

Committee Secretary
Senate Standing Committees on Environment and Communications
PO Box 6100
Parliament House
Canberra ACT 2600

Climate Change Bill 2022 and the Climate Change (Consequential Amendments) Bill 2022

The Financial Services Council thanks the Senate Standing Committee on Environment and Communications for the opportunity to provide a submission on the *Climate Change Bill 2022* and the *Climate Change (Consequential Amendments) Bill 2022* (the Bill).

The Financial Services Council (FSC) is a peak body which sets mandatory Standards and develops policy for more than 100 member companies in Australia's largest industry sector, financial services. Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advisory networks.

The financial services industry is responsible for investing more than \$3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

The need for Australia's greenhouse gas emissions reduction targets

As major allocators of capital in our economy, our funds management members are supportive of the Bill enshrining Australia's commitment to a 2030 target to reduce Australia's net greenhouse gas emissions to 43% below 2005 levels.

The lack of policy certainty has inhibited investment opportunity in Australia and the ability of funds to effectively manage climate risk. Last year, it is estimated that financial commitments for new large-scale renewable energy projects fell 17% to \$3.7 billion, due to policy uncertainty.¹ The Investor Group on Climate Change estimates that under a 'hot house' scenario where the private and public sector do not work together toward a net zero economy, there will be a lost investment opportunity by 2050 up to -\$265 billion². This Bill helps to provide greater climate policy certainty by signaling to all stakeholders through legislation that the government is committed to a path of emissions reduction. This commitment is reinforced through the requirement that the Minister provide an annual climate change statement to Parliament, informing Australia of progress toward

¹ Comments from the Clean Energy Investor Group cited in The Australian (May 22, 2022) 'Green Investors Tip Renewable Energy Revival'. <https://www.theaustralian.com.au/business/renewable-energy-economy/green-investors-tip-renewable-energy-revival/news-story/15675d62cb8dfa4a6e285f87e5e7bd40>

² https://igcc.org.au/wp-content/uploads/2020/10/121020_IGCC-Report_Net-Zero-Investment-Opportunity.pdf

meeting these targets. It is also reinforced by the provision of expert advice by the Climate Change Authority. Importantly, the 43% target acts as a minimum standard, and more ambitious targets can be set over time in accordance with the ratchet mechanism in the Paris Agreement.

With Australian policy and key government agency functions clearly committed to this 2030 emissions reduction target, investors can be more confident in making long term investment decisions in Australia. Globally, there is already a shift in the allocation of capital toward sustainability friendly destinations, driven by investor demand and long-term risk appetite, and it is important that Australia can take advantage of this shift. The legislated target can help increase capital flow into Australia by increasing investment opportunity. Further, it will help in providing greater certainty for fund managers in supporting investments in technology and energy transition domestically, as concerns from climate-aware foreign investors are alleviated around investing in Australia due to our sector risks and lack of targets.

How fund managers are helping to meet emissions reductions targets

To meet the challenge that climate change poses to our economy, government and the private sector both have important contributions to make toward the goal of emissions reduction to mitigate the risk of climate change.

The funds management industry has a key role to play in meeting emissions targets by allocating capital to investments that contribute to the transition to a low carbon economy. There are different estimates as to the levels of capital required. The IMF notes that *'successful transition demands a deep economic transformation, requiring the mobilization of private finance on a large scale. According to estimates, achieving net-zero carbon emissions by 2050 will require additional global investments in the range of 0.6 to 1 percent of annual global GDP over the next two decades, amounting to a cumulative \$12 trillion to \$20 trillion.'*³ The Net Zero Financing Roadmap estimates that globally, \$125 trillion USD is required to transition the global economy to net zero. \$13 trillion is required in the Asia Pacific region⁴. They estimate that 70% of this financing can come from the private sector, especially corporations and institutional investors.

Fund managers have a fiduciary duty to their clients as trustees of the savings of millions of Australians. As part of their duty to act in their client's best interest, they seek to maximise returns for Australians for any level of investment risk. This involves mitigating any risks to these investments. Any increase in risks requires a commensurate increase in returns, which can increase the cost of capital, leading to higher costs of projects. Investment funds see climate risk as a real material financial risk to their investments. Therefore fund managers, as part of ordinary risk management, incorporate ESG considerations into their investment decisions including considering

³ International Monetary Fund (October, 2021), *Global Financial Stability Report: Covid-19, Crypto, and Climate: Navigating Challenging Transitions*, pg 60.

⁴ See <https://www.gfanzero.com/netzerofinancing/>

the risk of climate change to their business and investments. In addition to managing climate risk, fund managers are also focused on the opportunities presented by the climate transition. Companies that are well positioned to provide solutions required for this transition can offer compelling, long-term, risk-adjusted returns.

Many fund managers also voluntarily set net zero commitments. The FSC's *Guidance Note 44: Climate Risk Disclosure in Investment Management*⁵ supports members who choose to adopt a net zero by 2050 target for their investment portfolios in line with the Paris Agreement. The guidance note seeks to ensure that when fund managers make net zero commitments, they back these up with evidence and data which demonstrates they are on the path to aligning their portfolio with their net zero target. This includes demonstrating the use of best practice emissions metrics (including assessing scope 1, 2 and 3 emissions), scenario analysis, stewardship and screening practices. The guidance note's central principle is that clear demonstration by funds of how they intend to meet their net zero commitment is key. To assess net zero alignment in their portfolios, funds undertake several methodological approaches including assessing financed emissions and weighted average carbon intensity.

Fund managers are also seeking to meet the increased demand for sustainable investments. Morningstar research shows retail assets invested in sustainable funds domiciled in Australia and New Zealand totaled \$38.7 billion at the end of the second quarter of 2022⁶. They have identified 178 Australia-domiciled sustainable investments and observe that assets invested in Australasia-domiciled sustainable investments have more than doubled since March 2020. The efficient allocation of capital toward sustainable investments requires that funds that claim to be sustainable funds or address sustainability concerns are true to label. Retail investors and clients need to be able to rely on the sustainability representations that funds make.

The FSC's Guidance Note 44 also seeks to support funds being true to label by encouraging best practice disclosure in support of sustainability claims. The FSC anticipates that wide adoption of the guidance note will increase the quality of Australian fund managers' climate-related disclosures, so that investors can have confidence that when they invest with a particular fund on the basis that it has a climate-related feature, this claim is backed by evidence. ASIC's recently released Information Sheet 271 will also assist to reduce greenwashing in the promotion of sustainability related products. We look forward to continuing to work with ASIC as the industry seeks to pursue greater consistency in sustainability labelling practices.

The importance of stewardship

Long term institutional investors see the consideration of climate change as vital to providing long term value for their clients. Fund managers typically undertake detailed analysis of investee

⁵ Available here: <https://www.fsc.org.au/resources/fsc-standards-and-guidance-notes/guidance-notes>

⁶ Morningstar (25 July 2022), *Sustainable Investing Landscape for Australian Fund Managers Q2 2022*

companies or sectors to assess the risks of climate change and the business opportunities in responding to shifting sustainability-based market preferences. When it comes to investee companies with significant exposure to revenue from high emissions activities, investment funds will typically work closely with their management and board to ensure that the company has appropriate climate risk governance and climate risk plans in place.

In managing the risk of climate change to their portfolios and in meeting emissions reductions targets, funds may undertake negative or positive screening. Positive screening involves deliberate investments in companies that are contributing to the fund's climate-related goals, such as companies engaged in renewable energy technology and production or companies that are innovators in lower emissions technology in their relevant sector such as electric vehicles, sustainable building or sustainable farming methods. Negative screening involves a commitment that a fund will avoid investing in companies or divest from companies that significantly contribute high emissions or have high revenue exposure to high emissions activities such as fossil fuel extraction and fossil fuel dependent energy production. The threat of a negative screen or divestment has a role to play to spur a company into action.

However, screening of companies is not the only or primary way investment funds encourage companies to meet emissions reduction targets. The screening of companies may not achieve real world emissions reduction. If funds only divest or negatively screen, there is a risk that the asset will be purchased by short term investors who do not have the same sensitivity to the medium to long term risk from climate change and therefore do not have the same concern for acting on climate change. Indeed, some industries currently with significant revenue exposure to emissions are necessary for the transition to a lower emissions economy, such as mining rare earth minerals. Energy companies that currently engage in high emissions activities may also play an integral part in a smooth and just transition. Mark Carney, former Governor of the Bank of England and UN Special Envoy for Climate Action and Finance has stated that investors should go where the emissions are. It is in providing the capital needed to assist high emissions industries to transition to lower emissions practices, combined with active ownership of those companies, that will make real world differences.

Funds see stewardship activities as central to encouraging high emissions companies to adopt lower emissions technology and to have robust governance structures to manage the risk of climate change. While it is not the role of investment funds to be involved in the running of investee companies' business and creating their business strategies, they do have an interest in ensuring proper governance of a company so that the company can provide long term value. Funds do this through the exercise of their votes at shareholder meetings, particularly with board composition and remuneration plans, as well as potentially supporting shareholder proposals, in line with funds' public stewardship policies on climate change which inform their voting decision making. They also directly engage companies' directors and managers in line with their public stewardship policies. The frequency of these engagements may increase depending on the level of climate-related risk exposure a company may have. These meetings with company directors and executives may involve

discussing governance arrangements and whether the board and company are adequately considering climate risk and taking actions to mitigate it, such as via a clear business plan. Where a company may not have a board that is properly considering and acting on the risks of climate change, or is not taking proper steps to mitigate the risk of climate by setting targets and having a clear strategic short, medium and long term plan to meet those targets, funds with voting power can constructively work with the board and encourage them to have better governance arrangements, provide better disclosure, and develop clear strategies to mitigate climate risk. Importantly, this engagement is typically ongoing.

The need for mandatory climate risk reporting

We see this Bill as just the beginning of providing a clearer framework for investor confidence. To more efficiently allocate capital and reliably achieve net zero targets, funds need reliable information about the emissions of investee companies and the risks and opportunities climate change may bring to these investee companies. As part of their stewardship activities, funds currently encourage investee companies to enhance their disclosures when it comes to climate risk. Currently, 103 of the top 200 ASX listed companies in Australia voluntarily meet the Task Force on Climate-related Financial Disclosures (TCFD) framework⁷. However, the consistency and quality of disclosures around scope 1, 2 and 3 emissions⁸ across companies can vary. There is also inconsistency in the use of scenario analysis and a lack of transparency on assumptions and metrics behind scenarios. This makes it difficult for funds to assess whether a company is truly aligned with the targets they have set to align their activities with the goal to limit warming to well below 2 degrees above preindustrial levels or 1.5 degrees.

We support a mandatory climate risk disclosure regime in line with the TCFD framework. It would lift the other half of the listed company sector currently not reporting according to the TCFD framework up to best practice, boost investor confidence and further facilitate the allocation of capital toward the transition.

The TCFD recommends that companies disclose information that would help companies assess climate-related risks and opportunities in the following areas:

- Governance: disclose the organisations governance around climate-related risks and opportunities.
- Strategy: disclose the actual and potential impacts of climate-related risks and opportunities on the organisation’s businesses, strategy and financial planning where such information is material.

⁷ See <https://acsi.org.au/wp-content/uploads/2022/08/WEBSITE-VERSION-ACSI-Climate-Change-Disclosure-in-ASX200-designed-1.pdf>

⁸ According to the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard, Scope 1 are emissions that occur from sources owned or controlled by the reporting company, Scope 2 are emissions from the generation of purchased or acquired electricity, steam, heating, or cooling consumed by the reporting company, and Scope 3 are all other indirect emissions (excluding scope 2) that occur in the value chain of the reporting company. For investment funds, Scope 3 emissions are emissions from its portfolio investments.

- Risk Management: disclose how the organisation identifies, assesses, and manages climate-related risks.
- Metrics and targets: disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

Fund managers would benefit from TCFD-aligned mandated disclosures from investee companies. A mandated disclosure regime would lead to better quality and more consistent disclosures across the economy leading to a more efficient allocation of capital toward sustainable investments. It will provide fund managers with better data to accurately assess the risks and opportunities of climate change to their investment portfolios and to align their portfolios to a net zero target. A mandatory climate risk reporting regime is needed to work hand in hand with the national emissions reduction targets.

Fund managers are themselves seeking to disclose their exposure to climate risk and emissions reduction. The FSC's Guidance Note 44 sets baseline expectations for the funds management industry to be reporting climate risks and opportunities to their business operations. As the guidance note states, best practice is for funds to disclose scope 1, 2 and 3 emissions, but the problem is the lack of data, particularly for scope 3 emissions where an investee company's value chain emissions may not have reliable data. A mandatory climate risk reporting regime would help funds assess their scope 3 emissions exposure through increasing the availability of quality data. Many funds are undertaking scenario analysis. This helps to assess their net zero alignment and whether their investments are aligned with the goal of keeping temperature at well under 2 degrees above pre industrial levels. It also helps to identify climate related risks and opportunities for investments under different climate scenarios such as under the scenarios provided by the Network for Greening the Financial System (ie an orderly, disorderly, hot house world or too little too late scenario)⁹.

The details of what a mandatory reporting regime looks like is something we are keen to work through with government and legislators. A mandatory risk disclosure regime should require the disclosure of qualitative and quantitative data in line with the TCFD, demonstrating how the company is mitigating risk in line with its climate-related strategy over time. We think that any Australian regime should seek to align with the TCFD, the new International Sustainability Standards Board standards and overseas regimes such as New Zealand, the United States, United Kingdom and Europe. It should provide enough information for capital markets to make efficient decisions when allocating capital toward investments that properly account for climate risk, while ensuring that the cost to business is not unduly onerous.

Conclusion

It is important that we achieve a fair, just and orderly transition where Australians are not left

⁹ <https://www.ngfs.net/ngfs-scenarios-portal/>

behind. To achieve this, government and the private sector will need to work together, particularly in ensuring that people continue to have access to reliable and affordable energy sources. Government needs to provide a clear framework within which businesses can make decisions and investors can allocate capital efficiently. We commend the Government for seeking support from various stakeholders for the Bill. This Bill sets us in the right direction, assuring the Australian community that the Australian Government is committed to meeting Australia's Paris Agreement commitments. It helps provide confidence to the investment community that Australia is moving in the direction of a low carbon economy. We encourage all sides of politics to boost private sector confidence by supporting the Bill.

However, this is just the beginning. A mandatory climate risk disclosure regime will provide valuable information for investors as they seek to assess investments for climate risk and allocate capital toward investments that account for the financial risk of climate change.

If you wish to follow up on this submission or have any questions, please contact **Chaneg Torres, Policy Manager** at ctorres@fsc.org.au. We would be happy to answer any questions or provide any further information the Senate Committee may request.

Yours sincerely,

Spiro Premetis
Executive Director
Policy & Advocacy

Chaneg Torres
Policy Manager
Investments and Global Markets