EXECUTIVE SUMMARY

Climate change is not some distant threat. It is a global tragedy unfolding before our eyes, disrupting ecosystems, communities and economies. For companies, investors and financiers the risks and opportunities are immediate and pressing. The expectations of markets and policymakers on emissions reduction targets and adaptation measures are ramping up. Customers, shareholders and regulators demand increasingly sophisticated responses. If Australian businesses and company directors fail to react urgently and coherently, then they will jeopardise their own future: assets will be stranded or uninsurable, investment will stall, debts will go unpaid, and companies will collapse.

An effective response requires effective disclosure — a frank acknowledgement of the threat that climate change poses to fixed assets and financial liabilities, and the potential for stricter controls on emissions and rapidly changing technology to disrupt established business practices profoundly. Adequate, timely disclosure is essential for appropriate pricing of risk and opportunity. Otherwise, capital will not flow to where it can be best used, profits will fall, and investments will fail.

This report focuses on a pivotal component of this bigger picture — the use of climate scenario analysis to help businesses plan for, and adapt to, an uncertain future.

One year ago, the International Taskforce on Climate-Related Financial Disclosures (TCFD) called on firms and investors to conduct scenario analysis in order to assess and disclose potential business, strategic, and financial implications of climate-related risks and opportunities. Since then, leading financial regulators, institutions and global investors have backed the TCFD recommendations as best practice. They have emphasised that scenario analysis can be a key driver of better corporate reporting on climate-related issues and, in turn, a concerted corporate response to climate change.

CPD's 2017 discussion paper *Climate Horizons* showed how scenario analysis could help Australian companies, investors and regulators manage climate-related risks and opportunities. This report updates our findings, offers new resources for organisations coming to grips with scenario analysis, and recommends next steps for regulators and policymakers to build on the progress made.

We find encouraging support for the TCFD recommendations, but a serious deficiency in consistency and quality in disclosures — especially on scenario analysis. More organisations are conducting scenario analysis and disclosing the results, but the outcomes are patchy, due to a combination of stretched capabilities, imperfect resources and divergent standards. Many scenario exercises have employed questionable assumptions and overlooked the physical impacts of climate change. There is also little indication that scenario analysis has influenced corporate decisions and strategy.

Global best practice adopts more ambitious climate targets for scenario analysis. The International Energy Agency now emphasises pathways that can keep warming to 2°C or less. These include a Sustainable Development Scenario that is aligned with Paris Agreement targets and also factors in further policy goals such as achieving universal global access to modern energy by 2030. The Intergovernmental Panel on Climate Change will soon release a report on mitigation and development pathways consistent with limiting warming to 1.5°C. Some leading companies have used 1.5°C scenarios to test their exposures and strategies, and new resources are emerging for considering more disruptive technological changes, policy transitions and physical impacts. Scenarios that assume limited policy change beyond what is already announced are losing credibility, as are corporate strategies built upon them.

Boards that are not up to speed on contemporary climate scenarios expose themselves and their shareholders to substantial risk. This is not an academic issue. Companies that rely on flawed scenario assumptions are likely to overlook critical risks and opportunities. If directors are to meet their lawful duties, then scenario analysis should be central to climate-related strategy and financial reporting. Rigorous scenario exercises can showcase strategies and risk-management processes geared towards long-term value and returns. Markets and investors will punish organisations whose scenario work is not up to scratch.

Australian financial regulators should continue to support a proactive approach to climate risk reporting and sustainable finance. Decisive leadership by the Australian Prudential Regulation Authority (APRA) in 2017 has highlighted the constructive role regulators can play. Further steps by other regulators can build this momentum. The Australian Securities and Investment Commission (ASIC) should provide updated guidance to company directors on climate-related financial reporting. The Reserve Bank Australia (RBA) should join a growing global conversation about how climate change connects to its mandate as a central bank. And the Council of Financial Regulators (CFR) should review the performance of Australian companies against the TCFD guidelines this reporting season. If the voluntary TCFD framework does not deliver more consistent and accurate climate disclosures, more rigorous mandatory reporting requirements will be necessary.

Financial markets and regulators can't go it alone on climate: the Federal Government should follow moves in the UK and Europe by appointing an Australian Sustainable Finance Taskforce. There is a huge opportunity for government and industry to work together to develop a policy roadmap for green and sustainable finance in Australia. This would seize on momentum for better management of climate-related risks and opportunities, and align Australia's efforts with major strategic shifts towards sustainable finance underway in our major trading partners. The Australian Sustainable Finance Taskforce (Taskforce) can be a hybrid of the British, European and Canadian examples, which are government supported but comprise a mixture of industry, academic and civil society stakeholders. The Taskforce should be assisted by a Secretariat from the Department of Prime Minister and Cabinet and include representatives from the CFR as observers. It should be asked to report back within 12 months, after the next Federal Election, and pay close attention to how the sustainable finance classification system is finalised in Europe.