



## **DELIVERING AN INVESTABLE LONG-TERM EMISSIONS STRATEGY**

### **Summary**

The Australian and New Zealand Governments have committed to release long-term emissions strategies in 2020 under the Paris Agreement. This Policy Brief provides an overview of the role and implications of long-term emissions strategies for institutional investors, such as super and pension funds, in Australia and New Zealand.

One of the key reasons long-term strategies are included in the Paris Agreement is to promote a long-term response to climate change. Without visibility of long-term goals, short-term decisions can create path dependency by locking in high emissions infrastructure. Long-term planning also can be used to define a country's long-term competitive advantages and identify new economic opportunities.

#### *Long-term strategies and investors*

Institutional investors take a long-term view on investment and seek to manage risks across the whole economy. A clear and robust long-term strategy to manage the systemic economic risks of climate change and achieve net zero emissions would support economic growth, avoid unnecessary disruption, unlock investment opportunities, and support a just transition in communities impacted by shifting global and domestic markets.

Specifically, for institutional investors, a credible long-term strategy would support them in managing transition and physical risks and opportunities across their entire portfolios. Greater transparency around future policy direction enhances the efficient allocation of capital by supporting investors in better pricing current and future climate risks. It also reduces the risk that investments will be stranded as governments increase action through time or act abruptly with sharp policy interventions at a later date. Finally, it allows investors to identify investment opportunities across the economy and support new industries where Australia and New Zealand will have competitive advantage.

#### *Key principles for long-term strategy development*

Based on feedback from members, the Investor Group on Climate Change (IGCC) recommends six key principles to guide the development of investable long-term strategies in Australia and New Zealand:

1. Engage in extensive consultation to build community consensus on long-term emissions pathways;
2. Undertake scenario analysis to avoid the false sense of certainty that can emerge from focusing on a single scenario;
3. Build on existing public and private sector processes, such as Australia's National Hydrogen Strategy;
4. Examine risks, opportunities and synergies and avoid an overreliance on macroeconomic modelling;
5. Ensure consistency with the objectives of Paris Agreement to limiting global warming to 1.5°C and well below 2°C, and;
6. Integrate the physical risks of climate change and national adaptation strategies to ensure long-term strategies are resilient to both the transition and physical risks of climate change.

IGCC looks forward to engaging with key stakeholders further to deliver a robust long-term and climate change resistant economic development strategy for Australia and New Zealand.



## DELIVERING AN INVESTABLE LONG-TERM EMISSIONS STRATEGY

### Introduction

Institutional investors play a critical role in the long-term health of the economy and in the financial well-being of millions of Australians and New Zealanders.

Superannuation and pension holders currently hold assets valued around \$2.9 trillion dollars across both nations. Investors have a clear obligation to be managing the financial and investment implications over the longer term, and across their whole portfolio holdings.

In addition, asset owners and managers deliver broader economic benefits including stimulating economic activity through capital expenditure and supporting the development of infrastructure and property assets. These benefits add billions of dollars of value to the economy and support tens of thousands of jobs.

Institutional investors also have systemic exposure to climate change risks. These risks have been acknowledged by financial regulators globally<sup>1</sup>, and climate change has been characterised in Australia as 'material, foreseeable and actionable'<sup>2</sup>, requiring robust governance and risk management approaches from institutional investors.

Early in 2019, the Investor Group on Climate Change (IGCC) published Policies for a Resilient Net Zero Emissions Economy, setting out what investors see as the core climate change policy priorities for Australian and New Zealand Governments over the next three years<sup>3</sup>. This policy brief examines one of the key recommendations from this report:

*Australia and New Zealand should develop 2050 economy-wide strategies to achieve net zero emissions, by the end of 2020. This should establish a road map for all sectors of the economy to contribute to achieving the overall emissions goal.*

This policy brief provides further guidance on key principles which investors have identified as being important for the development of long-term strategies in Australia and New Zealand.

### About Us

The Investor Group on Climate Change (IGCC) is a collaboration of Australian and New Zealand investors focused on the impact that climate change has on the financial value of investments. The IGCC represents institutional investors with total funds under management of over \$2 trillion, and others in the investment community interested in the impact of climate change. IGCC members cover over 7.5 million people in Australia and New Zealand.

IGCC would like to thank the members of its Policy and Advocacy Working Group and Prof. Frank Jotzo, ANU Crawford School of Public Policy, for input into the development of this Policy Brief.

*All dollar figures quoted are in AUD.*

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## DELIVERING AN INVESTABLE LONG-TERM EMISSIONS STRATEGY CLIMATE CHANGE AS A SYSTEMIC RISK FOR AUSTRALIA AND NEW ZEALAND

Climate change is recognised as a systemic threat to the financial system, requiring thoughtful and prudent management. The economic impacts of climate change are material to the investment returns of long-term asset owners and their beneficiaries (Figure 1). As such, institutional investors must consider climate risks as part of their fiduciary duty to their members<sup>4</sup>.

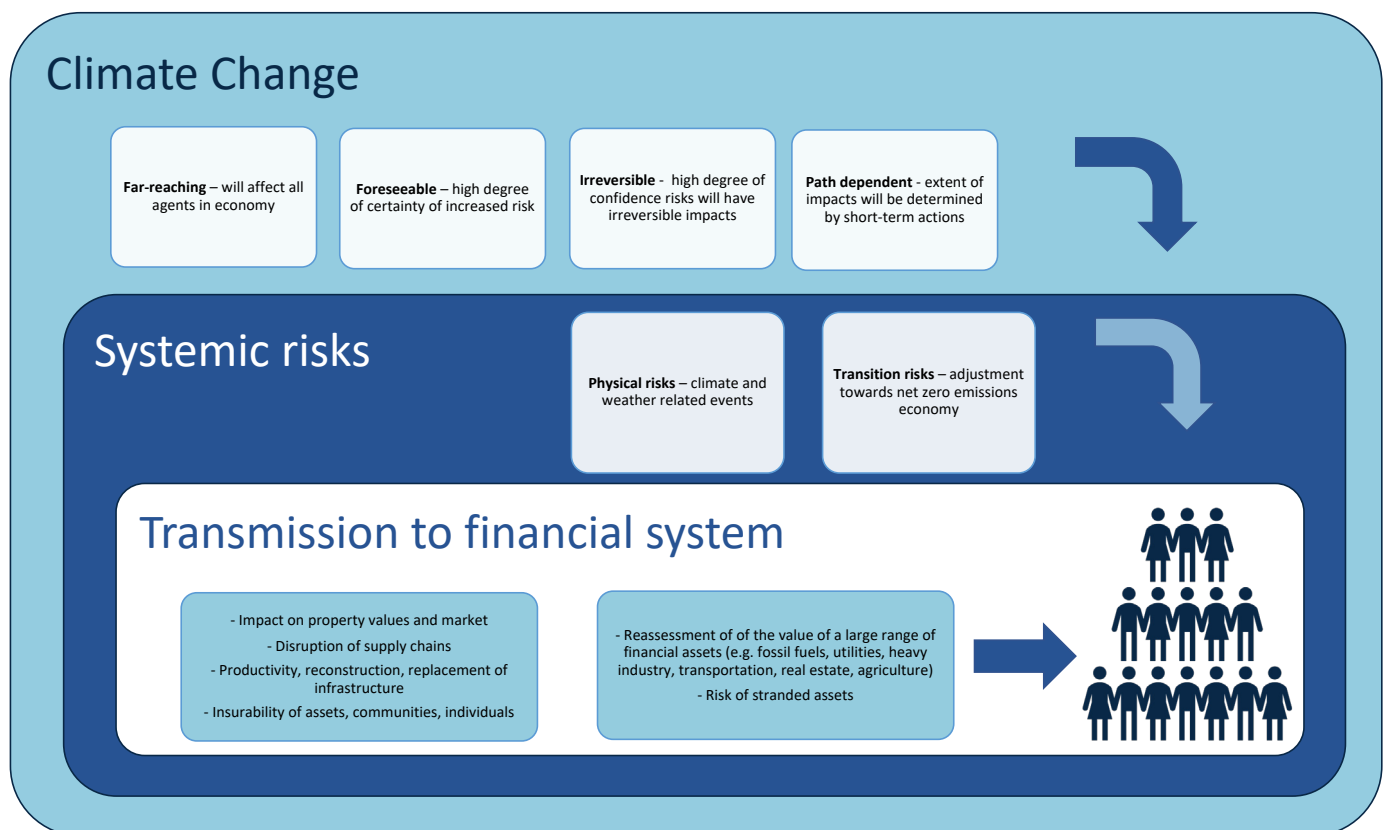
How Australia, New Zealand and the world address climate change will have a material impact on the returns to retirees and the broader economy. This will occur through a number of channels, including:

- **Transition risks:** This includes regulatory shifts, technology disruption and changes in market demand for carbon intensive goods and services. For example, as Australia's coal fired generation fleet continues to retire tens of billions of dollars of investment in new electricity generation, transmission and distribution will be required. Failure to manage this transition will negatively impact on the value of existing infrastructure and assets, increase electricity prices and threaten the reliability of the system. This will have knock on effects to households, the economy and the long-term returns for pension fund holders.
- **Physical risks:** Climate change can directly impact on the finance system through the consequences of extreme weather on property, agriculture production and other climate dependent industries. It will also have indirect impacts on supply chains, property market, insurance pricing or wider economic conditions<sup>5</sup>.



# DELIVERING AN INVESTABLE LONG-TERM EMISSIONS STRATEGY CLIMATE CHANGE AS A SYSTEMIC RISK FOR AUSTRALIA AND NEW ZEALAND

**Figure 1: Climate change and macroeconomic and financial stability.** Developed from Central Banks and Supervisors, Network for Greening the Financial System (2019)<sup>6</sup>





## DELIVERING AN INVESTABLE LONG-TERM EMISSIONS STRATEGY

### LONG-TERM STRATEGIES AND THE PARIS AGREEMENT

The Paris Agreement states nations should develop long-term strategies to reduce emissions in line with the objectives of the agreement - limiting global warming to 1.5°C and well below 2°C above pre industrial levels<sup>7</sup>. Countries are invited to develop and communicate the first of these strategies by 2020<sup>8</sup>. The Australian Government has committed to develop a long-term strategy in response to its 2017 climate change policy review, the Finkel Review and in recent international commitments<sup>9</sup>. Building on its response to the Productivity Commission, the New Zealand Government has committed to release its long-term strategy under the Paris Agreement in 2020<sup>10</sup>.

Many countries currently have or are updating their long-term emissions reduction targets and there is a growing trend towards establishing net zero emissions targets by 2050 (Table 1). More announcements are expected by the end of 2020.

However, the development of long-term strategies extends beyond just setting a 2050 emissions goal. For example, existing long-term strategies outline sectoral actions across the relevant economies<sup>11</sup>.

Long-term strategies are a key component of the Paris Agreement, and were included to:

- **Enhance the collective assessment of progress towards achieving the objectives of the agreement:** Limiting to 1.5 and well below 2°C requires actions to achieve net zero emissions around 2050<sup>12</sup>. Communication of long-term strategies allows investors, companies, governments, researchers and civil society to better understand whether the actions that countries are taking are consistent with the objectives of the agreement.
- **Promote long-term planning:** An orderly transition to net zero emissions requires long-term planning. Without visibility of long-term goals, short-term decisions can create path dependency by locking in high emissions infrastructure. Long-term planning can also be used to define a country's long-term competitive advantages and identify new economic opportunities.
- **Allow for learning to be shared between countries and to showcase innovative solutions:** Every country will face challenges and opportunities in transitioning to net zero emissions. The development of long-term strategies and their communication to the international community creates opportunities for nations to build on the work of others and find ways to overcome collective challenges.

In effect, these climate strategies are more akin to national economic development plans than international pledges to reduce emissions.



**Table 1: Snapshot of long-term emissions targets:** A range of national and subnational governments have legislated, have policy comments or are currently discussing long-term emissions targets<sup>13</sup>. There are also active policy discussions in other major emitters, like China and India, on how they will approach their long-term strategies under the Paris Agreement.

	LONG-TERM TARGETS	NOTES
Argentina		Net zero by 2050 under discussion
Canada	(-80% by 2050)	No target but LTS based round -80% on 2005 levels by 2050
Chile	Net zero by 2050	Proposed legislation
Columbia		Net zero by 2050 under discussion
Costa Rica	Net zero by 2050	
Ethiopia		Net zero by 2050 under discussion
EU	-80-95% by 2050	Net zero by 2050 under discussion
Austria	(See EU)	Net zero by 2050 under discussion
Belgium	(See EU)	Net zero by 2050 under discussion
Denmark	Net zero by 2050	
Finland	Net zero by 2035	
France	Net zero by 2050	Legislated
Germany	-80-95% by 2050	Net zero by 2050 under discussion
Ireland	(See EU)	Net zero by 2050 under discussion
Italy	(See EU)	Net zero by 2050 under discussion
The Netherlands	(See EU)	Net zero by 2050 under discussion
Portugal	Net zero by 2050	
Sweden	Net zero by 2045	Legislated
Spain	(See EU)	Net zero by 2050 under discussion
Iceland	Net zero by 2040	
Japan	-80% by 2050 "decarbonized society" early as possible in the second half of this century	
Mexico	-50% by 2050	Net zero by 2050 under discussion
New Zealand	biogenic methane: -24 to -47% by 2050 other gases: net zero by 2050	Legislated
Norway	Net zero by 2030	
Switzerland	Net zero by 2050	
UK	Net zero by 2050	Legislated
Scotland	Net zero by 2045	Proposed legislation
Uruguay	Net zero by 2030	
<b>Australian states</b>		
New South Wales	Net zero by 2050	
Queensland	Net zero by 2050	
South Australia	Net zero by 2050	
Tasmania	Net zero by 2050	
Victoria	Net zero by 2050	Legislated
Western Australia	Net zero by 2050	
<b>Other subnational</b>		
California	Net zero by 2045	Legislated
Hawaii	Net zero by 2045	Legislated
New York	Net zero by 2050	Proposed legislation



## DELIVERING AN INVESTABLE LONG-TERM EMISSIONS STRATEGY

### LONG-TERM STRATEGIES MATTER TO INVESTORS

Institutional investors take a long-term view on investment and seek to manage risks across the whole economy. A clear and robust long-term strategy to achieve net zero emissions would support economic growth, avoid unnecessary disruption, unlock investment opportunities, and support a just transition in communities impacted by shifting global and domestic markets. There are a number of reasons why having in place a credible long-term strategy would be beneficial for investors (Figure 2). They are important to institutional investors because:

- **Long-term, economy-wide approaches can promote better risk management:** Large institutional investors invest in companies, projects and infrastructure across all sectors of the economy. Transition and physical climate change risks will affect a broad range of asset classes and sectors. This means that investors cannot simply avoid climate risks by moving from one asset class to another and cannot diversify away from climate risk. A visible, credible long-term economy-wide strategy would support them to manage the risks and opportunities across their entire portfolios.

With credible long-term strategies in place, investors can assess the zero-carbon competitiveness of the Australian and New Zealand markets, better understand their exposure to the transition and physical risks of climate change, and better identify new zero carbon investment opportunities in both markets.

- **Infrastructure investments must be resilient to climate change risks:** Net zero carbon, climate resilient infrastructure will be a defining investment theme of the 21st century. For investors, finding and backing low carbon infrastructure projects that generate strong, stable and sustainable returns remains challenging, but is critical for tackling climate change. Visible long-term emissions pathways and strategies to manage physical and transition risks can help support the development of real-world solutions to unlocking capital for major infrastructure investments.
- **Greater transparency around future policy direction enhances the efficient allocation of capital:** With the right information on the future direction of government policy, investors can better price or value assets and avoid a misallocation of capital. Investing in long-lived infrastructure without a long-term plan can lead to costly outcomes for investors, communities and businesses, for example, by assets becoming stranded in response to unplanned shifts in government policy.

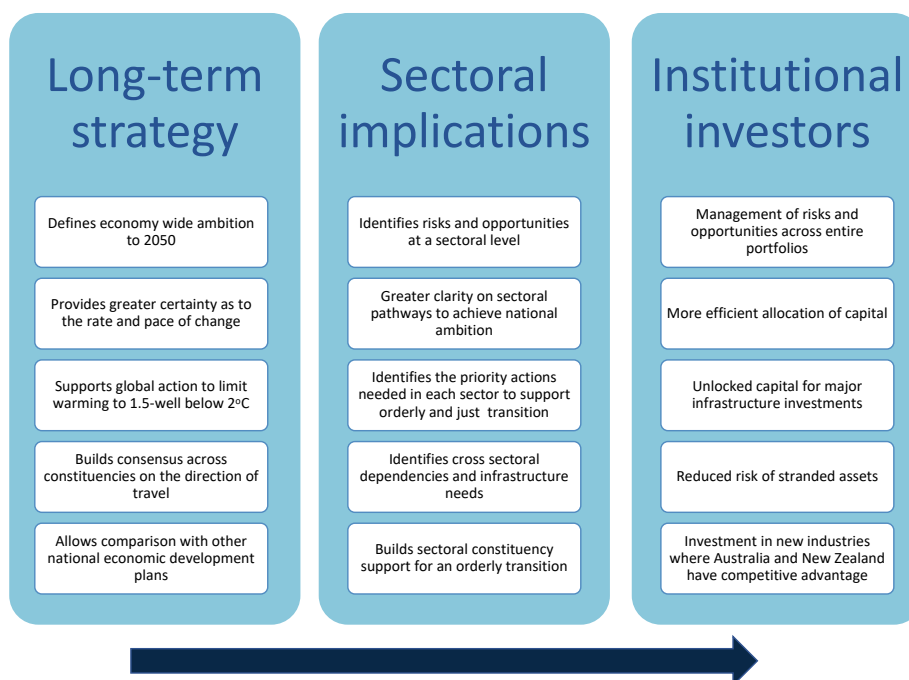


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## LONG-TERM STRATEGIES MATTER TO INVESTORS

- The pathway to net zero emissions matters to investors:** The Paris Agreement and its goal of achieving net zero emissions sends a long-term market signal on the direction of government policy. Investors take international agreements seriously and see long-term action to achieve net zero emissions a key factor influencing investment. Establishing a clear pathway to net zero emissions reduces investment risks, avoids locking in path dependency towards high emissions, and reduces the risk that investments will be stranded as governments increase action through time or act abruptly with sharp policy interventions at a later stage. It is also key to providing clarity on the timing of transition milestones to manage stranded asset risk.
- Long-term strategies can unlock capital:** There are no up-to-date assessments in Australia and New Zealand of investment needs to meet the objectives of the Paris Agreement and support climate change adaptation. Sectoral analysis is underway, for example the Australian Energy Market Operators Integrated System Plan and the development of a national hydrogen strategy, but economy wide assessments are lacking or out of date. Globally, recent analysis suggests that US\$90 trillion will need to be invested in infrastructure in the energy, urban and land use systems until 2030<sup>14</sup>. Institutional investors are key to unlocking this potential. Clear long-term policies and strategies to identify investment opportunities across the economy and support new industries where Australia and New Zealand will have competitive advantage can support institutional investment.

Figure 2: Long-term strategies and institutional investors: Supporting investment and managing risk







## **DELIVERING AN INVESTABLE LONG-TERM EMISSIONS STRATEGY SIX PRINCIPLES TO GUIDE THE DEVELOPMENT OF LONG-TERM STRATEGIES**

Both the Australian and New Zealand Governments are in the early stages of developing their long-term strategies. The Paris Agreement sets some boundaries about what both nations' long-term strategies should address, specifically, their contribution to limiting global warming to 1.5°C and well below 2°C.

The Australian Government has also set out a number of principles under which the development of its long-term strategy will occur. The Government will<sup>15</sup>:

- consult widely with businesses, the community and Commonwealth, state and territory agencies on the development of the strategy
- work with other G20 countries to share expertise and build capacity throughout the development of the strategy
- explore the emissions reduction opportunities and implications across all major sectors of the economy
- explore the transition towards a lower-emissions Australian economy in the context of the Paris Agreement's objectives to limit global warming to 1.5°C and well below 2°C
- ensure strong economic growth and an internationally competitive economy
- build on the Government's existing policy framework, and
- provide a framework to inform the five-yearly review of emissions targets under the Paris Agreement.

IGCC broadly support these principles. Based on discussions with its members, the following points elaborate on and provide additional guidance to guide the development of the Government's long-term plans.

- 1. Engage in extensive consultation to build community consensus:** One of the key benefits of long-term strategy development provides an opportunity for the community, business and investors to discuss and find solutions on how to address climate change risks and opportunities over the medium to long-term. While short-term transition issues are important, long-term strategy discussions create a conversation around a long-term journey and can build consensus around desired endpoints and strategic policy priorities. Institutional investors bring important perspectives to this engagement, not least because they invest across the economy over the longer term and have the ability to support transformative infrastructure investments.
- 2. Undertake scenario analysis:** The future is not perfectly predictable. Scenario analysis should be undertaken to stress test the long-term strategies against a range of possible futures. This kind of analysis is central to the emerging work from financial regulators in managing systemic risks from climate change<sup>16</sup> and climate related financial disclosures by investors and companies<sup>17</sup>. Scenario analysis avoids a false sense of certainty that can emerge from focusing on a single scenario. The baseline scenario for this analysis should be an emissions pathway consistent with the objectives of the Paris Agreement. Scenarios that fall short of the Paris Agreement's objectives will only deliver a false sense of confidence in the robustness of the economy against future change or that long-term prosperity can be achieved with limited change in investment practices to accommodate climate change factors.



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### LONG-TERM STRATEGIES MATTER TO INVESTORS

- 3. Build on existing public and private sector processes:** Governments already undertake long-term planning and scenario analysis in a range of sectors. For example, the Australian Energy Market Operator undertakes extensive scenario development, modelling and analysis, and consultation in the development of its Integrated System Plan for electricity transmission infrastructure. It is also beginning to factor in the physical impacts of climate change. Other examples include the work by New Zealand's Productivity Commission and Australia's national hydrogen strategy. Existing public sector processes can be important inputs to the national long-term strategy development.

Additionally, in many cases the private sector is well ahead of governments in developing long-term strategies to manage climate change risks and invest in low carbon opportunities. Initiatives like the Australian Sustainable Finance Initiative (ASFI), the New Zealand Sustainable Finance Forum<sup>18</sup> and individual investor and company experience in scenario analysis can be used to inform governmental processes.

- 4. Examine risks, opportunities and synergies:** The development of long-term strategies should be informed by detailed bottom-up analysis of risks and opportunities in individual sectors. It should also examine the synergies between sectors, for example, the impact of the electrification of transport, buildings and industry on the electricity sector and the impact that climate change will have on water infrastructure and the knock-on effects to other industries and communities.

The strategy should avoid an overreliance on macroeconomic modelling. Extensive macroeconomic modelling of climate policy has been taken over recent decades and new modelling is unlikely to give new insights beyond what we already know - a steady transition is affordable, delayed action is more costly and a significant part of Australia's economic exposure to climate change action is driven by less demand for emissions intensive commodities.<sup>19</sup> At worst, macroeconomic modelling can become a dangerous distraction from the real challenges nations face as political commentary inflates perceived costs and/or the structural changes and opportunities at a sectoral level get underplayed because of the inherent limitations in these kinds of modelling exercises.

- 5. Ensure consistency with Paris Agreement:** Long-term strategies form part of the suite of reporting that countries will undertake under the Paris Agreement. The Paris Agreement sets principles around the communication of these strategies including that they should be anchored in a national contribution to limiting global warming to 1.5 and well below 2°C.

Any national targets that are set within long-term strategies should also be consistent with the international rules-based system developed under the United Nations Framework on Climate Change (UNFCCC) and its Paris Agreement. Both Australia and New Zealand are extremely vulnerable to the impacts of climate change.



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Supporting agreed international rules for the accounting of national targets and action in line with the objectives of the Paris Agreement is therefore important to these nations' economic and social well-being. A nation's ability to influence and hold other nations to account for their own commitments is in part dependent on the nation implementing policy that is consistent with the international rules-based system.

**6. Integrate the physical risks of climate change and national adaptation strategies:** All sectors of the economy will be impacted by climate change and the physical effects of climate change are increasingly recognised as a financial risk for investors. This extends beyond the impact of climate change on a particular asset, to how climate change will impact supply chains, sectors, international trade and the overall economy. For investors, managing these risks requires the same levels of governance, oversight and active management as any other dimension of material financial performance.

However, there are a number of practical barriers to investing in and supporting climate change adaptation. Governments have a clear role in helping overcome these barriers to build more resilient communities and economies. These barriers include a lack of funding for basic climate science, coordination and clear accountabilities among the various levels of government on adaptation, no up-to-date national assessment of infrastructure, sectors and regions at risk to the effects of climate change, and no indicative quantification of the investment required for adaptation.

Addressing the impacts of a range of climate change scenarios will ensure long-term strategies are resilient to both the transition and physical risks of climate change. Failure to do so will create a false sense of security in communities and investments exposed to significant climate change impacts. In addition, not addressing physical risks leads to decisions that make communities more vulnerable to climate change impacts (maladaptation) and increases the exposure of the economy to systemic climate change risks.



## DELIVERING AN INVESTABLE LONG-TERM EMISSIONS STRATEGY

### CONCLUSION

Climate change is a systematic risk to investment returns, financial stability, communities and economies.

A managed transition to net zero emissions and actions to build resilience to the impacts of climate change will reduce the cost of climate change and open up investment opportunities. Long-term investors have a critical role in delivering this more prosperous future and are increasingly changing their investment practices to align with a net zero emissions economy.

However, investors can't do this alone. To strengthen investor confidence, it is vital that governments deliver credible and continued support for action to achieve a net zero emissions and climate resilient economy.

Institutional investors have a fiduciary duty to pursue sustainable, long-term returns on their investments. Lack of credible, durable and predictable policy frameworks mean investors will either choose to defer investment in local economies, invest in other countries where policy is more predictable, or factor in higher risk premiums on investments to hedge against policy risk. Put simply, the absence of credible long-term climate policy has a negative impact on the economy and investment decisions.

The development of credible and investable long-term strategies will improve investors' ability to assess climate-related risks and opportunities, to measure and disclose portfolio exposure to the low carbon transition and to further invest in opportunities to support the transition to a zero carbon, climate resilient world.

The Investor Group on Climate Change looks forward to engaging further on these issues with the Australian and New Zealand Governments.



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- <sup>6</sup> Network for Greening the Financial System: <https://www.banque-france.fr/en/financial-stability/international-role/network-greening-financial-system>
- <sup>7</sup> Paris Agreement, Article 4 Para 19: All Parties should strive to formulate and communicate long-term low greenhouse gas emission development strategies, mindful of Article 2 taking into account their common but differentiated responsibilities and respective capabilities, in the light of different national circumstances.
- <sup>8</sup> Decision 1/CP.21, Adoption of the Paris Agreement, Para 35: Invites Parties to communicate, by 2020, to the secretariat mid-century, long-term low greenhouse gas emission development strategies in accordance with Article 4, paragraph 19, of the Agreement, and requests the secretariat to publish on the UNFCCC website Parties' low greenhouse gas emission development strategies as communicated;
- <sup>9</sup> "Consistent with the Government's response to the Finkel Review, the Government will start developing in 2018 a long-term emissions reduction strategy by 2020. This is consistent with the approach adopted by most G20 countries." <https://www.environment.gov.au/climate-change/publications/final-report-review-of-climate-change-policies-2017>. See international communications: [https://unfccc.int/sites/default/files/resource/85\\_Australia%20Talanoa%20Dialogue%20Submission.pdf](https://unfccc.int/sites/default/files/resource/85_Australia%20Talanoa%20Dialogue%20Submission.pdf), [https://unfccc.int/sites/default/files/resource/SBI50\\_AUS\\_MA\\_QA.pdf](https://unfccc.int/sites/default/files/resource/SBI50_AUS_MA_QA.pdf)
- <sup>10</sup> "This response will lead into the development of more comprehensive climate strategies such as our long-term low emissions development strategy (being prepared by 2020 in response to the Paris Agreement)." <https://www.mfe.govt.nz/sites/default/files/media/Climate%20Change/Transition%20to%20a%20low%20emissions%20economy%20-%20The%20Governments%20response%20to%20the%20Productivity%20Commissions%20Low%20Emissions%20Economy%20report%20%20-%20Proactive%20Release%20%281%29.pdf>
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- <sup>17</sup> See <http://www.climateaction100.org>
- <sup>18</sup> See <https://www.sustainablefinance.org.au> and <https://www.theaotearoacircle.nz/sustainablefinance>
- <sup>19</sup> See for examples: DFAT (2015): <https://dfat.gov.au/about-us/publications/Pages/economic-modelling-for-australias-2030-target.aspx>