DISCUSSION PAPER RESPONSE

ASFA DISCUSSION PAPER: CLIMATE CHANGE RISKS

18 October 2021

This consultation response represents the view of the PRI Association and not necessarily the views of its individual members.

INTRODUCTION

The PRI is the world's leading initiative on responsible investment. Globally, the PRI has over 4,000 signatories (superannuation funds, insurers, investment managers and service providers) with approximately US $121 trillion in assets under management. Over 197 signatories, managing AUD $2.6 trillion are based in Australia.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

The PRI welcomes the opportunity to respond to the Association of Superannuation Funds of Australia's (**ASFA**) discussion paper on climate change risks.

ABOUT THIS DISCUSSION PAPER

ASFA has released a discussion paper on climate change risks (**Discussion Paper**) and is seeking feedback to its views on key issues relating to these risks. The Discussion Paper explores the reasons why climate change risks are a necessary consideration for superannuation funds when making decisions and outlines some mitigation strategies that superannuation funds can use to address these risks. Among other things, ASFA is seeking feedback on:

- Whether Australian regulators have provided sufficient clarity on their expectations for regulated entities when dealing with climate change;
- Whether a target of net zero emissions by 2050 is sufficient and if the superannuation industry should be accountable to those targets;
- How the best financial interests duty interacts with net zero emissions commitments;
- What methods superannuation funds should use to reduce their exposure to climate change risks and when they should engage with businesses they are invested in for best results;
- Whether the PRI's climate change approach for asset owners supports or inhibits regulatory expectations of superannuation funds in respect to climate change risks;

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SUMMARY OF PRI POSITION

The PRI welcomes engagement with the matters raised by ASFA in its Discussion Paper. Climate change and the net-zero transition are now widely recognised as some of the most significant risks facing society, the economy and financial markets. International market practice, financial regulation and industry guidance regarding the management and mitigation of these risks is also rapidly developing.

To effectively discharge their duties to act in the best interests of their beneficiaries, Australian superannuation funds must be enabled and supported to manage the systemic risks associated with climate change, to the greatest extent possible. In this context, strong leadership from respected industry bodies like ASFA is welcome and much needed.

In response to ASFA's discussion paper, the PRI's key recommendations are:

- Australian regulators should provide clearer guidance on the actions that superannuation funds need to take to mitigate and manage systemic climate change related risks, in the best long-term interests of their beneficiaries;
- To help their members mitigate systemic climate change related risks, leading national industry bodies like ASFA should provide support, guidance and thought leadership on the adoption and realisation of net-zero by 2050 targets and strategies.
- Regulators and industry bodies should support more effective stewardship practices to enhance superannuation funds' capacity to help mitigate systemic climate change related risks, including through the development of a harmonised stewardship code.
- The PRI's guidance for asset owners on climate change provides a useful starting point for superannuation funds when considering how to mitigate climate change related risks, but will need to be adapted for individual circumstances.

DETAILED RESPONSE

CLIMATE CHANGE RISK & SUPERANNUATION

Question 1: Have Australian regulators been clear enough in their expectations of organisations when dealing with climate change risk?

We welcome the increased recognition of Australian regulators (including APRA, ASIC & the RBA), the Council of Financial Regulators[1], and Treasury[2] of the significant risks that climate change poses, both generally and specifically to financial markets. However, it is our position that regulators' existing guidance can and should be improved. Our specific recommendations on how APRA could improve its draft Prudential Practice Guide CPG 299 Climate Change Financial Risks are set out in our consultation response to APRA. In particular, we recommend that:

- APRA should provide a clearer statement of its expectations in relation to identifying climate related risks as material risks within institutions' risk management frameworks;
- APRA should set an explicit expectation that prudent entities conduct scenario analyses that are aligned to the Paris Agreement's goals of limiting warming to well below two degrees and aiming for 1.5°C;
- Treasury, APRA and ASIC should phase in an internationally consistent economy-wide mandatory climate disclosure regime, aligned with the TCFD framework by 2024; and
- APRA should clarify that climate change presents a systemic, non-diversifiable risk for superannuation fund performance and beneficiary outcomes, permitting and requiring investment and stewardship activities intended to influence real-world emission reductions.

Noting the comments in the Discussion Paper that superannuation funds must consider how climate change risks impact their investment strategy, we would also like to draw attention to the updated legal opinion from Noel Hutley QC & James Mack, clarifying that superannuation trustees are obliged to not only assess these risks but manage them accordingly.[3] In this respect, we reiterate our view that managing systemic climate change risk will likely require trustees to consider and pursue real world emissions reductions through investment decision making and stewardship activities.

NET ZERO EMISSIONS COMMITMENT

Question 2: Do you support an objective of the superannuation industry being accountable for net zero emissions by 2050 (in terms of their investments)? Is that ambitious enough – should we be aiming for 2040?

Actions by superannuation funds to set and pursue targets to achieve net zero GHG emissions by 2050 or earlier are now emerging as best practice internationally for the management of systemic climate change related risks.

[1] Council of Financial Regulators. (2021, September 28). *Climate change activity stocktake* 2021. https://www.cfr.gov.au/publications/policy-statements-and-other-reports/2021/council-of-financial-regulators-climate-change-activity-stocktake-2021/

[2] The Hon. Josh Frydenberg MP. (2021, September 24). *Financial markets are preparing for climate change and so must we*. https://joshfrydenberg.com.au/latest-news/financial-markets-are-preparing-for-climate-change-and-so-must-we/

[3] Hutley, N. C., & Mack, J. E. (2021, February 16). *Memorandum of opinion: Superannuation trustee duties and climate change*. https://equitygenerationlawyers.com/wp/wp-content/uploads/2021/04/Hutley-SC-Mack-Superannuation-Trustee-Duties-and-Climate-Change-Memo-2021.pdf.

The PRI is a convenor of the [Net Zero Asset Owner Alliance](#) (**NZAOA**), which is an international group of 56 institutional investors (representing over USD 9.3 trillion AUM) that have made public commitments to transition their portfolios to net zero GHG emissions by 2050. The NZAOA has published numerous resources to support other asset owners in adopting a similar approach, including a [target-setting protocol](#) to help facilitate best practice and greater accountability in relation to methodologies and frameworks.

Across the globe, countries are rapidly committing to net zero targets. The UK, Japan, the European Union, Canada, New Zealand and South Korea have all legislated 2050 net zero targets. Other countries, like the US, Brazil, South Africa, and China have policies committing the countries to net zero by 2050 (or 2060 in the case of China).[4]

Australia must reach net zero emissions by 2050 at the latest to align with the Paris Agreement's goal of limiting global temperatures to 2°C. Climate science indicates that to achieve these goals, Australia should reduce emissions by at least 50% on 2005 levels by 2030.[5] PRI supports the Australian government committing to net zero by 2050 and introducing Paris aligned interim targets.

In order to manage the risks associated with these rapidly developing policy responses and the broader transition to net-zero of the global economy, superannuation funds should be encouraged and supported in setting and pursuing their own net-zero targets. To help their members mitigate systemic climate change related risks, leading national industry bodies like ASFA should provide support, guidance and thought leadership on the adoption and realisation of net-zero by 2050 targets and strategies.

Question 3: How does the "best financial interests" duty interact with the net zero emissions commitment?

In light of the widespread consensus about the financial risks associated with climate change, it is our understanding that the "best financial interests" rule requires superannuation funds to consider and manage these risks. In order to do so, many are committing to net zero emissions targets and taking investment and stewardship actions necessary to achieve those targets. The PRI is supportive of this approach.

According to recent analysis carried out by the law firm Freshfields Bruckhaus Deringer, superannuation funds are permitted to select stocks and steward assets to reduce emissions for the purposes of achieving financial returns.[6] As universal owners with widely diversified portfolios, superannuation funds long-term returns are heavily dependent on macroeconomic trends in the real-world economy.[7] In this respect, climate change is one of the most significant systemic and non-

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[4] Energy & Climate Intelligence Unit. (2021). Net zero emissions race scorecard. https://eciu.net/netzerotracker.

[5] Climate Targets Panel. (2021, January). *Updating the climate change authority's 2014 emissions reduction targets*. https://www.climatecollege.unimelb.edu.au/files/site1/docs/%5Bmi7%3Ami7uid%5D/ClimateTargetsPanelReport.pdf; Climate Targets Panel. (2021, March). *Shifting the burden: Australia's emissions reduction tasks over coming decades.* https://www.climatecollege.unimelb.edu.au/files/site1/docs/%5Bmi7%3Ami7uid%5D/Climate%20Targets%20Panel%20Report%20-%20March%202021.pdf; Other reports suggest emissions should be reduced by 75% on 2005 levels by 2035 and net zero much be achieved by 2035 to achieve the more ambitious goal of 1.5°C: see, eg, Climate Council. (2021). Aim high, go fast: Why emissions need to plummet this decade. https://www.climatecouncil.org.au/wp-content/uploads/2021/04/aim-high-go-fast-why-emissions-must-plummet-climate-council-report-210421.pdf; Climate Targets Panel. (2021, March). *Shifting the burden: Australia's emissions reduction tasks over coming decades.* https://www.climatecollege.unimelb.edu.au/files/site1/docs/%5Bmi7%3Ami7uid%5D/Climate%20Targets%20Panel%20Report%20-%20March%202021.pdf

[6] Freshfields Bruckhaus Deringer, The Principles for Responsible Investment, United Nations Environment Programme Financial Initiative, & the Generation Foundation. (2020). *A legal framework for impact: Sustainability impact in investor decision-making*. https://www.unpri.org/download?ac=13902. Australian Annex [2.2.30]-[2.2.40], [3.2.2]-[3.2.5].

[7] Hawley, J., & Lukomnik, J. (2018). The third, systems stage of corporate governance: Why institutional investors need to move beyond modern portfolio theory. *SSRN*. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3912977.

diversifiable risks. Consequently, there is a clear rationale for superannuation funds to pursue net zero commitments that align their portfolios and with emerging global trends and at the same time mitigate climate change in the real world to achieve financial returns for their portfolio as a whole.

Question 4: What role will products such as green bonds play in meeting the net zero emissions commitment? What other products need to be created to achieve the net zero emissions commitment?

We welcome any opportunity to explore with ASFA what regulatory framework would enable the development of products that would help investors meet their net zero commitments.

The PRI has been supporting regulators to develop sustainable finance taxonomies in both the European Union and China. The EU taxonomy is being developed to provide investors with a tool to identify whether certain economic activity significantly contributes and does no harm to environmental objectives, including climate mitigation. Similarly, China's taxonomy is being developed to classify green activities for bond issuers. In both jurisdictions, we are working to ensure that these respective taxonomies support investors goals of achieving net zero commitments.

We recognise that Australian regulators are currently monitoring the development of international taxonomies and discussing potential Australian approaches.[8] Accordingly, we would welcome the opportunity to work with ASFA and other industry bodies on regulatory recommendations for sustainable products to ensure investors can meet their net zero commitments.

ENGAGEMENT WITH BUSINESS

Question 5: What other methods could superannuation funds use to reduce their exposure to climate change risk? At what point should superannuation funds begin to engage businesses they are invested in for best results?

Stewardship is a necessary tool for superannuation funds to reduce their exposure to climate change risks, both physical and transition risks. Indeed, given the systemic nature of climate risk which pose threats to entire sectors and portfolios, stewardship which seeks to reduce investee companies' emissions should play a central role in investors' responsible investment approach. Accordingly, we are supportive of superannuation funds actions to engage with businesses through formal and informal stewardship practices.

As ASFA points out, engagement and shareholder voting are an important part in enabling funds to mitigate climate change related risks and reach their net zero commitments. To achieve these commitments most effectively, enhanced collaboration between superannuation funds and other investors is required.[9] Enhanced collaboration spreads superannuation funds' costs of addressing goals, such as achieving net zero commitments.

Collaborative action can occur using investment powers or stewardship (including policy engagement) and may involve alignment between investors on specific objectives for investee companies.[10] Examples of formal collaborative alliances that would support superannuation funds achieving net zero emissions include: Climate Action 100+ and the Net Zero Asset Owners Alliance.

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[8] Council for Financial Regulators. (2021, September). Climate change activity stocktake 2021. https://www.cfr.gov.au/publications/policy-statements-and-other-reports/2021/council-of-financial-regulators-climate-change-activity-stocktake-2021/
[9] Ibid, [B2.2. Box 2].
[10] The Principles for Responsible Investment. (2019). *Active ownership 2.0: The evolution stewardship urgently needs*. https://www.unpri.org/download?ac=9721.

When addressing systemic risks like climate change, robust stewardship and effective collaboration can enhance engagement outcomes. We encourage ASFA to provide stewardship guidance and support to its members in line with the PRI's approach to active ownership. In light of emerging global best practice, we would also welcome the opportunity to support regulators to more fully integrate stewardship into the regulatory framework in order to encourage high quality and standardised stewardship practices.

PRINCIPLES FOR RESPONSIBLE INVESTMENT

Question 6: Does PRI's three-step approach support or stand in the way of regulators' expectations of superannuation funds in relation to climate change risk?

PRI's climate change approach for asset owners supports APRA's, ASIC's, and other regulator's work on climate change risks. PRI's guide on Climate Change for Asset Owners introduces the topic of climate change to asset owners. It aims to explain the importance and relevance of climate change in the context of the investment process and to outline how asset owners might incorporate this into responsible investment policies, investment processes and stewardship practices.

The PRI's guide on Climate Change for Asset Owners highlights the need for asset owners to consider climate change factors in relation to existing investment, engagement and disclosure practices. It also provides extensive examples of actions they can take to do so, and links to resources with more detailed information. The guide is part of PRI's work to help investors protect their portfolios from climate related risks, to identify new opportunities and outline processes to help asset owners engage on this topic.

The PRI has experience of public policy on sustainable finance policies and responsible investment across multiple markets and stands ready to further support the work of ASFA to help its members respond to, manage and mitigate systemic climate change related risks, in the best interest of their beneficiaries.

More information on https://www.unpri.org/policy