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Joint Standing Committee on Trade and Investment Growth
Inquiry into the prudential regulation of investment in Australia's export industries

Centre for Policy Development Submission

The Centre for Policy Development (CPD) welcomes the opportunity to make a submission to this Inquiry of the Joint Standing Committee on Trade and Investment Growth.

About CPD

CPD is an independent policy institute that focuses on critical long-term policy challenges, including impacts of climate change. For several years CPD has been working to highlight the cross-cutting impacts of climate change across corporate governance, the economy and Australia's financial system, and to support more coordinated responses to climate and other key systemic risks. Most recently, CPD convened a December 2020 roundtable with senior legal experts, company directors, business leaders and union and public sector representatives to consider key climate-related challenges for investors, directors and trustees. The outputs from this process, including updated legal analysis of company directors' climate-related duties, are outlined below along with other matters relating to the terms of reference.

Overview of our submission

While the Terms of Reference for this Inquiry do not mention climate change specifically, the matters raised provide a timely opportunity to examine climate-related risks and opportunities and how they are being addressed by Australia's financial institutions, investors, and regulators. This is of the focus of our submission. The key points are:

- The legal foundations for boards, businesses, and investors to understand climate risks are very clear, and the consequences of failing to properly identify, manage and disclose the financial impacts of climate are stark.
- Steps by Australian regulators to identify and respond to climate-related risks within their established mandates are necessary, proportionate and consistent with actions taken by their global counterparts.
- Given legal and regulatory developments and large shifts in global decarbonisation and demand for certain commodities, it is inevitable and necessary that financial institutions and investors factor this into their decision making.
- Structural change driven by climate impacts and decarbonisation will create major challenges, risks and opportunities for many Australian businesses and regions. These require a comprehensive national policy response that identifies a whole-of-economy strategy and roadmap for decarbonisation, and supports effective transition planning for key regions and industries.

Company directors and other decision makers have clear duties to consider the financial impacts of climate change

The law is clear for company directors

Company directors' legal obligations to consider, manage and disclose the financial impacts of climate change are now well understood and reflected in widespread practice. The influential 2016 legal opinion by Noel Hutley SC and Sebastian Hartford Davis, commissioned by CPD, found that directors who do not properly manage climate risks could be held liable for breaching their legal duty of due care and diligence.[1] Their supplementary 2019 opinion highlighted scientific, regulatory and economic developments that amounted to "a profound and accelerating shift in the way that Australian regulators, firms and the public perceive climate risk". It concluded these factors had considerably elevated the standard of care directors must discharge on climate-related issues, and concluded that directors' exposure to climate change litigation was "increasing, probably exponentially, with time".[2]

CPD released a further supplementary opinion by Noel Hutley SC and Sebastian Hartford Davis on 26 April 2021, informed by a December 2020 CPD roundtable on directors' duties and climate risks. This updated opinion emphasised that the benchmark for directors continues to rise, and highlighted particular risks around 'greenwashing' as scrutiny of corporate climate-related targets and commitments grows:

> *"It is clear the benchmark for directors on climate change and attendant risks and opportunities continues to rise. Firms and sectors with significant exposures to a decarbonising global economy are facing pressure from their shareholders and stakeholders to consider net zero strategies and commitments…The COVID-19 pandemic has elevated a focus on how firms and sectors prepare and act in respect of other foreseeable systemic risks like climate change.*
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> *In our opinion, it is no longer safe to assume that directors adequately discharge their duties simply by considering and disclosing climate-related trends and risks; in relevant sectors, directors of listed companies must also take reasonable steps to see that positive action is being taken: to identify and manage risks, to design and implement strategies, to select and use appropriate standards, to make accurate assessments and disclosures, and to deliver on their company's public commitments and targets."*[3]

The key conclusions of the 2016 Hutley opinion have been endorsed by Australia's financial regulators and reflected in practical guidance by legal advisers, governance bodies, business groups and other standard setters. These obligations to consider climate risk stem from the fact that such risks are foreseeable and that they are material to the interests of the company. That is, the obligations exist independently of measures taken by regulators to raise awareness and supervise responses on climate risk (although as the 2019 and 2021 legal opinions make clear, regulatory measures do inform the standard to which directors will be held).

[1] Noel Hutley SC and Sebastian Hartford-Davis, "Climate Change and Directors' Duties - Memorandum of Opinion", Centre for Policy Development, October 2016. [link] ("2016 opinion")
[2] Noel Hutley SC and Sebastian Hartford-Davis, "Climate Change and Directors' Duties – Supplementary Memorandum of Opinion", Centre for Policy Development, March 2019. [link]. ("2019 opinion")
[3] Noel Hutley SC and Sebastian Hartford-Davis, "Climate Change and Directors' Duties – Further Supplementary Memorandum of Opinion", Centre for Policy Development, April 2021. [link] ("2021 opinion")

Other decision makers are also duty-bound to consider climate

Directors and decision makers of organisations governed by different legal frameworks also have obligations to consider climate-related risks similar to those created by s180(1) of the Corporations Act. The 2021 supplementary opinion observed that:

> *"…[T]hese considerations apply equally to other regulated decision-makers, including directors of superannuation funds and public sector authorities, to which the law applies an objective standard. Trustee directors under the Superannuation Industry (Supervision) Act 1993 (Cth) are required to exercise the same "degree of care, skill and diligence" as a prudent superannuation entity director. Likewise, directors of public sector authorities governed (for example) by the Public Governance, Performance and Accountability Act 2013 (Cth) are required to perform their powers, functions and duties with "with the degree of care and diligence that a reasonable person would exercise" in that position."* [4]

The 2020 CPD roundtable that informed the development of the updated legal opinion concluded that super funds should "prepare for greater scrutiny of their climate-related governance and risk management". It also highlighted that, "[a]s universal owners, superannuation funds have a major interest in supporting an economically and socially sustainable net zero transition".[5] The climate-related duties of trustee directors, including in the wake of the McVeigh v REST settlement, have been assessed in more detail in a separate legal opinion by Noel Hutley SC and James Mack.[6]

Similarly, public sector boards are likely to face similar scrutiny given the extent to which climate impacts and transitions cut across the mandates of public sector corporations, entities and investments. Separate CPD analysis of this issue, building on the 2016 opinion, concluded that directors of public authorities "likely have duties of care and diligence to consider climate risk in their activities which are at least as stringent as the duties of private corporation directors." [7]

Regulators' steps on climate have been consistent with international trends

Since 2017, Australia's financial regulators have established a co-ordinated regulatory focus on climate risks. This began with a series of important interventions by APRA, ASIC and the Reserve Bank to explain how climate-related issues intersect with their mandates for corporate governance and financial system stability, and to encourage greater awareness of these risks by firms and financial institutions. It now includes comprehensive measures to: provide detailed guidance on how climate risks should be managed and disclosed (for example, through APRA's recently-released draft guidance to banks, insurers and superannuation trustees on climate-related financial risk management)[8]; increase scrutiny of how these risks and being governed and reported (for example, through ASIC's surveillance of TCFD-aligned climate risk reporting)[9]; and improve system-wide understanding of potential climate-related shocks and

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[4] 2021 opinion, [12].

[5] Summary of Conclusions, CPD roundtable on discharging directors duties relating to climate risks, December 2020 [link].

[6] Noel Hutley SC and James Mack, 'Superannuation Trustee Duties and Climate Change – Memorandum of Opinion', 16 February 2021, [link].

[7] Public authority directors' duties and climate change, Discussion Paper, Centre for Policy Development, January 2019 [link]

[8] Draft CPG 229 Climate Change Financial Risks, APRA, April 2021 [link]

[9] "Managing Climate Risk for Directors", ASIC Commissioner Cathie Armour, February 2021 [link].

vulnerabilities (for example, through the climate vulnerability assessment currently being conducted by APRA).

These measures by regulators have been responsive to demands from directors, firms and investors for greater clarity on what regulators expect and better resources to help firms understand and respond to climate risks. As APRA Chair Wayne Byres noted recently, in many respects regulators have been "pushing on an open door… The industry as a whole has been increasingly alert to the potential risks of a changing climate."[10] These measures have also supported domestic and global investor confidence that climate-related risks are being properly identified and managed in Australia's economy. This has been especially important given extremely high policy uncertainty in this area in recent times.

The approach taken by Australian regulators on climate risk is consistent with steps taken by their global counterparts. Global regulatory action on climate risk has accelerated markedly since Mark Carney and the Bank of England first drew this agenda to global prominence in 2015. Over 89 central banks and financial supervisors, including the RBA, are now part of the Network for Greening the Financial System. The NGFS has declared that "climate change is a source of financial risk" and that it is therefore "within the mandates of central banks and supervisors to ensure the financial system is resilient to these risks."[11] Similarly, the International Organization of Securities Commissions (IOSCO) has observed that: "Regulators, supervisors and businesses are increasingly recognizing climate-related risks as a source of financial risk that can affect not only specific firms or sectors but more broadly the stability of the financial system.[12]

Most recently, regulatory action on climate-related risk has accelerated in the United States. The US Securities and Exchange Commission is undertaking a review of, and seeking public input regarding, how it can best regulate, monitor, review and guide climate change disclosures.[13] Similarly, the US Federal Reserve has highlighted the significant financial implications of climate change and created a new Supervision Climate Committee,[14] while the US Treasury has recently appointed a "climate tsar" to co-ordinate a whole-of-economy response on climate change.

Global momentum on climate and decarbonisation is accelerating rapidly

Domestically and globally, financial institutions are responding to the same economic and financial trends that are shaping the regulatory response to climate risk. The impacts of climate change and measures to reduce emissions rapidly will continue to have a profound impact on businesses and reshape global trade and investment, creating major risks and opportunities. Globally, efforts to support zero-carbon transition have accelerated despite the COVID-19 pandemic and have surged following the Biden Administration's commitment to an expansive decarbonisation agenda. In 2020 and 2021, there has been an unprecedented wave of commitments by corporates, financial institutions and national economies to reach net zero emissions by 2050.[15] More than three quarters (by export volume) of Australia's top trading partners have made net zero commitments.[16] Most recently, several of the world's largest economies announced

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[10] APRA Chair Wayne Bryes, speech to CEDA, 28 April 2021. [link]
[11] A call for action: Climate change as a source of financial risk, NGFS, April 2019 [link]
[12] IOSCO, 'Sustainable Finance and the Role of Securities Regulators and IOSCO', April 2020 [link].
[13] US SEC, 'Public Input Welcomed on Climate Change Disclosures', 15 March 2021 [link].
[14] Governor Lael Brainaird, "Financial Stability implications of climate change", March 2021 [link]
[15] Transition Pathway Initiative, 'TPI State of Transition Report 2021' (2021), [link]; ClimateWorks Australia, 'Net Zero Momentum Tracker' (2021), [link].
[16] Centre for Policy Development, 'Chasing the Pack: Australia's prospects on green trade and climate diplomacy', Discussion Paper, February 2021 [link].

ambitious national medium-term emissions reductions targets, consistent with a net zero trajectory, at President Biden's April 2021 Leaders Climate Summit. Several countries are also considering border adjustment tariffs on carbon-intensive goods. This momentum is likely to accelerate further in the lead up to COP26 in November.

Given these developments it is inevitable that firms, financial institutions, and investors will increasingly consider climate-related risks and opportunities as a mainstream and material financial issue in their decision making. Individually and collectively, financial institutions, asset owners and investors are taking prudent steps to understand these shifts in global demand and adjust their portfolios to optimise their risk profile and expected returns.[17] As an export oriented and emissions-intensive economy, Australia is highly exposed to these trends. A proactive and sophisticated response by firms, investors, regulators and policymakers should be unsurprising.

Collaboration and policy leadership is needed to support a faster, fairer transition

Structural economic changes associated with climate impacts and decarbonisation will create major challenges for some industries, regions and communities, as well as major opportunities. It is important that negative impacts and difficult adjustments are not overlooked, even as opportunities for new growth industries and exports are seized. Equally, acting as though these shifts can be forestalled or reversed will merely double down on existing risks and increase prospects of disorderly adjustments and missed opportunities. This would be detrimental for industries, regions and communities themselves, as well as for Australia's competitiveness, economic dynamism and wellbeing.

Australia needs a comprehensive and ambitious economic strategy for decarbonisation, including a dedicated focus on establishing new export industries and delivering effective transition planning in key regions and industries. This is the only path to success in a global economy that will be defined by these trends, and the only way to deliver the best possible outcomes for the industries and communities with most to gain and most to lose.

CPD's work with business, regulatory and policy leaders has reiterated that the need for a co-ordinated national approach to this challenge is well understood, and has highlighted significant appetite from major stakeholders to join this effort. The *Climate & Recovery Initiative*, which CPD convenes with ClimateWorks Australia and other partners to connect policy, business and regulatory leaders on climate and COVID-recovery priorities, has highlighted that scaled-up transition planning is viewed as a key priority and missing piece by many sectors and stakeholders.[18] Our December 2020 roundtable on directors' duties and climate change demonstrated that there is real desire and willingness for collaboration across industry, investors and business leaders on these issues. It concluded that:

> *There is growing enthusiasm to collaborate across sectors and supply chains to develop and roll out low-emissions technology and to design and deliver industry-level net zero pathways…There is significant appetite for further guidance and collaboration to support more consistent and effective climate-related governance and capability…The roundtable discussion underlined the critical role business and*

[17] For e.g., Net Zero Asset Managers Initiative, [link]; Climate Action 100+, 'Climate Action 100+ Calls for Net-Zero Business Strategies and Sets Out Benchmark of Largest Corporate Emitters', September 2020 [link].
[18] Further information on the Climate & Recovery Initiative is avaible on CPD's website here.

> *finance have in managing and responding to climate risks and in supporting the transition of regions and communities impacted by the management of such risks.*[19]

Business Council of Australia President Tim Reed, who participated in CPD's December 2020 roundtable, provided this reflection after the discussion:

> *"This is a pivotal moment for shaping Australia's response to climate change and a net zero agenda. Board-level duties are well understood, climate-related capabilities are growing and proactive business leadership will be essential.* ***Ultimately, climate risk is an economic risk and requires a whole-of-economy response. To keep pace globally, Australia needs business, investors, communities and all levels of government to drive this agenda and ambition together****."*[20] [emphasis added]

Ultimately, while many stakeholders have an important role to play, a co-ordinated agenda of this type requires ambitious policy leadership at the national level. What has been missing to date is a 'north star' to guide efforts already underway, and a mechanism for coordinating responses across the many institutions with key roles to play. At a minimum, this requires an unambiguous national net zero commitment that is aligned with global counterparts and competitors, and interim targets to track progress and support near- and medium-term emissions reductions pathways. A national framework to articulate goals and pathways and monitor progress towards them will better position Australian governments, businesses and communities to meet these challenges head on. This includes, most importantly of all, the challenge of planning and delivering a just and effective transition for workers, communities and regions that are disproportionately affected by climate impacts and transitions.

Thank you for considering CPD's submission. We would be happy to provide further evidence or information if that would be useful for the Committee.

Yours sincerely

[redacted]

Travers McLeod
Chief Executive Officer

Attachments:

Climate change and directors' duties, Further Supplementary and Original Memorandum of Opinion, Mr Noel Hurley SC and Sebastian Hartford Davis, 23 April 2021.

Summary of Conclusions, Public authority directors' duties and climate change, CPD roundtable on discharging directors' duties relating to climate risks, December 2020.

[19] Summary of Conclusions, CPD roundtable on discharging directors duties relating to climate risks, December 2020 [link].
[20] Summary of Conclusions, CPD roundtable on discharging directors duties relating to climate risks, December 2020 [link].