board ("AASB") have aligned the proposals in the second Consultation[4] and the exposure draft on Australian Sustainability Reporting standards with the final ISSB standards.[5,6]

The UK, New Zealand, Canada have stated that they will look to use the ISSB framework as their 'baseline'.[7] In the APAC region, Singapore and Philippines have already initiated steps to align their disclosure framework with the ISSB standards.[8] Beyond the ISSB, there are merits in considering the climate-related disclosure standards that were recently published in New Zealand by the External Reporting Board ("XRB").[9] Considering the large number of entities that operate across both Australia and New Zealand, and are listed in both markets,[10] the Treasury may want to also reference the New Zealand standards by the XRB when developing its own framework.

While developing the requirements for entities to report climate-related disclosures, the Treasury should consider acknowledging the growing prominence of wider sustainability matters which

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4 Climate-related financial disclosure: Second consultation (Australia Government – Treasury | 27 June 2023)

5 ISSB issues inaugural global sustainability disclosure standards (ISSB | 26 June 2023)

6 Exposure Draft ED SR1 Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information (AASB | 23 October 2023)

7 UK: PS21/24: Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers; New Zealand: Climate-related Disclosures » XRB; Canada: Canadian securities regulators consider impact of international developments on proposed climate-related disclosure rule - Canadian Securities Administrators (securities-administrators.ca).

8 Singapore: Singapore's Sustainability Reporting Advisory Committee Recommends Mandatory Climate Reporting for Listed and Large Non-Listed Companies; Philippines: SEC To Issue Revised Sustainability Reporting Guidelines For Publicly Listed Companies

9 Climate-related Disclosures » XRB.

10 Connecting New Zealand companies with global capital (ASX).

are becoming increasingly important to investors and other users of sustainability data, namely nature and biodiversity.

Task Force for Nature-related Disclosures (TNFD): The TNFD is one such global network which has developed a standard framework to report nature related risks and is gaining acceptance globally. Biodiversity and climate change are inextricably linked. Biodiversity loss reduces nature's ability to absorb greenhouse gases — forests, wetlands and oceans annually absorb 5.6 gigatons of carbon. Climate change, in turn, takes a bigger toll on nature.[11] We are seeing that regulators around the world are intensifying their focus on the destruction of ecosystems and the TNFD has developed a standard framework to report related risks.[12] Investors inevitably will be encouraged or mandated to integrate biodiversity loss into their portfolio decisions.

Developing a draft standard for biodiversity-related disclosures is one of the priority areas for ISSB as laid out in the Consultation on Agenda Priorities.[13] In the EU, the European Financial Reporting Advisory Group ("EFRAG") has already included biodiversity reporting as part of the set of European Sustainability Reporting Standards ("ESRS"), which was adopted by the EU Parliament in October 2023.[14]

Geospatial data for biodiversity and deforestation risks: Geospatial analysis, as suggested by the TNFD, may help investors and companies assess region-specific biodiversity risks. MSCI research found that 39% of MSCI ACWI constituents had assets in biodiversity-sensitive areas, with metals and mining companies representing a high share of assets in sensitive areas with limited practices to manage these risks.[15] By requiring entities to disclose metrics around their exposure to biodiversity and deforestation risks, investors will get access to a more comprehensive understanding of an entity's nature-related risks.

Priority 2: Develop a Sustainable Finance Taxonomy

Q3. What are the most important policy priorities and use cases for an Australian sustainable finance taxonomy? What are the key insights from international experience to date?

No comment.

Q4. What are priorities for expanding taxonomy coverage after the initial focus on climate mitigation objectives in key sectors?

No comment.

Q5. What are appropriate long-term governance arrangements to ensure that the taxonomy is effectively embedded in Australia's financial and regulatory architecture?

No comment.

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11 Biodiversity: The New Frontier of Sustainable Finance - MSCI.

12 Recommendations of the Taskforce on Nature-related Financial Disclosures (TNFD | September 2023).

13 Request for Information: Consultation on Agenda Priorities. (ifrs.org)

14 EFRAG welcomes the final adoption of the ESRS by the European Institutions. (EFRAG)

15 Location Matters: Using Geospatial Analysis to Assess Biodiversity Risks - MSCI.

Priority 3: Support credible net zero transition planning

Q6. 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?

Though advisable to conduct a comparative analysis of the transition plan disclosures by Australian entities along with the TPT framework, the TPT framework or any other transition plan disclosure framework may be embedded in the regulatory or policy initiatives before conducting such an exercise. The Australia Government may also consider the non-financial and financial frameworks while developing transition plan frameworks.

Non-financial - Task force on Climate related Financial Disclosures ("TCFD"), Science Based Target Initiative ("SBTi"), ESRS and U.S. SEC proposed climate disclosure rule.

Financial - Partnership for Carbon Accounting Financials **("**PCAF"), Glasgow Financial Alliance for Net Zero ("GFANZ"), Net Zero Asset Owner Alliance ("NZAOA"), Net Zero Banking Alliance ("NZBA"), Network for Greening the Financial System ("NGFS")

The following aspects of may be considered by the Treasury while developing a disclosure framework -

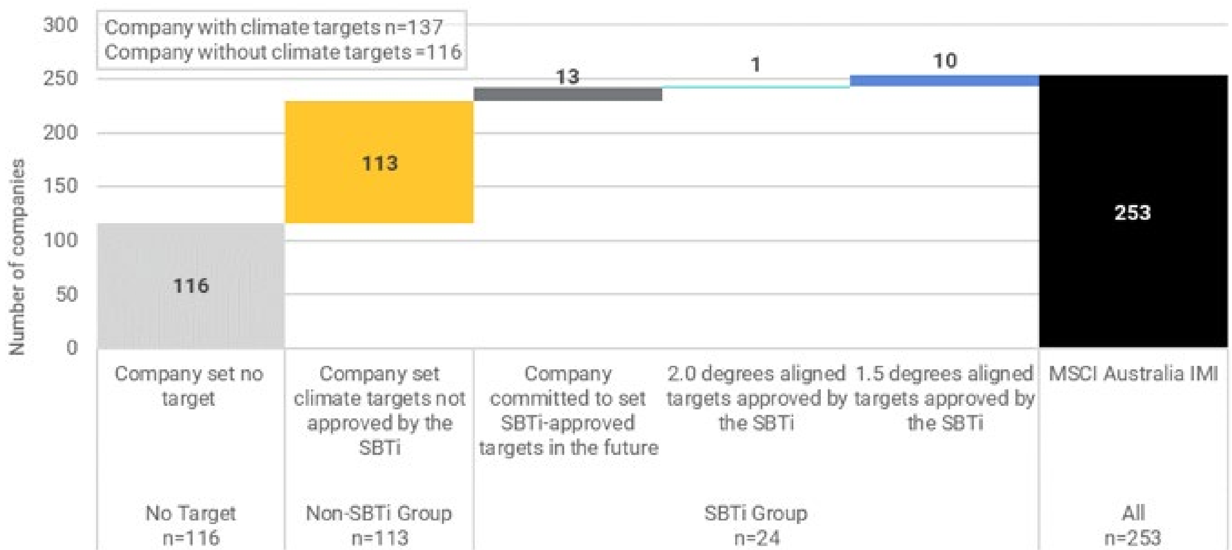
Entities should disclose robust and credible transition plans: To enable investors and other market participants to build a comprehensive picture of how an entity plans to transition to a lower-carbon economy, it may be helpful for the climate disclosure requirements to include disclosures recommended by the TCFD's transition plan elements.[16] This includes but is not limited to metrics. The transition plan should describe metrics the entity will monitor to track progress against plans and targets, including related operational and financial performance metrics, metrics aligned with the cross-industry, climate-related metric categories, and industry-specific or organization specific metrics.

Entities should disclose science-based targets: As per MSCI ESG Research, it has been observed that an increasing number of companies are setting climate targets, including net-zero emission targets. Of the 253 constituents in the MSCI Australian IMI as of August 31, 2023, 54% (137 companies) have set climate targets. Of these, only 24 companies have committed to SBTi standards, with 11 having set targets already approved by the SBTi and 13 having committed to setting SBTi-approved targets in the future. We also found 113 companies set climate targets without commitments to the SBTi standard.[17]

[16] TCFD, Guidance on Metrics, Targets and Transition Plans, October 2021.

[17] Science Based Target Initiative, Net Zero Standard.

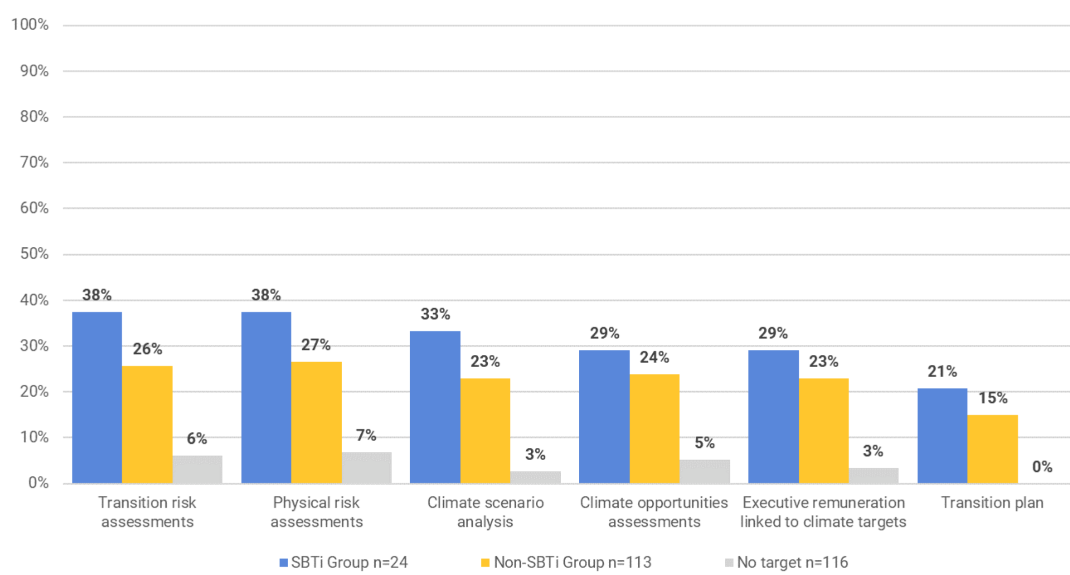
Exhibit 1: Variation in climate targets across companies in the MSCI Australia IMI



Source: MSCI ESG Research as of August 31, 2023

The GFANZ, for example, has proposed its own framework to help investors assess the credibility of corporate climate targets or likelihood that those targets will be met. We found companies with SBTi-approved targets typically scored better in the GFANZ framework than those without (see Exhibit 1). This may suggest that companies that went through a rigorous third-party target-validation process (e.g., SBTi) were more likely to have disclosed transition planning, executive pays linked to climate target achievement and transition risks and climate opportunities assessments — increasing the transparency of emissions-reduction strategies and enhancing the feasibility of climate targets.

Exhibit 2: Credibility assessments of constituents of the MSCI Australia IMI with climate targets



Source: *CDP. Company Disclosures. MSCI ESG Research as of August 31, 2023.*

MSCI has developed a three-part framework, the Climate Target Scorecard, for assessing the robustness of corporate decarbonization targets that may provide some guidance on what matters for investors (see table below).[18] The framework evaluates a company's climate commitments based on their comprehensiveness, ambitions and feasibility.

Analytical Framework	**Descriptions**	**Key Components**
Comprehensiveness of the target	Does the target focus on the majority of a company's emissions?	Type; Unit; Target scopes; Target coverages; and Percentage of company footprint covered by the target.
Ambition of the target	How much and how quickly does a target aim to reduce emissions?	Remaining emissions reduction; Normalized reduction per year; Target year; Projected target emissions against net-zero trajectory in 2030; and Projected target emissions against net-zero in 2050.
Feasibility of the target	How feasible is a given target, and how much confidence can investors have in its achievement?	Track record of meeting previous targets; Progress on active targets; Intention to use carbon offsets; Revenue from climate change solutions; and Decarbonization strategy by scope and category.

Q7. 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?

The disclosure of transition plan under the IFRS S2 Climate-related standards could be a good starting point to improve transparency and credibility of transition plans. The same also has been incorporated in the AASB exposure draft standards and an early adoption from July 2024 could enhance disclosures of transition plans. The Treasury may keep a close watch on the disclosures and the consistency of disclosures across sectors; to monitor results against the targets set by corporates.

Q8. Are there related priorities and opportunities for supporting enhanced target setting and transition planning for nature and other sustainability issues?

The following are the related priorities that should be considered while developing a transition plan disclosure framework –

18 Breaking Down Corporate Net-Zero Climate Targets (MSCI | May 2021).

1. **Priority should be given to transparency on the emissions reduction targets.** This is critical in assessing whether or not an organisation aims to align its transition plans with net zero or Paris- aligned targets. Further, the following elements should be added:

- Quantitative short and medium-term targets

- Any information regarding the methodology used to derive a temperature alignment

- Adjustments required to the business model to meet the target Alignment to a just transition framework is important to ensure an “orderly” transition.

2. **Target Setting**

- All the elements described are aligned to best practices around target setting and reporting

- We consider target coverage and / or boundaries to be critical to be able to measure the target impact in terms of emissions.

- An organisation should disclose its reliance on carbon offsets, how the offsets it uses are generated, and the credibility and integrity of the scheme from which the entity obtains the offsets.

3. **Management activities and plans** - To support ambitions and targets and to have sufficient cross-organisational ownership, plans need to be built with the direct involvement of management.

4. **Internal Policies** - To support management activities and plans, internal company policies can add credibility and emphasize the commitment of an organization to the transition.

5. **Products and Services** - As the real-world economy needs to decarbonise, products and services need to adapt to a carbon-constrained world. Being able to understand carbon savings from changes in products or services and importantly any plans to invest/develop low carbon products can act as an important forward-looking signal for investors. The value chain plays an important factor in the carbon footprint associated with a product or service and should be considered in line with emerging international standards on climate disclosure.

6. **Value Chains / Portfolio** - A company’s Scope 3 emissions are a critical component in understanding its complete emissions footprint. Engagement needs to be aimed at reducing value chain and portfolio emissions outside of the control of the organisation but in cooperation with suppliers.

7. **Public sector** - Direct and indirect lobbying needs to be aligned with the wider purposes of decarbonization. Focus should be given to partnering with public and private stakeholders to best align the development of real-world solutions.

8. **Metrics and Monitoring progress** - To support targets and ambitions, metrics and monitoring efforts need to be established and regularly reported. The disclosure of GHG emissions, business and financial KPI’s is critical to monitor how the organisation is executing its targets, business plan and finances during the transition.

9. **Skills, Incentives and accountability**

- The development of skills establishing appropriate incentives that include all stakeholders will support a just transition.

- Accountability may be a key factor in the success of an organisation's ambition and targets, thus the link of executive compensation to GHG targets is critical.

10. **Governance, roles and responsibilities** - Establishing plans and activities, monitoring and achievement, requires governance oversight

Priority 4: Develop a labelling system for investment products marketed as sustainable

Q9. What should be the key considerations for the design of a sustainable investment product labelling regime?

A legislation on sustainable investment product label will bring clarity to the retail investor and ensure the products are true to the label. Currently, the UK is planning a labelling regime,[19] and the EU has proposed to amend the Sustainable Finance Disclosure Regulation (SFDR) from a disclosure / transparency regime to a labelling regime. When developing the standards for a labelling regime, the Government could consider the experiences that other jurisdictions have had with establishing a similar system and draw out any lessons which can then be applied in the Australian context. One such example is the European Commission's efforts to introduce the EU Ecolabel for retail financial products.

The following are some of the key considerations for designing the standards for a labelling regime -

1. Australian Taxonomy to define environmentally sustainable economic activities – The Australian taxonomy is currently in the initial phase and caters to the environmental objective of "climate mitigation". In the EU, one noticeable challenge is to define the threshold of investments required to be made in environmentally sustainable economic assets. According to the latest version of the EU Ecolabel's proposed criteria - the fourth report by the Joint Research Centre – Ecolabel badged funds must invest certain minimum percentages of assets under management in 'environmentally sustainable economic activities', i.e., those qualifying as such under the EU Taxonomy for Sustainable Activities.[20] This is a stringent criterion to meet considering that the investment universe, or pool of eligible securities aligned with the taxonomy, is limited. If the Treasury proposes a minimum percentage, such an assessment may be required to be carried out by the Treasury while laying down any minimum standards that qualifies to use a sustainability label.

2. Quantitative thresholds to qualify for a prescribed sustainability label. Quantitative thresholds are effective mechanisms to provide clear criteria for classifying funds, the Treasury may also note that their fixed nature does not come without drawbacks. For example, thresholds may have an uneven impact as disclosure and data availability vary across regions, particularly in emerging markets, and asset classes. The uniform application of a fixed threshold may operate to exclude asset classes and regional investment that may otherwise align with

[19] CP22/20: Sustainability Disclosure Requirements (SDR) and investment labels (FCA | 25 October 2022)

[20] The fourth report by the Joint Research Centre (JRC). JRC Technical Reports - Development of EU Ecolabel criteria for Retail Financial Products. MSCI is part of the sub-group of the JRC created by the European Commission to develop a voluntary EU green label for green themed funds.

ESG and sustainable investment objectives. Further, as the ESG and sustainable investment landscape continues to evolve, the thresholds set for minimum standards today may not be fit for purpose indefinitely. Therefore, we recommend that any standards for a labelling regime with thresholds should not unintentionally and categorically exclude certain types of ESG or sustainable investment opportunities.

3. Transition category also needs to be taken into account, even if it is not using "ESG" or other sustainability terms – While drafting standards, the specific provisions should allow for "transition" or "transition-related" ESG and sustainability names for funds that allocate investments based on commitments and actions to meet transition and science-based targets. The Treasury should recognise that a supportive framework is needed to address the challenge of financing interim steps in the urgent transition of activities towards Australia's climate neutrality and environmental objectives. Without a transition category, funding from the capital markets will not flow in an optimal manner to these transitioning companies and fail the objective of the Treasury to support financing the transition to sustainability and phased transition efforts. We suggest that the standards establish a framework for the use of transition-related names rather than a quantitative threshold. The framework would include alignment of portfolio decarbonisation targets with a net zero transition pathway accompanied by metrics to communicate target progress and achievement.

Q10. How can an Australian model build off existing domestic approaches and reflect key developments in other markets?

No comment.

Priority 5: Enhancing market supervision and enforcement

Q11. Are Australia's existing corporations and financial services laws sufficiently flexible to address greenwashing? What are the priorities for addressing greenwashing?

One of the primary drivers of uncertainty around sustainability-related statements arises from differing expectations from market participants as to what should qualify as "sustainable". For example, one market participant (Group 1) may expect that no fossil fuel companies are found in a portfolio labelled as sustainable whereas others (Group 2) may expect categories of fossil fuel companies to be included in a sustainable portfolio. Group 1 may assert that any claim to sustainability may be misleading and evidence of "greenwashing" whereas Group 2 may have a very different view. The concept of "sustainability" (and other related terms) lies on a spectrum and without an unambiguous definition for all products and services as to what is sustainable and what is not, there will continue to be assertions of misleading claims. Recognising that this may be difficult to achieve as market perceptions continue to change, the most effective and realistic mitigant to "greenwashing" lies in effective transparency and disclosure. We would suggest the Treasury focus on the effectiveness of corporate disclosure, the development of action plans to clarify terminology in policy and regulatory frameworks and to set out clear expectations regarding transparency related to sustainability claims made by product owners and service providers.

Q12. Is there a case for regulating ESG ratings as financial services?

We support efforts that enable global and domestic rating providers to offer an independent, high-quality service to investors while adhering to important principles such as conflicts of interest management, transparency of methodologies and consistent application of rating methodologies. Regulatory policy should enable rating providers to be more capable of responding to innovations and meeting demands in a continuously evolving market. A mandatory regulatory framework for the industry may be too inflexible for such a nascent industry. **MSCI welcomes the development of voluntary principles-based Code of Conduct ("Code") for ESG ratings based on the final recommendations included in the IOSCO Report.**

1. **Voluntary principles-based Code of Conduct for ESG ratings based on the recommendations included in the IOSCO Final Report** - Policymakers have a unique opportunity to incentivise investment into sustainable finance and help shape the market framework to encourage a longer-term assessment of risk. MSCI stands ready to support this market transition. We welcome principles of conduct that create the foundations for ESG rating best practices such as those mentioned below:
   - *Conflicts of interest* - MSCI operates under strict policies and procedures that (1) protect against conflicts of interest (arising from, for example, relationships with or pressures from issuers, investors or government officials) impacting our ESG ratings and (2) ensure that our ratings are independent. All employees of our ESG ratings business are trained on, and certify to, our policies and procedures at least annually, with additional targeted training taking place throughout the year.
   - *Quality* – We have over 200 analysts globally who analyse data originating from corporate disclosures as well as from media, academic, non-governmental organisations (NGOs), and regulatory and government sources. MSCI has developed significant modelling capabilities which assist in transforming varied sources of unstructured data into derived data and meaningful research insights.
   - *Transparency* – We have made our ESG ratings,[21] ratings process and underlying methodology publicly available at no cost on our website.[22] Our clients have always had access to fully documented methodologies and to regular feedback processes for methodology enhancements.
2. **Code of Conduct should extend to other service providers who offer ESG ratings as a complementary service to their primary business.** The scope of the Code should not be limited in application to ESG rating providers who offer this service as part of their primary business and should extend also to other service providers who offer ESG rating products as a complimentary service to their primary business, for example, asset managers ("Other Service Providers"). The objective of the Code should be to protect users of ESG ratings. If Other Service Providers are left out it will leave Australia's domestic market exposed to ESG ratings that may suffer from conflicts of interest and would be to the detriment of the Australian capital market. For example, a fund manager assigning a score/rating to its own fund will face conflicts of interest in promoting investment into the fund and assigning an objective rating to that fund. Other Service Providers will not be required to publish a rating methodology or the meaning of their ratings, leaving investors unable to distinguish or ascertain the quality of the ratings assigned. Therefore, the Code should apply to all ESG ratings that have an external use,

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21 ESG Ratings Corporate Search Tool.

22 *See* MSCI ESG Ratings Process available at: https://www.msci.com/esg-and-climate-methodologies

including those developed internally by Other Service Providers and used in external publications.

3. **Should only cover ESG ratings and not ESG data**. Further, the Treasury may note that the Code should extend only to ESG ratings and not to "ESG data products" or "ESG data providers" as it presents a number of challenges:
   - **The universe of what constitutes "ESG data" is broad and rapidly evolving.** Cybersecurity, political risks, weather models and governance indicators are just a few examples of what could be captured as data used for ESG purposes. Defining boundaries and/or devising rules across so many different types of data sources is not feasible and will create an overly broad regulatory framework that is not appropriately tailored, stifles innovation and slows down the rapid evolution of solutions to assist the market in understanding and measuring ESG risk and opportunities.
   - **Not feasible to regulate the entire supply chain of raw data.** A Code that seeks to capture "ESG data products" and/or "ESG data providers" is difficult to apply in practice. A framework that seeks to capture "ESG data products" and/or "ESG Data Product Providers" is difficult to apply in practice. For example, publishing methodologies and procedures for the computation of data, which could extend to thousands of data points is not equivalent to the publication of a defined universe of methodologies. Publishing the underlying computations for ESG data is not feasible, undermines intellectual property and discourages service providers from creating solutions to address ESG risk.
   - **Principles of conduct that may be appropriate for ESG ratings presents significant challenges if applied to "data services".** For example, publishing methodologies and procedures for the computation of data, which could extend to thousands of data points within an analytical solution is not equivalent to the publication of a defined universe of methodologies. Publishing the underlying computations for ESG data is not feasible, undermines intellectual property and discourages service providers from creating solutions to address climate and ESG risk.

Priority 6: Identifying and responding to potential systemic financial risks

Q13. 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?

Climate scenario models, analysis or tools are of paramount importance to gauge the effects of climate change spread across various time horizons. Scenario analysis provides a powerful tool for financial institutions to understand the implications of climate change for their portfolios. However, one of the major challenges is the use of varied scenarios and tools by financial institutions, which means that results may not be comparable. Secondly, financial institutions are expected to determine which climate-related and environmental risks are material in the short, medium and long term with regard to their business strategy by using scenario analysis. The assumptions can span from quantitative and/or qualitative factors and not solely based on historical experiences.

We note that there are a range of models currently available in the market to assist financial institutions with forward-looking scenario analysis for certain lines of business. Financial institutions use tools made available by MSCI, such as Climate Value-at-Risk to gain a forward-looking lens when conducting scenario analysis. For example, by calculating the financial risks from climate change per security and per scenario, Climate Value-at-Risk provides a framework that can help banks identify and understand these risks and take necessary action for effective risk management and regulatory reporting purposes. The MSCI Climate Value-at-Risk model has three main underlying components which can be used separately or in aggregate:

1. **Policy risk**: This component aggregates future policy costs based on an end of the century time horizon. By overlaying climate policy outlooks and future emission reduction price estimates onto company data, the model provides insights into how current and forthcoming climate policies could affect companies.
2. **Technology opportunities:** This component is based on company-specific data on the patents each company holds related to low-carbon technologies, providing insights into how companies' strategic investments could affect their future competitive positioning in a low carbon economy.
3. **Physical risks:** This component estimates the impact and financial risk relating to several extreme weather hazards, such as extreme heat and cold and flood risk. An extensive asset location database comprising of over 400,000 company facilities has been overlaid with hazards maps. Based on sector-based vulnerabilities, each location's climate-related revenue loss for eight extreme weather hazards is computed with the help of damage and business interruption functions.

Different models and scenarios lead to results that are not comparable. While this gives financial institutions some flexibility to choose a model for self-examination, it is important for the market to be able to effectively compare the results of a prescribed scenario analysis on various financial institutions. This could be solved by having a minimum set of specific climate scenarios to consider. It would further be helpful if Australian Prudential Regulation Authority (APRA)'s guidance around scenario analysis were to provide examples of acceptable Representative Concentration Pathways (RCPs), Integrated Assessment Models (IAMs) and/or Shared Socioeconomic Pathways (SSPs) and prescribe precise time horizons.
Regulators around the world are adopting scenarios developed by the NGFS and requiring banks and financial institutions to align their climate stress tests accordingly (e.g., Bank of England[23], European Central Bank[24], Hong Kong Monetary Authority[25]). We observe that financial authorities, including regulators and supervisory bodies, are increasingly involved in assessing climate-related financial risks and conducting stress tests for banks and insurance companies to quantify their exposure to these risks. Such exercises were completed in the Netherlands and France, and are underway in the EU, the UK, Australia, Singapore and Canada.[26] More countries are expected to integrate climate-related risks into macroprudential regimes for the financial

[23] Key elements of the 2021 Biennial Exploratory Scenario: Financial risks from climate change (Bank of England | 2021)

[24] ECB Banking Supervision launches 2022 climate risk stress test (europa.eu) (ECB | January 2022)

[25] Pilot Banking Sector Climate Risk Stress Test (hkma.gov.hk) (HKMA | December 2021)

[26] FSI Insights on policy implementation No 34 Stress-testing banks for climate change – a comparison of practices (FSI | July 2021)

sector in the future.[27] We support improved climate data collection from financial institutions to make stress tests comparable and evaluate whether climate change risks threaten financial stability.

Priority 7: Addressing data and analytical challenges

Q14. What are the priorities for ensuring that data-related initiatives already underway are tailored to meet the needs of firms and investors?

No comment.

Q15. What key sustainability data gaps or uncertainties faced by financial institutions in Australia should be prioritised by the CFR?

No comment.

Priority 8: Ensuring fit for purpose regulatory frameworks

Q16. Do you agree that existing regulatory and governance frameworks and practices have adapted well to support better integration of sustainability-related issues in financial decision making? Are there barriers or challenges that require further consideration? This may include:

– Corporate governance obligations, including directors' duties

– Prudential frameworks and oversight, including in relation to banks and insurers

– Regulation of the superannuation system and managed investment schemes

No comment.

Q17. What steps could the Government or regulators take to support effective investor stewardship?

No comment.

Priority 9: Issuing Australian sovereign green bonds

Q18. What are the key expectations of the market around issuance of, and reporting against, sovereign green bonds? What lessons can be learned from comparable schemes in other jurisdictions?

No comment.

Q19. What other measures can the Government take to support the continued development of green capital markets in Australia?

The Treasury may consider developing a Green Bond framework that closely aligns with international standards while maintaining flexibility to respond to technological progress required for a net zero transition. If an Australia bond standard is developed, we recommend convergence with international standards, in particular around low carbon, transitional and enabling activities. Alignment with emerging frameworks such as the proposed EU Green Bond

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[27] NGFS publishes the report "Scenarios in Action: a progress report on global supervisory and central bank climate scenario exercises" | Banque de France (NGFS | October 2021)

Standard would help such a convergence. This will assist issuers across the world in issuing bonds that qualify as Australia-aligned green bonds.

Priority 10: Catalysing sustainable finance flows and markets

Q20. What role can the CEFC play to support scaling up of sustainable investment in Australia, as part of a more comprehensive and ambitious sustainable finance agenda?

No comment.

Q21. What are the key barriers and opportunities for the CEFC to support financing and market development in areas with significant climate co-benefits, including nature and biodiversity?

No comment.

Priority 11: Promoting international alignment

Q22. What are the key priorities for Australia when considering international alignment in sustainable finance?

No comment.

Priority 12: Position Australia as a global sustainability leader

Q23. What are other key near-term opportunities for Australia to position itself as a global leader in sustainable finance and global climate mitigation and adaptation?

No comment.

Q24 What are some longer-term international sustainability goals for Australia where sustainable finance can play a role?

No comment.

Q25. What are the key market, regulatory and institutional barriers to increasing private sector engagement in blended financing opportunities? How can these barriers be overcome?

No comment.

Q26 What are other means to mobilise private sector finance toward sustainability solutions in the Indo-Pacific region?

No comment.