Corporate Energy Transition
Part 1 – Disclosure

Climate-related business risks

In a February 2017 speech, APRA Executive Board Member, Geoff Summerhayes, warned that while climate risks had previously been seen as a 'future problem or a non-financial problem' this was 'no longer the case'. According to Summerhayes, climate risks were 'foreseeable, material and actionable now'.

The risks posed to businesses by climate change are generally categorised as:

1. Physical Risks: including risks posed by climate change impacts, e.g. risks of damage to company assets and disruption to operations or supply chains caused by extreme events or shifting climate patterns.

2. Transition Risks: including the risks associated with the transition to a low-carbon economy, e.g., the need to comply with changing regulatory requirements, potential litigation risks, business trends that include declining demand for carbon intensive products and new markets for climate friendly products, and reputational risks stemming from association with a particular asset or company.

Especially from 2017 onwards, there has been an upward trend in regulatory and investor expectations for the disclosure of climate risks. **Corporate law disclosure requirements** may affect corporate energy transition by:

focusing company attention on the financial risks posed by climate change and spurring the development of business strategy to manage these risks

allowing **investors to determine the risk exposure and transition strategy** of investee companies

Climate risks can **impact a company's bottom line**. Climate change also poses a significant risk to **broader financial instability**. On the flipside, there is a **range of potential business opportunities** associated with the transition to a low carbon economy, including the development of new clean energy markets and improved operating efficiencies.

Corporate law disclosure requirements

Increasingly, it is seen as **mandatory for companies to disclose climate-related risks as part of their annual mainstream reporting**, where climate change poses **material financial risks**. Supplementing general provisions in the *Corporations Act 2001* (Cth), specific updates to regulatory guidance in 2019 included:

- ASIC's Regulatory Guide 247: advises that climate change is a systemic risk that could materially impact an entity's future position and may need to be disclosed in an operating and financial review.
- ASX's Corporate Governance Principles and Recommendations: encourages entities to consider and report on material exposure to and management of climate change risks.
- AASB and AUASB's Practice Note: advises that climate-related risks should also be considered in the context of an entity's financial statements.

Climate risks may also be relevant for other disclosure obligations and reporting avenues, including **continuous reporting obligations, additional reporting requirements for mining, oil and gas companies, regulated fundraising documents** and non-compulsory **environmental, social and governance reporting**.

Oversight and enforcement

***Public enforcement*:** ASIC has a range of powers and enforcement options available for pursuing a breach of disclosure obligations. While formal enforcement action has yet to be taken, increasing surveillance by regulators suggests that this is only a matter of time.

E.g. ASIC is conducting an ongoing surveillance program into climate change risk disclosure practices by Australian listed companies. APRA plans to undertake a climate change financial risk vulnerability assessment, starting with the banks, and coordinated with ASIC and the RBA via the Council of Financial Regulators.

***Private enforcement*:** shareholder action can take a variety of forms, including claims for compensation for losses suffered as a result of misleading disclosure (e.g. via securities class actions), or claims seeking to compel a company to disclose material climate risks.

E.g. *Abrahams v Commonwealth Bank of Australia (2017)*: shareholders alleged CBA breached the Corporations Act by failing to disclose climate-related business risks. The claim was withdrawn after CBA committed to disclosures.

Emerging practices

The Task Force on Climate Related Financial Disclosures' (TCFD) 2017 recommendations provide best practice guidelines for company disclosure of climate-related financial risks. In Australia, **the TCFD recommendations have emerged as a widely accepted voluntary framework** setting out the form that disclosures – required under the principles-based reporting obligations described above – may take. Disclosure is recommended along four themes:

Governance	Strategy	Risk Management	Metrics & Targets

Scenario analysis is the key tool the TCFD recommends for entities to assess potential business, strategic, and financial implications of climate-related risks/opportunities and to disclose those in their financial filings.

Despite a good general understanding of legal obligations, the disclosure practices of Australian companies with regard to climate risks have been seen as **highly variable and, in many cases, significantly lacking in terms of coverage and quality**. While some companies have begun to disclose these risks, external investors have described the disclosure practices of Australian companies in general as 'totally inadequate', 'under-developed', 'reactive and piecemeal', 'non-strategic', 'pretty poor' and 'deeply deficient' (interviews, 2018). This was confirmed in a sample survey of TCFD-aligned reporting between 2017 and 2019.

Survey results

Mining & energy: High degree of variability across those surveyed (BHP, Rio, Santos, Whitehaven, Woodside, Origin, AGL). TCFD-aligned disclosures are in Annual Reports, separate Climate Change Reports or Sustainability Reports. While some emphasise coal or LNG, others are making improvements. Notable features include setting short, medium and long term targets and plans to reach these; disclosure of scope 1+2+3 emissions; reviewing industry association memberships; linking executive remuneration to climate change; tailored scenario analysis.

Banks & Insurance: (1) Reporting across CBA, NAB, Westpac and ANZ has remained fairly consistent over time, mostly in Annual Reports. Notable features include details of their governance and oversight structures, plus ongoing and phased implementation of scenario analysis. (2) The two insurers surveyed, QBE and Suncorp, report in either Annual Reports or Climate Change Reports, and a notable feature is their scenario analysis.

Superannuation funds: Some have started reporting in line with the TCFD in Climate Change Reports (Australian Super, UniSuper). Both note that the TCFD is designed for companies and not easily aligned with disclosure by investors.

External research has also indicated that 45.5% of reports from ASX300 companies contained little or no meaningful disclosure of climate change risk in FY19 reports (Barker et al. 2020)

Future developments

Awareness of the material financial risks of climate change is growing and there is increasing momentum towards using voluntary reporting frameworks, such as the TCFD, to disclose and manage these risks. Yet there is a need to ensure that disclosures are of sufficient quantity (i.e. entities with material exposure are reporting) and quality (i.e. adequate information to investors and other stakeholders). To this end, consideration could be given to the following:

- Formal endorsement for the **widespread adoption of the TCFD framework within a set timeframe** (e.g. UK Government, *Green Finance Strategy* 2019). Consideration may also be given to **mandating elements of the TCFD's disclosure framework for listed companies in Australian corporation law**.
- While disclosure requirements may focus internal company decision-making on material risks, they do not require entities to set targets to reduce emissions or to demonstrate contributions to global temperature goals. To this end, more ambitious steps could be taken. For example, in France, companies and investors are **required to report and quantify their performance in transitioning to clean energy**, for example, through targets for fossil fuel divestment or clean energy investment.
- Consideration to proposals tabled at the Centre for Policy Development's roundtable on climate and sustainability in November 2019, including **establishing consistent scenarios and common standards, sharing data and committing to targets**, and establishing a **government and economy-wide body** to share and develop information to understand climate-change financial risks and ways forward.